

- Subject: Is the EU's trade policy fit for the 21st century?
- SW/ER/ Chance discussion by Centre for European Reform (DVC)
- Date: 31 March
- Place: Brussels

SCENE SETTER

You are one of three panellists discussing whether 'the EU's trade policy is fit for the 21st century'. This is the fourth of a series of lunches that are jointly organised by the Centre for European Reform (CER) and Clifford Chance, albeit the first 'virtual' one due to the latest development around the Corona pandemic. The CER has published a few recent pieces that may come up in the discussion, a short summary of which you will find in the background.

The audience will consist of about 50-60 people – mainly business representatives, officials, diplomats, analysts and a few senior journalists. Each speaker gets about 7 minutes of introductory remarks, after which [REDACTED], [REDACTED], will moderate the questions and answers. This will be either via instant messaging or with the moderator turning on questioners' microphones, depending on numbers. Other participants are [REDACTED]

You received a number of guiding questions for which you will find suggested response elements in the background section of this briefing. In light of recent events, we would however, suggest to use the introductory round for a few general remarks on the crisis and then draw on the questions as you see fit (if you were to use the steering questions, it might appear a bit disconnected from reality).

CHECKLIST OF KEY MESSAGES**Intro**

- These are extraordinary times. First, let me say I hope you are all safe. This event was announced quite some time ago, so I have had ample opportunity to reflect on its title. But I believe that none of the cliffhangers I had considered for the introduction – from ideas of Yuval Harari's '21 lessons for the 21st century' to snippets from historian Tony Judt's famous book 'Thinking the 20th century' – are appropriate following recent events. In light of this new reality, my replies to the question posed by today's panel discussion can certainly not be the same they would have been 3 weeks ago....
- [Alternatively]: The pop culture fans among you may remember a contagion-style horror movie called '28 days later' released in 2002. Its plot is simple: a man wakes up after a month-long coma only to find society upended by a ramping virus. The fact that this popped up in my mind as a potential introduction this morning is surreal enough in itself, I believe... well, none of us was in a month long coma, but still it is difficult to keep up with the speed of developments. And my replies to the question posed by today's panel discussion can certainly not be the same they would have been 3 weeks ago....

Covid-19 Crisis

- We are facing a global crisis –the biggest of our generation. COVID-19 is affecting all the sectors of the EU economy. Demand has dropped, supply chains are disrupted, investments are put on hold, and the banking sector sees a surge in non-performing loans. All Member States are affected. The duration of the crisis is not yet known.

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- This is new territory. You will have seen that many commentators are even talking about a new historical divide. There is the world B.C. — Before Corona — and the world A.C. — After Corona. I believe we have not even begun to fully grasp what the A.C. world will look like.
- While we're still in the midst of it all, I see a few themes emerging in public discussion:
 - **Calls for decoupling-deglobalisation:** This is not new (US-China rivalry, 5G debate...) but louder calls now. It starts with critical medical equipment (e.g. export controls schemes) but same logic would apply to agricultural products or, more generally, to any goods we consider of some importance.
 - **Role of the state in the economy:** State-led reactions against the economic crisis. Massive subsidies will become the norm and states taking control of private companies (e.g; nationalisation of Alitalia).
 - **Risks for international organisations and multilateralism:** here again, the crisis is simply reinforcing a pre-existing trend. International actors have found it difficult to respond and national states are perceived as the only legitimate actors. WHO is perceived as not doing a good job and/or as too influenced by China.
- What is **most worrying in all of this is the trend to look inward** – as if closing down, severing ties with others, refusing to cooperate was the panacea to our problems. This looks to me too much like hysteric and short-term thinking, driven by politics more that economics or rationale thought.
- The Covid-19 crisis clearly has exposed the risks associated with global value chains and of a globalised and interconnected world. But the response to these problems surely cannot be to aim for autarky. North Korea is hardly the example we should be getting inspiration from.
- On the contrary, we need to focus our thinking on how to **strengthen international cooperation** and to build the trust and mechanisms needed to get out of the crisis together, rebuild and strengthen our economies and ensure that we avoid similar pitfalls in the future
- It was encouraging to see that the G20 leader statement included clear commitments to international cooperation in tackling this pandemic. (Note: there will be G20 Trade ministers exchange on Monday and it may need updating)
- Situation is complex and there is no black and white. I believe important to **distinguish between different phases** now: **crisis mode, later recovery and long-term strategic foresight.**

