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Europe in Competition with China and the US: More Strategic Autonomy, but Not More Autarky!

Europe's share of the global economy may be declining, but the EU remains a major economic power with strong ties to the rest of the world. If its pursuit of strategic autonomy devolves into a push for protectionism or even autarky, it risks losing that status – and becoming more vulnerable than ever.

When it comes to economic growth, Europe has been lagging behind the world's other major economic powers – the United States and China – for some time. No surprise, then, that the old continent's relative weight in the global economy is declining fast. How vulnerable does this leave the European Union – and what should EU leaders do about it?

When the Iron Curtain fell in 1989, the countries that comprise today's EU, plus the United Kingdom, accounted for 27.8% of global GDP (in terms of purchasing power parity). For the US, that share was 22.2%. China, with a share of 4%, still hardly registered as an economic power.

Thirty years later, the EU, together with the UK, accounted for 16% of global output, still slightly ahead of America's 15%. The big shift was in China's position, which had surpassed its Western counterparts with a share of 18.3%.

Europe Falls Further Behind

The COVID-19 pandemic is set to accelerate these trends. Despite a brief recession, the US is on track to surpass pre-crisis output levels as early as this year. More impressive, China's economic output could be 10% higher in 2021 than in 2019. The EU, by contrast, will not return to pre-pandemic GDP levels until 2022 at the earliest.

In principle, the robust recovery in China and the US is good news for Europe: industry in the EU, especially in Germany, is benefiting from strong demand from the world's two largest economies. Nonetheless, Europe's diminishing economic weight relative to the US and China raises serious questions about its ability to defend and advance its core interests.

Already, many fear that EU countries are being forced to make risky compromises. For example, Chinese investors have been buying up companies in Europe and even taking over critical infrastructure, such as ports, in countries like Belgium, Greece, and Spain. Germany has been accused of being slow to condemn Chinese human-rights abuses, in an apparent bid to protect its economic interests.

Who Is Dependent on Whom?

Europ's dependence on the US – particularly in security matters – has of course been viewed less critically. Yet, as former US President Donald Trump made clear, this also carries significant risks. And, indeed, calls for Europe to increase its "strategic autonomy" – that is, to reduce its dependence on outside powers – have been growing louder.

But all dependencies are not created equal; only those that are one-sided are truly problematic. Identifying which of the EU's economic dependencies fit into that category will require more careful analysis than has so far been carried out.

For starters, in international trade, is the importer dependent on the exporter, or vice versa? For goods and services with large fixed costs and high margins, the seller's dependence on market access is greater than for goods with lower margins. Importers are more dependent on supplies from a particular country if the goods are essential and difficult to obtain elsewhere.

In 2020, the EU (excluding the UK) imported €383 billion ($468 billion) worth of goods from China – more than from any other country – and exported €203 billion worth of goods to China. We don't know which partner earns higher margins or can substitute imported goods more easily. But the volume of trade in both directions suggests that there is considerable interdependence – certainly enough to provide some protection against aggressive trade policies.

The same is true with the US. When Trump threatened to impose tariffs on goods from the EU to address America's bilateral merchandise-trade deficit, Europeans pointed out that the US had a similarly sized surplus in services and primary income (for example, from licensing). And those US exports had high margins. With US companies highly dependent on the European market, the US could not have won a trade war with the EU. That's probably a major reason why Trump ultimately didn't pursue one.

Dependencies can also arise from cross-border investment. But here, too, it can be difficult to determine which side is better off.

Overall, European companies invest much more in China than Chinese companies invest in Europe, despite stricter regulations. The main concerns, it seems, relate to the *types* of investments Chinese companies are making in Europe.

If Chinese investors buy a European port company, have Europeans become dependent on China? Not necessarily. On the contrary, given the vital importance of port facilities, it is relatively easy for a national government to bring them under its control, or even to expropriate them, if the operators are deemed to be in breach of their duty to run it properly.

Technological dependencies raise further questions. For example, does Chinese companies' participation in building telecommunications infrastructure, such as 5G networks, create serious risks for the EU? Again, the answers are not cut and dried, not least because they may depend on factors, such as political influence, that are opaque and difficult to control.

Protectionism Is the Wrong Path for Europe

There is no doubt that excessive dependence can carry risks. So, in principle, the EU is right to strengthen its strategic autonomy. But, rather than rely on simplistic assumptions, it should carry out a comprehensive analysis of its economic relationships and the associated mutual dependencies, to identify which need to be reduced.

The EU must also consider carefully its options for doing so. Engaging less might not be the solution. In fact, Europe might balance the scales – or even tip them in its favor – by deepening ties. For example, promoting Chinese investment in Europe could help to reduce European investors' disadvantages in China by giving the EU more leverage.

Europe's share of the global economy may be declining, but the EU remains a major economic power with strong ties to the rest of the world. If its pursuit of strategic autonomy devolves into a push for protectionism or even autarky, it risks losing that status. If that happens, Europe really would be vulnerable.

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