

# A GAME OF JENGA WITH EUROPEAN INDUSTRY

THE STRATEGIC VALUE OF DUTCH INDUSTRY IN A GLOBAL CONTEXT



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# **A GAME OF JENGA WITH EUROPEAN INDUSTRY**

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CONTEXT

# ABSTRACT

This paper explores the external competitive pressures on EU industry. The orientation of the EU on open international markets as a resource-poor group of countries was based on the idea that everything could be bought on depoliticized international markets, and that the EU market was large enough to exert sufficient buying power to comply with the ever-growing body of EU rules and regulations. This is a stark difference from China's strategic approach to manage its import dependencies and the protection of its domestic market.

Much attention is focussed on the United States and the (impending) trade measures of the Trump Administration, but the export of Chinese domestic economic problems to world markets may be a more important issue to tackle. China has developed large overcapacities in many manufactured products, while domestic demand remains subdued. Ideally, economies will adapt to new fundamentals in an orderly fashion, but the reality is that the emergence of reforms is usually quite disorderly.

The EU has adopted an institutionalised short-term view on the economy and a belief that its soft and regulatory powers can be used to discipline the rest of the world into following its route to climate neutrality. However, the EU has come under increasing pressure from geopolitical and economic moves by the US and China, as well as by the larger emerging economies that comprise the BRICS-group. Trade agreement partners can be used for reshoring practises that do not play by the rules. For instance, China is engaged in practises to secure the best mineral ores for its smelters, reducing the competitiveness of smelters elsewhere and maintain a firm grip on critical minerals. The higher energy costs in the EU (and the Netherlands) are another worrisome factor in the uneven playing field in the EU.

The Trump Administration's trade policy should be seen as a geopolitical instrument to redress both international political and economic imbalances. China has failed to comply with the mores of the multilateral system. Instead, it has played its own game with its own rules. With the long growth spurt coming to an end, China may be challenged by the US, and maybe others, to comply and restructure its economy. The EU is exposed to this US-China battle, while the avenues to prevent EU industry from becoming collateral damage in this conflict may be limited. Both the US and the EU have become structurally dependent on certain Chinese supply lines, and it will take time to diversify these.

EU industry is confronted with the shock of structurally higher energy costs compared to those of producers elsewhere and is now dealing with the potential absorption of

Chinese oversupply in many products due to its open markets. Moreover, the EU may also encounter US trade policies, while Dutch industry also must grapple with an uneven playing field in the EU due to national policymaking.

The Draghi report pinpointed the ailments of the EU economy as the result of lower productivity (compared to the US), a lack of innovation (tech (US) and clean tech (China)), insufficient risk capital, and energy costs. The EU energy transition is, foremost, a so-called 'brownfield' transition and not a 'greenfield' transition, where current local industrial ecosystems play an important role. The EU may also simply lack the institutional make-up to organise an attractive economic climate for industry, despite its newly communicated competitiveness compass, while its policies limit or complicate the member states' ability to create such an environment for its industry. The renewed focus on security also repositions the importance of oil refineries, particularly those that are connected to the NATO pipeline system to deliver the needed fuel for tanks, trucks and planes. Strategic liquid fuel storage is also an important part of this value chain and the ability to quickly send out fuel to where it is needed. Ports that fulfil a function in the defence supply lines will have to maintain their capacities and, perhaps, expand them for future use. The same applies to steel, mineral processing, a wide variety of chemicals, and large and small manufacturing industry, needed for the energy transition and security-related industries.

In addition to coal, oil and natural gas, steel, mineral processing and certain chemical products also fall within the dependencies in the energy-intensive supply chains. The integration of chemicals, steel or other minerals into many other manufacturing sectors and end-products, as well as the importance of understanding the economics of co-production, are often underappreciated in discussions on strategic industries or, perhaps, better strategic industrial ecosystems where knowledge intense labour is at stake.

In the Netherlands, apart from the energy crisis in the EU, energy costs increased due to national policy choices and measures, such as the national CO<sub>2</sub> tax and network costs. Energy costs for industry in the Netherlands are substantially higher than in the surrounding member states. This uneven playing field in the EU is already problematic and comes on top of the growing competitive gap between EU industries and industries in the US, China and, potentially, other countries.

The locational benefits of Dutch industries, the deep integration of basic industries with a wide variety of other industries further down the value chain, infrastructure connecting the wider NW European industrial ecosystem, and technological competence should be supported by a healthy investment climate in the new geopolitical and international economic climate. Many of the basic industries are important for the energy transition, for small and medium sized companies, for strategic autonomy and for national security.

The Draghi report is focussed largely on longer-term structural internal ailments of the EU economy, innovation, and energy sector. However, urgent short-term matters are also arising in redressing the external imbalances to gain time for the policy reforms needed here. The window of opportunity to maintain the most important parts of the EU industrial base is shorter than the proposed remedies in the Draghi report imply. Once disinvestments start, the solid looking Jenga tower will weaken and instigate other disinvestments, causing industrial ecosystems to unravel and collapse. The priority should be to make the EU and the Netherlands attractive for investments again.

Apart from the inter-EU policy competition and the impact on the uneven playing field for Dutch industry (energy costs and taxation), EU de-industrialisation may also occur due to higher energy costs compared to those of China and the US, the relatively small scale of EU industries compared to newer facilities in China, India and/or the Middle East, the lack of demand for low-carbon intermediates and final products, and the impact on innovation (attrition) due to lower demand in general in the downstream part of the various value chains. They add up to a critical combination of weaknesses in the international arena.

The result of the various pressures on EU industry and Dutch industry is that vital (semi-finished) products for the energy transition, health and consumer goods – of which the EU is now a producer – may be imported in future. Moreover, the deep industrial integration of the various EU and Dutch value chains may become imbalanced and reduce the robustness of the European and Dutch value chains, also impacting industries important for national security. Once deindustrialization takes hold and industries disappear, other (small and large) industries in the value chain may follow suit. This 'Jengafication' can cause irreversible deindustrialization and a diminishing ability to realise the industrial energy transition, security of supply and strategic autonomy.

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# 1 INTRODUCTION

European industry is increasingly under competitive pressure. In the past 30 years, much EU effort went into deepening integration and EU enlargement. Meanwhile, the rise of China and the US pivot to Asia in the 2010s and subsequent trade war did not really change the direction of EU policymaking. Nor was the aftermath of the changing world economic order after the Financial and Economic crisis of 2008/09 sufficiently incorporated. The EU has adopted an institutionalised short-term view on the economy and a belief that its soft and regulatory powers can be used to discipline the rest of the world into following its route to climate neutrality. However, the EU has come under increasing pressure from geopolitical and economic moves by the US and China, as well as by the larger emerging economies that comprise the BRICS-group.<sup>1</sup>

The Draghi report<sup>2</sup> pinpointed the ailments of the EU economy as the result of lower productivity (compared to the US), a lack of innovation (tech (US) and clean tech (China)), insufficient risk capital, and energy costs. In the Netherlands, apart from the energy crisis in the EU, energy costs increased due to national policy choices and measures, such as the national CO2 tax and network costs. Energy costs for industry in the Netherlands are substantially higher than in the surrounding member states.<sup>3</sup> This uneven playing field in the EU is already problematic and comes on top of the growing competitive gap between EU industries and industries in the US, China and, potentially, other countries.

