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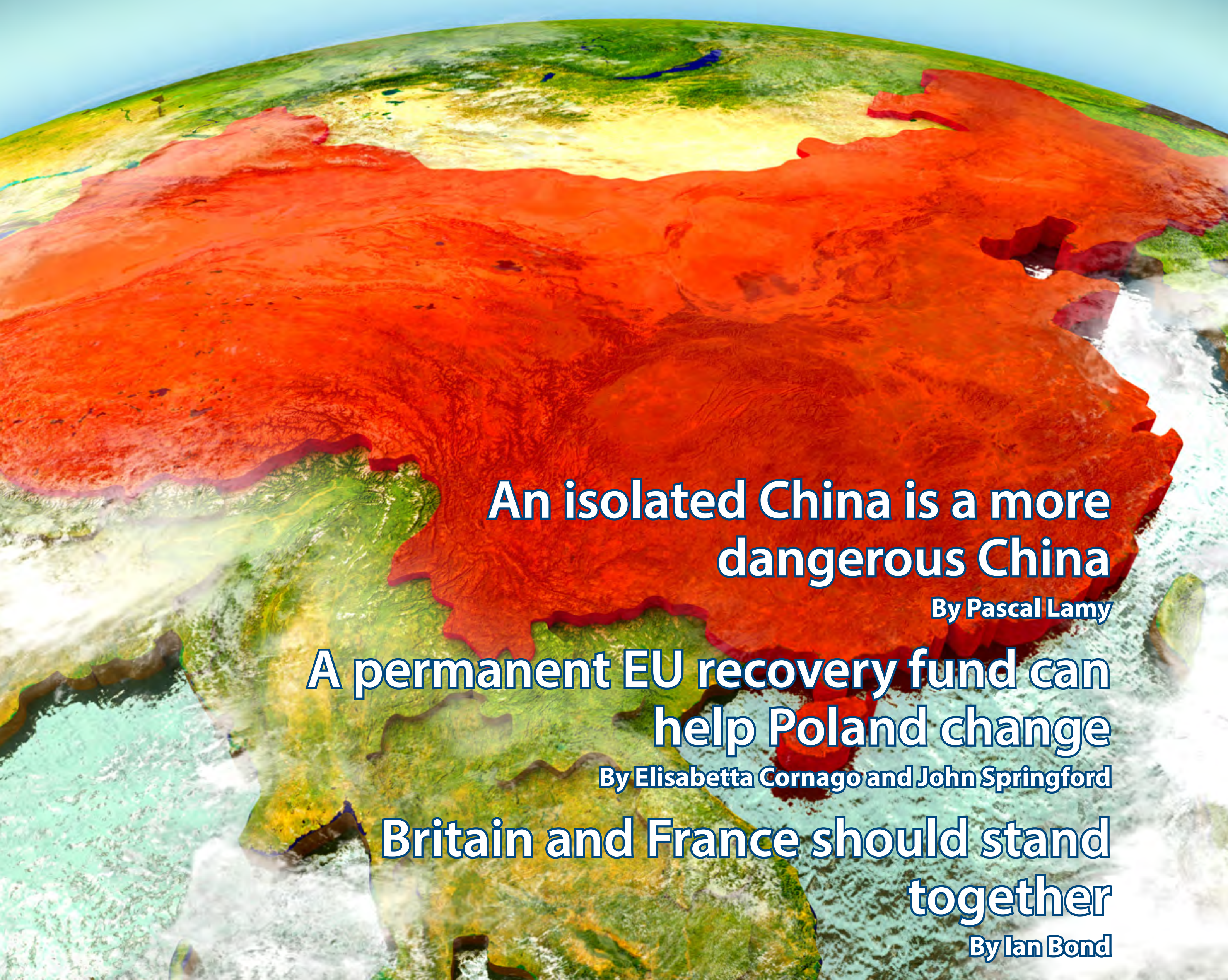

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CENTRE FOR EUROPEAN REFORM
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An isolated China is a more dangerous China

by Pascal Lamy

China is becoming a more difficult partner for Europe. Isolating it would only strengthen nationalist forces in Beijing, however. While standing up for its principles, Europe should help China's outward-looking forces.

