

APA POSITION

EU Economic Cooperation with Asia-Pacific Perspectives of German Business

May 2021

Content

APA Key Messages	2
I. Asia-Pacific: Region of the Future	3
II. Diversification	4
III. Rules-based Trade	6
IV. Sustainability	8
V. Innovation	10
VI. Assertive EU-China Strategy beyond Global Decoupling	11

APA Key Messages

- **Strengthen focus on a key global growth region:** To secure Europe's prosperity, it is increasingly important to participate in the high development dynamics in Asia-Pacific and to effectively represent European interests. The APA therefore calls for a common external economic policy approach of the EU and its member states.
- **Diversify economic partnerships in Asia-Pacific:** China's importance as a growth market and dominant player in the region will continue to increase. It is therefore important to broaden the focus to other growth markets in the region. The focus should be on improving frameworks through FTAs. Furthermore, the APA calls on the EU and its member states to utilize the geo-economic potential of the EU-Asia connectivity strategy and to back it up with the necessary financial resources and decision-making powers.
- **Expand dialogue with Asia-Pacific:** The German government and the EU should continue the close dialogue with Asia-Pacific. Asia occupies a key position in the fight against climate change. German business also advocates an accelerated expansion of cooperation with economic partners where common values and interests exist. This includes improving the protection of human rights, common rules on data protection or the reduction of trade restrictions and disadvantages.
- **Adopt a flexible EU trade strategy for a heterogeneous region:** As the most important growth region, Asia-Pacific will have a decisive influence on global economic governance. APA supports the active EU agenda on bilateral trade agreements in Asia but considers further steps necessary. It should stick to the goal of high standards, but also consider flexible and modular solutions.
- **Position the EU as a benchmark for sustainability:** The EU should take a global leadership role in sustainability and position itself as an attractive partner for Asia-Pacific. This applies to technologies, business models as well as emission and behavioural standards. The "European Green Deal" is the basis for achieving this goal and is supported by German business. However, swift and convincing implementation strategies are needed. This includes the unbureaucratic promotion of key innovations in the sustainability sector.
- **Develop the EU as an open and globally networked innovation centre:** The most important guarantor for an effective EU strategy in Asia-Pacific is strengthening its own competitiveness. The EU urgently needs an ambitious agenda that promotes research and development in a technology-neutral manner, increases the speed of implementation and drives the global connectivity of eco-systems forward.
- **Strengthening the integration of interests with China based on reciprocity and global convergence:** Risks for our market economy arising from economic interdependence with China and for national security must be specifically addressed. At the same time, risk mitigation measures must not lead to broad economic decoupling. The EU must confidently bring its interest in a policy "among equals" into the dialogue with the USA, Japan, Australia and other partners and, on the basis of its own position, develop ways towards long-term coexistence with China. The goal must be to increase the EU's own geo-economic capacity to act. Openness must remain a strength of the EU.

I. Asia-Pacific: Region of the Future

The year 2020 marked a historic milestone in the long-term shift of global economic power relations. For the first time since the early 19th century, Asian economies combined were larger than the rest of the world economy (measured by gross domestic product at purchasing power parity, IMF). Asia-Pacific countries are the main drivers of this development. They were responsible for about 70 percent of global economic growth in 2019 (IMF). Asia-Pacific's long-term global rise in importance was accelerated by the COVID-19 pandemic. Several Asian economies were able to cope comparatively well with the crisis and now have better forecasts for a rapid economic recovery than Europe and the United States.

To secure prosperity in Germany and Europe, it is becoming increasingly important to participate in and help shape the high development dynamics of the Asia-Pacific region. The region's share of the German economy's non-European trade in goods already exceeded 40 percent in 2019 and continues to grow. With the increasing economic importance of Asia for the German and European economy, the reduction of market access barriers in Asian countries and the creation of a level playing field will be more important than ever. This applies to China with its considerable differences in its economic system compared to the EU's open market economy, but also to other countries. Moreover, Asia-Pacific is not only the most important growth region but has also long been an important driver of innovation. For the innovation strategy of internationally oriented companies, it is becoming increasingly important to be present not only with production and sales, but also with research and development in the dynamic and technology-savvy Asian societies. Asia also plays a key role in the diversification of economic relations for greater resilience.

Parallel to the economic strengthening of Asia, the political importance of the world's most populous region is growing. Asian countries, and China in particular, are playing an increasingly important role in shaping the international order. Whether it is the further development of global trade rules, the regulation of digital global connectivity or the fight against climate change and against pandemics – effective solutions to global challenges can only be developed and implemented in dialogue with Asian states.