Trade policy's contribution to fighting the crisis

- Delicate balance to be struck and we will have to find a role and position ourselves. Trade policy will play a key role.
 - 1) **Preserving free flow of goods:** Keeping supply chains open is as important to address the immediate health threat as for the recovery of the global economy. Exceptionally, the Commission has introduced a time bound export authorisation scheme on a range of products (PPE, medicine) to support Member States' efforts to mitigate the impact of the crisis. However, emergency measures can and must only be temporary. Supply chains in today's world are highly integrated meaning that in the end, restrictions to do not make any sense.

- For example, big ventilator producers are located across the USA, EU and Asia, and depend on globally interconnected supply chains, where a disruption in one part of the chain will cause ripple effects.
- COVID testing kits have many different components (laboratory reagent, immunological pads, testing instruments), which EU countries import from many different places (e.g. China, Korea, US, Switzerland). 5 MS import in more than EUR 1 Bn – another 10 import in value over EUR 100Mn. If those sources dry up in response to closing our borders in other areas, we all lose out.

No country can secure supply on its own. This calls for more international cooperation and coordination, and a conscious effort to avoid protectionist policies, which would entail significant economic costs and increase the risks of economic and societal fallouts.

2) Bringing economy back on track: As several IMF economists have said, the virus has created a 'wicked cocktail' for world growth¹. As seen in the financial crisis 2009, trade will be an important driver for recovery. Ensuring open, rules-based trade, that provides a stable and predictable framework for business, will be extremely important.

- We have seen the economic costs of uncertainty and rising protectionism/barriers already before the Corona-virus crisis. We need to ensure that such costs do not exacerbate the economic crisis; but rather ensure that open trade will help EU business to recover.

3) Longer-term thinking: Ensuring strategic autonomy in a globalised world: The crisis has underlined the need for the EU's strategic autonomy and the build-up of resilient value chains through diversification and rules-based, open trade. Both need to go hand in hand.

Is our trade policy fit for the 21st century?

- The fundamental directions of our trade policy remain in place.
- In order to get out of the crisis and lay the ground for economic recovery, trade policy will continue to focus on what it does best: **creating jobs and growth**. This will continue to entail:
 - Building **stability** - supporting the multilateral trading system and the predictability it provides.
 - Developing our trade **relationships** with our partners (US and China being a clear focus), but also continuing to diversify our trade relations.
 - Ensuring **fairness** in trade (LPF and enforcement).
 - Contributing to addressing **global challenges**, including issues linked to climate change and sustainability, which will not become less urgent due to the Covid-19 crisis.

¹ <https://www.ft.com/content/be732afe-6526-11ea-a6cd-df28cc3c6a68> And Harvard professor Kenneth Rogoff added 'A global recession seems baked in a cake at this point with odds over 90 per cent'.

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The COVID-19 crisis will of course mean that certain adaptations will be pursued (e.g. strict monitoring to ensure that some 3rd countries do not exploit the economic crisis through unfair practices). But the fundamentals remain.

Conclusion

- We do not know when the Covid-19 pandemic will end; we do not know how it will end; and, at present, we can only speculate about its long-term political and economic impact.
- EU will have to adjust to this new reality, reflect on what it all means and how to best navigate through it. How can we use our priorities?
- Amid the many unknowns I believe one thing is clear though: the virus knows no borders: both the pandemic and the ensuing economic crisis are global problems. They can be addressed effectively only through global cooperation.