Sabres rattle in the South China Sea. Diplomatic sanctions scuttle a long-planned investment agreement between the EU and China. Chinese 'wolf-warrior' diplomats scorn their host countries. Not surprisingly, many Europeans have become wary of China. Since 2019, the EU has tried to capture its complex relationship with China by treating it simultaneously as a systemic rival, an economic competitor, and a partner in providing global public goods. While the EU has so far sought to find a balance between all three variables, the latest developments are pushing Europe closer to the stance of the United States, which primarily sees its relationship with China through a prism of confrontation. But isolating China further would be a mistake. While the EU must not be naive about Chinese intentions, a globalised China is less dangerous for Europe and the rest of the world than an autarkic China.

Strategic planners in Washington see China as a more significant long-term threat to Western domination of the international order than the Soviet Union, whose centrally-planned economy was never more than half the size of the US economy. The Obama, Trump and Biden administrations have therefore all been trying to mobilise US allies to contain China's growing power. In Beijing, such efforts bring back memories of the so-called century of humiliation, stir up popular nationalist sentiment and accelerate China's divergence from the West.

These developments stand in stark contrast to China's integration into the international system between the 1970s and early 2000s, when Deng Xiaoping pursued gradual domestic reform and opening up to the world. Francis Fukuyama, in the early 1990s, famously declared the end of history; from then on, economic and political liberalisation would go together. Such ideas informed Western decision-makers during the Clinton era, when China was admitted to the World Trade Organisation in return for opening its market and reforming its economy. Permanent most-favoured nation status allowed China to become the world's manufacturing hub and to experience growth rates that made it the world's largest economy by 2013 (in purchasing power parity terms).

There was no concurrent political liberalisation, however. It has instead become clear that sustainable political change in China must come from within – an ever-receding prospect. Instead, domestic human and political rights have been severely repressed in recent years, especially in Xinjiang and Hong Kong, and China has adopted an aggressive posture in its neighbourhood. The West and China are increasingly on a path of systemic rivalry. As a result, both China and the US are encouraging the diversification of supply chains – in other words, decoupling to lessen economic interdependence. This has been particularly evident in the technology sector, where security issues, data regimes and competition dynamics are most sensitive.

But there is a mismatch between the political imperatives for economic decoupling and the business reality, particularly for European firms. These are much more dependent on the Chinese market than their US counterparts. Eleven per cent of EU exports go to China, compared with just 6 per cent of American exports. With a ratio of exports to GDP of 44 per cent, the EU member-states are also nearly four times more dependent on exports than the US, which only has an exports-to-GDP ratio of 12 per cent.

Whether or not China's *Sonderweg* outside global liberal market capitalism is a sustainable model remains uncertain. A growing demographic burden, historically high levels of public debt, rising labour costs, and a real estate bubble are all testing the system. But reports of the Chinese model's imminent death have been greatly exaggerated for years: China's GDP growth has continued to be about triple the OECD average. For now, a significant presence in the Chinese market remains key to the international competitiveness of most large firms. Despite mounting political tensions, European companies continue to increase their investments in China. According to a recent survey, almost one-third of European companies operating in China increased their shares in joint ventures, and two-thirds took full ownership or a controlling stake in 2020.

But there are qualitative differences, depending on what is being traded. Goods are, for the most part, ideologically neutral. Digital services, on the other hand, are deeply intertwined with political values. The recent moves by the Chinese Communist Party (CCP) to increase control over China's domestic technology sector and the withdrawal of LinkedIn from the Chinese market underline that the free circulation of information and open cross-border data flows are incompatible with authoritarian governance. In the medium term, the CCP's political compulsions may make its technology firms less and less competitive, stalling China's push to increase the export of digital services. As most future economic growth will come from this sector, China could fall into the middle-income trap.

Whether or not that transpires, the EU would be well-advised not to play into the hands of those in China who want to isolate the country from the rest of the world. Most Europeans have learned from the history of the 20th century that a dark path lies ahead when countries cut their ties to the rest of the world in a jingoist frenzy. World War One serves as a reminder that interdependence is not a sufficient condition for peace. But economic integration can be a vital guardrail whenever great power politics leads political leaders down a dangerous slope.

Europe must be clear-sighted about China's direction of travel. It must not repeat the mistakes of 20th century appeasement, but stand shoulder to shoulder with other democracies to defend human rights and the rule of law. However it should co-operate with China to address shared global challenges. Any political solution to crucial issues for the future of the planet, in particular climate change and marine biodiversity, would be meaningless without the participation of the world's largest economy.