It is in the strategic interest of Germany and the EU to significantly increase the focus on the region. Strong economic and political partnerships with Asian countries as well as an increased presence in the region are essential to effectively shape the global future. The basis for this is a strong and globally capable EU that develops and successfully implements its own ambitious concepts for the future. The EU must continue to grow into a globally networked geo-economic heavyweight. Especially in the area of sustainability, the EU can take a global leadership role and position itself as an attractive partner for the Asia-Pacific region.

The APA welcomes the Indo-Pacific Guidelines of the German government (2020). The Indo-Pacific papers of the French (2018) and Dutch governments (2020) have also provided important impulses for the European debate on Asia. However, national strategies are not sufficient. Especially in view of the challenges posed by the emerging world power China, only a coherent EU approach can provide the necessary economic and political weight to effectively assert Europe's own interests and values. The APA therefore supports the conclusion of the Council of the EU from 19 April 2021 to develop an 'EU strategy for cooperation in the Indo-

Pacific'. With this paper the German business community wants to contribute to the further drafting of this strategy.

II. Diversification

The public debate on the Asia-Pacific region is mostly focused on China. There are good reasons for this emphasis. China is a world power with growing international ambitions and the main global growth engine. The size of the Chinese market is roughly equal to that of the rest of the Asia-Pacific countries combined. Nevertheless, it is necessary to broaden the focus when looking at the region. Diversification of sales and procurement markets makes sense and should be supported above all by an active EU free trade and foreign trade policy in the Asia-Pacific region.

Germany and the EU have a growing interest in deepening relations with partners such as Japan, Australia, New Zealand or South Korea in order to meet new challenges on the basis of democratic values and market economy rules. An important goal, for example, is a joint design of regulatory frameworks in areas such as digitalisation and data traffic or in dealing with subsidies and state-owned enterprises.

Japan

Cooperation with Japan plays a central role here. Based on the agreements concluded in 2018 (*Economic Partnership Agreement (EPA)* and *Strategic Partnership Agreement (SPA)*), this should be comprehensively expanded. Through close cooperation, the EU can also benefit from Japan's long-established position in the region. Especially with regard to infrastructure development, Japan is a valued economic partner that has held its own position against China and successfully asserted itself in some countries. Japanese products and solutions are considered in many places to be higher-priced but more sustainable alternatives in the long term. Stronger European-Japanese cooperation in the region is a self-evident goal to strive for. In this sense, the APA welcomes the 2019 *EU-Japan Partnership on Sustainable Connectivity and Quality Infrastructure*.

ASEAN

In addition to closer strategic coordination with democratic, market-based partners, it is important to position the EU strategically in leveraging new growth potential in the region. German economy regards the Asia-Pacific region as a whole and not just China as the growth market of the future. The development of additional pillars, unlocking the potential of new markets and the dissemination of solutions for sustainable development – especially in South-east and South Asia – is playing an increasingly important role. The heterogeneity in the region poses a challenge, as a closer examination of the ASEAN countries reveals. While the EU was recently able to conclude a high-quality and comprehensive free trade agreement (FTA) with Vietnam, and Singapore has long been established as a reliable economic and political partner in the region, cooperation with other countries in the community faces varying obstacles. The recent military coup in Myanmar serves as an example alongside political unrest in Thailand or the ongoing political crisis in Malaysia. With the EU's foreign and trade policy, the aim must be to manage the balancing act of addressing problems openly and tackling them in partnership without sliding into a spiral of accusations and sanctions.

In the sense of a rational geo-economic strategy, the EU should nevertheless place a special focus on deepening relations with ASEAN. This is not only due to the growing economic importance of individual members – for example, the growing importance of Vietnam as a production location, or the market potential of Indonesia, the most populous member state. Rather, ASEAN's political importance for the shaping of regional institutional frameworks is also growing. The APA therefore welcomes the official elevation of the EU-ASEAN relationship to a strategic partnership in December 2020, which provides both sides with a new basis for comprehensive *region-to-region* cooperation.

India

Relations with India should also be a focus of an EU-Asia strategy. India has great political and economic weight and therefore offers great potential both as a political and an economic partner of the EU. India's challenges in shaping sustainable development offer many approaches for economic and technological cooperation. However, in order to realise the potential for deepening economic cooperation with India, further economic reforms, a general improvement of the framework conditions in India and trade facilitation for exports to India are indispensable. The pronounced domestic orientation of Indian politics makes approaches towards more cooperation at the international level difficult. Nevertheless – or precisely because of this – the EU should actively continue the dialogue. Both sides should define the space for a deepening of relations based on mutual interests. The resumption of negotiations for a trade agreement decided in May is a good step in this direction.