This paper is focussed on international developments that led to the competitive predicaments of the (NW) European industry. China's rise as a major geopolitical and economic powerhouse,<sup>4</sup> without playing by the rules of the international economic

1 Brazil, China, Egypt, Ethiopia, India, Iran, Russian Federation, South Africa, United Arab Emirates and Saudi Arabia. See also: What is the BRICS Group and Why is it Expanding?, backgrounder, Council on Foreign Relations, 12 December 2024, <https://www.cfr.org/backgrounder/what-brics-group-and-why-it-expanding#chapter-title-0-9>.

2 Mario Draghi, The Future of European Competitiveness, parts A and B, [https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead\\_en#paragraph\\_47059](https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead_en#paragraph_47059).

3 Grid Fee Outlook for the Netherlands 2045, August 2024, Aurora Energy Group; Electricity Costs for Large Industrial Consumers: An In-Depth Comparative Analysis of the Netherlands, Germany, France and Belgium, E.Bright, <https://e-bridge.com/portfolio-items/electricity-costs-for-large-industrial-consumers-an-in-depth-comparative-analysis-of-the-netherlands-germany-france-and-belgium/>.

4 Richard Baldwin, China is the World's sole manufacturing superpower: a line sketch of the rise, VOXEU/CEPS columns, 17 January 2024, <https://cepr.org/voxeu/columns/china-worlds-sole-manufacturing-superpower-line-sketch-rise-and-Is-China-misthinking-manufacturing?>, LinkedIn, 17 May 2024, <https://www.linkedin.com/pulse/china-misthinking-manufacturing-richard-baldwin-cwr2e>.

order, and the current power play of the Trump Presidency to redress the large imbalances in trade and investments in strategic manufacturing capacities may further impact the position of European industry. Also, certain practises and regulations in the EU have come into the Trump administration's crosshairs. Although tariffs may not be the most efficient measure from a domestic cost of living or competitiveness perspective in the US,<sup>5</sup> they are quick to assert. They must, therefore, be seen as a geopolitical tool, rather than as an economic instrument, to force China to sit at the negotiation table (again) and refrain from dumping their oversupplies on international markets and game the current and future strategic supply lines. Moreover, using the trade tool allows either a retreat to normalisation of relations or a step towards invoking the stickier non-tariff barriers or sanctions. The choice of the US toolbox may also impact the EU, either directly, when tariffs are used to redress imbalances with the EU, or indirectly, when Chinese products are funnelled into the EU market directly or by reshoring to avoid barriers to entry the EU market. EU industries are squeezed between international developments and internal EU and national pressures to invest in clean energy technologies for which the business model and infrastructure are not yet there. The challenge is to find a makeshift way for EU industry to survive this double jeopardy.

5 Adam Tooze, The Stakes in the Struggle over Trump's trade strategy, Chartbook 337, 2 December 2024, <https://adamtooze.substack.com/p/chartbook-337-the-stakes-in-the-struggle>; Paul Krugman, Trade in the ruins, 4 January 2025, <https://paulkrugman.substack.com/p/trade-in-the-ruins-wonkish> and The Dollar and the Trade Deficit, 2 January 2025, <https://paulkrugman.substack.com/p/the-dollar-and-the-trade-deficit>.

## 2 THE NETHERLANDS

Industry in the Netherlands was organized based on a combination of its coastal location and deep-water harbour in Rotterdam, its natural gas production, and its networks and excellent infrastructural connections with the hinterland (pipelines, rivers, rail, road). Also, availability of a qualified workforce helped Dutch industry to compete prior to 2020. The Netherlands is part of the Amsterdam-Rotterdam-Antwerp-Rhein/Ruhr industrial cluster, where most of the EU (energy-intensive) industry is based (see Figure 1 and Figure A-Annex). This cluster or industrial ecosystem compares to the traditional clusters in the greater Houston area in the US and in Singapore, and to Chinese petrochemical clusters, among which the cluster in the Bay of Hangzhou is an important one developed during the period of China's economic expansion. The Netherlands functions as a gateway into NW Europe and to markets in the rest of the world and has the ambition to remain a gateway in the future.

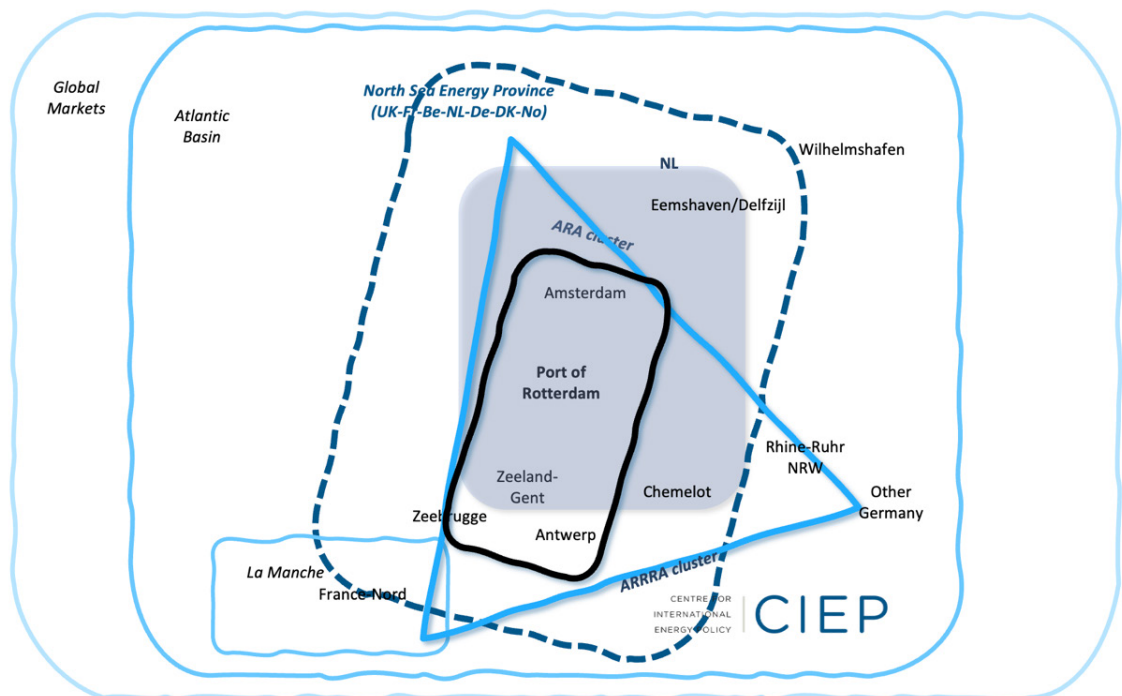


FIGURE 1 GATEWAY TO THE NETHERLANDS

The Dutch climate negotiations of 2017-2018 (Climate tables) and the subsequent studies into an integrated approach to the new energy system (Cluster Energy Strategies- CES) resulted in a substantial task for industry to reduce CO2 emissions and led to a flurry of plans for the start of a hydrogen economy, more electrification and circularity. The government earmarked substantial funds to improve sustainability and innovation in the economy. Since 2020, despite the significant EU and national funding available for low-carbon investments, not many of these plans have reached the Final Investment Decision (FID) stage. The reason is that the regulatory straitjacket hinders companies from embarking on a step-by-step change in their production sites, while demand for their higher-cost (intermediate) products remains uncertain. While some projects – such as Hydrogen 1, Shell's electrolysis hydrogen project; Porthos, the first Rotterdam CCS project; and investments in biofuels – reached FID, many others are still in various stages of investment decision-making due to the energy crisis of 2022 and recent market developments. In 2024, reflecting on the newest Cluster Energy Strategies, PBL expected delays compared to the earlier CES plans, indicating the change in outlook for NW European industry.<sup>6</sup>