Moreover, reciprocal market access and a level playing-field for the exchange of goods, services or capital will not only continue to benefit EU consumers and industry, but will also strengthen the outward-looking forces in China that interact with the rest of the world. They will have a material stake in continued co-operation and are more open to outside ideas and values. Efforts by the EU to encourage some firms to diversify their supply chains should be restricted to narrowly defined sectors of strategic importance, where it is absolutely necessary to reduce one-way dependence. Because of the specific character of the digital domain, the EU should also link its political values more explicitly to cross-border data flows, and consider offering digital market access only on a reciprocal basis. That would incentivise China (and others) to rethink their current approach to data governance or risk becoming uncompetitive in the digital economy.

Lastly, the EU should support China's equitable access to key mechanisms of global governance. This includes the long-overdue quota reform at the International Monetary Fund, which would support China's integration into the existing international order and discourage it from establishing or bolstering alternative governance arrangements. Taken together, these measures would help to support those in China who look outward rather than the nationalist forces that are the most likely threat to global peace and prosperity.

This is based on a report to be published by the Jacques Delors Institute (Paris).

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A permanent EU recovery fund can help Poland change

by Elisabetta Cornago and John Springford

Poland's relationship with the EU is already in a bad state, with continuing disputes about the rule of law, the recovery fund, and the Polish government's opposition to LGBTIQ rights. The EU's climate ambitions will only add to this tension, given Poland's largely coal-fired economy.

Warsaw will have to enact unpopular reforms that will hurt industrial communities to end coal production, as agreed between the government and the coal mining industry in order to comply with EU climate goals. Poland's government will be tempted to blame the EU for the tough choices ahead, but the EU's recovery fund could be used to defuse the conflict, if it is made permanent and reformed.

The authoritarian and nationalist Law and Justice party (PiS), which now leads a coalition government, rose to power in superficially benign economic conditions, with Poland's GDP per capita growing strongly at 4 per cent a year between 2004, when the country joined the EU, and 2019. That performance masked growing income inequality and the continued loss of younger, skilled people from Poland's regions to Warsaw and to countries in Western Europe. Poland's coal-fired economy is about to go through wrenching change, especially the mining region of Silesia, which might encourage Law and Justice and its coalition partner United Poland to further whip up antipathy towards the EU.

Consider the similarities between the UK in the 1980s – the first big European coal producer that let its industry shrink rapidly – and Poland now. In 1980, the UK was producing 130 million tons of coal a year: by 2010, that had fallen to 18 million. Poland will go through an almost identical change: in 2019, Poland produced 122 million tons of coal and lignite, and the government and coal mining industry agreed last year that production should end in 2049, thirty years later.

Margaret Thatcher's victory in the 1985 miners' strike and the rapid deindustrialisation that followed remains a feature of Britain's economic and political geography. Former industrial regions in Wales, Scotland and northern England remain significantly poorer than southern England. Poland's Law and Justice government is keener to avoid alienating voters in industrial regions than Thatcher was. The party has close ties to the coal business, and Poland's 83,000 miners and their families represent an important voting bloc. Law and Justice is seeking to protect employment in industrial regions – a legitimate goal, given the permanent scars left by deindustrialisation in other countries. It is only reluctantly ceding to EU pressure to reduce the environmental impacts of heavy industry.

In September, Poland's prime minister, Mateusz Morawiecki, partly blamed the EU for rising gas and electricity prices, saying they were "tied to the EU's climate policies". Poland has refused to close a lignite mine on the border with Czechia that may be illegally drawing groundwater from Czechia's territory, despite being ordered by the European Court of Justice to close it in May 2021. Poland's Energy Plan published in March 2021 entails fairly limited cuts in coal-fired electricity generation in the 2020s, postponing most action to the 2030s.

Over the last two decades, money from the EU budget has helped reduce pollution and improve the energy efficiency of the Polish economy by closing dirty plants and improving infrastructure. The recovery fund, set up in 2020 to help EU member-states overcome the COVID-19 crisis, requires 37 per cent of the money to be spent on climate investment, such as renewable energy, energy-efficient building renovations and charging stations for electric vehicles. As a result of the standoff with the Polish government over its politicisation of the judiciary, the Commission has so far refused to sign off Poland's plans for recovery fund spending, which would provide €14 billion for improvements to energy efficiency and infrastructure, and €7.5 billion for greening transport.

