



Making Open Strategic Autonomy work – European Trade in a Geopolitical World

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Foreword

Since 1945, liberal democracy combined with an open market economy has proved to be a successful way to organise society. Through free trade and the invisible hand of the market, social benefits and public goods have been delivered widely and globally to an increasing part of the population.

Globalisation has been the force that wove economies together, emboldened by the parallel advance of the internet and digital technologies. Free trade and open markets have been tested at several moments: the 1997 Asian financial crisis, the 9/11 events, and the 2008 global financial crisis to name a few. And even though the market economy took a hit in the wake of the 2008 crisis, globalisation nevertheless remained an important driver of business and industry.

The recent COVID-19 pandemic has dramatically highlighted existing supply chain dependencies, such as Asia being the biggest source of basic personal protective equipment. Despite the challenges, companies adjusted strategies quite swiftly and global supply chains broadly demonstrated a high degree of resilience. Globalisation showed once again that it can adapt to external shocks.

The consequences of the pandemic have prompted analysis and debate on how globalisation can be improved. The scarcity of certain commodities and raw materials is now playing out in the markets. The recent gridlock in the Suez Canal provides another reminder of vulnerabilities in global supply chains. Therefore, it is no surprise that conversations about reshoring are gaining momentum and volume.

Nevertheless, faith in the resilience of supply chains and globalisation remains strong among business leaders. In the most recent edition of The Conference Board's semi-annual surveys of the CEO's & Chairs in ERT, while shortage of supplies and trade tensions

came out as the most disruptive risk, two-thirds of the ERT Members stated that their companies are adjusting their supply chains on either a temporary or permanent basis, to adapt to this changing environment.

ERT firmly believes that businesses are best placed to manage their own supply chains. Diversification and flexibility driven by industry itself would make supply chains more resilient. Policies to enforce stockpiling or reshoring are only justified in specific and exceptional circumstances. This is especially important now, as the green and digital transitions are an intercontinental race the EU is running in a spirit of both partnership and competition. Being successful in this race requires that European industry be as adaptive and competitive as possible.

Our aim with this publication is to provide analysis that communicates the outlook and ambitions of the leaders of some of Europe's biggest global companies on this vital topic of international trade. It is comprised of three sections that underpin European trade: Global value chains and resilience; Transatlantic relations; and the EU-China relationship. Each of these sections provides recommendations which could hopefully guide and inform the current debate on the most pressing trade issues of our time.

Jacob Wallenberg

Chair, Investor AB

Chair, ERT Committee on Trade & Market Access



Introduction

The geopolitical, economic and social context for European trade policy is changing rapidly. Emerging new technologies present us with great opportunities, as do the green and digital transitions. But European industry also faces the twin challenges of competing globally on a playing field that is increasingly uneven and in an environment that risks becoming hostile to globalisation.

The way in which we navigate through this uncertain environment will be critical, not only for European jobs and growth in the industries of tomorrow, but for Europe’s ability to act independently and to exert influence globally.

This report assesses these challenges and identifies the priorities for policymakers if we are to rise to meet them.

It does so through the prism of three developments of global significance which are now recasting the realms of the possible and the desirable for trade policy – the pandemic and the stresses placed on global supply chains, political changes in the US, and tensions in the EU-China relationship.

Throughout this report, our recommendations are intended to help policymakers as they work with industry to find new opportunities by levelling the playing field, by bolstering globalisation, and by addressing the genuine concerns that many people have about some of globalisation’s consequences.

This report does not attempt to cover all aspects of Europe’s trade or industrial policies, but only those that are directly relevant to the themes described above. More detail on the ERT’s views on trade policy can be found in the Expert Paper on the EU’s trade policy review which ERT published in November 2020.¹

As in all areas of policy, successful implementation is essential, and it is outcomes that ultimately matter most. For that reason, in an annex to this report, we also set out ideas for how progress on European trade policy should be assessed. This draws on ERT’s proposal from November 2020 for a balanced scorecard of indicators to track the performance of the EU’s industrial strategy.²

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¹ ERT Expert Paper on “*The EU’s trade policy review*”, November 2020
https://ert.eu/wp-content/uploads/2021/01/ERT-Expert-Paper-the-EUs-Trade-Policy-Review_Nov2020.pdf
² ERT Paper on “*Putting the EU Industrial Strategy into action*”, November 2020
https://ert.eu/wp-content/uploads/2020/11/ERT-Publication-Putting-the-EU-Industrial-Strategy-into-action_Nov-2020.pdf

Executive Summary

Being open to trade is a source of strength, not weakness. It allows the EU to build, expand and preserve the strong global value chains that are essential for competitiveness, and growth. It allows diversification and flexibility in supply chains, making them more resilient. And it creates mutual dependencies that encourage international cooperation between the major economies.

The EU's trade and industrial policies should seek to strengthen the global value chains of European firms by increasing openness, building capabilities, and ensuring a level playing field for competition, both in Europe and globally.

Global value chains that meet Europe's needs

Resilience begins at home and so the EU should further strengthen the Single Market to support diversification and flexibility in supply chains. This means removing regulatory frictions that restrict intra-EU trade and make it harder to source flexibly. As part of this, the EU should reinvigorate the Single Market standardisation process in close cooperation with industry and standardisation bodies.

To ensure that supply chains are resilient the EU needs a clear definition of critical goods and a precise approach to applying the concept of open strategic autonomy. Critical goods should mean those for which supply disruptions could potentially undermine the ability of policymakers to meet core public policy objectives – such as national security, public health, and fair competition – and which would, consequently, materially impact the lives of European citizens.

Businesses are best placed to manage their own supply chains. Targeted interventions to support the resilience of supply chains for critical goods should be the exception, not the rule. As such, the default setting for the policy of open strategic autonomy should be openness. The EU should encourage international diversification to support this. Policies to encourage inventory accumulation or reshoring are only justified in specific, exceptional circumstances.

Innovation helps to strengthen value chains and the EU should seek a better enabling environment for innovation through stronger protection of intellectual property internationally. The incentives created by IP rights have for example also contributed to the rapid development of vaccines.

To improve resilience, it is essential that the EU invests in developing strategic trade and investment relationships with like-minded partners, including the US. The EU also needs a comprehensive economic and regulatory diplomacy strategy to help enhance supply chain flexibility.

In its trade policy, the EU should promote internationally agreed rules and standards for international investment protection, to prevent companies from suffering from unfair practices or discrimination by the host state.

New opportunities from the transatlantic alliance

The EU and US acting together can build a stronger transatlantic economy, shape standards globally based on transparency and our shared values, and strengthen multilateral institutions and the rules-based system. The new EU-US Trade and Technology Council will provide a dedicated platform for cooperation on trade policy and related areas.

This platform should have a broad agenda that includes regulatory cooperation. Some of the most promising areas for collaboration are in new technologies, both to build transatlantic capabilities and to set standards internationally. The priorities include artificial intelligence, IoT, platforms, 5G, and cybersecurity.

Businesses are best placed to manage their own supply chains. The default setting for the policy of open strategic autonomy should be openness

The EU and US should aim to build a common transatlantic digital economy. As part of this, they should work together and with others to enhance the free, cross border flow of data. As a matter of urgency, they should agree a new transatlantic framework for data transfer.

To level the playing field for business globally, the EU and US should work together on a package of WTO reforms. They should identify and counter unfair trade practices used by non-market economies. And they should drive efforts to level up ESG standards globally, working through multilateral bodies where possible.

In this and other areas, the EU and US should enter dialogue with business on priorities. ERT and our US counterpart the Business Roundtable (BRT) offer our full support.

To establish momentum, the EU and US require early successes that resonate with citizens. The trade dimension to COP26 provides an immediate opportunity, where the priority should be to encourage the wider adoption of carbon pricing and a common approach to carbon leakage.

Finding a positive way forward in the China relationship

The EU-China economic relationship is critically important for European industry, jobs, and growth. It is also one of the most complex and challenging relationships.

It is essential that European policymakers and political leaders face up to the challenges, while remaining focused on Europe's long-run interests. That means making steady but visible progress on the core task of rebalancing the economic relationship, both through increasing access on fair terms for European firms in China and in ensuring that Chinese firms compete on fair terms in the Single Market and globally.

To support this, the EU should establish a dedicated China unit in the European Commission to bring urgency and coherence to the management of the relationship. The new unit should engage with industry on China policy. There should always be a business element to EU-China negotiations and summits as well.

The EU must address barriers to market access in China, including non-tariff barriers such as discriminatory licensing, further reductions in the negative list for investment, encouraging China to join the WTO's Agreement on Government Procurement, and protections for IP.

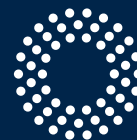
The EU must also equip itself with the right tools to challenge unfair competition from China. This includes making full use of existing tools such as antidumping and countervailing duties, while adopting the proposed new instrument to level the playing field with foreign firms that benefit from subsidies.

The EU and China should address concerns about the Comprehensive Agreement on Investment, including the scope and enforceability of labour and environmental commitments. They should ratify the agreement when the political conditions allow as this will bring immediate commercial opportunities and help to rebalance the relationship.

Trade policy is an important tool for realising European climate ambitions and achieving climate neutrality by 2050. The EU's dialogue with other stakeholders, including China and the US, should identify opportunities for cutting emissions while building a more sustainable, competitive economy.

As a practical step towards this, an immediate priority for the EU and China should be to collaborate to develop and promote multilateral carbon accounting standards and share expertise on plans to cap emissions, on emissions trading, and on green finance.





Global value chains that meet Europe's needs

In a globally integrated economy, building strong global value chains³ is essential for the competitiveness of European industry and for jobs and growth in the European economy. Supply chain resilience is a critical part of this. Resilience begins at home, in the European Union, with an integrated and flexible Single Market. Being open to trade is a strength, both because it allows diversification and flexibility and because it creates mutual dependencies that encourage international cooperation. The EU's trade and industrial policies – along with the EU's approach to implementation of the concept of open strategic autonomy – should seek to strengthen the global value chains of European firms by building capabilities, supporting innovation, increasing openness, and ensuring a level playing field for competition, both in Europe and globally.

³ In this report, we adopt the definitions used by the [OECD](#) for global value chains and supply chains. Accordingly, global value chains refer to "the full range of firms' activities, from the conception of a product to its end use and beyond... it includes activities such as design, production, marketing, distribution and support to the final customer". Global supply chains refer to a narrower range of activities, namely focused on the operational process of producing and distributing a good or service, rather than the value-adding activities.

Understanding supply chain resilience

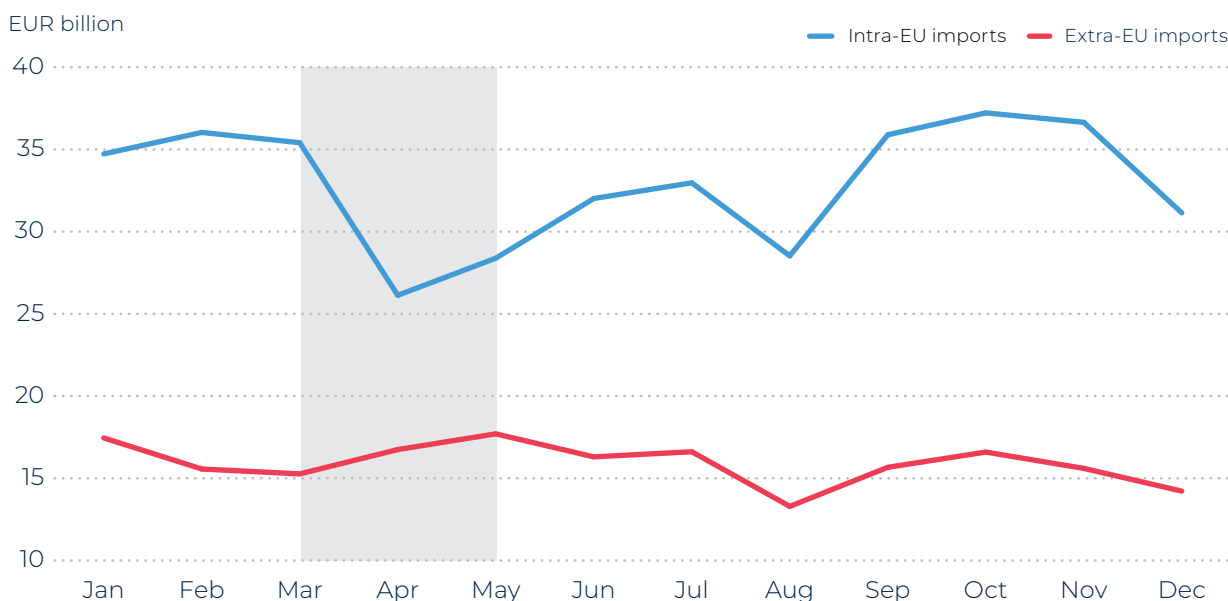
In the wake of COVID-19, a consensus has emerged that the resilience of supply chains needs to be strengthened, but differences remain over how this should be done. Supply chains must be able to withstand and recover from external shocks of all kinds, ranging from pandemics to cyber-attacks and to extreme climate events. Supply chains also need to be resilient to isolated, unforeseen events, such as the blockage to the Suez Canal in March 2021, which disrupted international trade estimated to be worth \$10 billion per day.⁴

Strategies to build resilience should not focus on preparing for the last crisis or any one specific threat, but on enabling supply chains to adapt quickly to disruptions or spikes in demand. We do not know what the next crisis will look like. While the COVID-19 pandemic sparked a surge in demand for personal protective equipment, ventilators and vaccines, future crises may see a rapid increase in demand for a different set of goods or services. Given this uncertainty, policymakers should work with industry to support versatility, to enable companies to manage agile and flexible supply chains that are resilient in times of crisis.

Strategies to build resilience do not require a wholesale rethink of current models, which have proven remarkably resilient throughout the pandemic. European supply chains adapted quickly as soon as they came under pressure and in many cases performed well during this historic ‘stress test’. When internal EU trade fell in March and April 2020 – as some countries put up barriers to exports – the gap was quickly filled by global supply chains that drew in imports from outside of the EU.⁵ It was openness to external trade that allowed the EU to meet the surge in demand for many essential products.

The capacity to innovate also enabled European manufacturers to respond quickly to new challenges. Many companies completely reworked their manufacturing facilities to produce ventilators and other vital equipment in record time. At the height of the first wave of the pandemic, the number of European companies producing face masks increased from 12 to 500 in less than two months.⁶ This flexibility and agility of European supply chains – enabled by the capacity of companies to innovate in response to new challenges – revealed itself as a cornerstone of European resilience.

Extra-EU manufacturing imports grew at the start of the pandemic



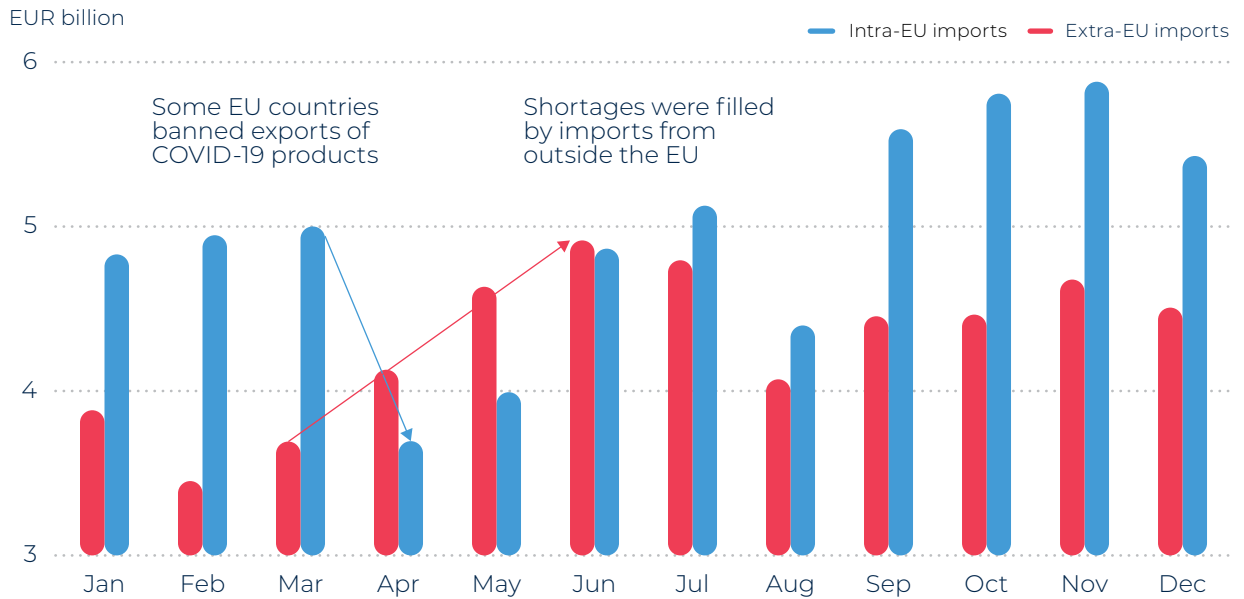
Source: Eurostat. Link: <https://appsso.eurostat.ec.europa.eu/nui/submitViewTableAction.do>

⁴ Financial Times, March 2021 <https://www.ft.com/content/7afcdae6-b116-424f-bd1c-08e6bbdf6b77>

⁵ ECIPE Paper on “Covid-19 and the Danger of Self-sufficiency”, March 2021 <https://ecipe.org/publications/covid-19-and-self-sufficiency/>

⁶ ECIPE Paper on “Covid-19 and the Danger of Self-sufficiency”, March 2021 <https://ecipe.org/publications/covid-19-and-self-sufficiency/>