→ **Market-based diversification of investments:** Due to the trade conflict between the USA and China – and made more pressing by the effects of the COVID-19 pandemic – discussions about improved risk management of German and European companies in the region have gained momentum in politics and business. A much-discussed collapse of international supply chains is not backed by real developments on the ground. An OECD study presented in November 2020 underlined that the international integration of value chains had a stabilising effect during the COVID-19 pandemic.

Regarding China, it can be stated: The absolute majority – around 70 percent – of German companies in China produce for the Chinese market and not for export. Relocating production out of China is therefore only an option for a very small number of companies. The importance of the Chinese market for the German economy is increasing rather than decreasing. A diversification strategy should therefore not aim at relocating production out of China, but at expanding activities. The focus should be on improving framework conditions through FTAs (see Chapter IV).

→ **Bringing the "EU-Asia Connectivity Strategy" to life:** The connectivity strategy presented by the EU Commission in September 2018 aims to expand transport, energy and digital infrastructure on the Eurasian continent. From the APA's perspective, it should play a central role in increasing the EU's presence in the region. The strategy rightly makes fair competition, openness, transparency, social, environmental and financial sustainability as well as local value creation a precondition for projects. European businesses, oriented towards high quality standards, can contribute to achieving these goals. However, the geo-economic potential of the strategy remains untapped so far. What is needed above all is a solid financial underpinning of the strategy. The APA pleads for a separate EU budget title for connectivity projects. Through coherent coordination between the EU Commission

and member states, direct EU project funds and their allocation, especially via the EIB, could be dovetailed with project funds from the member states' development banks, thus multiplying their impact. Public-private partnerships could provide additional impetus. Furthermore, there is a need for a clear definition of strategic focus objectives, close interlocking with related EU programmes, and a central and high-level coordinating body within the EU institutions to which companies from the member states can turn.

The strategy also needs to be better promoted. Partner countries outside the EU should know what they can expect and to what extent. Targeted political support by the member states is indispensable for effective implementation. The German and European economy is waiting to be able to contribute its expertise in the sustainability of infrastructure and digital projects to a powerful and comprehensive EU strategy. Targeted connectivity partnerships could help drive its implementation. The connectivity partnership with Japan should play a pioneering role here. To this end, the EU together with Japan must quickly launch concrete joint lighthouse projects by companies in the fields of sustainability or digitalisation. In addition to Japan, the USA, Australia, South Korea and India could also be partners.

III. Rule-based Trade

The multilateral trade order is in a deep crisis. Not only has a comprehensive reform of the World Trade Organisation (WTO) not been achieved for years. The WTO's role as the central settlement body for international trade disputes has also been severely damaged by the US obstruction of the now dysfunctional WTO Appellate Body. As a result, the importance of bi- and plurilateral FTAs has greatly increased.

The future of global trade rules will be significantly shaped by the Asia-Pacific region as the most important growth area. The conclusion of RCEP in November 2020 underscored the importance of the region, and of China in particular, in shaping global trade. With a population of 2.3 billion people and accounting for 30 percent of global economic output, RCEP is one of the most relevant FTAs in the world. But compared to modern EU trade agreements, the agreement shows major gaps. For example, it has no sustainability chapter – neither on labour standards nor on environmental protection. The impact of subsidies and state-owned enterprises on trade is not covered. Especially due to harmonised rules of origin, RCEP is nevertheless a significant step for regional economic integration. As a result, trade between RCEP members could increase and trade with non-members could decrease. European exporters must expect a relative deterioration in market access to the region and trade diversion effects, especially vis-à-vis Japanese, South Korean and Chinese competitors. With RCEP, competitive pressure on the EU as a location increases.

For the EU and for the United States, RCEP is a wake-up call. Both are currently not effectively involved in regional governance of the key growth region. The EU has successfully pursued a very active and ambitious trade policy in the region in recent years and has been able to conclude several comprehensive bilateral FTAs with high standards. The APA supports the EU's trade policy approach in Asia. However, we believe that new impetus is needed to successfully assert our own values and interests in shaping the global trade order.