With grants from the recovery fund amounting to 0.7 per cent of GDP a year for six years, it would be surprising if Poland did not eventually compromise. However, for now, Law and Justice appear to have decided on a course of confrontation with the EU, with Morawiecki threatening to veto the adoption of the Commission's proposed Fit for 55 climate package if Poland's recovery plan is not agreed.

The EU's hawkish north could conclude that the recovery fund means throwing money at a recalcitrant east and spendthrift south, and that it would be best if it were a one-off, ruling out a permanent EU fiscal union focused on investment. That would be a mistake. In a recent CER policy brief, 'Why the EU's recovery fund should be permanent', we argue the recovery fund should be extended beyond 2026, and provide much stronger incentives for Poland and other laggards to overcome the difficult domestic politics that they face in relation to the energy transition.

By making the recovery fund permanent, the EU would be providing a constant stream of investment for the climate transition, which will of course continue long after the fund's current end year of 2026. Public investment was the biggest victim of the austerity round of the 2010s, because it is easier to cut future spending than raising taxes or taking money from welfare, pensions or public services. But it was one of the worst budget lines to cut: public investment stimulates private investment, especially when economies are weak. A permanent fund could help ensure that public investment across Europe is more stable across the economic cycle, rather than being cut in downturns.

The recovery fund as it stands today, however, is too small to move the dial on climate change: the Haut Conseil pour le Climat, an independent advisory body to the French government, estimates that France's recovery plan will reduce emissions by less than 1 per cent compared to 2020 levels. As discussed in our policy brief, total spending on climate under the fund will be around €45 billion a year across the EU. According to the EU and member-states' estimates, public investment on climate will have to reach approximately €460 billion a year across the EU to meet 2030 emissions targets. If climate investment through the recovery fund made up half of that annual expenditure – €230 billion – it would reduce the cost of climate action, by providing grants and cheap finance to more indebted or less developed member-states. Richer member-states are responsible for more historical emissions, so transfers are justified. And a bigger, permanent fund would provide powerful incentives for climate-sceptic or short-termist governments to act. A larger prize may also provide the Polish government with fewer incentives for confrontation with the EU on the rule of law.

The recovery fund's governance arrangements make it much less susceptible to the mis-spending and, in some cases, outright corruption that has dogged the EU budget. Alongside investments, member-states' recovery plans include proposals for domestic reforms, such as digitising public services, accelerating permits for wind and solar farms, and speeding up civil cases in the courts, which should raise economies' growth potential. Money only starts flowing when the Commission is satisfied with the government's spending plans, including the quality of the institutions that prevent fraud and abuse, such as the judiciary. The Commission can stop money transfers if periodic reform and investment milestones are not met.

2026 may seem far off, but the climate emergency will dominate at least the next three decades of European politics. Climate change may become the next front in the long battle between nationalist and pro-EU governments. The EU's leaders should start work on a permanent recovery fund before it is too late.

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Britain and France should stand together

by Ian Bond

UK-French relations are fractious across the board. The two countries must not lose sight of their common international security interests. As Europe's pre-eminent military powers, they need each other.

Wherever one looks, London and Paris are arguing – whether about fishing rights, migration or trade. Until September, defence co-operation had been less affected by Brexit-related tension than other parts of the relationship – but then Australia cancelled its €56 billion contract for French submarines, and announced that it would buy nuclear submarines from the UK or US instead. This so-called AUKUS pact led French ministers to question the UK's reliability as a defence partner. Now Boris Johnson reportedly wants "a new strategic alliance" with France – though the substance remains vague. Both parties would have to compromise on core principles to reach any significant agreement.

On the face of it, Britain and France should be a natural fit as partners in defence. Between them, they account for more than 40 per cent of defence spending by European members of NATO – though their combined defence budgets still only amount to about one-sixth of America's. They are the only European armed forces able to conduct high-intensity operations in distant theatres with limited US or other allied assistance.