DEFENSIVES

How should the EU respond to China's aim to shape globalisation for its own ends? Is there much that it can do using existing multilateral tools to curb distortionary practices?

- The EU is committed to engaging with China to uphold the rules-based international order. However, we cannot ignore that China's engagement in favour of multilateralism is sometimes selective and based on a different understanding of the rules-based international order.
- It is therefore essential that China – which often repeats its desire to shape global governance in order to give emerging economies greater participation and decision-making power - accepts new rules reflecting the responsibility and accountability that come with its increased role. Selectively upholding some norms at the expense of others weakens the sustainability of the rules-based international order.
- As to addressing distortionary practices, the EU's preferred option is to address this through the negotiation of multilateral rules. However, when this is not possible, we have to strengthen our own toolbox to be able to respond to such distortionary practices.
- On a different note: Role of China during crisis: attempt to turn health crisis into geopolitical opportunity. China has started reframing its role from that of the country that accelerated the virus's spread through cover-ups, to that of the magnanimous global power offering leadership at a time of panic and peril in much of the rest of the world (offering support and sending much-needed equipment such as ventilators to various countries, including in EU neighbourhood e.g. Serbia, Morocco).

What do you make of France, Germany, Italy and Poland's proposals to weaken merger control in order to facilitate the growth of European champions? (ECR views [here](#) – see also [background](#)).

Note: while we generally agree with the arguments, we thought some important perspectives were missing (see last para).

- The author examines the recent French, German, Italian and Polish joint request that EU competition rules should be reviewed, in particular to “introduce more justified and reasonable flexibility” to its decisions about mergers between European companies, to “take better account of third countries’ state intervention”. In his view, developing European champions is not the right approach to deal with Chinese competition.
- First, China’s rapid economic rise says little about the degree of competition that EU manufacturers are actually facing. There is a growing consensus that China distorts competition globally through its various policies that shelter domestic companies from competition as well as providing cheap capital to Chinese companies in strategic sectors in order for them to move up the value chain. These strategies are well-known developing country strategies.
- A more detailed analysis shows that, overall, China has actually been making slow progress in moving up the value chain. While both China’s electronics and industrial machinery sector grew rapidly between 2005-2015, China has yet to build a large exporting base in aircraft, trains, chemicals, pharmaceuticals and cars, which make up 45 percent of the EU’s exports. In addition, the share of high-technology goods (aside from electronics) in its total exports only grew by about 1 percentage point in that decade.
- Furthermore, the author argues that China has found it easier to penetrate high-technology markets outside the EU and that its exporters have performed better in sectors in which the EU is weaker: electronics, electrical equipment and textiles. They have struggled to dislodge their European competitors in the areas Europe is strong, such as cars, planes, rail and pharmaceuticals. In addition, the speed of Chinese entry into higher-technology EU markets was no faster than into lower-technology ones
- Second, creating European champions in high-technology sectors would probably distort competition within Europe. European companies with more domestic market power would raise prices and lower innovation. Building European champions also carries with it considerable risks for European consumers.
- Trade policies are preferable to relaxing domestic competition policy in addressing trade distortions. However, it will be very difficult for the EU to change China’s behaviour. In the face of this, there are four areas that the EU should explore as the basis of a strategy:
 - First, raise investment in R&D.
 - Second, offer alternatives to closer ties with China, including by providing more EU capital for strategic infrastructure, such as ports and railways, to seek to outbid Chinese investment, while maintaining strong oversight to prevent corruption.
 - Third, use new investment screening rules effectively.
 - Fourth, if the EU is serious about tackling Chinese subsidies and safeguarding the WTO, it could propose that China opens its domestic market and reduces subsidised lending and discriminatory regulation in return for the US and EU curbing subsidies to farmers and aircraft manufacturers (though the author acknowledges that politics of such a deal would be very difficult).