→ **Shape international cooperation at the multilateral and plurilateral level in a flexible and issue-based manner:** For German business, strengthening and modernising the multilateral trading system is a key concern. The EU should continue to work vigorously towards a reform of the WTO. The priority must be to restore the functioning of the Appellate Body and, until then, to have a functioning replacement mechanism. An update of the WTO subsidy rules is just as important as a conclusion of the negotiations on illegal fisheries subsidies, where India and China have so far put the brakes on. Negotiations on WTO e-commerce, environmental goods, health goods, as well as investment facilitation and small and medium-sized enterprises should also move forward quickly. Finally, accession of China and other Asian countries to the WTO Agreement on Government Procurement remains important. Here, China needs to further improve its latest offer. The multilateral process can be a cornerstone for permanently regulating competition with China in the sense of a level playing field. For this, the open market economies must pursue a common approach and enter a constructive dialogue with China and other WTO members.

More efforts are also needed below the multilateral level. In areas where international rules and standards are still being developed, the EU should remain flexible. These issues currently include artificial intelligence, cybersecurity, digital trade and data flows. Wherever overlapping interests in these areas allow, negotiated solutions should be found with China to counteract global technological fragmentation. Where this is not the case, the EU should pursue its interests in the broadest possible alliance of like-minded partners.

→ **Seek regional agreement with Asia-Pacific:** In recent years, the EU has concluded a whole series of bilateral agreements with Asian partners such as South Korea, Japan, Singapore and Vietnam. Further agreements, for example with Australia, New Zealand or Indonesia, are currently being negotiated. German business supports the EU's active bilateral FTA agenda in Asia. In addition, it should be examined whether regional agreements along the lines of RCEP are a possible way forward. The EU should stick to the goal of high standards agreed in partnership. However, in order to achieve free trade agreements with as many trading partners as possible, more flexible and modular solutions could be sought in the future. For example, in its negotiations the EU could rely more on flexible transition periods or a gradual entry into force of individual modules.

→ **Seek a fresh start for a transatlantic cooperation agenda as a counterweight to RCEP:** The United States, with its exit from TPP, and both economic blocs, United States and EU, with the failure of TTIP, have missed great opportunities to create economic alliances. RCEP will create an Asian market with low to no tariffs and harmonised rules of origin. This free trade area is far superior to the United States' Mexico Canada Agreement on Trade (USMCA) or the EU – not in terms of depth of regulation, but in economic potential. A reorganisation of transatlantic economic cooperation would be an important counterweight.

→ **Close gaps in defensive economic policy instruments while avoiding isolation:** The EU needs balanced and effective instruments to increase the resilience of the market economy towards market distortions brought into the Single Market from outside. Regarding trade, the EU has already made an important regulatory adjustment with the reform of the basic anti-dumping regulation in 2017. In the future, too, the trade protection instruments should be constantly reviewed and adapted as needed. In addition, multilateral efforts to reduce subsidies are still needed. Outside of trade in goods, major regulatory gaps

still exist. The European Commission's legislative proposal for a new competition law instrument to deal with subsidies from non-EU countries, published in May 2021, indicates a way of taking more decisive action against market distortions caused by foreign subsidies in the case of takeovers, public tenders and other economic investments of a certain size. It is important that the instrument is coherent with other legal acts and instruments, and that new bureaucratic burdens, costs and risks for EU companies remain strictly limited. German business also supports the European International Procurement Instrument (IPI) and the principle of reciprocity in public procurement enshrined therein. However, it should not impose additional burdens on EU companies when bidding for public contracts in the EU.

IV. Sustainability

Even in times of the COVID-19 pandemic, the sustainable transformation of the global economy remains the central challenge of our time. The economic, social and ecological consequences of dragging this out would be devastating.

Asia faces particularly great ecological and social challenges due to its high development dynamics. Not only in China, but also in India and many countries in Southeast Asia, the environmental and social issues are complex. Meanwhile, the industrialised countries in and outside the Asia-Pacific region must acknowledge their historic contribution to climate change and press ahead with the transformation of their industries as quickly as possible.

At the same time, consumers are rightly demanding more and more vigorously that companies keep the ecological and social dimensions of sustainability in mind when producing and providing their products and services. The expectation not only of political but also of economic actors is increasingly to counter autocratic tendencies. Compliance with human rights and labour standards are part of the self-understanding of business in the 21st century. Companies' own guidelines on *corporate social responsibility* are continuously reviewed and their implementation is subject to ever closer monitoring.

Withdrawing from certain markets would be just as ineffective as blindly hoping for automatic fulfilment of the dictum "change through trade". What is needed is active co-creation and a self-confident insistence on rules for ecological and social sustainability. Germany and the EU should offer solutions to the existing challenges and at the same time push for compliance with internationally recognised social and ecological standards and goals. Successful sustainability concepts make European business attractive as a partner for Asia. A clear policy framework for social sustainability is essential to guide companies in their engagement in the region.