The energy system approach in the Netherlands resulted in infrastructure plans that were expected, among other demand functions, to facilitate the industrial energy transition. Since then, bottlenecks in the electricity network have grown and will hinder, apart from costs, various electrification plans from being implemented by the target date of 2030 in all industrial clusters in the Netherlands. Moreover, the network bottlenecks cannot keep pace with the growth of offshore wind production, despite efforts to funnel some of it into coastal electrolysis hydrogen production to increase absorption capacity. Although the hydrogen network is under construction, and demand for hydrogen in the Rotterdam-Moerdijk industrial cluster is substantial, demand for low-carbon hydrogen is not materialising due to competitiveness issues and complicated regulations at the EU and national levels.

Another complication for industries in the ARRA-cluster is that it spans three different EU member states, in which the translation of important EU Green Deal policies differs, and where various levels of government support industries in different ways. Thus, apart from international competition, internal policy competition must also be considered when analysing Dutch industry and its ability to absorb the climate change investment demands and external competitive pressures. The Netherlands is a major exporter to both EU and international markets, underpinning the position of a coastal industrial centre and part of the North Seas Energy Cooperation. The Netherlands is also an important re-exporter of goods. The contribution of the Netherlands to world imports and exports of goods and services shows the external orientation of the Dutch economy (see Figures 2 and 3). A trade

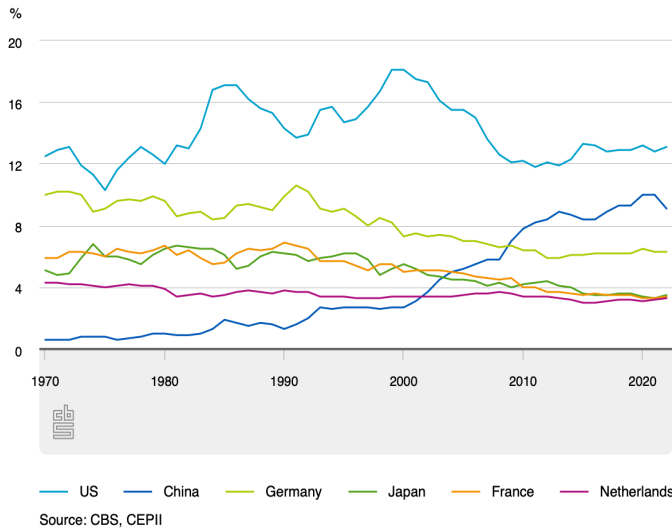
6 Reflectie op Cluster Energy Strategieën 3.0, PBL, 5 December 2024.

war between the US and China, and possibly also the EU, will affect the Dutch economy (and German and Belgian parts of the cluster). Meanwhile, trade policy is vested at the EU level, while specific measures needed for Dutch industry may have difficulty finding support in the EU arena. The EU strategic industrial policy in the making may favour larger member states more than smaller ones.<sup>7</sup> Moreover, the reforms recommended by Enrico Letta and Mario Draghi may take a long time to negotiate and may favour the greater EU good over the good of regional economic ecosystems such as ARRRRA or smaller member states.<sup>8</sup> With trade and monetary policy vested in EU institutions, the Dutch toolbox consists mainly of taxes, subsidies, the institutional structure, and the translation of EU regulations into Dutch law befitting the needs of Dutch industry. The practise of adding further national taxes and levies claw back part of the transition funding, an action that does not help the competitive position of Dutch industries.

7 Jan Strupczewski, Frustration grows inside the EU as German Infighting hurts block's goals, Reuters, 23 February 2024, <https://www.reuters.com/world/europe/frustration-grows-inside-eu-german-infighting-hurts-blocks-goals-2024-02-23/>; Martin Bresson, Martijn Swinters, Anne Murray, Size does matter, FleishmanHillard Institutional Research Unit, 13 November 2013, <https://fleishmanhillard.eu/2014/11/size-does-matter/>; Nicole Rae Baerg, An uneven playing field: Larger EU member states receive weaker Commission oversight than smaller states, LSE blogs, 21 September 2016, <https://blogs.lse.ac.uk/euoppblog/2016/09/21/an-uneven-playing-field/>.

8 Enrico Letta, Much More than a Market, Speed, Security and Solidarity, April 2024, <https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf> and Mario Draghi, The Future of European Competitiveness, parts A and B. [https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead\\_en#paragraph\\_47059](https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead_en#paragraph_47059).

### 3.6.1 Contribution to worldwide goods imports



### 3.5.1 Contribution to world goods exports

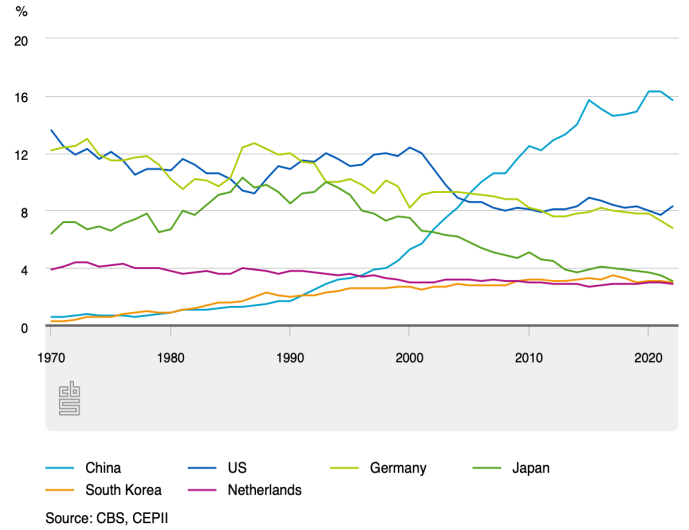
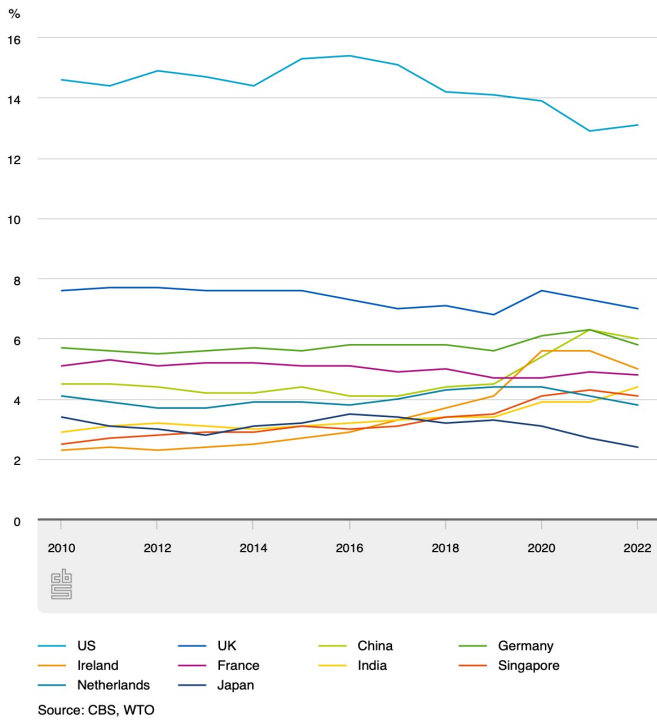