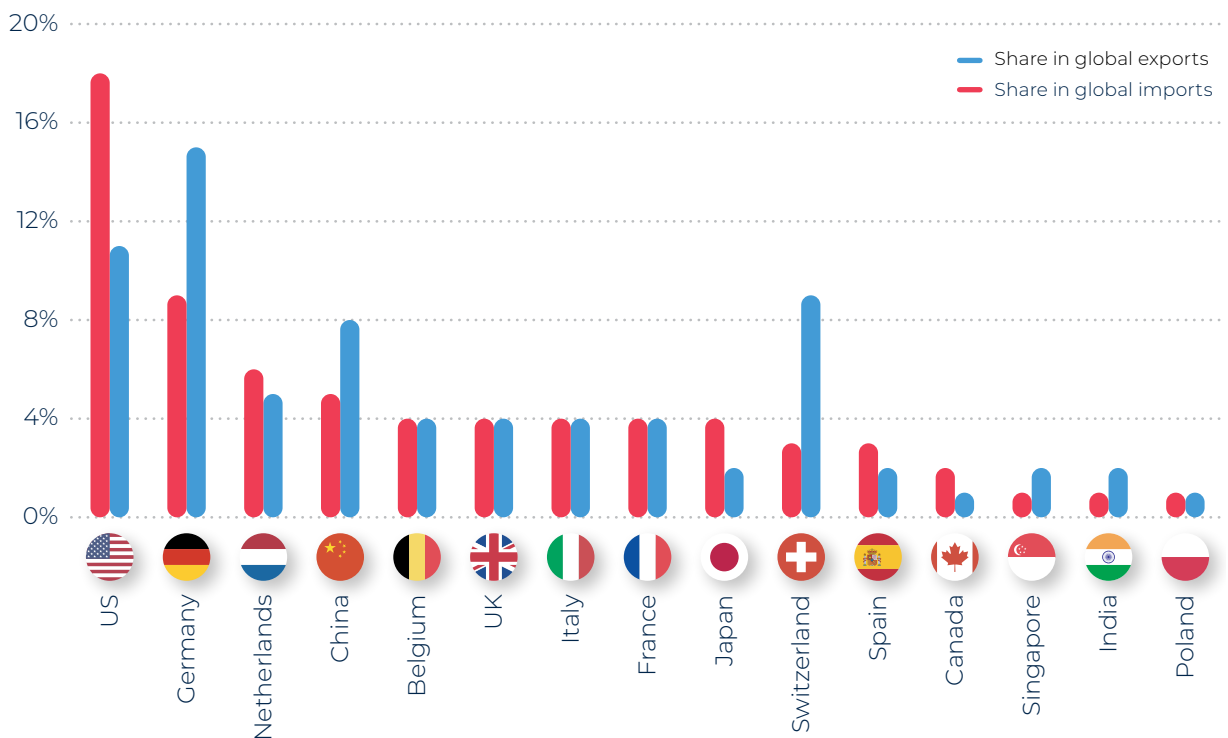
Extra-EU imports of COVID-19 products filled the gaps when intra-EU imports fell in 2020



Source: Eurostat. Link: https://ecipe.org/wp-content/uploads/2021/02/ECL_21_PolicyBrief_02_2021_LY02.pdf

European countries account for a large share of trade in COVID-19 related goods

Share of global exports/imports of COVID-19 related goods, 2018



Source: OECD. Link: <https://www.oecd.org/coronavirus/policy-responses/trade-interdependencies-in-covid-19-goods-79aaa1d6/>

What this experience underlines is the importance of individual companies being free to decide on their own supply chain architecture. Managing global value chains is complex, as supply chain needs vary by industry and by product. The average tier 1 company has more than 5,000 suppliers globally.⁷ Industry is best placed to decide which strategies will be most effective at reducing dependencies and building the resilience of specific supply chains. Getting it right is important not only for resilience, but also for competitiveness.

Supportive policies are, however, needed to help companies build and maintain resilient supply chains. Industry has strong incentives to internalise and manage risks to supply chains. But these firm-level strategies must be matched by an enabling trade policy. In practice, this means creating a level playing field for competition at home and abroad, with EU innovation protected by world-class IP regimes, and by allowing companies to restructure supply chains as

Box 1: Open strategic autonomy and supply chains

The European Commission observes in its trade policy review that *“open strategic autonomy”* is about *“the EU’s ability to make its own choices and shape the world around it through leadership and engagement, reflecting its strategic interests and values”*.

The concept combines two European policy imperatives. The first is the principle of being open to trade, investment, the exchange of ideas, and the movement of people, while working together with international partners for our mutual benefit. The other is the recognition that in certain circumstances, dependencies can potentially create strategic vulnerabilities that must be managed in the public interest. The aim is an EU that can act in the world rather than being acted upon.

The concept of open strategic autonomy is broad and has been described by the Commission as a *“mind-set for decision makers”*. However, if it is to have a positive impact on behaviours and outcomes, without the risk of unintended consequences, it must also be deployed with precision and in the circumstances where it matters most. It is especially important that it does not lead to protectionism or inadvertently undermine European competitiveness. In this section, we propose how the concept should be applied to the global supply chains of European firms. Importantly, the approach outlined below should not preclude a facts-based, proportionate, and targeted industrial policy, which addresses strategic dependencies and strengthens EU capacities in critical technologies and services.

Critical goods

ERT recognises that policymakers have a responsibility to work with industry to ensure the supply of critical goods. In this context, we define critical goods to mean those for which supply disruptions could potentially undermine the ability of policymakers to meet core public policy objectives and which would, consequently, materially impact on the lives of European citizens.

ERT believes the focus should be on core objectives rather than core interests, as this provides a more specific and tighter test before a policy intervention potentially becomes justified.

These core policy objectives include areas such as national security, public health, and fair competition. Certain components like semi-conductors or technologies are essential for national security. Life-saving medical products or elements in their supply chains, such as active pharmaceutical ingredients, are essential for public health. And some inputs like the rare metals required in battery manufacturing and the production of electric vehicles are essential for fair competition.

Critical goods may be final goods, intermediate goods, or raw materials. If supply chains for critical goods are not resilient, there is a risk that policymakers will fail to meet core public policy objectives, such as those described above. Moreover, if these supply chains are controlled by unfriendly or rival states, there is a risk that European dependence on them will be exploited. In these circumstance, open strategic autonomy

7 McKinsey, March 2021 <https://www.mckinsey.com/industries/public-and-social-sector/our-insights/effectively-implementing-president-bidens-supply-chain-review>

and when this is needed, free from redundant regulatory barriers and arbitrary tariff costs.

Open strategic autonomy in practice

The concept of open strategic autonomy requires clarity if it is to be operational. The focus of the European Commission's trade policy is on strengthening Europe's position in the world through a strategic approach and it describes open strategic autonomy as a mind-set for policymakers, leaving scope for flexibility

in how this is interpreted. The more recent industrial strategy update puts the emphasis on strategic dependencies and how these have the potential to impact on the EU's core interests, but does not provide clear definitions either.⁸ ERT welcomes the EU's efforts to address strategic dependencies in areas such as health, security, or the digital economy. Ambiguity in the concept of open strategic autonomy creates uncertainty. It is important to avoid this for trade policy and for businesses that are already operating in a complex environment.

must inevitably place additional responsibilities on policymakers to collaborate with businesses to ensure resilient supply chains for these critical goods.

Putting open strategic autonomy into practice

There are potentially several ways in which the resilience of supply chains can be enhanced. In most cases little or no intervention will be required. But in some circumstances a more concerted effort will be needed. In some cases, efforts to improve resilience may have an immediate effect, while in others it may take time. It is essential that the approach is carefully designed and calibrated to match the form and scale of the risk.

The default setting for the policy of open strategic autonomy should be openness. In most circumstances, being open strengthens the resilience of supply chains, while bringing considerable benefits to European consumers and boosting the competitiveness of European companies, which is essential for jobs and for growth of the European economy. The threshold for taking a different approach should be high and only apply in carefully defined circumstances.

Moreover, there are potentially several ways to strengthen the resilience of supply chains, ranging from finding substitutes, encouraging diversification, forging strategic relationships with suppliers, stockpiling, or encouraging domestic production. The best approach – or combination of approaches – will depend on the specific circumstances.

Figure 7 provides a decision tree to guide policymakers. It illustrates how, in many or most cases, openness to trade or investment and forging partnerships with other countries will be important.

Practical considerations

It is essential that the implementation of the policy of open strategic autonomy is pursued with transparency, so that all stakeholders can be confident that the focus is in the right areas and that the appropriate criteria and approaches are being used. It is also essential that policy interventions are targeted, proportionate, and based on a factual assessment, as argued in the industrial strategy update. As part of this, dialogue between the private and public sectors is required and ERT welcomes the commitment by the Commission in the industrial strategy update to work in close collaboration with the relevant stakeholders.

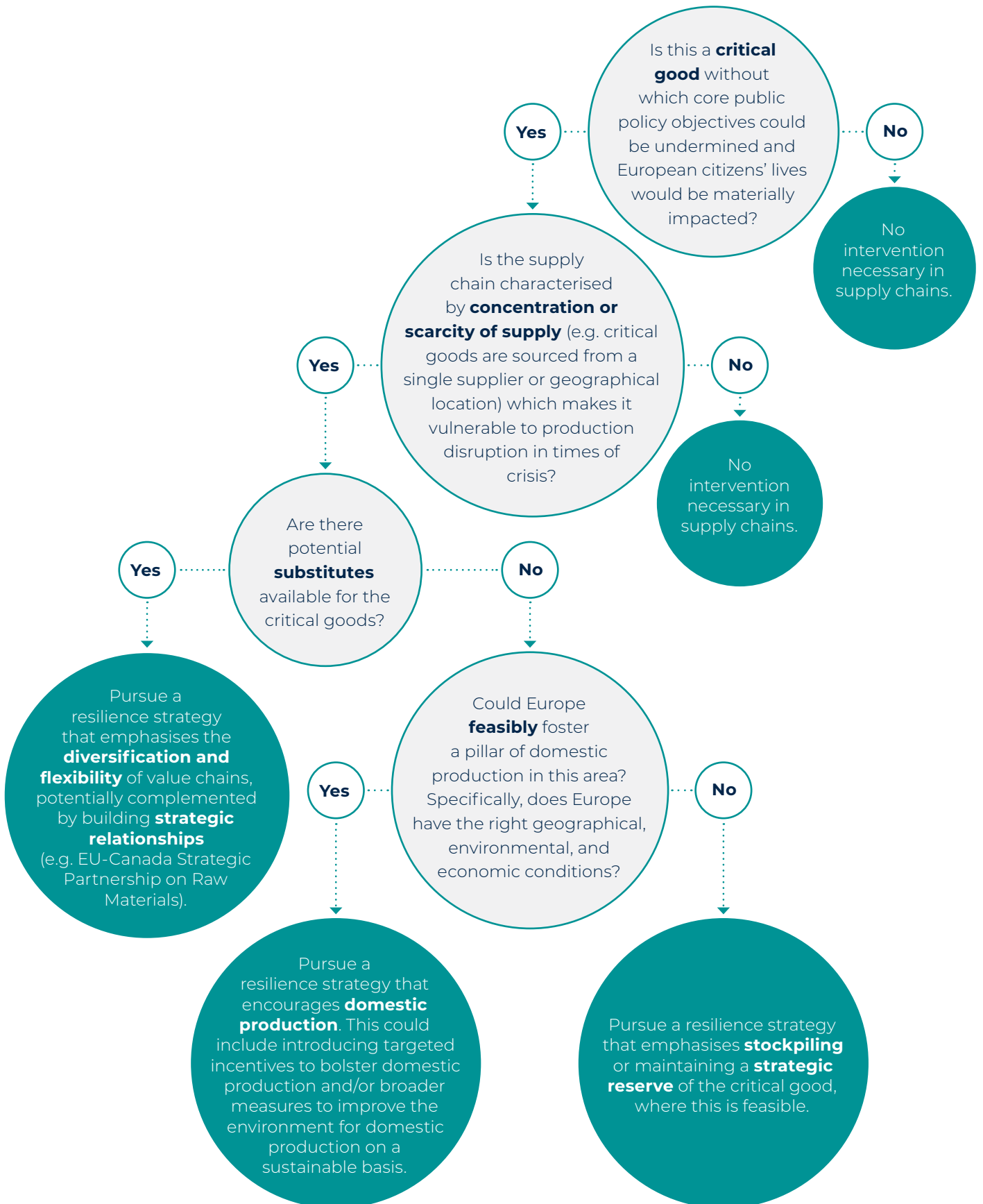
As noted above, in some circumstances there is a risk that European dependence on supply chains for critical goods controlled by unfriendly or rival states. In these circumstances, a bias towards actions that are likely to have a more immediate impact on the resilience of supply chains may be warranted.

In those circumstances where the increasing domestic production is the right approach, it is essential that policymakers provide incentives to encourage investments that build this capacity, without resorting to excessive regulations or an overly bureaucratic approach that seeks to enforce onshoring.

8 European Commission Communication on "Updating the 2020 New Industrial Strategy: Building a stronger Single Market for Europe's recovery", May 2021 <https://ec.europa.eu/info/sites/default/files/communication-new-industrial-strategy.pdf>

Decision tree on open strategic autonomy and the supply of critical goods

The default setting for open strategic autonomy should be openness.



A sharper and more operational definition of open strategic autonomy is required if it is to help guide trade policy.

Box 1 proposes a definition of critical goods and how the concept of open strategic autonomy should be applied to ensure their security of supply. We explain the rationale for this in more depth below. ERT’s approach is consistent in many ways with the EU’s approach, as set out in the industrial strategy update, while clarifying how the concept should be defined and deployed in practice.

Open strategic autonomy should mean strengthening Europe’s position through openness in all circumstances and strategic autonomy where necessary.

Support for an open and fair rules-based trading system that creates a competitive level playing field for EU firms at home and abroad must be the guiding principle that anchors EU trade policy. A reformed WTO and a stronger multilateral system are essential for this. The concept of open strategic autonomy must not undermine global trade and investment as this would weaken the global value chains established by European firms and damage European competitiveness.

Resilience and the Single Market

Building resilience must start at home and the unincumbered functioning of the Single Market is essential for value chain resilience.

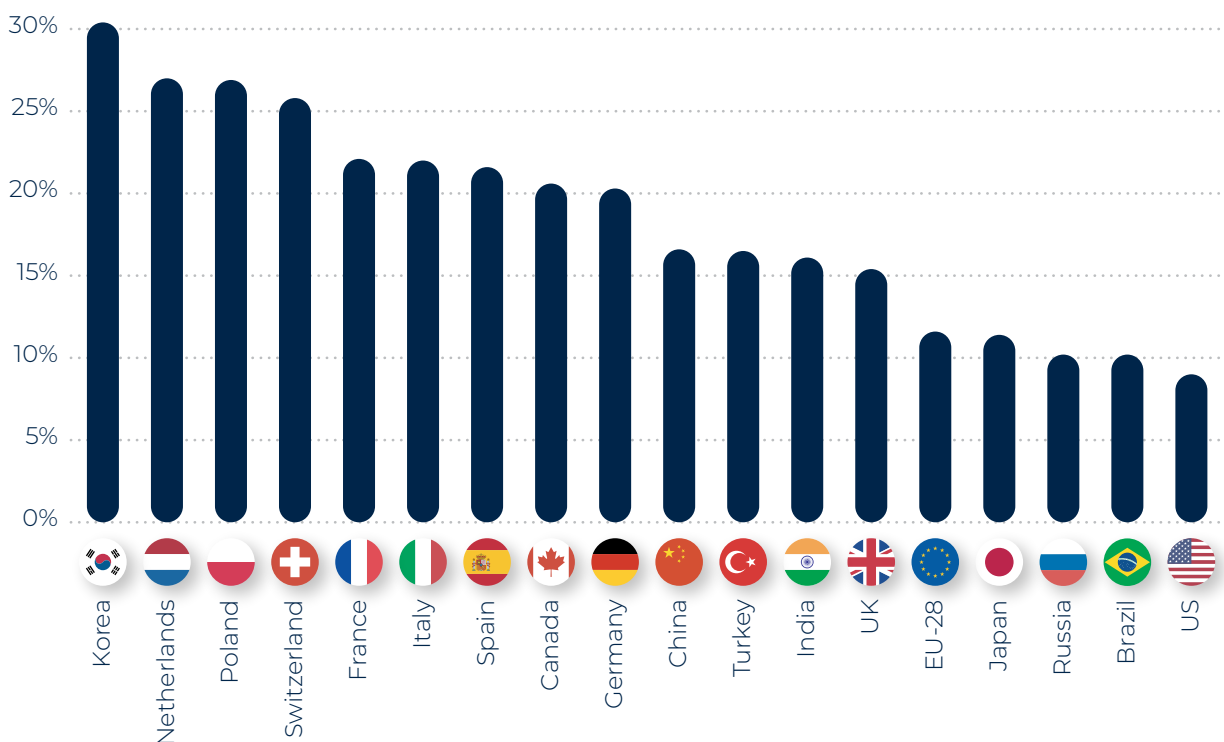
To support this, the EU should continue to make progress in the standardisation and harmonisation of rules in the Single Market. Internal fragmentation and regulatory barriers inhibit companies from sourcing flexibly in the EU. ERT welcomes the commitment in the industrial strategy update to present a strategy on standardisation that will both bolster the Single Market and increase the EU’s influence over global standards.

The need for deeper integration in the Single Market is particularly strong in the energy and digital sectors.

It is crucial to ensure the interoperability of supply chains. Even though some barriers are less visible to policymakers or not of immediate concern to public opinion, every obstacle to the freedom of movement of people, goods, services, or capital constitutes a barrier to the flexibility that is required for companies to act quickly during a crisis.