→ **Implement the European Green Deal forcefully and pragmatically:** With a modern EU industrial strategy that includes clear targets, predictability and targeted research and innovation funding to develop future technologies, the European Green Deal could give European companies a unique competitive advantage. With a successful climate policy, the EU can take a global leadership role and offer itself as a sustainable development partner for Asia. European companies are at the forefront of environmental and resource-efficient production.

Cooperation with partners in the region can further strengthen this lighthouse character – one example could be the envisaged German hydrogen cooperation with Australia. The SPA with Japan also offers a good platform for targeted technology cooperation to promote environmental sustainability. In order to prevent *carbon leakage* – i.e. a shift of CO₂ emissions to countries with lower climate protection requirements – the EU's commitment to the implementation of international climate targets in Asia-Pacific is of central importance. Duty-free access to the EU's large internal market remains attractive for many countries in Asia-Pacific, but it should be linked to rules on the pursuit of high sustainability standards.

- **Positioning the EU as a global "green champion":** The EU has a serious problem in marketing itself in terms of sustainability. International partners often perceive European climate policy as overambitious, compartmentalized and unrealistic, and feel that their development potential is limited by the inclusion of sustainability clauses in trade agreements. On the other hand, the EU itself sometimes finds it difficult to conclude ambitious FTAs with value partners due to internal interests – for example in the case of New Zealand, whose offer in some areas is even going beyond the EU's demands in the current negotiations. What is needed is a consistent and coherent policy at the EU level, which the German government must also advocate. Setting ambitious targets is not enough. The EU must distinguish itself internationally above all by implementing the goals in a technologically, economically and socially acceptable way. The "European Green Deal" is the basis for this and is supported by the business community.
- **Determined commitment to human rights:** For German business, the universality of human rights is non-negotiable. The definition of a dignified life is not culture-specific in its basic features. It applies worldwide. According to Article 23 of the Universal Declaration of Human Rights, the right to choose one's occupation freely and to work in satisfactory conditions is part of one's inherent dignity, regardless of religion or ethnic origin. This results in the clear commitment of German business to take action against forced labour and to exclude it from its immediate suppliers as well. German and European policymakers can therefore be sure of the full support of German business where they clearly address violations of international labour standards and demand the ratification or consistent implementation of the relevant ILO conventions. This support also applies to political action against restrictions on other inalienable rights, such as freedom of expression, freedom of the press and the right of assembly.
- **Feasible supply chain due diligence laws:** For German business, the need for a responsible design of global supply chains and respect for human rights is self-evident. For this reason, globally active companies in particular have international *codes of conduct* and supplier contracts to implement the UN Guiding Principles on Business and Human Rights, in which they commit themselves and their partners to respecting human rights. The companies take on these obligations in their own interest and adhere to processes developed for this purpose in order to verify compliance. The international activities of German companies contribute to higher standards of labour protection and workers' rights and a better level of education and training.

An EU supply chain law must realistically measure the due diligence obligations of companies and make them practical and SME-friendly. Existing certificates for compliance with social standards and human rights must be sufficiently considered but should not serve as the exclusive basis for due diligence obligations. German business argues for a limited

scope of application (e.g. to directly verifiable suppliers), a high threshold and support measures for affected SMEs. Civil liability for third parties who are not in the direct sphere of influence of the companies must be excluded. A supply chain law must not impose obligations on business that even EU governments have been unable to enforce in agreements with other states for several years.

- **Vocational education and training as a contribution to economic and social sustainability:** The promotion of vocational education and training is a low-threshold factor for securing livelihoods, increasing and maintaining quality of life and equal opportunities for many people. At the same time, it offers the possibility of social and economic participation for people in disadvantaged regions within the framework of further education and lifelong learning concepts. Vocational education and training are decisive drivers for the application and implementation of innovations in the economy and society and should therefore be an integral part of an EU-Asia strategy. The German business community, including the German Chambers of Commerce Abroad, is ready to contribute its decades of experience in vocational education and training to enhanced cooperation with Asia-Pacific.