FIGURE 2 CONTRIBUTION TO WORLD IMPORTS AND EXPORTS IN GOODS

SOURCE DUTCH TRADE IN FACTS AND FIGURES 2024, [HTTPS://LONGREADS.CBS.NL/DUTCH-TRADE-IN-FACTS-AND-FIGURES-2024/INTERNATIONAL-TRADE-IN-GOODS/](https://longreads.cbs.nl/dutch-trade-in-facts-and-figures-2024/international-trade-in-goods/)

### 4.5.1 Share of world services exports



### 4.6.1 Shares in global exports of services

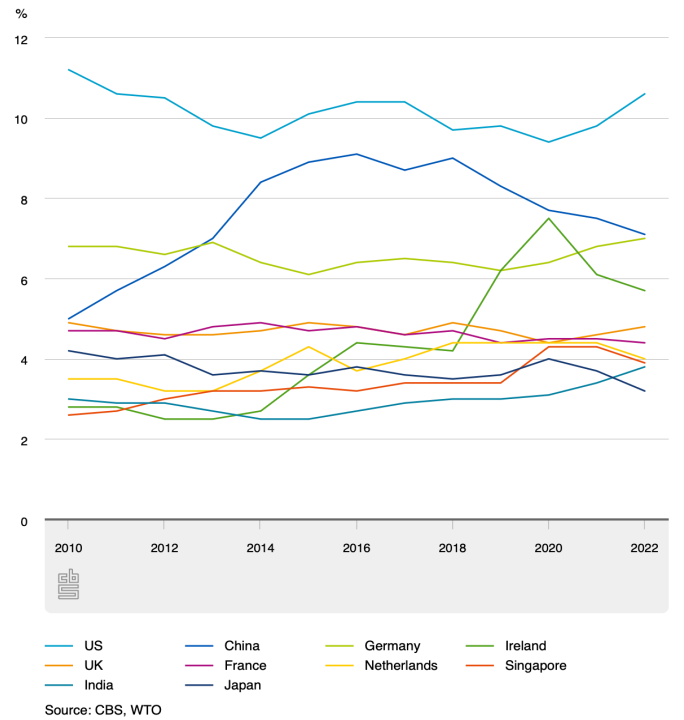


FIGURE 3 CONTRIBUTION TO WORLD IMPORTS AND EXPORTS IN SERVICES

[HTTPS://LONGREADS.CBS.NL/DUTCH-TRADE-IN-FACTS-AND-FIGURES-2024/INTERNATIONAL-TRADE-IN-SERVICES/](https://longreads.cbs.nl/dutch-trade-in-facts-and-figures-2024/international-trade-in-services/)

### 3 REALITY CHECK FOR EU AMBITIONS

The EU's ambition to be competitive and to realise the single EU market seemed a good fit with the era of globalisation between the 1990s and the mid-2010s, at least based on how globalisation was perceived in Europe in that time. The Single European Market and the 2004 EU enlargement played an important role in the move towards more market-based governance, but this governance was almost immediately overtaken by energy-transition-inspired government interventions. Furthermore, the period of relative low prices of oil and gas between 2014 and 2020 may have wrongly signalled the importance of energy diversification for the competitiveness of industry. Short-termism is not a strategy.

According to Bressand, the EU internal energy market implementation of the 2000s aimed to “roll back the role of governments, national champions, rents and subsidies.”<sup>9</sup> Yet the (national) implementation of the 2008 Climate and Energy Directive reintroduced the role of government, rents and subsidies before the market-based instruments could take hold.<sup>10</sup> With regard to the EU policies, Bressand states: “The danger for Europe is that it will embark on a heroic transformation of its electricity system that will affect the Earth's climate only marginally but could empower central planners, open opportunities for lobbyists, and reduce Europe's competitiveness at the time it can least afford to.” Here, Bressand refers mainly to the unfolding competitive disadvantage to the US resulting from structurally lower natural gas prices due to the shale revolution. At the time, he could not fully foresee the growing competitive disadvantage compared to China in 2025. Though relatively resource poor, like the EU, China has strategically invested at home and abroad in managed energy and mineral flows and kept energy costs down for industry. Ownership, long-term contracts, a broad processing base and resource diplomacy were part of the strategic industry policy. Whereas the shale revolution in the US helped the US to lower energy prices (and bring emissions down due to the switch away from coal-generated power to natural gas), and China combined the rollout of wind and solar with maintaining coal power plants burning substantial volumes of domestically mined coal, the EU embarked on an energy transition route that pushed energy costs deliberately higher and fragmented markets. This was obscured by the

9 Albert Bressand, *The Changed Geopolitics of Energy and Climate and the Challenge for Europe*, a Geopolitical and European Perspective on the Triple Agenda of Competition, Energy Security and Sustainability, CIEP paper 2012-04, December 2012, p. 47, [https://ciep.energy/media/pdf/uploads/The\\_changed\\_geopolitics\\_of\\_energy\\_and\\_climate\\_bressand.pdf](https://ciep.energy/media/pdf/uploads/The_changed_geopolitics_of_energy_and_climate_bressand.pdf).

10 Com (2008) 30 final, <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0030:FIN:EN:PDF>.

relatively low natural gas prices in the period 2014-2020, when pipeline supplies and Liquefied Natural Gas (LNG) was in ample supply and allowed the member states to pile additional (system) costs on final consumption prices of, for instance, natural gas.

The EU energy transition strategy is based on a combination of squeezing out traditional energy carriers in favour of low-carbon energy carriers and pricing CO<sub>2</sub> emissions. A mismatch in availability of new energy carriers or the infrastructure to carry them from A to B and compounded national taxes and levies and other administrative costs increase energy costs. Furthermore, infrastructural bottlenecks and strict definitions of low-carbon energy disallow the use of alternative or intermediate energy technologies to manage costs in the medium term.

The orientation of the EU on open international markets as a resource-poor group of countries was based on the idea that everything could be bought on depoliticized international markets, and that the EU market was large enough to exert sufficient buying power to comply with the ever-growing body of EU rules and regulations.<sup>11</sup> This is a stark difference from China's strategic approach to manage its import dependencies and the protection of its domestic market – witness the Made in China 2025 policy introduced in 2015. China's trade surplus of has increased to unprecedented levels in recent years (see Figure 4).

