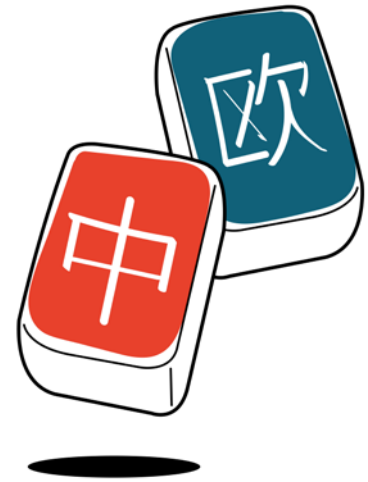


FEBRUARY 10, 2023

# MERICS

## Europe China 360°



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## ANALYSIS

### Navigating balloons and export controls in a time of hot peace

By **Francesca Ghiretti**

Despite the new episodes of tensions involving an alleged [spy balloon from China flying over US air space](#), both countries will likely try to stabilize their relationship in 2023. The trip to Beijing of US State Secretary Blinken may have been postponed in response to the incident, but the episode has not fatally wounded the desire from both sides to find a better way to coexist. As expressed by President Biden's address to the US Congress, his Presidency "[remains committed to work with China](#)" but that does not mean that the US will not "[act to protect](#)" itself.

The balloon incident was only the latest episode that shook strained US-China relations by interrupting attempts to communicate and engage. Washington's adoption of semiconductor export controls targeting China was another flash point highlighting the complicated nature of the relationship. While a potential spy balloon required a prompt response from the US, China needed a few months to respond to US export controls by introducing its own export controls on photovoltaic technology. Whether intentional or not, China's response occurs just as the US appears to have garnered Dutch and Japanese support for new export controls.

Despite the increased tensions in US-China relations, actors around the world are seeking to stabilize relations with China, and China is trying to do the same. Australia is one of the countries [seeking to patch up the relationship with China](#) despite persistent differences. A 90-minute meeting between Australia's Trade Minister Don Farrell and his Chinese counterpart Wang Wentao apparently yielded little tangible progress. But still, it is an important step towards improving strained relations. Farrell even received an invite to visit Beijing "in the near future", which he duly accepted.

#### ***What about the EU - US - China triangle?***

The European Union is undergoing its own process of stabilization regarding its relationship with China. French President Emmanuel Macron is expected to visit Beijing this year and has asked Ursula von der Leyen to join the trip, once again turning a France-China into an EU-China meeting. However, the EU cannot escape the pitfalls of US-China competition.

The recent debate on export controls is the obvious example that comes to mind, just look at how the EU proposed its own green industrial strategy, the [Green Deal Industrial Plan \(GDIP\)](#), in response to the US's Inflation Reduction Act (IRA). The IRA seeks to incentivize production at home so as to decrease dependence on China, but it appears to equally disincentivize production in partner countries, such as those in Europe. On one hand, it has been reiterated that the EU wishes to be a close ally of the US and coordinate with Washington on a broad set of issues, including China. On the other, the EU wishes to adopt its own approach to China.

Alignment becomes difficult when the US unilaterally adopts measures circumvent the EU to lobby single member states of interest, such as the Netherlands for the adoption of new

export controls. China sees this rift between the US and the EU, too, and it can be expected that it will try to capitalize on it. 2023 has begun with attempts by China to convince the EU of its goodwill, more of this can be expected.

The US-adopted approach on export controls, and especially the IRA, will hopefully not become the new normal in transatlantic relations. [French and German Economy Ministers Bruno Le Maire and Robert Habeck went to Washington](#) to find a solution to the agreement's negative implications on Europe. Hopefully next time, such negative spillovers will be avoided altogether. And yet, despite the enduring appeal of China's market, Brussels should remain clear-eyed about the similarly enduring characteristics of economic coercion and barring of European enterprises from strategic sectors that have underpinned China's engagement with the bloc in past years.

Stabilization is a key word for 2023 and the attempts on all side will continue but the paradox is that it should not be seen as the resolution of all tensions and issues, but the finding of an equilibrium that is not frictionless. However, in this new normal the actors involved come to have a better understanding of how to approach one another and offer more predictable responses in situations of tension and crisis.