V. Innovation

While some Asian countries have long been established as successful locations of innovation – such as Japan, South Korea or Singapore – the impression that the innovative capacity of economies across the region is rapidly increasing has been growing in recent years. Despite some deficits in the area of digitalisation, in global comparison Germany and Europe are still strong regarding research and development. Germany ranks fourth in the global ranking of the Innovation Indicator by BDI, Fraunhofer ISI and ZEW. At second place, Singapore is the only Asian country in the top 10, which are dominated primarily by European countries. China has only climbed three ranks since 2000, from 29 to 26. Nevertheless, challenges such as the management of megacities and the environmental impact of transport and industrial production put pressure on the countries of the region to act, which contributes to local innovation dynamics. Those who want to be global market leaders must also be active with research and development in the dynamic Asia-Pacific region.

While digitalisation opens up global opportunities, the APA observes with concern the creation of barriers between the digital ecosystems of the large economies China and the United States. Therefore, the effects of decoupling tendencies on supply chains and R&D systems must be limited and reversed. The flexibility of international companies to adapt to decoupled standards, suppliers and production locations is limited and the damage to European economies would be enormous. Developing Europe as an innovation hub in the race for tomorrow's solutions is as important as strengthening international cooperation.

- **Strengthen own innovative power:** In a free market economy, the state should not relieve companies of entrepreneurial risks. However, an ambitious EU agenda that promotes technology-open research and development in the member states together with powerful instruments for transferring innovations into the economy remains an important vehicle for maintaining our innovative strength and competitiveness. The European economy needs frameworks that enable flexibility, creativity and speed. This includes agile instruments

such as *regulatory sandboxes* or living labs, thematically open research funding programmes that are easily accessible to small and medium-sized enterprises, more investment in (digital) education, the determined promotion of key technologies, the better integration of business and science, the reduction of bureaucracy in funding applications, the provision of sufficient risk and growth capital, a modern and internationally oriented data policy and the guarantee of data security.

- **Keep a seat at the table of the global debate on digital standards:** With the GDPR, the EU has proven its regulatory clout despite all the criticism. Influencing global norms, laws and standards according to European security interests, values and a strong focus on the protection of individual data remains in the strategic interest of the EU, especially with regard to the technologies of the future (e.g. AI, 5G, cloud computing). The recent EU White Paper on Artificial Intelligence points in the right direction and must be implemented quickly. Overall, it is important to minimise the negative effects of the drifting apart of norms and standards between the leading economies. Discussions with the governments of the United States, China and emerging economies from Asia-Pacific on the design of digital infrastructures should be intensified.
- **Expand research and development cooperation with Asia-Pacific while also keeping an eye on risks:** European universities, research institutions and companies have a strong interest in expanding their activities in the dynamic Asia-Pacific region. Politics, research, business and culture in the EU also need more Asia proficiency. The APA recommends expanding exchange programmes with Asia-Pacific in science and education and at the same time intensifying the exchange of experience in the EU on positive and negative experiences of R&D cooperation with Asia-Pacific. Coherent EU approaches to R&D cooperation should take precedence over national programmes in the member states. Cooperation should be scaled back where there is a strong negative experience with regard to technology protection.

VI. Assertive EU-China Strategy beyond Global Decoupling

Economic relations with China are of particular importance in the EU's strategic positioning vis-à-vis the Asia-Pacific region. This is true not only because of China's enormous economic size and dynamism. Rather, a new global competition between democratic market economies and China's party-state controlled hybrid economy requires a coordinated interdepartmental European approach, which should also be explicitly reflected in an Asia strategy of the EU.

China's system converges neither politically nor economically with the principles and values of democratic market economies. State-induced market distortions are increasingly having an impact in the EU's internal market and in third markets. Moreover, China increasingly shapes other markets, international institutions and global economic, technological and political norms according to its own interests and values, which often do not coincide with those of the EU.

EU China Strategy

The APA takes a positive view of the EU Commission's China strategy of March 2019, according to which China is simultaneously a cooperation and negotiation partner, an economic competitor and a systemic rival. Instead of relying on comprehensive disengagement and

confrontation on the one hand or the closest possible conflict-averse partnership on the other, the EU is taking the path of a differentiated strategy with the "Communication of the European Commission on China". The complex relations with China require a balanced, multi-pronged approach.

On the one hand, the risks and disadvantages that result from close economic and technological integration with China for the functioning of market economy processes and for national security must be taken seriously. These must be addressed in a targeted manner and long-term EU interests and values must be confidently ascertained vis-à-vis China. For only through effective risk management can the close economic relationship with China be led into a sustainable future despite the systemic differences.

At the same time, existing risks must not call into question the entire economic cooperation with China. China remains a crucial growth market and innovation driver. Broad economic decoupling is not in the EU's interest. Dependence is not a weakness if it is mutual. Mutual dependence can contribute to the stability of our relations. Moreover, despite all differences on key issues such as climate protection or the reform of the WTO, the EU is only making progress with and not against Beijing.