Foreign value added is essential for export competitiveness

Foreign value added as a % of gross exports in 2016 (most recent year data available)



Source: OECD. Note: Foreign value added for the EU-28 is extra-EU only. Link: https://stats.oecd.org/OECDStat_Metadata/ShowMetadata.ashx?Dataset=TIVA_2018_C1&Coords=%5bVAR%5d.%5bEXGR_FVA%5d&ShowOnWeb=true&Lang=en

Continuing support for industrial alliances and Important Projects of Common European Interest (IPCEIs) in the industrial strategy update are important. The industrial strategy has a role to play in boosting Europe’s domestic capabilities, particularly when sufficient resilience in supply chains for critical goods cannot be built through other means, as shown in Box 1. Industrial alliances on raw materials, batteries and hydrogen are good examples of this. The forthcoming alliances on microelectronics and communication technologies, as well as industrial data, edge, and cloud, are welcome. The IPCEI instrument also has the potential to boost European innovation and competitiveness, and IPCEIs should build on industrial alliances where possible.⁹

Resilience and competitiveness are two sides of the same coin. Building resilience is not just about reducing Europe’s strategic dependencies, but about fostering mutual dependencies between trading partners. This can be a natural consequence of increasing the competitiveness of European industries in the long run. Initiatives to boost European

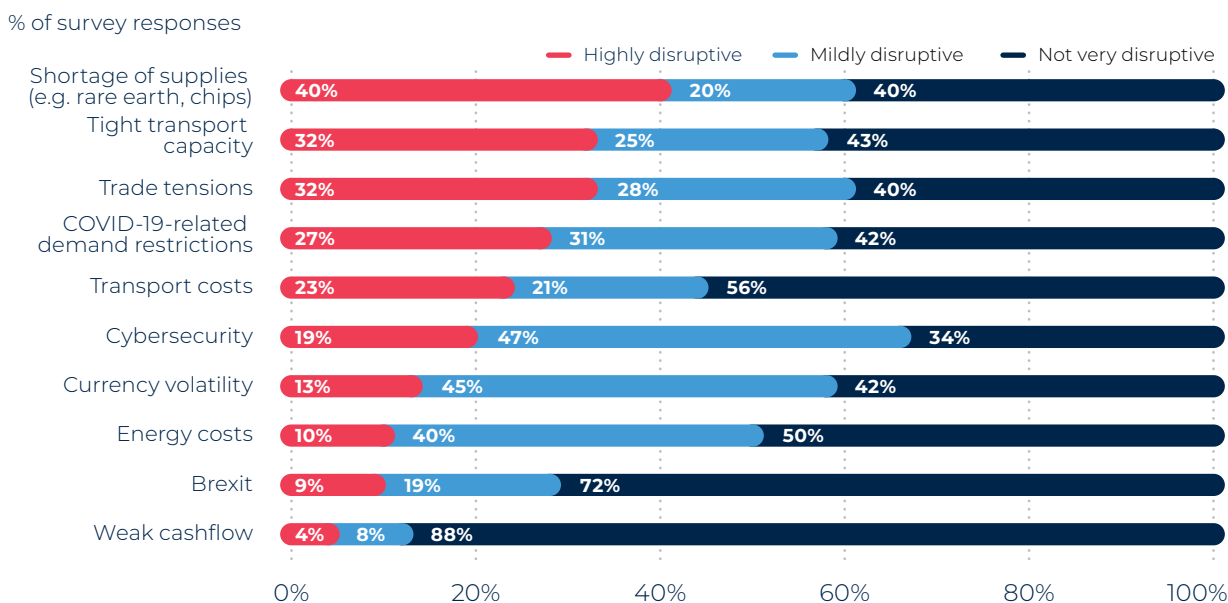
capabilities, such as the industrial alliances and IPCEIs, must therefore take a long-term vision of enhancing Europe’s competitiveness through targeted and sustainable strategies.

Resilience through diversification and partnerships

The main guiding principles for building resilience of global supply chains should be diversification and flexibility. The ability to rely on an adequate number of geographically diversified supply partners strengthens the resilience of supply chains. Globalised production enables economies to replace imports from one country with imports from another if supply is disrupted during a crisis.

To support diversification, the EU should continue to foster strategic partnerships to create the widest possible range of options for European companies. This means strengthening existing ties with key trading partners. It also means strengthening or building new ties with other countries to create the widest possible range of supply options across multiple geographies and jurisdictions.

Shortage of supplies is the biggest risk of disruption for companies led by Members of ERT over the next six months



Source: The Conference Board & ERT. **Note:** Response to the question “To what extent do you expect any of the following issues to be disruptive to your business over the next 6 months?” Responses grouped as follows: “Not very disruptive” if an issue was rated ‘1’ or ‘2’, “Mildly disruptive” if respondents picked ‘3’, and “Highly disruptive” if rated ‘4’ or ‘5’. Survey published in May 2021.

⁹ For more information on ERT’s views on industrial policy and digital policy, see ERT Papers on “Turning Global Challenges into Opportunities”, December 2019 <https://ert.eu/documents/turning-global-challenges-into-opportunities/> and “Mapping a New World with the EU Digital Compass”, May 2021 <https://ert.eu/documents/digitalcompass/>

Strategic partnerships can be pursued through formal treaties or by more informal means.

Treaty-based structures include free trade agreements and bilateral investment treaties, which should continue to promote European values and high standards in areas such as the environment and labour rights. More informal channels include regulatory dialogues that makes it easier to access markets and to diversify suppliers. The EU is improving its ability to track non-tariff barriers faced by EU exporters and the Commission’s Access2Markets database should be used to inform the EU’s priorities for its economic diplomacy with key partners.¹⁰

Improvements in the breadth and quality of relationships should also be pursued at a multilateral level, including at the WTO.

The EU should champion initiatives such as international protocols to avoid beggar-thy-neighbour policies in times of crisis, including export bans. The EU should avoid such policies itself as it undermines trust in the EU as a trading partner and could limit Europe’s ability to foster long-term, constructive strategic relationships.

The limits of reshoring

Open strategic autonomy must not undermine the global value chain model or lead to enforced reshoring.

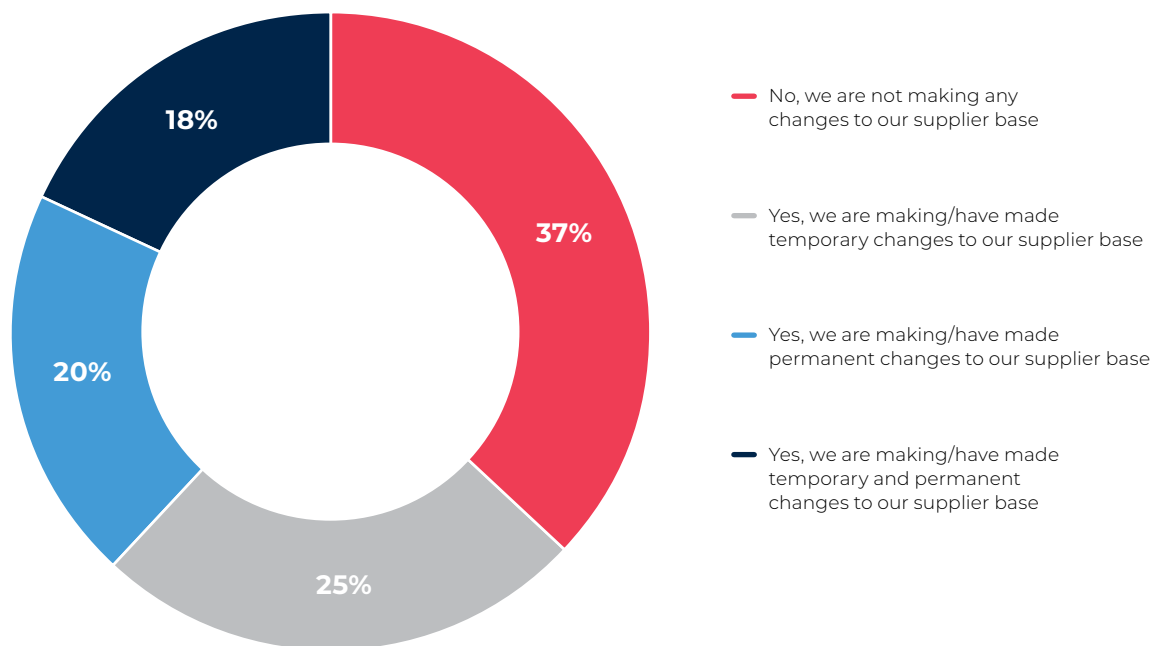
While the importance of diversity and openness are acknowledged in the trade policy review and the industrial strategy update, the review of strategic dependencies should not lead to either reshoring or nearshoring playing an excessive role in building resilience.¹¹

Reshoring or nearshoring could lead to the geographical concentration of supply chains and there is little evidence that this makes countries more resilient.

In fact, studies show that this increases the likelihood of a bigger economic contraction during a crisis, by replacing reliance on imports with dependence on a smaller range of domestic producers.¹² For these reasons, enforced reshoring and nearshoring should play a limited role and only in exceptional circumstances.

Most companies led by Members of ERT are reorganising their supply chains, either temporarily or permanently

Have you changed your company’s supply chain due to the pandemic?



Source: The Conference Board & ERT. Note: Survey published in May 2021.

¹⁰ See <https://trade.ec.europa.eu/access-to-markets/en/content/welcome-access2markets-market-access-database-users>

¹¹ See <https://ec.europa.eu/info/sites/default/files/strategic-dependencies-capacities.pdf>

¹² NBER Working Paper on “Global Supply Chains in the Pandemic”, May 2020 https://www.nber.org/system/files/working_papers/w27224/w27224.pdf

Organic reshoring of production and jobs is often a natural, market-driven consequence of Europe being an attractive location and government policies can be supportive of this. The emphasis should be on using the full range of policy tools, including industrial policy, to build capabilities and capacity in certain industries, such as the digital sector. Rather than being protectionist, trade policy should help foster an innovation-friendly environment through guaranteeing a level playing field, tackling unfair competition, and protecting intellectual property rights.

The importance of innovation

Strong intellectual property (IP) frameworks protect and incentivise European innovation and support resilience. Innovative commercial ventures often involve taking risks and significant up-front investment. IP rights allow industry to recoup these investments and to continue investing in research and development. The incentives created by IP rights contributed to the exceptionally rapid development of vaccines and form the bedrock of a pro-innovation environment that enhances European competitiveness. They also increase the capacity of European companies to adapt to new challenges during a crisis, providing certainty that successful innovation will be rewarded.

The IP waiver proposed by some countries for COVID-19 vaccines threatens to undermine European innovation and the resilience of supply chains. Waiving IP protection for vaccines would not solve the current challenge of scaling up manufacturing to meet global demand. Moreover, it could discourage innovation by undermining incentives to continue research into new variants, diagnostics, and future vaccines. The EU should continue to advance alternative solutions, such as investment in manufacturing facilities and capacity building, especially in developing countries. In this regard, ERT welcomes the establishment of the joint EU-US COVID Manufacturing and Supply Chain Taskforce which will identify and resolve issues around expanding vaccine production capacity, including by building

new production facilities and maintaining open and secure supply chains.¹³

Europe should continue to foster strong enabling environments for innovation, which help technology transfer and incentivise investments in new technologies. IP rights allow companies to share knowledge and technologies without fear of competitors using this to their disadvantage. In regard to vaccines, IP protection has encouraged over 200 technology transfer deals that involve companies sharing know-how of processes and technologies.¹⁴ The issue extends beyond vaccines and applies to all areas of European innovation. **We do not know what the next crisis will look like – but we can be sure that innovation will be needed to overcome future challenges and allow supply chains to adapt fast and flexibly.**

The role of transparency

Transparency can help businesses and governments to identify and manage supply chain risks and thereby build trust and public support for global supply chains. More transparency may be needed, but this must be done in a way that is flexible and which does not inhibit companies from adapting their supply chains to changing commercial circumstances. It should be proportionate and avoid being prescriptive, to avoid imposing unnecessary costs on business. It must also recognise and respect commercial sensitivities regarding the disclosure of confidential supplier information.

The proposed supply chain due diligence legislation (see Box 2) is expected to increase transparency requirements for human rights and environmental standards. Supply chains that comply with human rights and environmental standards are less vulnerable to some risks, such as accidents or labour stoppages. While compliance may enhance resilience, corporate reporting requirements should be designed in a way that is manageable for all companies and does not stop supply chains adapting swiftly during a crisis.

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 13 See <https://www.consilium.europa.eu/media/50443/eu-us-summit-joint-statement-15-june-final-final.pdf>
 14 IFPMA, April 2021 <https://www.ifpma.org/resource-centre/covid-19-vaccine-industry-cautions-immediate-action-needed-to-remove-manufacturing-supply-barriers-to-meet-production-targets-and-keep-on-course-to-equitable-and-fair-access-to-covid-19-vaccines/>

The importance of services

Strategies for building global supply chain resilience should include supporting and strengthening critical services. Global value chains depend on services – from internet connectivity and telecommunications to logistics and supply chain management – to facilitate trade in goods. A trade policy that supports trade in services and digital trade can strengthen the resilience of global value chains by improving production processes and logistics.

A high level of digitalisation across business operations may expose some supply chains to cybersecurity risks. It is important that policymaking recognises the role that digital infrastructure and services play in the smooth functioning of supply chains. The risk of disruption should be mitigated through a range of policy actions, centred on efforts to build a harmonised European framework for cybersecurity and to foster closer regulatory cooperation with partners such as the US.

Box 2: Corporate due diligence

The concept of mandatory value chain due diligence has been gaining traction in the EU under the Commission’s sustainable corporate governance initiative.¹⁵ ERT welcomes the Commission’s commitment to propose mandatory due diligence legislation that includes within its scope human rights and the environment in relation to value chains.

The creation of a harmonised legal framework across the EU should reduce legal uncertainty for businesses, create a level playing field, and provide more leverage with business partners to deliver on human rights and environmental commitments throughout the value chain. It should encourage greater transparency and underpin a longer-term change in corporate culture, which will help increase public support for international trade and globalisation. Many companies already demonstrate strong leadership in advancing the Sustainable Development Goals and are committed to adhering to global standards in this field.

Mandatory due diligence requirements must be carefully designed to avoid constraining value chain agility during a crisis. Resilient value chains are flexible and agile, and onerous reporting requirements could undermine this. Due diligence frameworks should therefore

be designed in a way that is manageable for all companies, including SMEs, and does not inhibit companies from adapting their value chains to changing commercial circumstances.

The EU’s due diligence legislation should be aligned with the international standard of the UNGPs and the UN and ILO conventions and the OECD Due Diligence Guidance for Responsible Business Conduct. Companies should demonstrate that they are taking reasonable steps to prevent and address human rights and environmental impacts across their value chains. This should include the provision of a ‘safe harbour’ for businesses to disclose the issues and risks they face along their value chain and to take action to mitigate and address them on the ground. Due diligence legislation should not inadvertently lead to situations where companies are held liable because they have taken meaningful due diligence measures.

Finally, constructive engagement with and support to the authorities of third countries where harms occur is important, in order to ensure other states fully respect their ‘duty to protect’ by effectively implementing and enforcing relevant international laws and standards.

15 See <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance>

Extraterritorial measures

The EU should develop a strategy to mitigate the impact of extraterritorial measures, such as sanctions or regulations, on the global value chains of European firms. Extraterritorial measures – both imposed by third countries and

sometimes by the EU itself – can undermine supply chains. While sanctions can disrupt supply routes, extraterritorial regulation can also add complexity for firms by requiring them to comply with two sets of national and

Main recommendations on Global value chains

- 1. The EU should establish a clearly defined, high threshold for introducing strategies that emphasise autonomy over openness and diversification with regard to critical goods (see Box 1).** Businesses are best able to manage their own supply chains. Targeted interventions to support the resilience of supply chains for critical goods should be the exception, not the rule. Where stockpiling is necessary, there should be a fair sharing of the costs so that the burden is not passed to end users. In circumstances where a greater capacity to produce in Europe is necessary, incentives should be provided to encourage this, and companies should not be coerced into onshoring production. Such targeted strategies should only be used if resilience cannot be achieved through other means.
- 2. Resilience must begin at home and so the EU should further strengthen the Single Market to support diversification and flexibility in supply chains.** This means removing regulatory frictions that restrict intra-EU trade and make it harder to source flexibly. The EU should reinvigorate the Single Market standardisation process in close cooperation with industry and standardisation bodies. Standardisation forms the cornerstone of an innovative and dynamic European Single Market and provides a basis to improve the interoperability of international markets and supply chains. Digital standards are a priority as they are essential for the digital transition and will help to strengthen the global value chains of European firms by improving production processes and logistics.
- 3. The EU should invest further in developing strategic trade and investment relationships with key partners.** This will help European companies to build resilience through diversification. Priorities include, among others,
- the US, Canada, the UK, Japan, India, Mercosur, Africa, Australia, and New Zealand. The EU's economic and regulatory diplomacy should seek to avoid duplicative regulatory requirements or product standard certification, and to minimise regulatory frictions of all kinds that are faced by companies when switching suppliers. The focus should extend to services as well as goods. Greater harmonisation, equivalence, or mutual recognition in critical industries could have a material impact in improving supply chain flexibility.
- 4. The EU should seek to reduce to zero tariffs for critical goods on a most favoured nation basis.** One of the consequences of preferential trade agreements is incentivising the organisation of supply lines along margins of preferences that make switching to suppliers outside the free trade zone artificially expensive. Sector-specific multilateral or plurilateral agreements under the WTO that liberalise tariffs on critical goods would therefore ensure that companies are not penalised by higher tariffs when they switch suppliers during a crisis.
- 5. The EU should support innovation through stronger protection of intellectual property in the EU and in foreign markets.** The incentives created by IP rights have contributed to the exceptionally rapid development of vaccines and form the bedrock of a pro-innovation environment that enhances European competitiveness. Waiving IP rules for vaccines would send the wrong signal to innovators and risks setting a dangerous precedent in this and other sectors. Strengthening and enforcing IP regimes in third markets would support other industrial policy objectives and help to foster mutual dependencies that underpin the stability of the global trading system.

extraterritorial regulations. To mitigate the impacts of sanctions on supply chain resilience, the EU should develop proposals for an anti-coercion mechanism, which is intended to avoid undue pressure being put on European entities,

in line with international law. The Commission should also ensure European companies are properly consulted about the introduction of any new extraterritorial regulations, with sufficient time to adjust supply chains where necessary.

6. The EU should adopt a more agile procurement process in times of crisis to allow supply to respond quickly to changes in demand or disruptions to supply.

To a large extent, the supply challenges during the pandemic stemmed from a lack of coordination between EU national authorities and lengthy standard certification processes. The EU should implement a more strategic public procurement framework based on the Most Economically Advantageous Tender (MEAT) concept to avoid tenders being awarded based on the lowest price alone. Other factors to consider are whether goods are procured from jurisdictions with high regulatory standards, to ensure that rapid procurement does not pose risks for consumers or distort competition.

7. The EU should work with the G7 and G20 to improve the coordination of national responses to future crises – including pandemics – and avoid self-defeating protectionism.