#### Read more:

- The Times: [There is no choice but to engage with China.](#)
- Sinification: [The 'Spy' Balloon and US-China Relations as Viewed by Fudan Scholar Shen Yi](#)
- The Economist: [The lessons from the Chinese spy-balloon](#)
- The China Project: [CSIS analyst Gerard DiPippo deflates the balloon hype and brings the discussion back to earth](#)

## UPDATE

### German dependency, diversification and decoupling debates on China

Ahead of the publication of Germany's new China strategy, debate intensifies Berlin's approach to China. Policymakers seem to agree on one thing: Diversification yes, decoupling no.

#### What you need to know:

- **China-strategy leak and update on the drafting process:** A draft of the German China strategy and a China strategy paper of the Economy Ministry were leaked late last year, triggering a flurry of reactions. Chinese ambassador Wu Ken criticized the draft of the German China strategy that circulated on Chinese social media platform WeChat as being "guided by ideology," causing each of the coalition parties to push back. Industry associations such as APA or BDI called for "a balanced approach." Publicly the government tries to convey unity on issues related to the China strategy. Commentators have noted, however, that the Chancellor's Office would prefer less policy detail, perhaps to give greater leeway, whereas the Ministry of Foreign Affairs (MFA) pushed for a thorough and policy-oriented document.

- **Debate on China strategy fuels debate on economic dependence:** Economically speaking, Germany is the most China-dependent nation in Europe. However, studies that distinguish Germany's vulnerabilities from its dependencies reveal a diverse picture, and the case for decoupling remains underwhelming. The debate gained momentum early last year when Russia's invasion of Ukraine raised urgent questions about structural energy dependence. The debate has evolved from a stage of mere recognition of dependence to the current stage where measures are being taken. The focus of government action currently lies on reducing import dependence of raw materials used in the automotive or solar industry. More actions are set to follow for imports in the pharmaceutical, electronic and textile industries.
- **German actors on economic dependence:** The Chancellor, Vice Chancellor, and Foreign Minister are busy traveling Latin America, Africa, and India to find alternative exporters for specific goods that are currently majorly sourced from China. The government is calling on companies to diversify and is attempting to eliminate incentives, possibly by being more restrictive on providing investment guarantees for China. Medium-sized companies appear to be more active in this respect. Despite heightened geopolitical tensions and a potential cut in business ties due to a Taiwan conflict, larger German firms still look to strengthen their investments in China.

#### **What to watch:**

Germany is hurrying to diversify imports in certain vulnerable areas, such as raw material imports, but taking its time in others, for example, to assess companies' dependency levels. Disclosure requirements for companies are one way discussed to get a clearer picture of the situation.

Important divisions between the MFA and Chancellery remain and will shape the final strategy. Traditionally the Chancellery tends to have the final say when it comes to major decisions on foreign policy and China. The Liberals (FDP) and main opposition party CDU/CSU have called for the establishment of a national security council which could serve as a platform for more coordinated foreign policymaking and better representation of viewpoints when it comes to decisions on China.

#### **Read more:**

- Handelsblatt [DE]: [Chinas Ambassador in Berlin Wu Ken: "Cold War Mentality"](#)
- Position paper of „Asien-Pazifik-Ausschuss der deutschen Wirtschaft“ (APA) [DE]: [Chancen nutzen - Risiken verringern Empfehlungen der deutschen Wirtschaft für die China-Strategie der Bundesregierung](#). January 2023
- Handelsblatt [DE]: [Debate about German China strategy makes economy nervous](#)



## Germany to reduce dependency and diversify, but not decouple

Selected quotes from German stakeholders in politics and business



**Annalena Baerbock**  
Minister for Foreign Affairs

A lesson from Germany's Russia policy is "that we no longer make ourselves existentially dependent on any country that does not share our values ... That does not mean complete decoupling ... but developing alternative markets in the Asian region, diversification and risk management."

