

Europe Express **European Union**

Europe wakes up to collateral damage from US-China rivalry

Germany's debate on decoupling from Beijing highlights the perils of walking the tightrope between the great powers



German chancellor Olaf Scholz is struggling to develop a clear-eyed and coherent strategy for navigating relations with China © Bloomberg

Sam Fleming OCTOBER 29 2022

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Welcome back. I'm Sam Fleming, the FT's Brussels bureau chief, standing in for Tony Barber.

The rivalry between the US and China has intensified ominously in recent weeks. The 20th Communist party congress in Beijing [spooked financial markets](#) as Xi Jinping tightened his control and packed his politburo with loyalists.

In the US meanwhile, the imperative to further restrict high-tech trade with China is one of the few areas where there is enthusiastic bipartisan support as the midterm elections approach. In the wake of a set of highly intrusive measures on technology exports to China, analysts are predicting even tougher restrictions to follow as hostilities between the two countries worsen.

So where does that leave the EU? Leaders meeting in Brussels last week signalled their readiness to take a hard-headed approach to relations with Beijing. But a look at the debate in Germany shows how difficult capitals are finding it to walk the tightrope between strategic reliance on the US and economic ties to China

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Shortly after taking up his post as European Council president in 2019, Charles Michel warned of the “collateral damage” the EU faces as it gets caught up in the great-power conflict between the US and China.

His words anticipated one of the key thrusts of EU policy under the current commission — namely a drive for greater European self-reliance, or in a ubiquitous phrase, “strategic autonomy”.

This has spanned areas including military power, high-tech industries such as semiconductors, key raw materials such as lithium, trade defences and rules on inward investment and public procurement.

For all those Brussels-driven initiatives, the anxiety about Europe’s vulnerability to the US-China conflict is becoming increasingly acute in the big capitals — including Berlin, where I visited during the week.

A year after taking office, German chancellor Olaf Scholz is [struggling to develop a clear-eyed and coherent strategy](#) for navigating relations with China. Scholz has in recent weeks, for example, been hammered domestically over [his willingness to permit an investment](#) by Chinese shipping conglomerate Cosco in the Tollerort container facility in Hamburg.

Germany depends on China as a top source of imports as well as exports

€bn 2021

Imports



Berlin finally [agreed to the sale](#) of a pared-back 25 per cent stake this week, and officials play down the significance of the transaction, pointing to the relatively modest investment and the fact that China holds larger interests in other major European ports.

But the fumbled deliberations, which divided Germany's government, exposed Scholz to attacks by rivals who argued Berlin needs to toughen its stance on strategic Chinese investments and has yet to fully learn the lessons from its over-reliance on Russia and its fossil fuel reserves.

German officials acknowledge the worrying direction of travel under Xi's leadership, but they display no appetite for the kind of rupture in trade with China pursued by first Donald Trump and now the Biden administration.

Underscoring that calculation, BASF, the German chemicals giant, this week announced it will shrink its European footprint shortly after opening the first part of its new €10bn plastics engineering facility in China.

For his part, Scholz is making his first official trip to China in early November, together with an entourage of business leaders. He is deeply wary of any moves to "decouple" Germany from China, stressing the importance of the market for German firms.

Yet the political and economic balancing act faced by Berlin and other big EU economies will only get tougher. Take the far-reaching [US export controls on semiconductor equipment](#) sales to China that were announced in October.

ASML of the Netherlands, the EU's most important and valuable equipment maker, struck a sanguine note on the rules, predicting Washington's latest export controls against China would have a limited impact on the company's 2023 shipping plan.

But some EU officials fear capitals haven't appreciated how severe US economic penalties on China could become — and how wide-ranging the effects on European businesses could prove.

The US wants to [widen its regulatory power](#) over the global semiconductor industry as it seeks to curb China's technological advances, and it appears more than willing to apply provisions with extraterritorial impact to ensure its allies walk the line.

European officials bemoan the unilateral nature of the US export controls, contrasting it with the US approach to Russia sanctions, where there has been deep transatlantic co-operation.

EU governments, and officials are still analysing how their own tech companies could be affected if current US policy trends continue. Some companies may need to fence off operations serving China from those that touch the US, adding to cost and complexity.

The same forces are at play in Europe's fraught attempts to mute the impact of the US Inflation Reduction Act, which attempts to boost American self-reliance in renewable technologies at the expense of China.

The EU fears the US subsidies under the act will damage European interests by conferring an unfair [competitive advantage upon American-based manufacturers](#). But again, the imperatives on the US side — onshoring production capacity in areas including green technologies, and distancing itself from China — will override any qualms in Washington about the implications for German or French industry.

There is no reason to expect the direction of travel on America's China policy to change — indeed quite the contrary. The midterm elections are likely to see the Republicans retaking the House of Representatives and potentially winning back the Senate.

Analysts argue this will pave the way to a widening range of hard-hitting measures on China, adding to the knock-on effects for EU business and forcing hard policy choices. "Everything will get more and more radical," says one business leader.

The next step, predicts Noah Barkin of consultancy Rhodium group, is likely to be a US outbound investment screening regime, and there will again be pressure for Europe to follow suit.

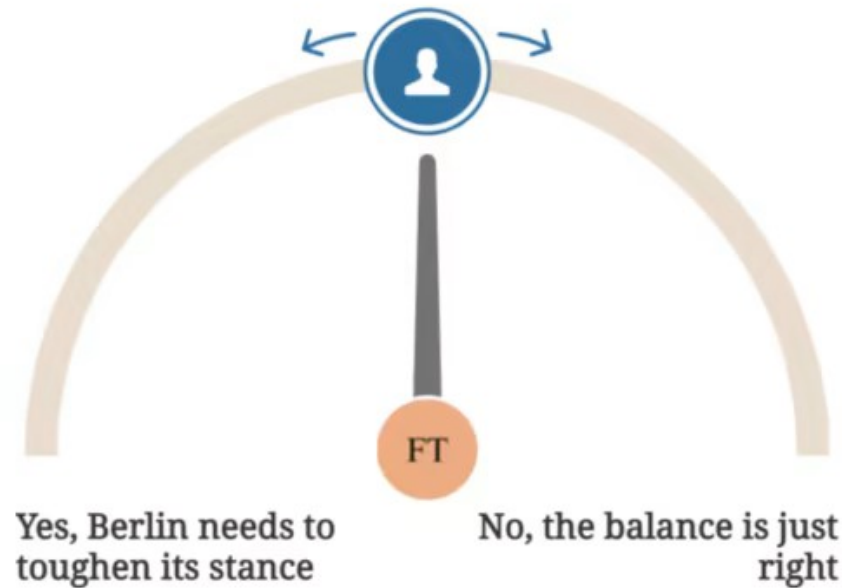
"Germany is not yet at the point where it is prepared to pay a short-term economic price for the long-term strategic goal of reduced dependence on China," he says.

"But I expect Berlin to be pushed in this direction in the years ahead, both by internal forces and by its allies abroad. There is no going back to business as usual with China, even if the signals Olaf Scholz has been sending lately suggest this is what he would

prefer.”

Does Germany need to do more to distance itself from China, or is it getting the balance right? [Take our poll.](#)

Does Germany need to do more to distance itself from China?



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