The pandemic illustrated that protectionism can undermine resilience. The G7 and G20 summits present an opportunity to agree new frameworks for international cooperation including, for example, WHO-led efforts for a new international pandemic prevention treaty and a new WTO trade and health initiative. These efforts should produce clearer and tighter protocols for introducing trade restrictions and common principles for procuring critical goods during a global emergency.

8. The EU should seek to strengthen the rules-based multilateral trading system through WTO reform, as this allows businesses to diversify their supply chains across the widest possible range of countries.

The WTO is the backbone of the global trading system and a guarantor for stability in trade relations. Reform

of the WTO must include re-establishing the dispute settlement system, modernising WTO rules, and facilitating plurilateral negotiations, such as updating the WTO pharmaceutical agreement, expanding global participation in the information technology agreement, finalising the WTO e-commerce negotiations, and reviving negotiations on trade in environmental goods.

9. Businesses should be transparent about their supply chain risks.

This helps connected businesses to manage their own risks and so to reduce systemic risks. Transparency is preferable to more bureaucratic approaches, which could do more harm than good by reducing the efficiency of supply chains or by making it harder to adapt them quickly. Industry groups should consider how they could help firms to identify and follow best practice for transparency in supply chain risks, while recognising that the approach will need to be tailored to different sectors and the circumstances of individual firms.

10. The EU should avoid or take steps to counter the impact of extraterritorial measures on the value chains of European firms.

Extraterritorial measures, both imposed by third countries and by the EU itself, can undermine value chains and be a source of disruption to international trade. The envisaged anti-coercion legislation under the EU's enforcement regulation could help to protect European companies from extraterritorial measures by other countries. With regards to the EU's own extraterritoriality, European companies should be properly consulted about proposed new measures with sufficient time to adjust their supply chains where necessary.





New opportunities from the Transatlantic alliance

The EU and the US acting together can build a stronger transatlantic economy, shape standards globally, and strengthen multilateral institutions and the global rules-based system. There is a close alignment between EU and US values and interests in many aspects of trade policy and in related areas, creating a strong potential for bilateral cooperation. The EU and US should resolve bilateral disputes, such as Boeing-Airbus and the additional tariffs imposed on steel and aluminium, while forging a positive agenda for collaboration. The trade dimension to COP26 provides an immediate opportunity, where the priority should be to encourage the wider adoption of carbon pricing and a common approach to carbon leakage. Some of the most promising areas for collaboration are in new technologies, both to build transatlantic capabilities and to set standards globally. The EU and US should seek to build a common transatlantic digital economy. In this and other areas the EU and US should enter dialogue with business – including ERT and the US Business Roundtable (BRT) – on priorities.

Creating a Transatlantic digital economy

The EU and US should aim to build a common transatlantic digital economy, starting with closer cooperation on digital governance, regulation, and standard setting. The intensity and scope of regulation of digital technologies and activities such as artificial intelligence (AI) and data sharing have increased. Without closer collaboration there is risk of further regulatory fragmentation, which would impose unnecessary costs on businesses. Closer integration of the transatlantic digital economy would drive trade and innovation. Moreover, the EU and US should use their combined influence in this area to set standards globally, based on transparency and shared values.

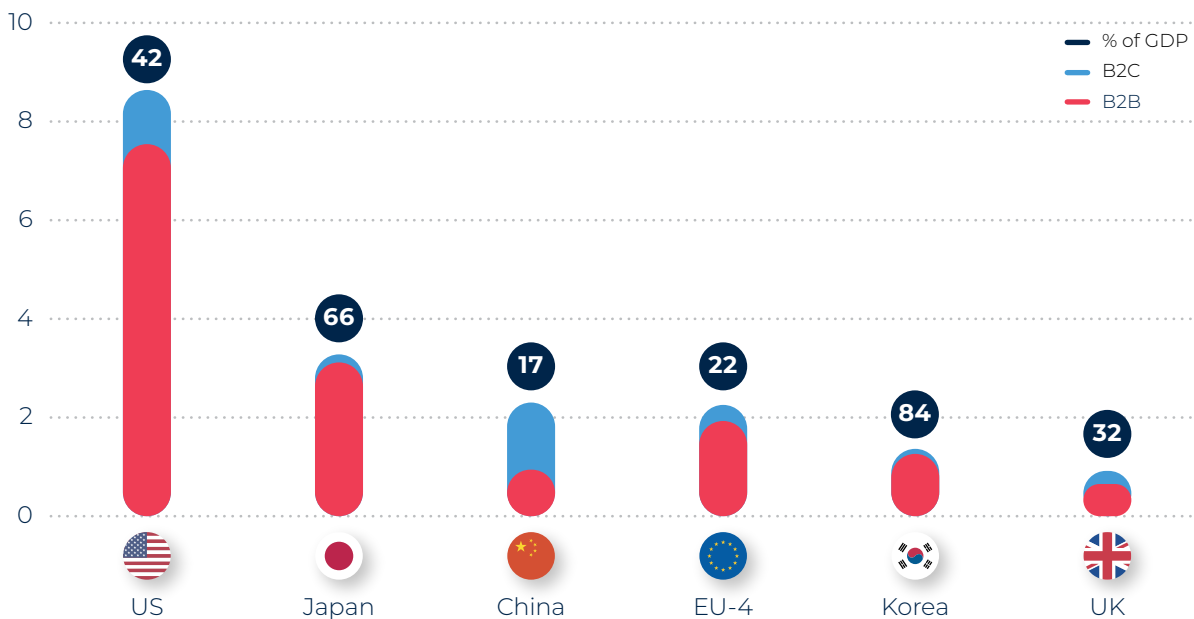
The new Trade and Technology Council (TTC) that is being established by the EU and US provides an opportunity to strengthen collaboration in this area.¹⁶ The TTC and its working groups should seek to facilitate trade and develop shared standards, establish a transatlantic dialogue on the responsibility of online platforms and other

large tech companies, and encourage EU-US cooperation on AI governance, data governance and protecting critical technologies.

Despite the positive intent, there are diverging views on competition, content regulation, and AI and data governance that need to be resolved. While both EU and US policymakers are increasingly concerned about the market power of large technology firms, views on how to address this diverge across the Atlantic. Whereas in the US competition authorities are prioritising ex-post antitrust enforcement against individual companies, in the EU policymakers have moved to more prescriptive and all-encompassing ex-ante rules for gatekeepers. US policymakers appear disinclined to follow the EU’s approach of developing binding obligations on content regulation for platforms. The US lacks a federal framework for data protection and has so far demonstrated a preference for voluntary rather than binding rules to govern AI use.

The EU and US digital marketplaces are large but have room to grow

E-commerce sales, USD trillion, 2018



Source: Hamilton and Quinlan (2021), drawing on UNCTAD data. **Note:** EU-4 includes Germany, France, Italy and Spain. **Link:** http://www.wilsoncenter.org/sites/default/files/media/uploads/documents/TransatlanticEconomy2021_FullReportHR.pdf

¹⁶ See <https://www.consilium.europa.eu/media/50443/eu-us-summit-joint-statement-15-june-final-final.pdf>

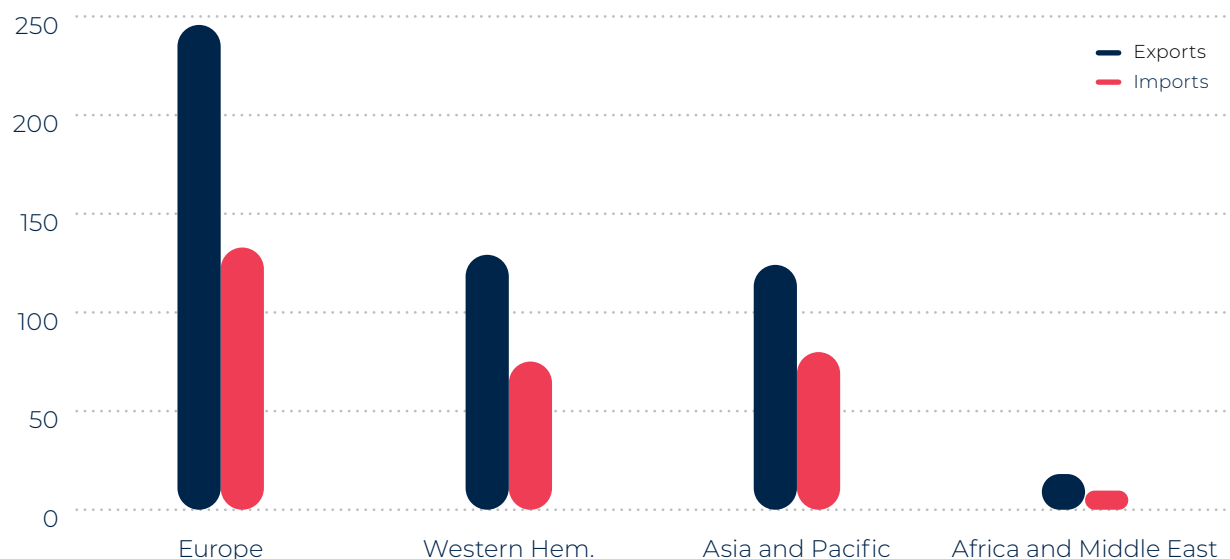
The EU and US should not avoid addressing difficult issues, but this effort must be balanced by collaboration on innovation and in supporting critical and emerging new technologies. Shared concerns about unfair competition from China should add momentum to this positive agenda, which could include joint innovation and R&D projects in advanced technologies and joint investments in supply chain resilience for critical goods or technologies such as semiconductors. The EU’s emphasis on open strategic autonomy must be defined and implemented with sufficient flexibility to embrace collaboration with partners such as the US.

Another area where interests are largely aligned is regarding a potential multilateral agreement to liberalise digital trade.

The Commission’s trade review calls for the EU to play a central role in setting rules for e-commerce by pushing for an ambitious and comprehensive WTO agreement on digital trade, including provisions on data flows and consumer protection, and an expanded information technology agreement. While US scepticism about the WTO and a lack of a transatlantic agreement on data flows and privacy issues may slow progress, the US remains likely to support measures to reduce barriers to digital trade given the prominence of its tech companies in global e-commerce. President Biden’s 2021 trade agenda states his administration’s intention to liberalise digital trade through both the WTO and bilateral agreements.¹⁷

Europe is the key market for US digitally enabled services trade

US digitally enabled services trade by partner, USD billion, 2019

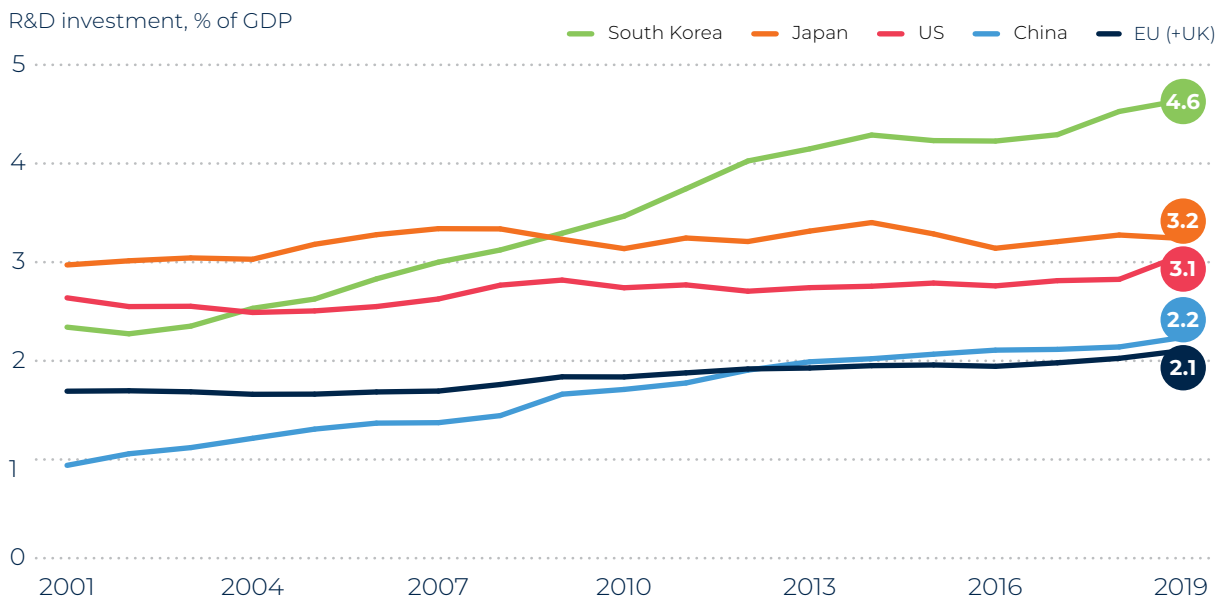


Source: Hamilton and Quinlan (2021).

Link: http://www.wilsoncenter.org/sites/default/files/media/uploads/documents/TransatlanticEconomy2021_FullReportHR.pdf

17 See <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/march/biden-administration-releases-2021-presidents-trade-agenda-and-2020-annual-report>

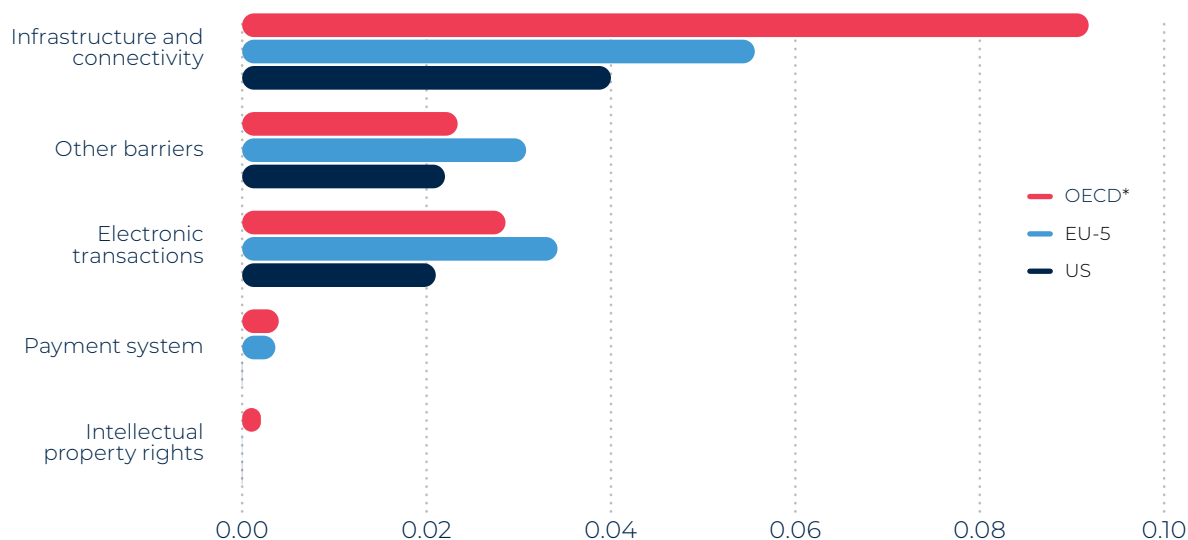
European investment in R&D is flatlining



Source: OECD. Link: <https://data.oecd.org/rd/gross-domestic-spending-on-r-d.htm>

There is scope to liberalise trade in digital services

Trade Restrictiveness Index value: 0 = complete openness to trade, 1 = complete closure to foreign service providers



Source: OECD. Note: EU-5 includes France, Germany, Italy, Spain, Netherlands; OECD* is the average of all OECD countries, excluding EU-5 and US. Link: https://stats.oecd.org/index.aspx?DataSetCode=STRI_DIGITAL

Broader regulatory cooperation

The EU and US should prioritise relatively easy wins for regulatory collaboration.

This might include reviving the Commission’s proposal to the previous US administration on mutual recognition of conformity assessments for industrial products. The EU’s proposal

seeks an agreement under which the EU and the US would accept the conformity assessments made by each other’s assessment bodies, certifying products against the legal requirement of the other side.

There are several other areas where bilateral collaboration through the TTC or other fora could have a high impact. This includes alignment in regulation and standard setting for emerging technologies beyond digital, such as for green tech or autonomous vehicles. The decision by the EU and US in June 2021 to work towards a Transatlantic Green Technology Alliance is a promising step in this direction.¹⁸ The combined market shares of the EU and US enables them to set standards internationally in many sectors. Other priorities for greater regulatory alignment include mutual recognition of good clinical practice and of qualifications. Alignment in these areas would not only allow the EU and US to reduce regulatory frictions to transatlantic trade, but to influence regulation elsewhere.

The EU and US should seek closer alignment of investment screening rules and export controls. Both the EU and the US see export controls and investment screening as important tools in limiting the ability of other states to exploit Western technology in ways that are harmful for security or strategically, including economically. These policy areas remain national competences in the EU, with the Commission’s role largely limited to coordination and exchange of information. Even

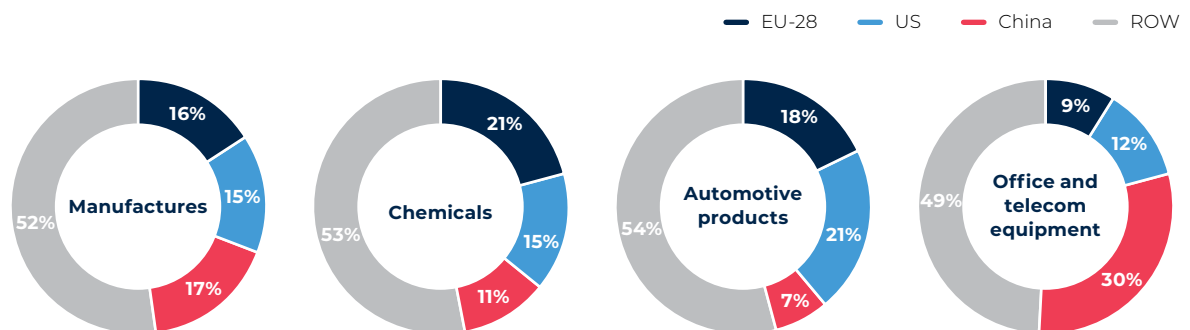
so, the new TTC envisages closer cooperation on investment screening and export controls, and this would be welcome providing it does not lead to a disproportionate tightening of controls. In practical terms, collaboration could include the US and EU aligning on investment screening criteria and sharing information.