Despite their similarities, defence co-operation has not gone smoothly. In 1998, British Prime Minister Tony Blair and French President Jacques Chirac agreed that the EU "must have the capacity for autonomous action, backed up by credible military forces", enabling the creation of the EU's Common Security and Defence Policy (CSDP). But in 2003, Chirac led European opposition to the invasion of Iraq while Blair was its leading supporter. British Prime Minister David Cameron and French President Nicolas Sarkozy sought to consolidate UK-French defence co-operation through the 2010 Lancaster House treaties – one on defence and security co-operation and one on nuclear stockpile stewardship. But Cameron resisted the French desire for a greater role for the EU in defence procurement and operations.

Since 2010, the British and French militaries have increased their co-operation. The Combined Joint Expeditionary Force (CJEF) became fully operational in 2020. That allows London and Paris to deploy a joint land, air and naval force of up to 10,000 personnel rapidly, for everything from disaster relief to high-intensity combat operations. UK and French forces are working together or in complementary roles outside Europe – the Royal Air Force provides helicopter lift for French forces in the Sahel, and 300 British troops participate in the UN peacekeeping mission in Mali, which works in close co-ordination with the French.

Defence industrial co-operation presents a mixed picture. In 2020 British and French defence ministers announced a contract to produce a common autonomous maritime mine countermeasures system – intended to replace the existing mine countermeasures vessels of the two sides. The European missile company MBDA (whose largest shareholders are BAE Systems and Airbus, with the Italian-UK firm Leonardo holding a smaller stake) is working on a number of joint missile projects for UK and French forces, replacing previous national systems. On the negative side, two armed drone projects were abandoned, and the UK and France are backing rival projects for next-generation combat aircraft – the UK working with Sweden and Italy, and France with Germany and Spain.

The UK and France are also Europe's nuclear powers. They share some research facilities that help to ensure that their nuclear weapons remain safe and effective. London and Paris are both lobbying to ensure that the 2022 US nuclear posture review does not rule out the US responding to a non-nuclear attack with nuclear weapons. A new US policy on these lines could lead an adversary to think that a conventional attack would never give rise to a nuclear response, thus undermining the deterrent effect of US nuclear forces. It could also put political pressure on the UK and France to copy the US decision.

For all the areas of agreement, however, London and Paris are deeply divided over the roles of the EU and NATO in European security. The UK's post-Brexit absence from EU discussions has widened the gap. France has taken Brexit as an opportunity to promote Macron's ideas for European strategic autonomy. Though the concept now stretches to avoiding excessive supply-chain dependence on China (and others, including the US), France's original focus was on enabling Europeans to carry out military operations without having to rely on US support. This required a more prominent EU role in some areas of security, including capability development.

As the US focuses increasingly on countering China's rise, Europe is right to take more responsibility for maintaining its own security. In the joint statement that Biden and Macron issued following a telephone call designed to clear the air after the AUKUS row, the US recognised "the importance of a stronger and more capable European defence, that contributes positively to transatlantic and global security and is complementary to NATO". France has emphasised the European aspect, however, and downplayed the issue of complementarity. France is keen that NATO's new strategic concept – the guiding document for alliance strategy and plans – which will be adopted in 2022, explicitly endorses an increased EU role in European defence, but Paris is resisting efforts to increase EU-NATO co-ordination in defence capability development. France also opposes broadening the scope of NATO activity to reflect new challenges, whether from China or emerging and disruptive technologies. Macron, who in 2019 described NATO as "brain dead", has moderated his language, but does not seem enthusiastic about revitalising NATO.

The UK has the opposite problem: it refuses to accept that the EU plays a significant role in European security and is becoming a defence actor in its own right. Though Theresa May had sought an agreement with the EU on foreign, security and defence co-operation as part of the EU-UK Brexit deal, Boris Johnson rejected the idea. 'Global Britain in a competitive age', the government's March 2021 review of security, defence, development and foreign policy, is almost entirely silent on the potential contribution of the EU to European defence and security, apart from a reference to the UK supporting closer practical co-operation between the Union and NATO. A recent article by Foreign Secretary Liz Truss on Belarus did not refer once to the role of the EU in tackling the crisis there.

Both France and the UK need to take their ideological blinkers off. Macron needs to admit that NATO will do some things better than the EU for the foreseeable future, and accept that many of the EU member-states that take defence most seriously (especially those in Central Europe and the Nordic/Baltic region) support an expanded role for NATO. Johnson should stop pretending that there is no area of European foreign, security or defence policy where the EU's institutions can add value to what individual member-states or NATO are doing. If Canada, Norway and the US are willing to participate in an EU project to facilitate the movement of military forces around Europe, for example, why is the UK still ignoring it?