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Our assessment: The article raises some interesting perspectives in relation to the best way of addressing Chinese trade distortions and unfair competition. However, there are certain elements that are lacking from the analysis, which would have been useful to gain a more comprehensive picture. First of all, nothing is mentioned in relation to the competition EU companies face on third country markets. Furthermore, as regards the composition of Chinese exports, the author has exposed himself to a risk in focusing largely on the period 2005-2015. There have certainly been significant developments in the last four years, and had 2009-2019 been used, a different picture may have emerged. Finally, the analysis completely ignores China's extensive efforts to move up the value chain – for example, the Made in China 2025 strategy was only introduced in 2015, something this analysis does not take into account at all.

Does it matter that Europe's tech sector is behind that of the US and (in some areas) China, and is there anything that the EU should do to try to catch up? Or should it seek to regulate to ensure that US companies serve European interests?

- Issue of competitiveness of European tech goes well beyond trade policy (mostly industrial policy and internal market related)
- But EU trade policy does contribute to ensuring the competitiveness of European companies via:
 - Opening markets
 - Fight against non tariff barriers (data localisation requirements, obligations to give source codes...)
 - Preserving a level playing field (notably via actions against subsidies that have an harmful effect in the single market...)

BACKGROUND

Recent ECR publications:

John Springford: Should the EU develop 'European Champions' to fend off Chinese competition? (5 March 2020) <https://www.cer.eu/insights/should-eu-develop-european-champions-fend-chinese-competition>

- This is the article referred to in one of your questions
- Main arguments:
 - China is distorting world trade through its aggressive industrial policy. But fostering 'European champions' in order to compete is premature – and risky (notably for European consumers)
 - China is some way from becoming a significant player in European markets for high-technology goods. And any industrial strategy that simply transfers power from Chinese companies to European ones is unlikely, ultimately, to raise the EU's competitiveness, as incentives to innovate will be weaker if the EU relaxes its merger regime.

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- The EU would do better to tackle distorting Chinese policies using trade and investment defences, however slow and frustrating that may be – while directing aid to early-stage ventures that may turn into the world-beating products in the future.

Christian Odendahl and John Springfield (10 March 2020) <https://www.cer.eu/insights/bold-policies-needed-counter-coronavirus-recession>

- Main arguments:

- Even before COVID-19 reached Europe, its economy was struggling.
- Now that the outbreak has become an epidemic, a recession in the first half of 2020 is all but certain. This makes early and aggressive action to stimulate the economy – and to manage expectations about future stimulus – imperative.
- Stimulus policies should ideally be co-ordinated across Europe, the US and Asia, to signal to firms and markets that the world is determined to minimise the fallout of the epidemic.
- Since the virus is so contagious, the rate of infection is likely to peak within three to four months, before falling back, which means that governments have more certainty than usual about the future path of an economy.
- If they fail to act, they risk a wave of bankruptcies and rising unemployment. They must be bold.

Agata Gostynska-Jakubowska and Luigi Scazzieri: The EU needs to step up its response to the Covid-19 outbreak (23 March 2020) <https://www.cer.eu/insights/eu-needs-step-its-response-covid-19-outbreak>

- Main arguments:

- The EU has taken important steps to counter the coronavirus outbreak after initially responding slowly and in a haphazard manner. But the EU needs to do more if it wants to avoid boosting eurosceptic sentiment.
- The way in which the Union responds to the coronavirus will shape the eurozone's future, and exert a profound influence on how citizens perceive the Union.
- If the EU fails to rise to the challenge, it will be weakened and lose legitimacy in the eyes of EU citizens.
- Conversely, if the EU acts robustly and resolutely, co-ordinating member states' actions and adding value to their efforts to counter the outbreak, it has a chance to emerge from the crisis stronger, and with its image greatly enhanced.

Contact person: Art. 4.1 (b) 26/03/2020