Regulatory collaboration at the official level should be supported and informed by a dialogue with transatlantic business on these issues. These exchanges are crucial to understanding the areas where regulatory alignment is most needed and to agreeing a common way forward. ERT and BRT offer their joint support for such public-private dialogues.

Sanctions are increasingly used as a foreign policy tool by both the US and the EU. Often, these sanctions reflect shared foreign policy objectives that are largely aligned. In some cases, however, where foreign policy objectives diverge, they not only have less impact, but can also impose significant bilateral economic damage because of their extraterritorial reach. This is not only counter-productive, but also damaging to the bilateral relationship. Better coordination on the substance, timing, and legal form of extraterritorial sanctions – as well as more restraint – is therefore needed.

Europe and the US combined have powerful market shares in many sectors

% shares of imports and exports combined (extra-EU-28 trade only), 2019



Source: WTO, own calculations.

¹⁸ <https://www.consilium.europa.eu/media/50443/eu-us-summit-joint-statement-15-june-final-final.pdf>

Working together on WTO reform

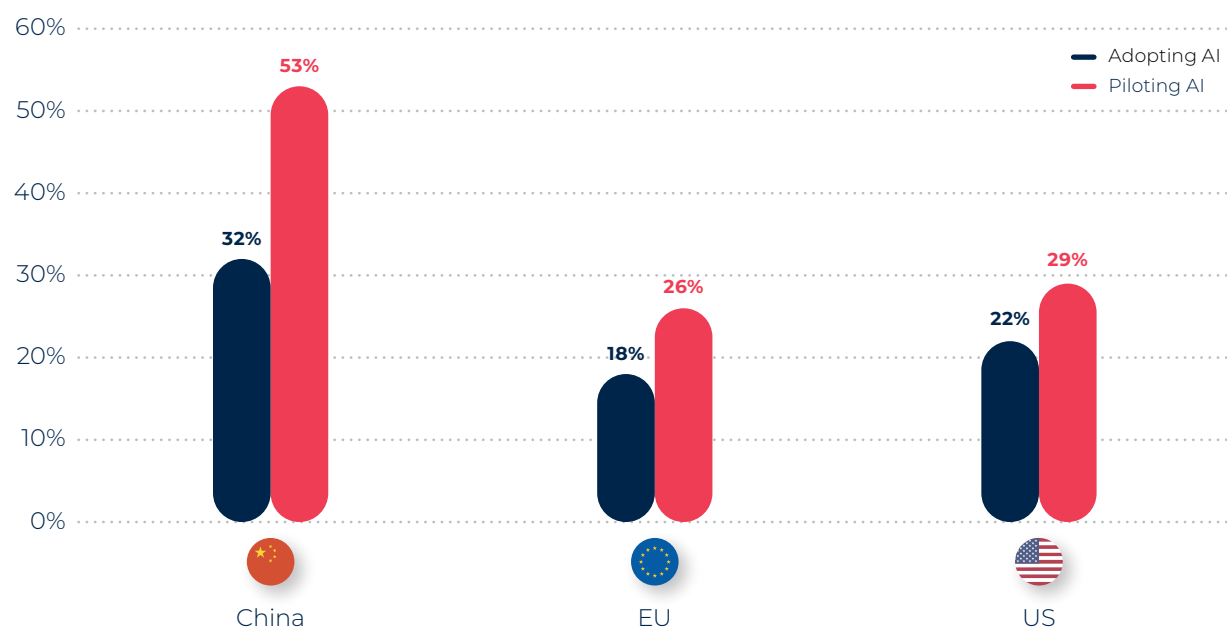
The Biden administration’s renewed commitment to international institutions offers the prospect of greater transatlantic cooperation on reforming global governance of trade. The European Commission recognises this in its trade policy review when it calls for EU-US cooperation to reform the WTO, with the aim of seeking maximum “convergence on their respective positions, including possible joint proposals”. The Commission acknowledges the concerns raised by the US about the WTO’s Appellate Body and notes the need for stricter timelines and new rules to restrain state-owned enterprises. At a recent meeting of G7 trade ministers, EU participants reiterated the importance of unblocking the WTO and boosting multilateralism. The EU and US agreed to work cooperatively to agree meaningful WTO reform at the leaders’ summit in June 2021.

The pragmatic way forward may be to accelerate discussions on all aspects of WTO reform simultaneously. The US continues to oppose judicial appointments to the Appellate Body. It is possible that the US (and other parties to negotiations) may be reluctant to make concessions in any one area of WTO reform in case this reduces their leverage in others. A package of reforms is therefore needed, and this should be pursued with urgency.

There are at least four other issues that are central to WTO negotiations and which are likely to be difficult to resolve. One is the perceived unfair application of developing country status, particularly with regards to China. The second is unfair trade practices used by state-capitalist economies. The third is non-compliance with transparency and notification requirements. The fourth is the role of WTO dispute settlement in matters of national security, on which the US and EU take different positions. A national security premise was used by the US when imposing additional tariffs against steel and aluminium imports in 2018.

The EU and US both face strong competition in AI

% of firms developing AI in 2018



Source: Center for Data Innovation. **Note:** Based on a survey of 2,700 managers across a range of sectors conducted by Boston Consulting Group. **Link:** <http://www2.datainnovation.org/2019-china-eu-us-ai.pdf>

Another area where the EU and US must bridge their differences is public procurement and the new US administration’s Buy American policy.

The US has strengthened requirements for federal authorities to devote more spending to American suppliers, even though this could violate the WTO’s plurilateral Agreement on Government Procurement (GPA) which both the EU and US have signed. The European Commission says it is assessing whether the US is complying with its commitments and the US position has revived European interest in establishing an International Procurement Initiative that would seek to establish reciprocity in public procurement. ERT supports openness in procurement and the interests of both sides would be best served by keeping public procurement open to all EU and US providers.

Cooperation on climate change

The EU and the US are in many ways aligned on the role of trade policy in achieving climate goals and a green transition, and they agreed to set up a High-Level Climate Action Group in June 2021.

Both the Commission’s trade policy review and the US president’s 2021 trade agenda seek to use bilateral and multilateral channels to develop international standards to address climate change, tackle harmful environmental practices, and ensure responsible use of natural resources. Both stress the importance of working with allies and like-minded countries. Both also raise the possibility of introducing carbon border adjustment taxes as a means of preventing carbon leakage from abroad.

Yet despite this alignment, there are challenges for transatlantic collaboration on green trade policy.

Although both agree in principle that trade should be used to promote sustainability at the multilateral level, the EU’s preference is for this to happen through the WTO, where the US remains in dispute. While EU plans for a carbon border adjustment tax are advancing, and the US says it is considering carbon border taxes, the US climate envoy John Kerry has said a carbon border tax should be “a last resort”, if international climate negotiations fail. A further complication is the lack of a federal carbon tax or a federal carbon pricing mechanism in the US, which could potentially lead to a carbon tax being applied on some US goods at the EU border.



COP26 provides an early focal point for EU-US cooperation on trade and climate and both sides should pursue an ambitious agenda for collaboration.

If successful, this could set a positive tone for broader collaboration. They should seek a common ground on the role of sustainability provisions in free trade agreements and together build momentum towards the conclusion of a new multilateral environmental goods agreement. COP26 also provides an opportunity to achieve greater alignment in carbon pricing internationally and to address the problem of carbon leakage, which are both essential to maintain a level playing field as we accelerate the green transition. COP26 may also be an important

milestone towards subsequently addressing the issue of a carbon border adjustment tax.

Another potential area for transatlantic cooperation is in setting standards for sustainable activities in the EU and US markets.

The EU is developing a taxonomy of economic activities that are considered sustainable. It would be beneficial for both transatlantic trade and the sustainable financing of European and American firms to avoid competing standards being set in this area. The EU and US should therefore seek to develop a global understanding on the activities that are considered sustainable, to create a level playing field on this issue at a global level.



Removing additional bilateral tariffs

Under the Biden administration, the EU and the US have made progress in unwinding the additional tariffs that have weighed on transatlantic trade relations in recent years.

The EU and US announced in March 2021 that they were each suspending tariffs applied as part of the longstanding Airbus-Boeing dispute and the suspension was extended to last for five years following the EU-US summit in June 2021.¹⁹ The two sides agreed to establish a working group, enhance subsidies transparency and collaborate to address unfair practices from third countries in the sector, as they seek a permanent solution. Resolving the 16-year long dispute may still prove difficult however.

Section 232 tariffs on European steel and aluminium remain in place and cast a shadow over the transatlantic relationship.

For now, the US plans to retain these, but this may be reassessed as part of a planned ‘whole of government review’ of trade policies that have been carried over from the previous administration. Domestic political calculations may discourage their removal, however, as the Biden administration may be fearful of being accused by the steel industry and unions of failing to stand up for US industry and workers. The EU’s decision in May 2021 not to escalate retaliatory tariffs should help to create a constructive environment to resolve this dispute.

Aligning approaches to China

There is potential for closer collaboration between the US and the EU in their approaches to China on trade policy. The EU and US are relaunching a bilateral dialogue on China covering a wide range of topics including reciprocity, resilience, human rights, security, multilateralism, and areas for constructive engagement with China, such as climate change.²⁰ This will take place at senior, official and expert levels, suggesting high ambition.

There is already considerable alignment on objectives. The US president’s 2021 trade agenda identifies priorities that include forced technology transfer, intellectual property protection, economic coercion abroad, the role of state enterprises in the Chinese economy, and the participation of Chinese firms in Western critical infrastructure. The EU has alighted on similar issues, with the trade policy review speaking of “*negative spill-overs caused by its [China’s] state-capitalist economic system*”. The EU and the US are also already in trilateral discussions with Japan aimed at developing new rules at the WTO to address non-market-oriented policies in other countries, including industrial subsidies.



19 See https://ec.europa.eu/commission/presscorner/detail/en/fs_21_3002

20 See <https://www.state.gov/joint-statement-by-the-secretary-of-state-of-the-united-states-of-america-and-the-eu-high-representative-for-foreign-affairs-and-security-policy-vice-president-of-the-european-commission/>

The combined heft of both the EU and the US has a greater chance of influencing China's economic behaviour for the better.

Together they represent approximately one third of global gross domestic product, compared to China's one sixth. However, while high-level agreement on principles and objectives will be relatively easy to achieve, aligning on concrete actions may be more difficult.

The EU and the US currently have different strategies towards China, which could hamper collaboration.

The EU wants to compartmentalise its relationship with China, treating it alternatively as a competitor in the global economy, as a partner on issues such as climate change, and as a rival in the geopolitical sphere. Under the current and previous administrations, the US approach has been to focus on what it regards as the overall threat posed by China to the global rules-based order, with values and economic and security considerations seen as being interlinked.

Main recommendations for Transatlantic relations

- 1. The concept of open strategic autonomy should be defined carefully and sufficiently broadly to embrace partnerships with key allies, such as the US.** A strong and balanced transatlantic alliance can help Europe to maintain control over economic and strategic decisions, whereas acting alone is likely to lead to market fragmentation that ultimately erodes European influence in key areas. Strategic partnerships – that work for the EU and allies alike – are the foundation stone for enduring strategic autonomy, and the partnership with the US is the most important of all.
- 2. The new Trade and Technology Council should have an agenda that is both broad and ambitious.** It should include: the elimination of tariffs on industrial goods; improving regulatory cooperation and agreeing the mutual recognition of standard certification in areas such as medical devices, pharmaceuticals, and chemicals; collaborating on digital standards and governance; and seeking to play a leading role as a global standard setter in other areas where standards do not yet exist, including a through a new transatlantic AI agreement to set a blueprint for global standards aligned with EU values.
- 3. An early priority for the EU and the US should be to collaborate on trade-related objectives at COP26.** This should include seeking a new multilateral environmental goods agreement and aligning environmental standards incorporated into free trade agreements. The EU and US should also work together on level playing field mechanisms to address the risks of carbon leakage. They should aim to bring carbon prices closer together in both markets. It is important that the EU's proposed carbon border adjustment mechanism should not reduce cooperation with the US on climate change or lead to tensions in the trade relationship.
- 4. The new Transatlantic Green Technology Alliance that the EU and US are committed to working towards should foster innovation in clean and circular technologies.** This could include renewables, grid-scale energy storage, batteries, clean hydrogen, and carbon capture, use and storage. Developing a global taxonomy to determine which economic activities are considered sustainable and collaboration on the broader international framework for sustainable finance and reporting would help to support this. The international process through the IFRS Foundation should be supported to achieve this.

The EU has also recently demonstrated its willingness to act alongside the US and other allies in its China policy. The EU, US, UK, and Canada have coordinated the sanctioning of Chinese officials over alleged human rights abuses in Xinjiang. This has led to

a strong Chinese response that could jeopardise collaboration with China in other areas, including on the ratification of the Comprehensive Agreement on Investment. It could also make the EU strategy of compartmentalising the relationship with China harder to sustain.

5. The EU and the US should seek to create a common transatlantic digital economy. To do this, they should work together (and with others) to enhance the free cross-border flow of data. As a matter of urgency, the EU should prioritise reaching agreement with the US on a transatlantic framework for data transfer to replace the privacy shield, thereby sufficiently addressing the shortcomings identified by the Schrems II judgement of the European Court of Justice. Closer alignment is also needed on new areas of regulation such as AI, IoT, platforms, 5G and cybersecurity, as without this there is risk of further regulatory fragmentation. Moreover, the EU and US should work together to seek a multilateral agreement on digital taxation, as part of a broader agreement at the OECD.

6. The EU and US should work together on WTO reform. An immediate priority is reforming and reactivating the dispute settlement mechanism and the WTO's Appellate Body. They should also seek to modernise WTO rules to address the challenges from state capitalism, notably trade-distorting subsidies, export financing, forced technology transfers, and substandard IP protection and enforcement. The agenda for collaboration should also include reaching plurilateral agreements on sector-specific issues such as e-commerce, new technologies (through an expanded information technology agreement), healthcare trade (updating the pharmaceutical agreement), and trade in environmental goods. As part of this effort, the

EU and US should seek to make progress in their trilateral dialogue with Japan on WTO reform.

- 7. An early priority is for the EU and US to resolve the dispute on section 232 tariffs on steel and aluminium.** A pause in the section 232 tariffs and retaliatory EU tariffs could allow discussion on a bilateral mechanism that shields both the EU and the US steel and aluminium industries from the adverse effects of global overcapacity, while work on a long-term solution to that issue continues.
- 8. The EU and US should cooperate more closely on extraterritorial measures, including both sanctions and other regulations.** Where foreign policy objectives are similar, coordination is needed to ensure that any extraterritorial measures are aligned in their substance, timing, and legal form. This not only makes them more effective but reduces the risk of bilateral economic damage. When considering extraterritorial regulation, greater alignment is needed to avoid creating legal jeopardy for firms and to ensure a level playing field.
- 9. The EU should develop a distinctly European approach to bilateral relations with China, while working closely with the US.** The EU should advocate trilateral or multilateral collaboration, involving China, wherever appropriate, such as on climate change. The EU should also act as a mediator and seek to ease US-China trade tensions, wherever possible.





Finding a positive way forward in the China relationship

The EU-China economic relationship is critically important for European industry, jobs, and growth. It is also one of the most complex and challenging relationships because of the increasing fusing of political and commercial interests on both sides. It is essential that European policymakers face up to the challenges and remain focused on Europe's long-run interests as these challenges are addressed. That means making steady but visible progress on the core task of rebalancing the economic relationship, both through increasing access on fair terms for European firms in China and in ensuring that Chinese firms compete on fair terms in the Single Market and globally. The ratification and implementation of the Comprehensive Agreement on Investment has an important role to play if and when the political conditions are established to allow this. At the same time, the EU needs to equip itself with the right tools to challenge unfair competition from China and to use these tools effectively. The EU must also seek to maintain a positive agenda for collaboration with China. Working together to make progress on the economic transitions required to reach net zero provides an immediate area of opportunity.