## DEALING WITH CHINA

In recent months, a discussion among economists throws more light on the merits of trade policy in response to China's growing manufactured exports to world markets. Paul Krugman sees the Chinese trade surplus as a sign not of strength but of weakness because China is unable to address its fundamental economic problems.<sup>12</sup> The trade surplus compensates for the lack of domestic demand. In his recent post, Stagnation With Chinese Characteristics he writes: "China hasn't moved at all toward the kind of lower investment, higher consumption economy it needs to become. Instead, investment as a share of GDP has gone even higher, thanks to government policies that both fueled a monstrous real estate bubble and pushed investment in government-favored industries even when they already had excess capacity."<sup>13</sup> For the importing countries, despite the advantages of importing cheap

11 "China's existing current large-scale coal mine capacity is 3.88 billion tons per year, the report found, which is nearly half the global total. China, the world's largest producer and consumer of the fossil fuel, mined a total 4.66 billion tons of coal in 2023, a record high, data from its statistics bureau showed", <https://www.reuters.com/business/energy/china-has-more-than-1-bln-tons-year-new-coal-mines-pipeline-report-says-2024-09-10/>

12 Paul Krugman, China's Very Bad, No Good Trillion-Dollar Trade Surplus, It's a sign of weakness, not strength, but a problem for everyone, Krugman works out, 16 January 2025, <https://paulkrugman.substack.com/p/chinas-very-bad-no-good-trillion>

13 Paul Krugman, Stagnation With Chinese Characteristics, How to manage a downshifting economy, Krugman works out, 27 December 2024, <https://paulkrugman.substack.com/p/stagnation-with-chinese-characteristics>



products from China for national income, the uneven local impact of the loss of jobs and of certain manufacturing capabilities has political implications and may weaken the longer-term industrial base or uproot the coherence of industrial ecosystems in economically important products.

Noah Smith, argues that national security (and infant industries and national champions) concerns could be a reason to impose tariffs to counter China's policy to enforce deindustrialisation in foreign markets by exports "promoted by cheap loans, government subsidies and a host of other policies."<sup>14</sup> Pettis argued in the Financial Times that "As long as there are large economies that implement mercantilist trade and industrial policies that allow them to subsidise manufacturing production at the expense of domestic demand, they must run trade surpluses to balance the gap.

And as long as they export their excess savings to the US, the US must run a corresponding deficit and run inverse policies. That means that through an overvalued currency, or any number of mechanisms, the US economy effectively subsidises consumption at the expense of manufacturing production."<sup>15</sup>

The reported trade surplus is an open invitation to the rest of the world to impose trade restrictions. Regarding the tariff plans of the Trump administration and China's attempt to export itself out of a policy failure, Krugman states: "Tariffs on China are unavoidable unless China makes major policy changes, but the tariffs should be smart and reflect policy concerns, not a visceral belief that trade deficits mean you're losing. (...) And since China's trade surplus is a global concern, we should be acting in concert with our allies, not alienating Europe, Canada and Mexico with tariffs on everyone. Among other things, let's not forget that Trump basically wimped out on China last time after the Chinese retaliated against U.S. farm exports; that would be much less likely to happen if America was working with its allies, not against them." The EU has benefitted from its soft power approach, trying to use its economy as a main geopolitical tool to manoeuvre between the US and China, but now threatens to become a victim of its own short-term success if the US imposes tariffs on trade unilaterally, and Chinese trade flows to Europe increase substantially, to the detriment of domestically produced products. The US may opt to push the EU in disciplining China. Consequently, the EU may be forced to change its stance on relations with China (again). For instance, between 2013 and 2020, the EU, with support from France and Germany, negotiated an agreement on investments with China. The EU is obviously struggling with its position. Interestingly, Friedrich Mertz from CDU, leading the polls in the upcoming German elections, recently issued a

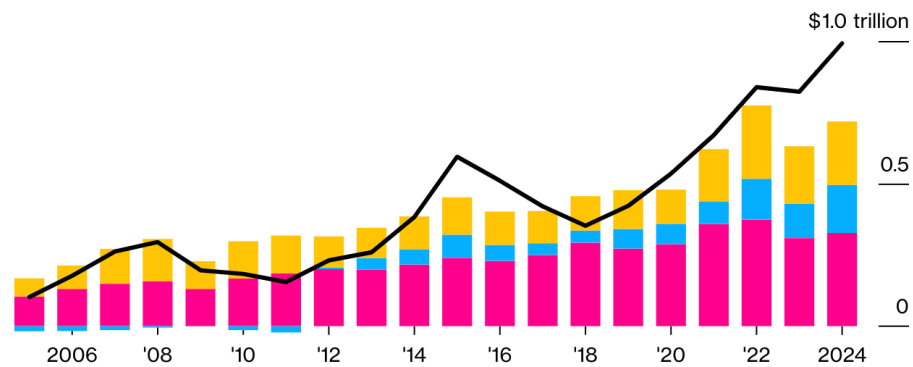
14 Noah Smith, When are tariffs Good? National security, infant industries, national champions, and some more unorthodox theories, Noahpinion, 6 February 2025.

15 Robert Armstrong, Michael Pettis answers his critics on tariffs and trade, How to solve global imbalances, Financial Times, 6 February 2025.

## China's Surplus Continues to Soar

Frontloaded demand from US only explains part of the surge

Legend: Total (black line), US (pink), Asean (blue), EU (yellow)



Source: China's General Administration of Customs

FIGURE 4 TRADE BALANCE CHINA (AS PRESENTED IN 'KRUGMAN WONKS OUT' ON SUBSTACK)

warning that German companies are investing in China at their own risk and that they will not be bailed out when the investments do not pan out.<sup>16</sup>

The website of the European External Action Service (EEAS), the diplomatic service of the EU, includes an interesting explainer, dated 27 August 2020, on EU-China relations titled The Sinatra Doctrine. How the EU should Deal with the US-China Competition. This article reads as a far-from-gracious assessment of China as a reliable partner to level the playing field. Nevertheless, the conclusion of negotiations on a Comprehensive Agreement on Investment (CAI) on 30 December 2020 is defended on the grounds that, apart from a more-level playing field (not a level playing field full stop) for European companies in China, important promises on human rights and sustainability are also part of the agreement.<sup>17</sup> With the election of President Biden, US pressure to step away from the agreement mounted and further moves towards ratification were frozen in March 2021.<sup>18</sup>

The EU and some of the large member states were struggling with their approach towards the US and China, with the soft economic approach on the one hand and the moralistic approach on the other. Regarding EU sensitivity to geopolitical developments, in 2012, Bressand had already noted: "Focussed on meeting targets

16 German election frontrunner warns of 'great risk' for companies investing in China, FT, 23 January 2025.

17 EU and China reach agreement in principle on investment, [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_20\\_2541](https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2541)

18 Lily McElwee, The Rise and Demise of the EU-China Investment Agreement: Takeaways for the Future of German Debate on China, CSIS, 20 March 2023, <https://www.csis.org/analysis/rise-and-demise-eu-china-investment-agreement-takeaways-future-german-debate-china>.

it set for itself with little consideration for other countries' strategies, Europe displays what one might label 'parochial universalism'. Gains tend to be assessed with reference to the world as Europeans would like it to be rather than as it is. Adopting a geopolitical perspective rather than a moral standpoint – more generally a relative rather than an absolute standpoint – alerts one to the risk for Europe of a 'policy lock-in' in which means become an end in itself."<sup>19</sup>