For a strategic alliance to be a realistic ambition, both leaders need to rebuild mutual trust and put aside the short-term political incentives to fuel bilateral tensions. Johnson's popularity with his pro-Brexit supporters benefits from picking fights with France; Macron's electoral chances against eurosceptic rivals improve if Brexit is seen to harm the UK. But Europe is under threat from Russian revanchism in the east, violent extremism and regional conflicts in the south and the rise of China's authoritarian model of governance globally. France and the UK should not respond by squabbling about fishing licences and migrants in rubber dinghies.

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CER in the press

Euronews
17th November
Ian Bond, director of foreign policy at the **CER** argues that he's sceptical that Putin actually wants to take over Belarus, because having a weak, dependent Lukashenka suits him better than having to assume full responsibility for a country whose economy is not in a good way.

Financial Times
12th November
The **CER** is making the case for why the bloc's post-pandemic recovery fund based on mutual debt should be a permanent EU outfit. One argument: if the bloc is serious about its climate ambitions, the current fund is nowhere near sufficient for the green transition investments needed.

The Times
11th November
An analysis by John Springford of the **CER** suggests Brexit so far has reduced UK goods trade by 15.8 per cent compared with what might have been expected if Britain was still in the EU.

The New York Times
10th November
"Warsaw also does not want the oversight of its actions that Frontex might provide," said Luigi Scazzieri, a research fellow at the **CER**.

Euronews
30th October
Elisabetta Cornago, a research fellow at the **CER** said that "experts are hoping for a leap forward with final climate actions plans" at the summit to keep the 1.5°C target "within reach." "Currently, that seems hard, as most plans fall far short of that goal," she deplored.

The Independent
29th October
John Springford, deputy director at the **CER**, [said] he is "pretty confident that the impact of Brexit in the long run will be greater than Covid". Mr Springford's modelling of the impact of Brexit on the UK's trade with the EU was used to help inform the OBR's analysis.

Le Monde
29th October
"France mistakenly thought that the UK was going to become a sort of deregulated Singapore-on-Thames. It also wanted to gain access to the market share in the City or in the automotive sector, "said Charles Grant, director of the **CER**. "Paris took a hard line to deprive the extreme parties of arguments in favour of Brexit," added the expert.

The i
20th October
Sam Lowe, a senior research fellow at the **CER**, said the small size of New Zealand meant that the overall benefit to the UK's economy would be small. He told i: "It's a politically significant agreement but not an economically significant one, although of course there will be some firms that benefit from it."

The Economist
20th October
"A new head of the Bundesbank willing to take on Germany's conservative consensus would help give the ECB cover in the critical months ahead," says Christian Odendahl, chief economist at the **CER** in Berlin.

Al Jazeera
14th October
"We've seen so many breaches of fundamental rights throughout the pandemic," said Camino Mortera-Martinez, a senior research fellow at the CER in Brussels, referencing those who were blocked from entering their countries because they were not vaccinated.

Financial Times
24th September
"With the end of free roaming charges after Brexit, the cost of phone bills when travelling in Europe is only going to increase for UK consumers," writes Zach Meyers, a research fellow at the **CER**.

Recent events

17 November
Webinar on 'The European fiscal framework and climate change'
Speakers: Paulo Medas and Maarten Verwey

17 November
Breakfast on
'Labour's policy review', London
Speaker: Anneliese Dodds

12-13 November
Conference on
'The politics of climate change', Ditchley Park
Speakers included: Joseph Aldy, Agnès Bénassy-Quéré, Arancha González Laya, Zeke Hausfather, Beata Javorcik and Martin Sandbu

29 October
Webinar on
'The EU's carbon border adjustment mechanism and the rest of the world'
Speaker: Ignacio García Bercero

27 October
CER/KREAB webinar on
'Building a strong European Health Union'
Speaker: Giorgos Rossides

14 October
Conference on
'Cyber security and European autonomy', Brussels
Speakers: Tyson Barker, Jonathan Faull, Lise Fuhr, Toomas Hendrik Ilves, Kay Jebelli and Julian King