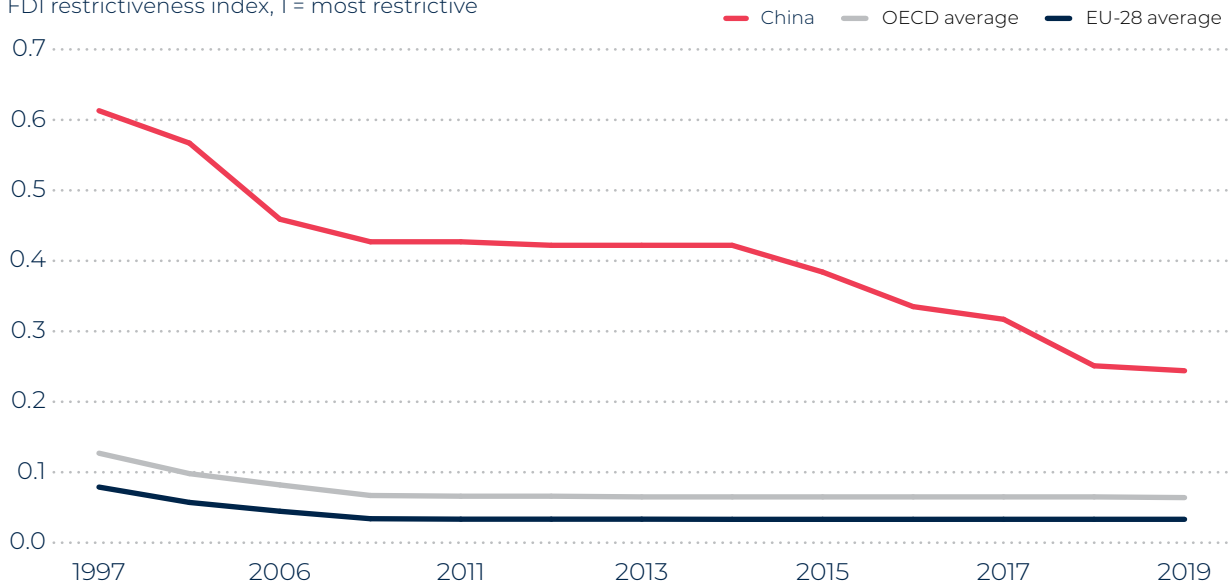
Improving market access

Implementation of market liberalisation reforms in China needs strengthening and accelerating in many areas, including the reduction of non-tariff barriers. The European

Chamber of Commerce in China noted in its 2020 Business Confidence Survey that China is increasingly struggling with “*promise fatigue*”.²¹ Indirect market access barriers

The pace of opening to investment in China has slowed

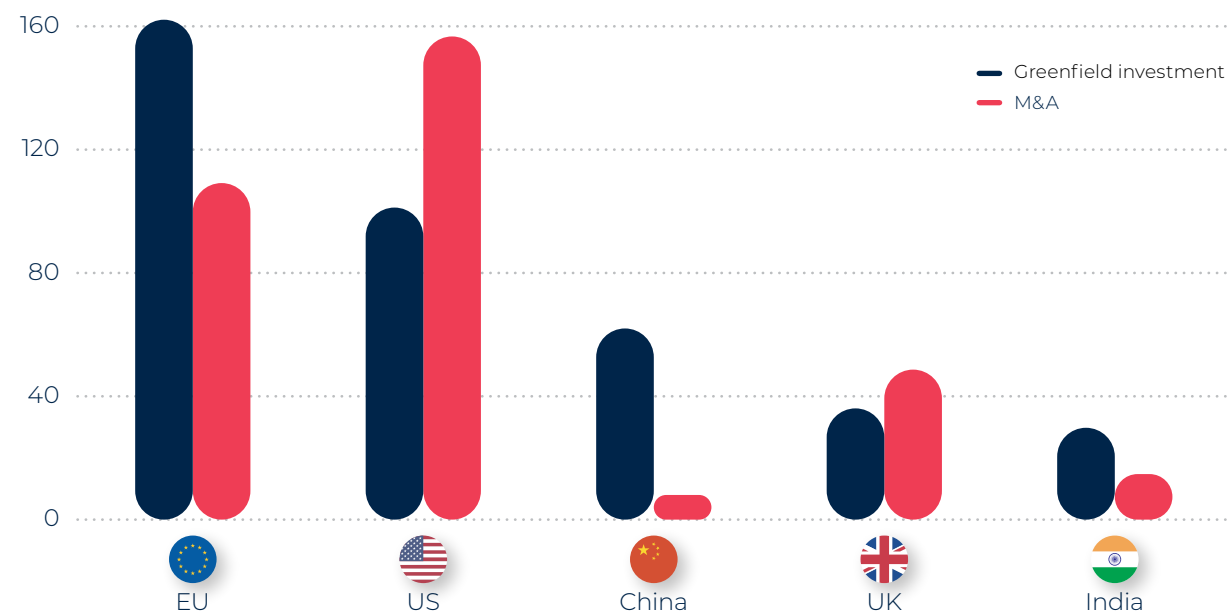
FDI restrictiveness index, 1 = most restrictive



Source: OECD.

FDI inflows to China remain relatively low, especially M&A

FDI inflows in 2019, USD billion



Source: UNCTAD.

²¹ See <https://european-chamber.com.cn/en/publications-business-confidence-survey>

remain prevalent, with European companies citing discrimination in public procurement tenders, licencing processes, enforcement of environmental regulation, and an unfair sharing of risk in joint ventures as among the problems.

Indirect market access restrictions are often harder to address than direct restrictions, but the EU should seek to do so through a constructive dialogue with Chinese counterparts. Support for a closer relationship with China among Member States and in the European Parliament can only be built and strengthened if there is an understanding that China too is working to level the playing field and to provide European companies with the same fair treatment in China as Chinese companies enjoy in Europe.

Further revisions that shrink China’s negative list for investment are a priority and could help boost the EU-China commercial relationship. European companies welcome recent revisions, but these have yet to produce significant, tangible new opportunities. Besides sectors such as financial services

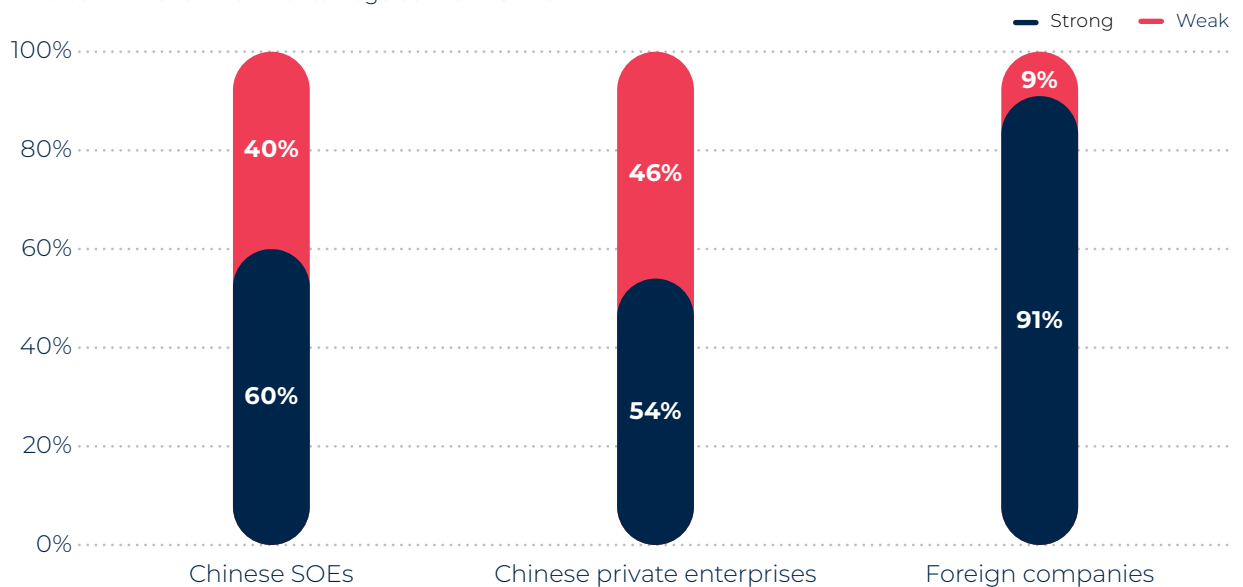
and environmental goods and services, where conditions are improving, the same European Chamber of Commerce survey cited above showed that 44% of European businesses continue to struggle with direct or indirect restrictions. The percentage of mergers involving a foreign company that were subject to regulatory scrutiny remained high, at 27% as of June 2020, compared to 6% for domestic mergers. This has led to a steady decrease in deals targeting Chinese assets where foreign buyers are involved, down from almost 25% in 2015 to just over 10% in 2020.²²

China’s home market advantages have helped create national champions, while undermining the ability of European companies to compete with Chinese firms.²³

Direct and indirect barriers to China’s vast home market have protected Chinese companies and allowed them to generate high profits, invest in R&D, and scale up, before venturing into external markets, including in Europe. Government support has also hindered European competition in industries that are technically open to foreign firms, such as railways. China’s desire

European firms are unfairly treated in China

Enforcement of environmental regulations in China



Source: European Chamber of Commerce in China, Business Confidence Survey 2020.
Link: <http://european-chamber.com/en/publications-business-confidence-survey>

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 22 Asia Society Policy Institute Paper on “China Dashboard”, January 2021 https://aspi-gist-cdn.sfo2.digitaloceanspaces.com/chinadashboard/websites/5ff763b6d9ac920410bd7c65/pages/5ff763b6d9ac920410bd7c67/pdf/The_China_Dashboard--Winter_2021--Full_Report.pdf
 23 See European Council on Foreign Relations Paper on “Home Advantage: How China’s Protected Market Threatens Europe’s Economic Power”, April 2021 <https://ecfr.eu/wp-content/uploads/Home-advantage-How-Chinas-protected-market-threatens-Europes-economic-power.pdf>

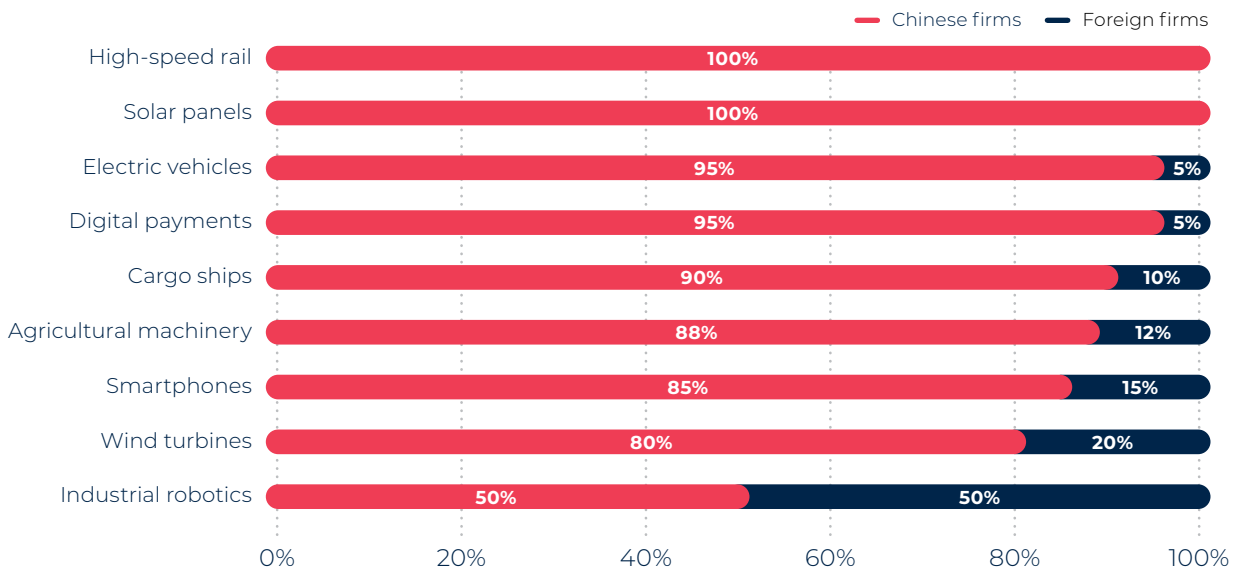
to strengthen domestic supply chains risks exacerbating this problem, especially for European companies in technology sectors.

The EU should identify and prioritise the opening of sectors where there is alignment with China’s own policy objectives. China’s market access choices will be shaped by domestic considerations, and pragmatism requires that the EU understands what is

driving these and where this is likely to create early new opportunities for European firms (see Box 3 on China’s industrial policy). The EU should emphasize the mutual benefits from openness and continue to pursue broader objectives for market access. But a pragmatic approach that delivers tangible, early opportunities for European businesses is essential to maintain European public support for an open commercial relationship with China.

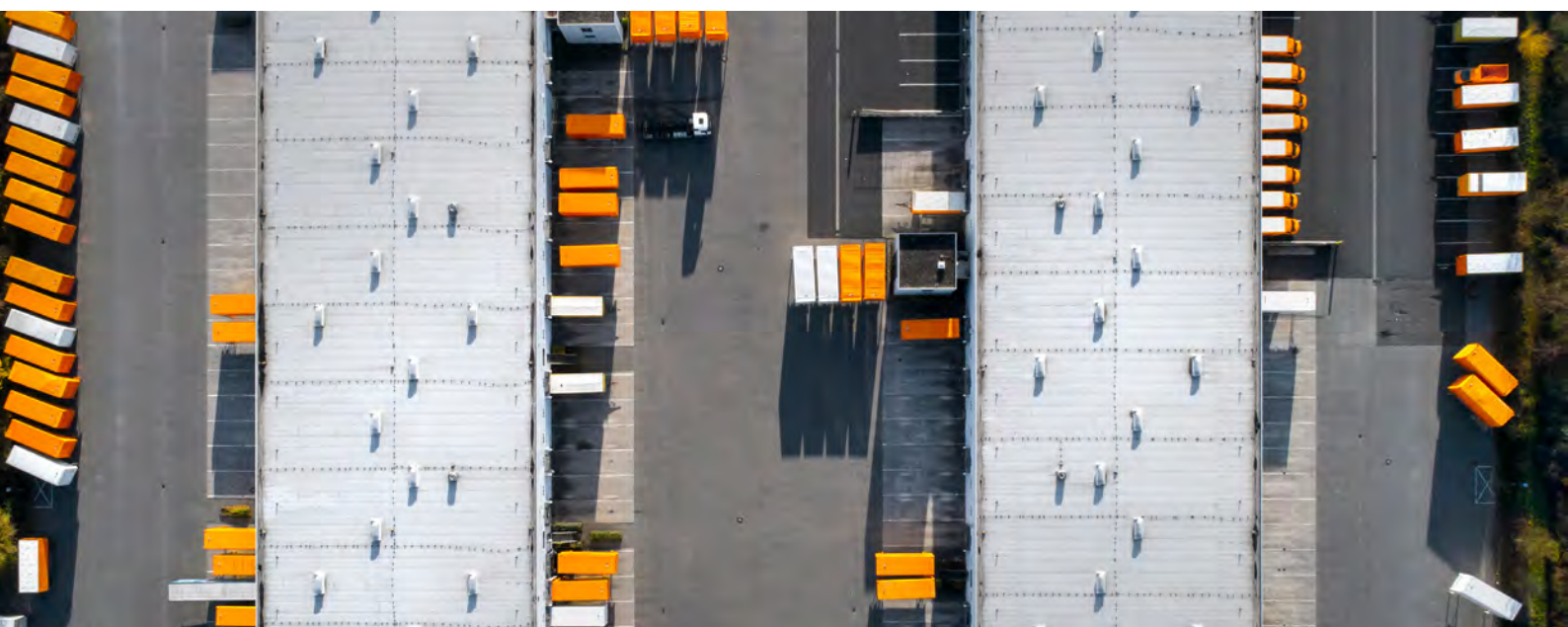
Chinese firms dominate the Chinese market in many sectors

Market shares in selected sectors in China



Source: McKinsey Global Institute.

Link: <https://ecfr.eu/publication/home-advantage-how-chinas-protected-market-threatens-europes-economic-power/>



Box 3: Industrial policy and China’s 2021-25 five-year plan

Industrial policy has been a major focus of the Chinese leadership over the last ten years and is increasingly linked to national security. The latest five-year plan, which was approved in March 2021, shows that ‘Made in China 2025’ remains a priority. It states that R&D spending will increase by 7% annually and be concentrated in seven priority sectors that include AI, semiconductors, quantum computing, and biotechnological research.

The five-year plan and China’s industrial policy underscore several challenges for the EU-China relationship. The Chinese leadership wants the country to become self-reliant in key technologies, which means more state support. In early 2020, President Xi Jinping said state-owned enterprises will need to play an even larger role in China’s development. The State-Owned Asset Supervision and Advisory Commission then followed up in October of the same year by

saying SOEs should increase their R&D spending as a share of revenue from 2% to 5% by 2022. A growing role for state-owned enterprises could undermine support for open markets in Europe.

China’s five-year plan also makes clear that there will continue to be opportunities for European companies in China, and for increased collaboration with Chinese partners. The plan says, for example, that the Chinese government will help foreign firms that want to set up innovation centres in China. Moreover, although aerospace remains a relatively restricted sector for foreign investors, the shift to low-emission commercial and passenger transportation will require more cooperation with European businesses that are leading in this field. The combination of European expertise and Chinese desire to develop its green technology and aerospace capabilities should open doors for EU companies, providing they can be reassured that their IP will be protected.

Ratifying and building on the CAI

The Comprehensive Agreement on Investment (CAI) will provide fresh opportunities for the EU-China relationship if and when it is ratified and implemented.²⁴

The Commission has temporarily put on hold efforts to ratify the agreement because of tensions in the EU-China relationship and criticism of some of its elements and concerns about enforceability, including in the European Parliament. The EU should address these concerns and pursue the ratification as soon as the political conditions allow. European businesses will support the Commission as it makes the case.

The CAI is economically important, but also controversial, and so even when the ratification process resumes, it may prove to be long and challenging. The agreement has been reached at a time when there is renewed attention to human rights in China. There are also concerns about the labour and environmental commitments in the agreement and whether these are sufficiently strong and enforceable.

The more detailed and time-specific the Chinese authorities are on the implementation of these aspects of the agreement, including the ILO Fundamental Conventions, the more it will help to create trust and to build support in the European Parliament for ratification once the time is right to pursue this.

The CAI is significant because it offers more on market access than any investment agreement negotiated previously by China with other nations.

It shows the benefits of engagement by the EU with China on long-standing challenges for the relationship. It does not mean that those issues are now fully resolved, but it is an important step towards establishing a commercial relationship that is more balanced, fairer, and beneficial for both sides. The agreement binds in, or in some sectors extends, China’s openness to European firms, while also providing a basis for further strengthening the trade and investment relationship.

Table 1 sets out some of the key elements.

²⁴ See https://trade.ec.europa.eu/doclib/docs/2021/january/tradoc_159343.pdf

Table 1: Some key elements of the CAI

New energy vehicles

Improved market access in the new energy vehicle (NEV) sector would benefit both European and Chinese industry. China’s political leadership welcomes cooperation in the field, because Chinese companies can benefit from working with their European peers, while European companies have an opportunity to expand their presence in the world’s largest NEV market.