Today's coexistence of different systems will remain. Cooperation, competition and confrontation must be balanced, and coexistence must be responsibly shaped and constantly recalibrated. German business also bears responsibility regarding the effects of its engagement. In shaping this coexistence, the EU should work closely with other democratic market economies – especially the United States and those in Asia.

Global decoupling

The conflict between the United States and China increasingly raises the question of whether the world's two largest economies are heading for a comprehensive decoupling, ushering in a new era of de-globalisation marked by political and geo-economic rivalry. Growing divergences in technology standards and data regulation rules in the United States, China and the EU are fragmenting global technology markets and are increasing pressure on companies to localise. European companies are increasingly caught in the crossfire of security policy measures that affect technological value chains. Rising costs due to duplicated structures in supply chains, data storage and research and development as well as declining economies of scale threaten the business model of export-oriented German SMEs in particular.

The U.S. government has been pushing decoupling through unilateral and extraterritorial measures over the past two years. However, the United States is responding to China's continued selective market opening, non-tariff trade barriers, state-led distortions of competition, the strengthening of party structures and political control in the Chinese economy, a pronounced economic nationalism and resulting competitive distortions in global markets. During the COVID-19 pandemic and the conflict with the United States, Beijing has once again significantly strengthened its industrial policy ambitions for economic and technological independence under the catchword "*dual circulation*". In addition, Beijing is increasingly creating its own set of instruments for unilateral and extraterritorial measures.

The EU has an overriding interest in preventing widespread technological and economic decoupling. The global interconnectedness of the European economy is one of its greatest strengths. The EU is not alone in this interest. The countries of the Asia-Pacific region also want to avoid a situation where they would have to choose between two economic and technological spheres led by the United States and China. The EU should confidently bring its fundamental interest in a balanced approach that does not rely on comprehensive global decoupling and bloc formation into the dialogue with the United States and other partners. The stronger and the more united the EU is, the more successful it will be.

The EU should seize the opportunity to act as a moderating power and, together with the United States and partners such as Japan and Australia, actively develop strategies for a path towards long-term coexistence with China. A common definition of security-sensitive areas as well as common negotiating positions for a dialogue with China would counteract global technological fragmentation. The EU can thus help to ensure that the confrontation between the United States and China does not become a threat to globalisation.

In this sense, the concept of "open strategic autonomy" put forward by the Commission should be interpreted neither as a rejection of global networking nor as a turning away from the traditional transatlantic partnership based on shared values. The goal should be to increase the EU's own geo-economic capacity to act. Openness must remain a strength of the EU. The EU must show more presence internationally, not less.

- ➔ **Be united and confident vis-à-vis China:** No EU member state can meet the challenges posed by China alone. Only a strong and united Europe can provide answers. German business supports a unified EU strategy, EU-wide policy approaches and more EU instruments. The goal should be to significantly increase the EU's strategic and economic policy capacity to act. Indispensable elements of this are a strengthening of the industrial base, great innovative strength as well as security and defence policy capabilities. In order to achieve unity in the EU, interests within the Union must also be balanced. This expressly implies Germany's willingness to put up existing positions for negotiation to a reasonable extent in the European framework and to orient them towards a maximum overall benefit for the EU's internal market. This also includes all EU member states phasing out their individual parallel diplomacy with China where it weakens EU positions. The EU should translate its economic strength into political self-confidence and demand a "One Europe" policy from China.
- ➔ **Vigorously implement the agenda to strengthen the EU as a business location:** The most important guarantor for an effective EU strategy vis-à-vis China is strengthening its own position. If Germany and the EU want to continue to compete with the emerging global power China in the future, the EU's innovative capacity must be increased through an ambitious modern industrial policy. Only as a strong global driver of innovation the EU will be in a position to interact with China in a self-determined manner. In doing so, EU institutions and member states should not follow the dirigiste approach of Chinese industrial policy but try to make greater use of the efficiency advantages of the market economy. Key demands of the business community are the expansion of digital and other infrastructures, an ambitious expansion of European research and innovation funding, faster procedures for the approval of investment projects, investments in education and, above all, a genuine deepening of the Single Market – for digital, energy and services. The EU

should place special focus on the issue of sustainability. A boost in innovation around a European Green Deal would not only allow us to negotiate with China from a position of strength but would also provide a basis for confidently demanding the necessary cooperation from China to combat climate change.