### SEARCHING FOR STRATEGIC AUTONOMY

As part of the discussion on declining EU competitiveness, strategic autonomy is becoming an important buzzword.<sup>20</sup> Strategic autonomy was first used in relation to EU defence and security, but, ten years later, it also trickles down into a modern-day translation of industrial policies, whereby policymakers are trying to find justification for promoting and protecting certain industries in the context of international competition and other powers' strategic economic manoeuvring. Based on the Critical Minerals Act, mineral processing industries were earmarked as important.<sup>21</sup> Despite the interesting papers on the concept of strategic autonomy, it remains unclear how it could be applied to NW European industrial sectors because it fails to clarify the integration and interconnections among various value chains of current industries and their importance for the low-carbon economy and national security. Strategic autonomy should include like-minded countries in the neighbourhood. The EU energy transition is, foremost, a so-called 'brownfield' transition and not a 'greenfield' transition, where current local industrial ecosystems play an important role. The EU may also simply lack the institutional make-up to organise an attractive economic climate for industry, while its policies limit or complicate the member states' ability to create such an environment for its industry. Bastein (et al.) refer in chapter 5 of their study on critical resource processing industries to ecosystem conditions that may generate investor support. They also signal the difficulties EU and Dutch industries are encountering. The minister of economic affairs Beljaarts'

19 Albert Bressand, The Changed Geopolitics of Energy and Climate and the Challenge for Europe, a Geopolitical and European Perspective on the Triple Agenda of Competition, Energy Security and Sustainability, CIEP paper 2012-04, December 2012, [https://ciep.energy/media/pdf/uploads/The\\_changed\\_geopolitics\\_of\\_energy\\_and\\_climate\\_bressand.pdf](https://ciep.energy/media/pdf/uploads/The_changed_geopolitics_of_energy_and_climate_bressand.pdf).

20 Briefing EU Strategic Autonomy Monitor July 2022, European Parliament Research Service (EPRS); On the path to 'strategic autonomy', the EU in an evolving geopolitical environment, European Parliament Research Service (EPRS), September 2020; A definition of strategic autonomy is explored in: Issues paper 8, Strategic autonomy, strategic choices, Council of the European Union, 5 February 2021.

21 Ton Bastein (TNO), Elmer Rietveld (TNO), Ivan Vera Concha (TNO) and Amrish Ritoe (Number Three), Verwerking van kritieke grondstoffen in Nederland, Naar een plan van aanpak, September 2024, <https://app.1848.nl/document/tkapi/526206>.

letter to parliament of 16 December 2024 acknowledges the importance of this industrial sector but is disappointing in concrete steps.<sup>22</sup>

In this paper, strategic autonomy or strategic industry<sup>23</sup> refers to industry providing basic economic needs now and in the future. In doing so, industry would contribute to the domestic capacities and capabilities to produce goods important for the domestic economy, with important interlinkages to other sectors; and would represent a level and structure of import dependence (share of geopolitically sensitive countries or corporations in trade and services and the ability to diversify).

Post-corona, the energy crisis of 2022/23, the growing non-commercial costs (partly due to the EU energy transition plans), and increased strategic competition practises from China and the US have radically changed the international competitiveness outlook of many European industries, as communicated by the Draghi report.

## EU GROWTH MODEL

In the last 30 years, the EU developed a structural dependence on relatively cheap Russian energy (coal, oil, oil products, natural gas, electricity) for its own relatively energy-intensive industrial sectors and, at the same time, a dependency on China for labour-intensive finished and semi-finished manufactured products. The EU largely bypassed the relatively cheap labour costs in new member states after the financial and economic crisis in favour of investments or purchases in China, while the early enforcement of the free movement of people kept labour costs relatively low in the low-tech sectors in traditional member states. In addition, the ECB policy may not be able to correct the resulting imbalances in member states' economies due to the role of institutional and other factors, causing some misallocation of capital and labour.<sup>24</sup> Also, the fiscal pressures in some EU member states were never resolved sufficiently and still persist today.<sup>25</sup>

22 Kamerbrief verwerkingscapaciteit kritieke grondstoffen, <https://open.overheid.nl/documenten/cd2dede2-8c1f-4f6e-8ea8-077bf373cda7/file>

23 Martin C. Libicki, What makes Industries Strategic, The Institute for National Strategic Studies, Mc Nair Papers, number 5, November 1989, <https://www.files.ethz.ch/isn/23415/mcnair05.pdf>

24 Heterogeneous impact of monetary policy in the euro area?, Deutsche Bundesbank, Monthly Report, September 2023, 38, <https://www.Bundesbank.De/resource/blob/916768/759123e4a0cf20b9bf0822899ac4ff1f/472b63f073f071307366337c94f8c870/2023-09-geldpolitik-data.Pdf> and pablo burriel and allessandro galesi, uncovering the heterogeneous effects of ecb unconventional monetary policies across euro area countries, european economic review, 2018, vol. 101, Issue c, 210-229, also available as working paper no. 1631 Of banco de espana, 2016, <https://www.Bde.Es/ff/webbdes/secciones/publicaciones/publicacionesseriadas/documentostrabajo/16/fich/dt1631e.Pdf>

25 The EU government debt-to-gdp ratio was 80.8% and in the euro area 87.4% in 2023. The Netherlands was well below the 60% threshold and recorded a small fiscal deficit well within the threshold. Germany had a fiscal deficit just within the threshold and a government debt-to-GDP ratio on the threshold. "at the end of 2023, the lowest ratios of government debt to GDP were recorded in Estonia (20.2%), Bulgaria (22.9%), Luxembourg (25.5%), Sweden (31.5%), Denmark (33.6%) and Lithuania (37.3%). A total of 13 member states had government debt ratios higher than 60% of GDP, with the highest registered in Greece (163.9%), Italy (134.8%), France (109.9%), Spain (105.1%) and Belgium (103.1%)." Government finance statistics, [https://ec.europa.eu/eurostat/statistics-explained/index.php?Title=government\\_finance\\_statistics](https://ec.europa.eu/eurostat/statistics-explained/index.php?Title=government_finance_statistics)

Due to the huge demand shock of the corona crisis, with its disruptions to vital value chains, the inflationary recovery followed by the energy crisis created fundamentally different economic circumstances in the EU. With the end of the period of cheap energy and the tightening of climate policies, the competitive pressure to restructure the economies of the member states is mounting.