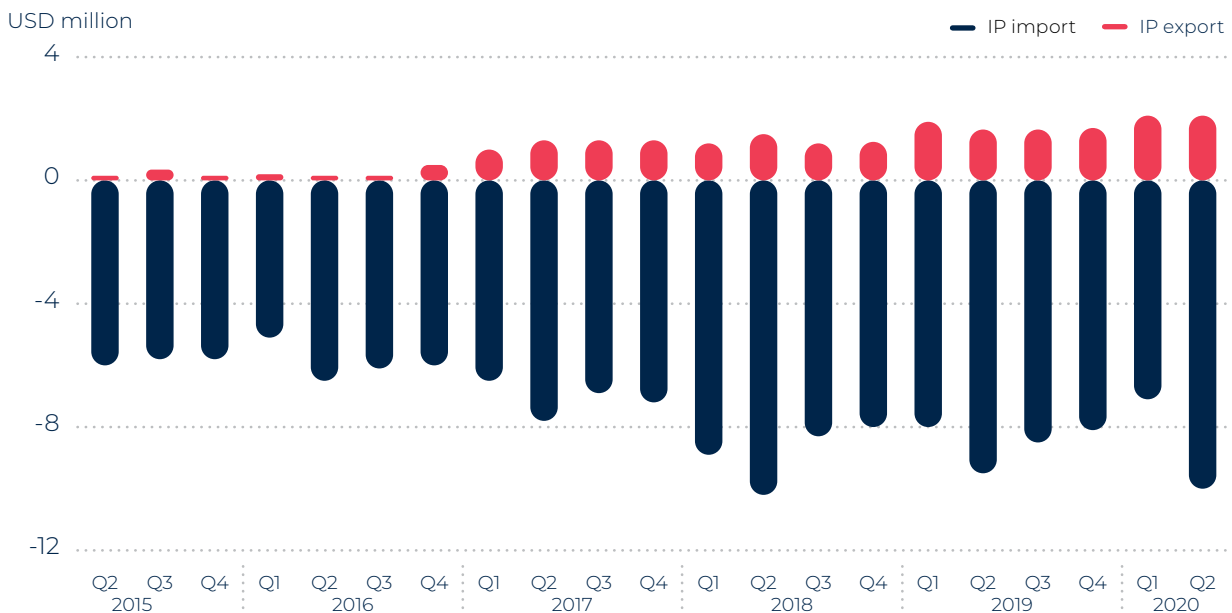
Renewable energy

Chinese companies would be able to make limited investments in Europe’s renewable energy sector, providing European companies receive the same access in China. This is based on the principle of reciprocity and should help to address the market access imbalances that favour Chinese companies operating in Europe. European companies may still face both direct and indirect restrictions in China, however, so effective implementation and enforcement is essential.

Forced technology transfers

The CAI adopts similar provisions to the US-China agreement reached in January 2020.²⁴ While some provisions have proven hard to enforce, with IP theft still one of the main issues of concern for foreign businesses in China, there have been encouraging developments. President Xi Jinping has said strong IP protection is key to building a modern Chinese economy, as Chinese entrepreneurs will not continue to innovate if they do not believe the government will protect their IP. The country’s supreme court has said it will pay more attention to protecting the rights of foreign businesses to support trade, investment, and IP rights, while the standing committee of the National People’s Congress approved in October 2020 a revised patent law that significantly increases penalties for violations.

China is gradually becoming an IP exporter



Source: National Bureau of Statistics, Rhodium Group. **Link:** https://aspi-gist-cdn.sfo2.digitaloceanspaces.com/chinadashboard/websites/5ff763b6d9ac920410bd7c65/pages/5ff763b6d9ac920410bd7c67/pdf/The_China_Dashboard--Winter_2021--Full_Report.pdf

²⁵ See https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic_And_Trade_Agreement_Between_The_United_States_And_China_Text.pdf

The ratification and implementation of the CAI would send a positive signal to European investors.

It would provide reassurance that China’s market opening commitments are irreversible, even if they are not always new, allowing European firms in areas like private healthcare and green technologies to make new investments and commit to expansion in China’s fast-growing market. It would also signal that China wants EU companies to play a significant, long-term role in the country’s economic development in areas like new energy vehicles.

If the ratification of the agreement is delayed for a prolonged period, then the EU should seek to apply some of its core components on an interim basis.

This could be done in those areas that offer the biggest immediate benefits and where there is a mutual understanding that early implementation would benefit both parties. These areas include investment liberalisation in the renewable energy and new energy vehicle sectors.

Reaching net zero

The interests of the EU and China are closely aligned on the need to tackle climate change.

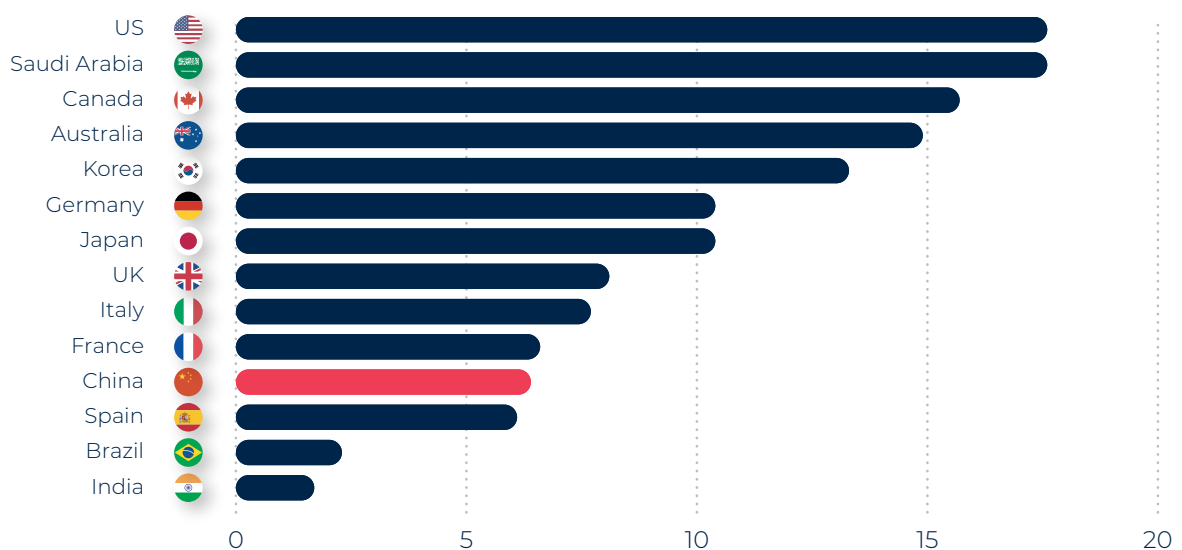
Neither can meet their goals without actions being taken by the other. While there are differences of view about the pace of change and burden sharing, these are outweighed by the urgency that is now needed to address the problem. Industrial firms in Europe and China must be part of the solution. As the EU and China seek to collaborate to address climate change, this will create new opportunities and obligations for Chinese and European industrial firms.

China’s commitment to reach net zero by 2060 opens a new avenue for cooperation with the EU.

The Ministry of Ecology and Environment has now incorporated climate action into local government performance criteria, and the Ministry of Industry and Information Technology has repeatedly said that a reduction in steel production is needed to reach China’s emissions reduction goals.²⁶ This would also help tackle the problems created by China exporting its overcapacity, which is undermining the competitiveness of European companies.

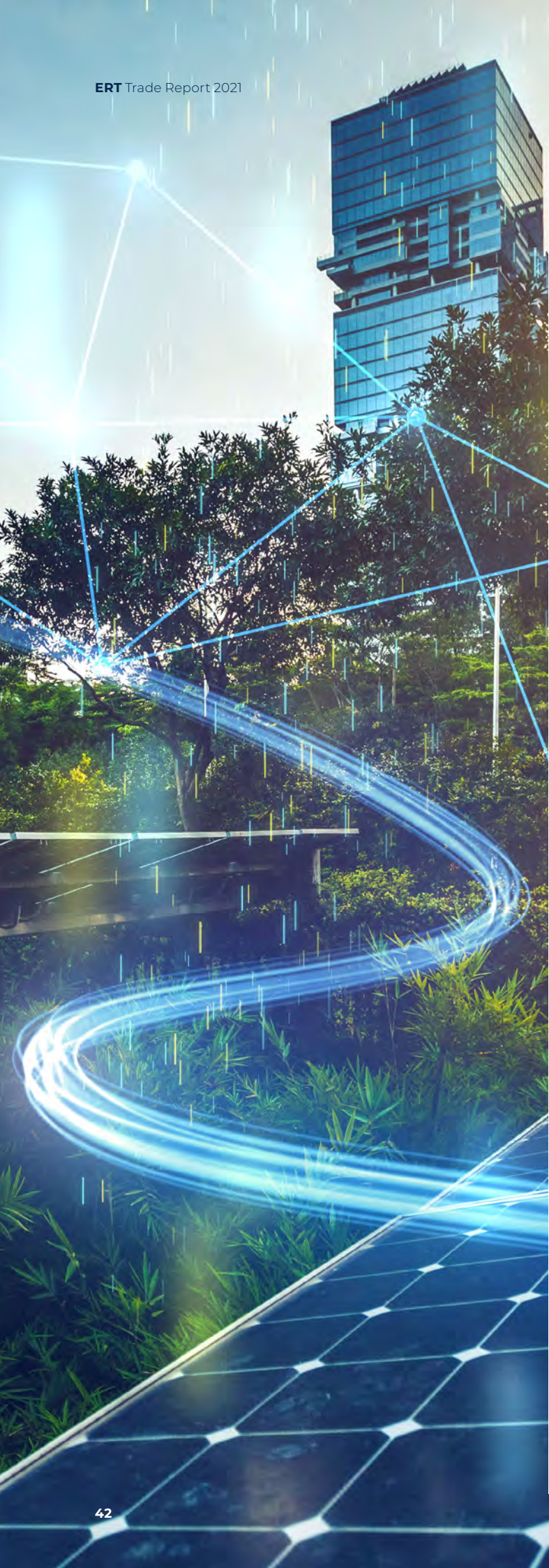
China is now a major emitter in per capita terms

Emissions per capita, metric tons



Source: Global Carbon Project, World Bank. **Note:** Uses consumption-based emissions to attribute emissions from traded goods to the countries where they are bought. **Link:** <https://www.bloomberg.com/opinion/articles/2021-02-28/china-s-five-year-plan-will-determine-the-future-of-decarbonization>

²⁶ See <https://www.spglobal.com/platts/en/market-insights/latest-news/metals/030421-chinas-two-sessions-expected-to-target-steel-industry-carbon-emissions-analytics>



EU policymakers need to take advantage of this newfound desire in China to deal with climate change.

The EU-China high-level environment and climate dialogue, which was established in September 2020, is a good place to start.²⁷ China will soon release its plan for emissions to peak by 2030. The EU and China should share expertise and insights from the development of their respective plans to reach net zero and engage with businesses on this.

The EU and China should work together to support businesses that are helping to address the climate change threat.

China understands the importance of technology in achieving net zero and Chinese political leaders have said there is an urgent need for smart manufacturing to help reduce emissions. Chinese leaders have also noted that smart manufacturing technology from European companies has helped Chinese companies to produce goods more efficiently, and thus to reduce emissions.

Nevertheless, there are gaps in the international regulatory framework that is needed to ensure the transition to net zero happens sufficiently quickly and without unnecessary costs.

For instance, there are currently no globally recognised carbon accounting standards for products and services. Europe and China should join forces with other countries to drive global standardisation of carbon footprint tracking and make this a priority for COP26. The EU should also work with China to develop common standards for green technologies.

Implementation of the CAI's provisions on sustainability would help to level the playing field for European firms competing in China and in third countries.

Commitments in the CAI to avoid lowering environmental standards to attract investment align well with recent developments in China, where enforcement of environmental protection has markedly improved since 2017, according to European Chamber's latest confidence survey.

27 See https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1648

European and Chinese companies in energy-intensive industries continue to be treated unequally, however, including in the enforcement of regulations by local government in China.

Effective implementation of the CAI's sustainability provisions – either

in the context of the full ratification of the agreement or separately – is therefore urgently needed to help address this and to ensure that both European and Chinese companies play their part in reducing emissions.

Strengthening the EU's defensive toolkit

Sensitive data and technologies need to be protected, while allowing digital trade to grow and new technologies to be adopted internationally. China's new five-year plan makes clear it wants to become a global leader in emerging technologies such as AI, 5G and quantum computing. We are also seeing an increasing blurring of the lines between the public and private sectors in China. Whether it is fair or not, distrust among the European public and policymakers about the intentions of many Chinese technology companies has increased.

The EU and European governments therefore need a comprehensive and coherent approach to foreign investment screening.

The current system is fragmented, and several EU states still do not have effective mechanisms in place. While investment screening is needed to block politically motivated acquisitions in strategically important sectors, this should not be used as a back door for protectionism that discriminates against foreign investment. A decoupling of the technology and digital sectors in China and the West, either by design or by accident, should be avoided.

The EU and China should strengthen their economic and trade dialogue and use it to develop a positive agenda for cooperation, especially on climate change.

IP theft and forced technology transfers remain major obstacles to fair trade with China.

They have allowed Chinese businesses to gain unfair advantages in traditional manufacturing and high-tech sectors. Provisions on IP protection are included in the CAI. Given the extent

to which this undermines fair competition, it is important that the EU prioritises working with China, the US, and others to develop new IP protections and to enforce existing ones.

Chinese subsidies, export financing, and artificially low prices on exported goods continue to place European firms at a disadvantage. The EU has instruments it can deploy to address these issues and should make full use of its anti-dumping tools to tackle anti-competitive behaviour in sectors like steel and solar energy.

ERT supports the Commission's proposal for a new foreign subsidies instrument to help level the playing field in Europe.²⁸ Blocking government-subsidised foreign companies from acquiring European rivals and limiting their access to the EU's public procurement market could help deter such behaviour by non-market economies. It is important that the policy is enforced consistently across the EU.

Working together within the EU and with allies

It is essential that EU Member States and institutions bring urgency and coherence to the development and implementation of policy towards China. Member States sometimes have different, and occasionally even competing interests, in the trade and investment relationship with China. But they collectively have more influence if these differences are resolved internally, and when they work together in developing the relationship with China through EU institutions.

28 See https://ec.europa.eu/competition/international/overview/proposal_for_regulation.pdf

A re-invigorated transatlantic relationship creates both opportunities and challenges for collaboration between the EU and China.

Closer cooperation with the US should improve prospects for encouraging positive change in China. This should include a constructive agenda for trilateral (or broader) collaboration with China on issues like climate change or global standards in technologies, as well as tackling more difficult

issues, such as security, human rights and reciprocity in trade and investment. The re-launch of the EU-US China dialogue provides an opportunity for the EU and US to align better, but without alienating China. A decoupling and the creation of separate supply chains for the US and Chinese markets should be avoided, as this would increase costs for companies and citizens worldwide and slow innovation.

Main recommendations for EU-China relations

1. **The EU and China should strengthen their economic and trade dialogue and use it to develop a positive agenda for cooperation, especially on climate change.** This and other platforms, such as the EU-China high-level environment and climate dialogue, should be used to share expertise and to support China as it develops plans to cap emissions by 2030, in implementing its emissions trading scheme, and in developing its green-finance market. The EU should use these dialogues to encourage China to align more closely with the EU's climate goals.
2. **The EU and China should seek closer alignment of standards for new technologies, especially those related to climate change.** The lack of common standards for climate-friendly technologies increases costs for businesses and reduces innovation, while holding the world back from reaching net zero. As part of this effort, the EU could collaborate with China to develop internationally recognised carbon accounting standards, while triangulating with the US in this area.
3. **The EU should support innovation by European companies through better protection of IP rights in China.** There is already growing momentum in China to strengthen IP rights through domestic legislation, as the country moves from being an importer to being an exporter of IP. The EU should encourage China to strengthen legal patent rights and protections using bilateral and multilateral fora, such as the WTO and WIPO.
4. **The EU should mitigate risks from foreign investment in critical technologies, including from China, through investment screening.** The Commission should use existing tools and seek to harmonise investment screening mechanisms across Member States where there are gaps and inconsistencies. It is essential that investment screening rules are implemented fairly and proportionately and that they are not used as a back door for protectionism.
5. **The Commission should continue to strengthen the EU's policy toolkit for levelling the competitive playing field for EU companies in the Single Market and elsewhere.** The EU should hold China to its commitment to competitive neutrality, which is a key principle of China's industrial strategy. This is critical to ensure that EU companies are not unfairly disadvantaged when competing with heavily subsidised Chinese companies. More attention should also be paid to home market advantages enjoyed by China. The EU should make full use of existing policy tools such as antidumping and countervailing duties to achieve this. The EU should also proceed expeditiously to introduce the proposed new instrument to level the playing field with foreign firms that benefit from subsidies.

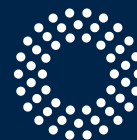


- 6. The EU should work with China to address other market access barriers faced by EU exporters and investors in China.** Immediate priorities include: a reduction of non-tariff barriers such as discriminatory licensing and approval processes; further reductions in the negative list for foreign investment; encouraging China to join the WTO's Agreement on Government Procurement; reduction and eventual elimination of Chinese export subsidies; and strengthening Chinese competition policy to establish a transparent and limited framework for State Aid.
- 7. The EU and China should address concerns about the scope and enforceability of labour and environmental commitments in the CAI and pursue ratification when the political conditions allow.** The European Commission should explain more fully to Member States and the European Parliament its approach to human rights in China. The recent escalation of political tensions must not prevent progress in the important task of rebalancing the EU-China economic relationship, as this would damage Europe's long-run interests. EU supply chain due diligence may help address some concerns about the CAI, by providing reassurance that European firms are not benefiting from lower standards in China or elsewhere.
- 8. If the ratification of the CAI is delayed, the EU should still pursue implementation of its key elements.** Unlike free trade agreements, the implementation of the CAI's provisions are not contingent on ratification. A progressive

implementation of provisions should prioritise those that are most clearly in the EU's interest and that are mutually beneficial, including in the renewables and automotive sectors, where China is making significant concessions. CAI ratification could then act as a lock for Chinese commitments. This would allow the EU to make progress without losing leverage.

- 9. The EU should complete negotiations on an investment protection agreement with China and clarify how disputes would be resolved under the CAI.** As well as providing a framework for resolving disputes between investors and host governments, investment protection agreements deter direct or indirect expropriation. The CAI's dispute settlement mechanism is not currently well defined and this needs to be remedied if it is to be implemented effectively. One approach is to set up a separate EU-China committee to discuss and resolve trade and investment disputes.
- 10. The EU should establish a dedicated China unit in the European Commission to manage the China relationship.** This should serve as a clearing house for political and policy irritants impacting on the trade and investment relationship and be the main interlocutor with China to address such challenges. The unit should engage with industry, including ERT, on China policy. There should always be a business element to EU-China negotiations and engagement with European businesses before and during summits with China.