OCTOBER 2022



**Olaf Scholz**  
Chancellor

"Decoupling would be the completely wrong way" ... "The order of the day - or rather, the order of the Zeitenwende [paradigm shift] - is not decoupling, but rather smart political and economic diversification ... We also need an active raw materials strategy. We cannot afford to be unnecessarily fussy."

OCTOBER 2022



**Robert Habeck**  
Vice Chancellor,  
Federal Minister for Economic Affairs and Climate Action

"We will continue to have trade relations with China. But we are working to reduce our strategic dependence ... And we need to change and diversify some public instruments with China in mind, such as investment guarantees."

NOVEMBER 2022



**Franziska Brantner**  
Parliamentary State Secretary at the Federal Ministry for Economic Affairs and Climate Action

"Germany is dependent on China - and it will stay that way for now." We need "staying power ... Processes such as raw material extraction, further processing and recycling cannot be relocated overnight. It's about licenses, energy requirements [etc.] ... Looking at the necessary investments, we are talking about years, if not decades [to diversify]."

DECEMBER 2022



**Karl Haeusgen**  
President, German Machinery and Equipment Manufacturers Association (VDMA)

"[The] 'change through trade' concept should not be abandoned despite current problems. China is an indispensable market for mechanical engineering, but also an ever-increasing competitor ... It would be encouraging if politics would help [companies] to open up new sales markets 'Beyond-China'."

DECEMBER 2022



**Siegfried Russwurm**  
President, Federation of German Industries (BDI)

"The China strategy will have to address three dimensions: China as a partner for solving global challenges, China as a systemic competitor - but China is and will also remain a central market for our German industry."

DECEMBER 2022

Source: MERICS

## SHORT TAKES

### **The European Commission releases a list of 70 Global Gateway projects**

The initiative, expected to feature EUR 300 billion of public and private investment by 2027, is now acquiring a clearer list of objectives. The, so far internal, list primarily covers a range of infrastructure projects, including an undersea optical fiber cable connecting MENA countries and a hydropower plant in Cameroon. There are also indications that the Commission is planning to appoint a special envoy to the Global Gateway.

- Politico: [EU lines up 70 projects vto rival China's Belt and Road infrastructure spending](#)

### **The EU's WTO cases against China move forward**

As the EU and China failed to resolve two trade disputes – one related to economic coercion towards Lithuania and another to an enforcement of intellectual property rights – the WTO has now established dedicated dispute panels to resolve the issue. The WTO bodies can be expected to produce the final report in nine to ten months, unless China lodges an appeal, which likely adds a further three months to the process.

- WTO: [Panels established to review EU complaints regarding Chinese trade measures](#)

### **EU to launch a new center tracking Chinese and Russian interference**

The Information Sharing and Analysis Centre on foreign information manipulation and interference (FIMI), announced by High Representative Josep Borrell on February 7, will coordinate efforts of the EU27 and relevant civil society organizations. Parallel to the announcement, the European External Action Service (EEAS) released its first report on FIMI threats. While Russia remains the key actor of concern for the EU, the EEAS has been building its capacity to tackle FIMI originating from China.

- EEAS: [Speech by High Representative Josep Borrell at the EEAS Conference on Foreign Information Manipulation and Interference](#)

### **Wang Yi's apparently shortened trip to Europe**

Despite previous signals, Wang, now in his new capacity as the CCP's top diplomat, will not travel to Brussels for exchanges with EU actors. As of now, it appears that he still scheduled to travel to Germany to join the Munich Security Conference.

- Politico: [What happens to Europe when the balloon goes up?](#)

## **New Czech President becomes first EU head of state to exchange call with Taiwanese President**

Petr Pavel held the phone call a day after winning the Czech presidential elections. Two days later he stated in a public interview that “China and its regime are not a friendly country at the moment.” In the past and during the campaign, he has made several comments that suggest he will push for a more assertive China policy. This will be in sharp contrast to his predecessor, Miloš Zeman, a long-time proponent of engagement with Beijing.

- Euractiv: [China fumes at new Czech President over Taiwan](#)
- CHOICE: [End of an Era in Czech-Chinese Relations as Czechs Vote for a New President](#)

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