The Draghi report is full of analysis and recommendations on how best to restructure the EU economy to regain competitiveness.<sup>26</sup> The advantage of the US in energy costs and higher labour productivity, mainly in the tech sector, provide the Draghi-report with some far-reaching conclusions on how and where the EU is falling short. The report calls for more coordination among member state policies, involving full implementation of the internal market, strong alignment of industrial, competition and trade policies and financing innovation, decarbonisation, and security of the EU. Large public investments are needed to achieve the suggested reforms. Productivity gains are imperative to manage the debt-to-GDP ratio. The report has ignited a plethora of reactions, with quite a few taking a critical stance on how realistic the sometimes disruptive proposals are in the current political climate in the member states of less Europe rather than more.<sup>27</sup> Although some of the proposals may appeal to industry or the governments of member states, the total package may be a bridge too far; for example, the proposals on financial markets or reform of the EU budget could ignite the old discussion among member states that can attract capital on international financial markets to invest in their economies and those that cannot. The latter will view the Draghi bonds as an opportunity to attract capital, while the others, often already net contributors to the EU budget, may see the Eurobonds as a reward for a lack of fiscal discipline. Much will depend on the navigation skills of the second Von der Leyen European Commission to read the 'political tea leaves' in the member states, while the impact of a spluttering German economy should not be underestimated.

26 Mario Draghi, The Future of European Competitiveness, Part A and B, September 2024.

27 Jacques Pelkmans, A Critical First Response to Mario Draghi's Competitiveness report, What it Says, What it Means – and is it Feasible?, CEPS 2024-7, [https://cdn.Ceps.Eu/wp-content/uploads/2024/09/2024-07\\_a-critical-first-response-to-mario-draghis-competitiveness-report.Pdf](https://cdn.Ceps.Eu/wp-content/uploads/2024/09/2024-07_a-critical-first-response-to-mario-draghis-competitiveness-report.Pdf); Sander Tordoir, Aslak Berg, Elisabetta Cornago, Zach Meyers, Luigi Scazzieri, Draghi's Plan to Rescue the European Economy: Will EU leaders do whatever it takes?, Cer Policy Brief 17 September 2024; Coby van der Linde, The Draghi Report, EU Industry between a Rock and a Hard Place, Ciep Discussion Notes 2024 01, November 2024.

## 4 REACHING THE GLASS CEILING OF CHINA'S RISE?

The era of globalisation brought large changes to the organisation of supply lines. Cheap labour in China led to a large expansion of manufacturing capacity in the country. The expansion of the Chinese economy was largely coal driven, first by domestic coal and, after 2000, also increasingly imported coal, turning the first decade of the twenty-first century surprisingly into the age of coal.<sup>28</sup> By 1995, China had already become a net oil importer, which led to a foreign investment drive of Chinese state energy companies in 2000, first in oil and later in foreign LNG projects and minerals to feed the energy and resource hunger of the fast-expanding economy.

China was admitted to the WTO in 2001 amidst (too much) optimism that they would comply with international practises, lowering many tariffs and opening markets for goods produced in China; an investment boom followed. Chinese compliance with WTO standards proved to be challenging, particularly when certain Chinese sectors and resources fell increasingly under strategic industrial or energy policies to gain market dominance.<sup>29</sup> Although some companies managed to sell into the growing Chinese market, very often a Chinese partner was required to reach consumers or could only export their production. Moreover, Chinese partners very quickly developed into competitors based on imported, then copied, and further developed technology. Examples are the nuclear energy sector, cars, pharmaceuticals, telecoms, electronics, etc. Despite some reforms, the even playing field envisaged by China's WTO entry never materialised – for instance, in domestic oil pricing in 2008. A variety of state support policies for industry continue today, including cheap loans, land and permitting.

After the financial and economic crisis in 2008, China maintained growth through a large support programme to bolster the economy. With the US and EU economies in a downturn, various solar and wind energy companies, as well as companies such as Swedish Volvo and the Greek Piraeus Port Authority, survived under Chinese ownership. A substantial number of container terminals in the EU have Chinese

28 Atsua Sagawa, Koichi Koizumi, The Trend of Coal Exports and Imports by China and its Influence on Asian Coal Markets, ieej, november 2008, <https://eneken.leej.Or.Jp/data/2459.Pdf>; ciep, age of paradox, exploring the Uncertain World of Energy: 200-202, CIEP, December 2011, <https://ciep.energy/publications/publication/age-of-paradox>.

29 USTR Releases Annual Report on China's WTO Compliance, February 23, 2024, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2024/february/ustr-releases-annual-report-chinas-wto-compliance>

(majority) shareholders.<sup>30</sup> This led to a surge in new manufacturing capacities in China based on the purchased technologies. Around the same time, solar manufacturing capacities in the US and EU were rationalised or shut down, and production moved to China. China continued its industrial expansion, keen to become self-sufficient in many sectors, such as oil refining, petrochemicals, passenger cars, rare earth processing, steel, etc.

Many Western firms moved their factories to the special economic zones in China in the 1990s and 2000s, particularly in textiles, clothing, shoes and electronics, while Chinese firms expanded their base in (international) mining and processing of minerals. Also, in the 2010s, Foreign Direct Investments (FDI) were concentrated mainly in manufacturing and strategic manufacturing (including clean tech, electronics, telecom and critical minerals).<sup>31</sup> These investments were often in joint ventures with Chinese companies. Leading investors in China were Asian countries, with Hong Kong,<sup>32</sup> Japan, South Korea and Singapore representing the lion's share, and smaller shares for the US, France, Germany, the UK and the Netherlands.

In the 2010s, China switched to strategic industrial policymaking to gain international dominance in new growth markets (telecoms, clean tech, processing of (mineral) resources, etc.) and self-sufficiency in other sectors (refining, chemicals, steel, etc.). This change has had a large impact on international markets, such as the EU. In 2025, China exports not only relatively cheap and low-tech consumer goods, but also more-advanced semi-finished and finished goods. Competition from Chinese export products is intensifying as a result. The drive for self-sufficiency in sectors such as chemicals, oil refining, mineral processing, solar panels, etc., combined with overoptimism about domestic economic growth, has subdued domestic consumer spending and sharper Chinese carbon emission policies, resulting in more and more sectors in oversupply. These Chinese overcapacities must either find their way to international markets and enforce restructuring of sectors in importing markets, or, when trade and other measures prevent Chinese exports of these surpluses, Chinese sectors must consolidate.

30 Research For Tran Committee Chinese Investments In European Maritime Infrastructure, [https://www.europarl.europa.eu/regdata/etudes/stud/2023/747278/ipo\\_l\\_stu\(2023\)747278\(sum01\)\\_en.pdf](https://www.europarl.europa.eu/regdata/etudes/stud/2023/747278/ipo_l_stu(2023)747278(sum01)_en.pdf); Chinese Strategic Interests In European Ports, European Parliament, [https://www.europarl.europa.eu/regdata/etudes/atag/2023/739367/eprs\\_ata\(2023\)739367\\_en.pdf](https://www.europarl.europa.eu/regdata/etudes/atag/2023/739367/eprs_ata(2023)739367_en.pdf).

31 IMF, Asia Pacific department, China's foreign direct investments: inward and outward, IMF eLibrary, 30 august 2024, <https://www.elibrary.imf.org/view/journals/002/2024/276/article-a004-en.xml>.

32 "While Hong Kong was once crucial as China's primary gateway for international investment, mainland cities like Shanghai and Shenzhen have developed their own important financial sectors. However, Hong Kong's financial infrastructure and international connections continue to make it valuable for China's global economic engagement with the rest of the world", Hong Kong vs. Mainland China: What's the Difference, 2 December 2024, <https://www.investopedia.com/articles/investing/121814/hong-kong-vs-china-understand-differences.asp#:~:text=Hong%20Kong%20continues%20to%20serve,helps%20facilitate%20China's%20global%20trade>.