Annex: Tracking progress on trade

Clear evidence can help European decision makers to devise effective policies and take farsighted investment decisions. In November 2020, ERT proposed a balanced scorecard of 28 key performance indicators for the EU's industrial strategy.²⁹ Below we explain how the EU might draw on this to evaluate its success on trade policy and in related areas.

²⁹ ERT Paper on "Putting the EU Industrial Strategy into action", November 2020
https://ert.eu/wp-content/uploads/2020/11/ERT-Publication-Putting-the-EU-Industrial-Strategy-into-action_Nov-2020.pdf

The balanced scorecard

The balanced scorecard for industrial policy combines indicators under four headings, or 'quadrants', which cover its key components, time horizons and perspectives. These are:

- 1) output performance – industry's value creation in the EU;
- 2) internal processes – the way production is organised in the EU;
- 3) future orientation – how the EU invests in productive assets; and
- 4) global relationships – the success of European products on international markets and the EU's attractiveness as a place for foreigners to invest and do business.

The balanced scorecard focuses on impacts rather than inputs. Outcome measures describe the results of past actions and are more prevalent in the output performance and global relationships quadrants. Performance drivers are the factors that will influence future outcomes.

In the 2020 report, ERT proposed 2030 targets for the 28 KPIs that reflect the EU's priorities or should guide the collective endeavour of industry stakeholders in maintaining and increasing European industrial competitiveness. These targets have been calibrated, so they are tough but achievable.

Table 2: Seven KPIs on trade and supply chain resilience

Output performance	
6) Industrial Alliances	
Global market share	2030 target: Production in key products to outperform EU global economic share by 30%
Internal processes	
8) Intra-EU goods exports	
% of GDP	2030 target: increase intra-EU goods exports to 25% of GDP
9) Ease of doing business	
Rank	2030 target: Rank among the top-five economies
Global relationships	
22) Export of manufactures	
Global market share	2030 target: Equal EU global economic share
23) Export of high-tech manufactures	
Global market share	2030 target: Outperform EU global economic share by 30%
25) Economic openness	
Total trade as % of GDP	2030 target: Be the most open large economy
28) Trade and investment barriers	
Net new restrictive measures	2030 target: Reduce net new restrictive measures to zero

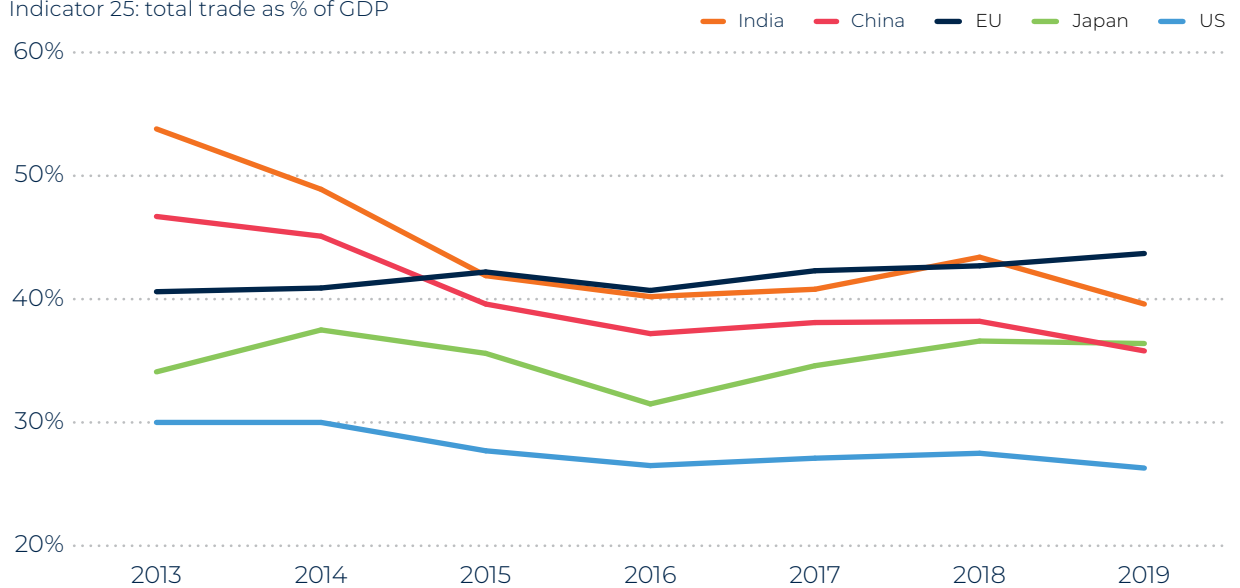
Tracking progress on trade

The balanced scorecard was designed to track EU industrial competitiveness and not the performance of European trade and supply chain resilience per se. Nonetheless, trade is an important aspect of competitiveness and many of the KPIs are directly relevant.

The fourth quadrant on global relationships is where most of the relevant indicators are located. For this report, indicator 25 on economic openness, measured by total trade as a percent of GDP, offers the best starting point. The EU economy is heavily dependent on trade.

The EU has long been one of the most open major economies

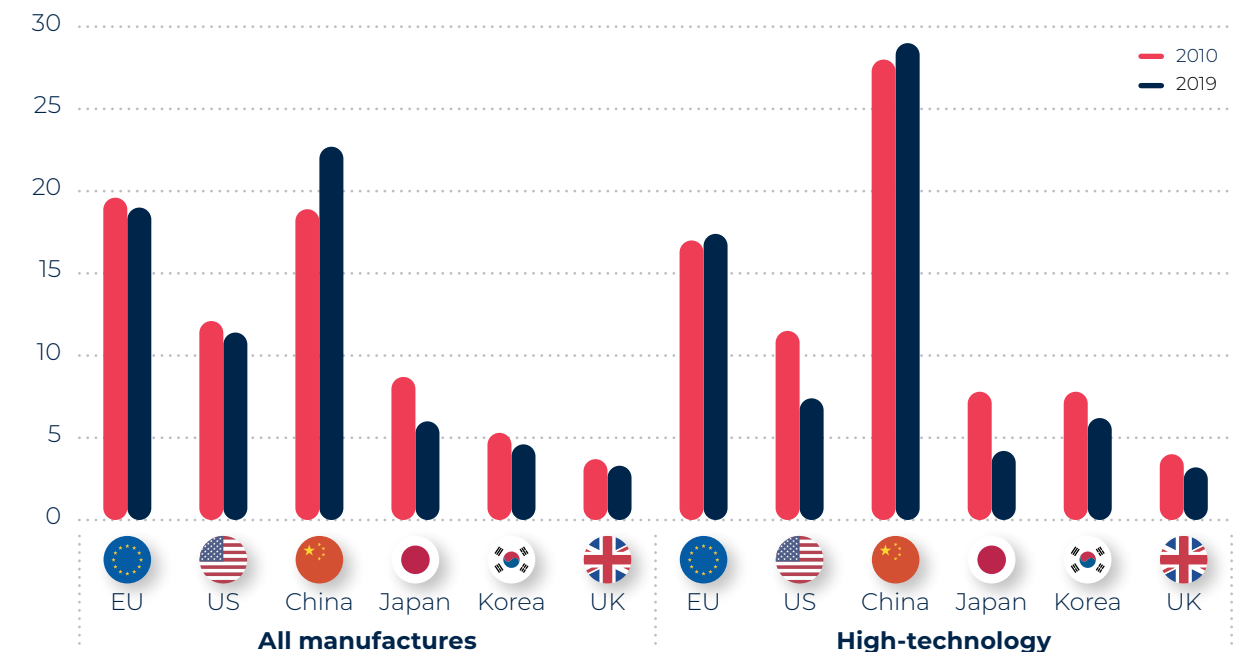
Indicator 25: total trade as % of GDP



Source: World Bank, Eurostat, own calculations.

Chinese manufactured goods dominate global markets, even in high-tech products

Indicators 22 and 23: global market shares in manufactured exports, %



Source: World Bank, Eurostat, own calculations.

This is true for both exports and imports as European companies are heavily integrated into global value chains. By 2030, the target should be for the EU to ensure that it is the most open large economy by this indicator.

Indicators 22 on export of manufactures and 23 on export of high-technology manufactures provide insights into the presence of EU industrial companies in global markets. Both reflect the demand for European products abroad and hence EU competitiveness. They may also reflect differences in market access. A higher EU market share globally likely means a more diversified base of customers. High-tech manufactures include products – such as aircraft, pharmaceuticals, computers, and communication equipment – which are high in value creation and rely on technologies that are set become even more important in future, as demonstrated during the pandemic.

Indicator 28 on trade and investment barriers measures how many new restrictions EU companies face abroad and how much trade is potentially affected by them. European firms have faced increasing trade and investment barriers in recent years. China is one important market where barriers have impeded commercial activity. A closer relationship with the new US administration could also help

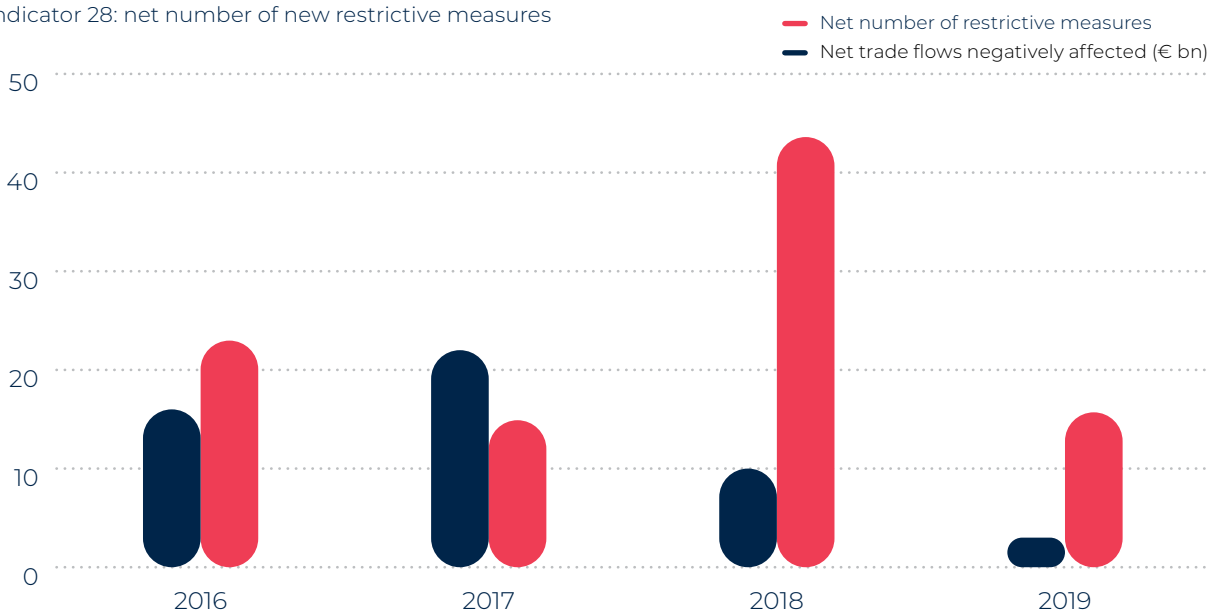
resolve issues in bilateral economic relations through dialogue rather than unilateral tariffs.

Indicator 6 on industrial alliances captures the importance of the EU working with industry and in some circumstances this may be used to improve the resilience of supply chains. The Commission has initiated industrial alliances such as the European Battery Alliance, the European Clean Hydrogen Alliance and the European Raw Materials Alliance which bring together different stakeholders and use the Important Projects of Common European Interest (IPCEI) instrument to mobilise public and private investment, which could potentially also be used to reduce supply chain vulnerabilities.

Building resilience must begin at home and that means strengthening the Single Market. The quadrant on internal processes contains two important indicators. Indicator 8 on intra-EU goods trade measures the extent to which product markets are integrated through goods trade between Member States. Indicator 9 on the ease of doing business captures how regulation affects small firms that trade across borders. Business regulation and trade barriers are often costlier for smaller firms, so removing red tape would help to improve their operating environment and hence the resilience of supply chains within the Single Market.

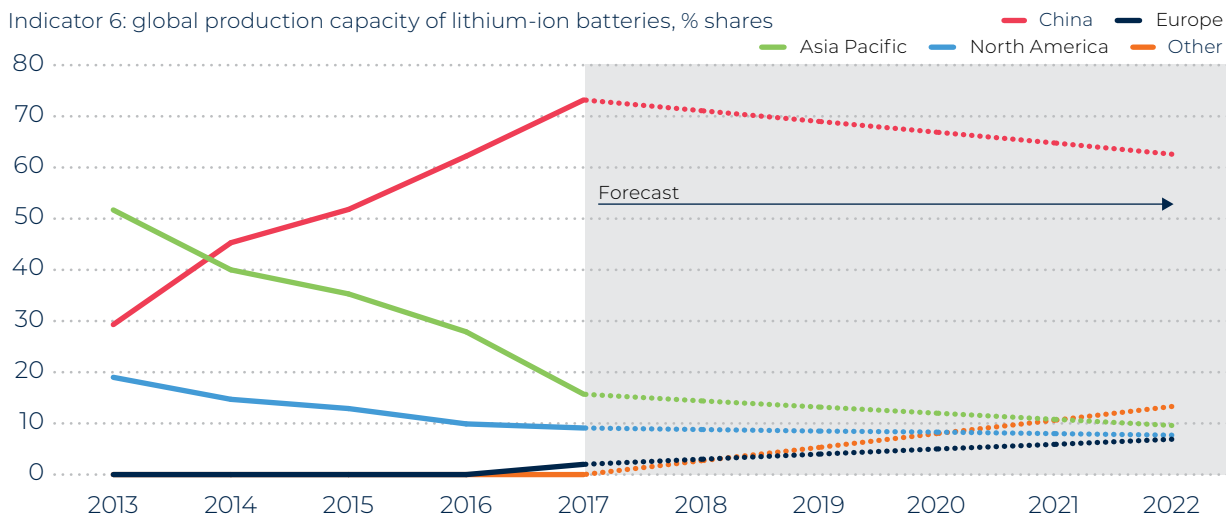
New trade and investment barriers affect a significant amount of new trade each year

Indicator 28: net number of new restrictive measures



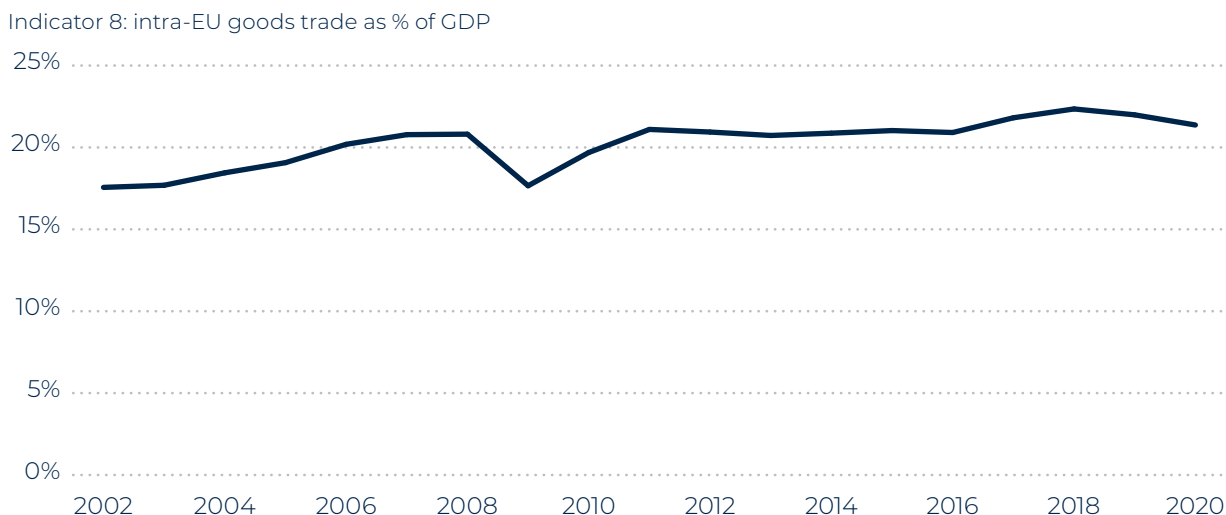
Source: European Commission.

Industrial alliances play a key role in boosting production in strategic value chains



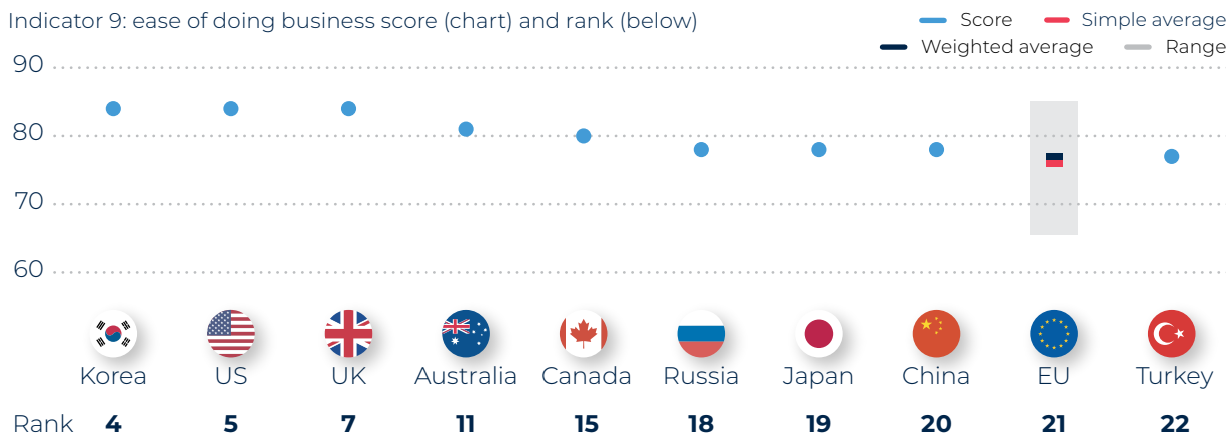
Source: International Energy Agency.

Further Single Market integration could boost efficiency and resilience



Source: Eurostat.

High bureaucratic hurdles exist for SMEs in the EU that trade



Source: World Bank, IMF, own calculations





List of ERT Members

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