- **Embed CAI in comprehensive China agenda:** The Comprehensive Agreement on Investment (CAI) agreed between the EU Commission and the Chinese government at the end of 2020 contains several important advances. Overall, the APA assesses the agreement positively as one element of an overall strategy. However, it does not provide a completely level playing field, symmetrical market access and has clear deficits in the areas of sustainability and workers' fundamental rights. Therefore, the EU must keep up the pressure on China to achieve these goals. The APA insists on further substantial concessions on market access, economic reforms to strengthen market principles, the transformation of China's industry and energy supply towards greater sustainability, and the implementation of internationally recognised workers' rights, including the ban on forced labour. Overall, the CAI shows that the bilateral negotiation track is only part of the solution. The EU must focus in parallel on international cooperation in a multilateral framework, on effective plurilateral coordination with like-minded partners, and on the expansion of unilateral instruments.
- **Clearly define national security risks in economic relations:** German business recognises the national security risks posed by China's party-state-led hybrid economy. The EU must build up its capabilities to minimise risks. However, the areas where actual threats to national security and public order exist must be defined as clearly as possible. The steady extension of the concept of national security to more and more areas of economic activity is a global phenomenon, driven in particular by China and the United States. The EU should counteract this trend by establishing as clear, narrowly defined and EU-wide uniform rules as possible in investment audits, critical infrastructure protection and in export control.
- **Coordinate China agenda with partners:** All democratic market economies are in the same boat when competing with China's party-state controlled hybrid economy. Close coordination with the United States, Japan, Australia, South Korea and other partners would improve the negotiating position vis-à-vis China, for example on climate change or in dealing with subsidies and state-owned enterprises. Greater coordination of unilateral measures such as investment audits, export control measures, sanctions instruments, or economic policy defensive instruments would also help minimise the adverse effects of China's hybrid economic system. In particular, common digital standards would be a significant step in competition with China.
- **Protect EU companies from political pressure from abroad:** EU companies are already affected in a multitude of ways by U.S. export control and sanction measures against third countries. In expanding its export control regime, China, like the United States, is now focusing on the broadest possible extraterritorial effect and a comprehensive definition of national security. Of particular concern are regulatory developments in China that could put EU companies in the position of being unable to comply with Chinese and U.S. law simultaneously. The EU should make clear to both partners its reservations on measures with extraterritorial effect. A new instrument against coercive measures by third countries announced by the EU Commission could improve the position of EU companies.

In addition to formal export control or sanction measures, there is also an increased risk of informal or indirect coercive measures with regard to China. Political differences between China and democratic states are not new. However, the points of friction have not only increased sharply in recent years, but they are also having an increasingly significant impact on economic relations. China has demonstrated several times in the recent past that it is willing to put pressure on individual foreign companies or economic sectors in order to achieve foreign policy goals. The APA calls on EU member states to send unconditional signals of solidarity in such cases. The Chinese government must be aware that measures against individual member states always have an impact on the overall relationship with the EU.

- **Openly address and actively defend liberal-democratic values vis-à-vis China:** Political issues (e.g. treatment of minorities, Taiwan, Hong Kong) have an ever-greater influence on German companies with business in China. Within the scope of their options, companies advocate for responsible conduct on the ground. The APA and its member associations also raise political issues such as the human rights situation in China directly with Chinese politicians. In addition, German business supports a clear commitment by the EU and its member states to the protection of universal human rights. In demanding higher human rights standards in China and other third markets, business is dependent on clear political guidelines and support from the EU and its member states. Politicians must not shift the burden of solving political problems onto business.
- **Make national exchange on and with China more European:** Business and politics should exchange even more on China at the European level. Furthermore, the exchange with China should also be Europeanised. National dialogue formats with China should gradually provide pragmatic impulses for Europeanisation. The German government could, for example, embed the German-Chinese government consultations or business delegations to the region more firmly in the pan-European context.

About APA

The Asia-Pacific Committee of German Business is building bridges between German companies doing business in Asia and politics in Germany as well as in our Asian partner countries. The APA pools the economic concerns of German businesses active in the Asia-Pacific region and strives for more intense cooperation with Asia-Pacific and helps promoting trade and investment in both directions. The APA is an initiative of the Federation of German Industries (BDI), the Association of German Chambers of Industry and Commerce (DIHK), the German Asia-Pacific Business Association (OAV), the Federation of German Wholesale, Foreign Trade and Services (BGA) and the Association of German Banks (Bankenverband). Since February 2019 it is chaired by Joe Kaeser, Chairman of the Supervisory Board of Siemens Energy AG