## CHINA'S DOMINANCE IN MANUFACTURING

In the past 30 years, China's growth drove investments at home and abroad (in energy, for instance). In 2021, China represented an 18.9% share of world GDP, compared to 15.5% and 15.2% for the US and the EU, respectively.<sup>33</sup> China's GDP per capita in most coastal provinces compares well with high-income countries, while other provinces compare with lower middle income or middle-income countries. Comparing the contribution of various sectors to GDP, some important differences stand out. In 2023, the contribution of industry or manufacturing in China was 38%, compared to 18% in the US, 17% in the UK, 27% in Japan, 19% in France, 28% in Germany and 25% in India.<sup>34</sup> The contribution of manufacturing to GDP is, thus, relatively high in China, while the contribution of services stands at a relatively low 55%, compared to 70% in the US, 73% in the UK, 71% in Japan, 70% in France, 63% in Germany and 50% in India. In the EU, the relatively high contribution of manufacturing and the relatively lower contribution of services in Germany compared to France is remarkable. Furthermore, just as in Germany, China's GDP is relatively dependent on net exports. Where China really stands out is in its relatively low contribution of consumption to GDP, standing at 53%, compared to 83% in the US and the UK, 77% in France and Japan, and 73% and 71% in Germany and India, respectively.<sup>35</sup>

Germany was, perhaps, the most prominent proponent of an economy benefitting from relatively low-cost energy imports from Russia and exports to the US and China (for instance, cars). German and other European car companies have minority shares in several Chinese car companies, which are now competing on the EU market with EVs, creating a dilemma for policymakers in terms of how they should respond. France has long-standing and intense relations with China in nuclear energy.<sup>36</sup>

33 EU Represented 15.2% Of World's GDP In 2021, Eurostat, News Article, <https://ec.europa.eu/eurostat/web/products-eurostat-news/w/ddn-20240530-2#:~:text=the%20largest%20economy%20in%20the,third%20place%2c%20with%2015.2%25>.

34 Unpacking China's GDP, China Power, Unpacking The Complexity Of China's Rise, CSIS, [https://chinapower.csis.org/tracker/china-gdp/#:~:text=china's%20economic%20development%20has%20been,united%20states%20\(18%20percent\)](https://chinapower.csis.org/tracker/china-gdp/#:~:text=china's%20economic%20development%20has%20been,united%20states%20(18%20percent)).

35 Unpacking China's GDP, China Power, Unpacking The Complexity Of China's Rise, CSIS, [https://chinapower.csis.org/tracker/china-gdp/#:~:text=china's%20economic%20development%20has%20been,united%20states%20\(18%20percent\)](https://chinapower.csis.org/tracker/china-gdp/#:~:text=china's%20economic%20development%20has%20been,united%20states%20(18%20percent)).

36 China And France Open A New Chapter In Joint Exploration Of Nuclear Energy After 40 Years Of Partnership And Trust, Global Times, 6 May 2024, <https://www.globaltimes.cn/page/202405/1311735.shtml>; china and france aim to strengthen nuclear energy cooperation, world nuclear news, 9 may 2024, <https://www.world-nuclear-news.org/articles/china-and-france-aim-to-strengthen-nuclear-energy>; China Equals France In Number Of Nuclear Reactors In Operation, Foronuclear, 10 JUNE 2024, <https://www.foronuclear.org/en/updates/news/china-equals-france-in-number-of-nuclear-reactors-in-operation/>.



The EU has a growing trade deficit with China,<sup>37</sup> mainly in machinery and vehicles and other manufactured goods, while it has a surplus in food and drink and raw materials. A small surplus in energy (mainly middle distillates, from refined crude oil) and chemicals trade turned into a deficit after 2022 (energy crisis).

The EU chemical industry is an important importer from and exporter to international markets. The EU, the US and China are the largest traders in chemicals and related products, with the EU being the largest net exporter in 2023.<sup>38</sup> The main trade flow concerns medical and pharmaceuticals and, to a smaller extent, organic chemicals. EU Imports originate from the US (24%), Switzerland (20%) and China (13%), while exports are destined mainly for the US (26%), Switzerland (11%), the UK (9%) and China (8%). Trade with China is largely concentrated on imports of organic chemicals (52%), and exports to China are mainly medicines and pharma (53%).<sup>39</sup>

### FROM GROWING STRATEGICALLY INTO OVERSHOOTING BADLY

The change in China, after President Xi came into power in March 2013, led to a reorientation of the economic strategy. In 2014, Xi already alluded to the necessary upgrade of Chinese manufacturing, away from energy-intensive and relatively low-tech production and ahead of the impending decline of the labour force. He called for more investment in Research and Development (R&D) and improved coordination among government, academia and industry. The restrictions on rare earth exports and the ambition to export goods containing these products instead represented a first warning of China's intentions to become a high-tech industrial powerhouse.<sup>40</sup> In 2015, the *Made in China 2025* plan was launched and included the following sectors: next generation IT; high-end numerical control machinery and robotics; maritime engineering equipment and high-tech maritime vessel manufacturing; advanced rail equipment; energy-saving vehicles and NEVs; agricultural machinery and equipment; new materials; and biopharmaceuticals and high-performance

37 China-EU International Trade In Goods Statistics, February 2024, [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=china-eu\\_-\\_international\\_trade\\_in\\_goods\\_statistics](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=china-eu_-_international_trade_in_goods_statistics).

38 Trade And Production Of Chemicals And Related Products, Eurostat, [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Trade\\_And\\_Production\\_Of\\_Chemicals\\_And\\_Related\\_Products#:~:Text=Eu%20is%20the%20largest%20exporter%20of%20chemical%20products,-Looking%20at%20the&Text=The%20united%20states%20was%20the,Billion\)%20for%20both%20trade%20flows](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Trade_And_Production_Of_Chemicals_And_Related_Products#:~:Text=Eu%20is%20the%20largest%20exporter%20of%20chemical%20products,-Looking%20at%20the&Text=The%20united%20states%20was%20the,Billion)%20for%20both%20trade%20flows).

39 Trade And Production Of Chemicals And Related Products, Eurostat, [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Trade\\_And\\_Production\\_Of\\_Chemicals\\_And\\_Related\\_Products#:~:Text=Eu%20is%20the%20largest%20exporter%20of%20chemical%20products,-Looking%20at%20the&Text=The%20united%20states%20was%20the,Billion\)%20for%20both%20trade%20flows](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Trade_And_Production_Of_Chemicals_And_Related_Products#:~:Text=Eu%20is%20the%20largest%20exporter%20of%20chemical%20products,-Looking%20at%20the&Text=The%20united%20states%20was%20the,Billion)%20for%20both%20trade%20flows).

40 European Union Chamber Of Commerce In China, China Manufacturing 2025, Putting Industrial Policy Ahead Of Market Forces, 2017; Jost Wubbeke, Mirjam Meissner, Max J. Zenglein, Jacqueline Ives, Bjorn Conrad, Made In China 20225 – The Making Of A High-Tech Superpower And Consequences For Industrial Countries, Mercator Institute For China Studies, No. 2, December 2016, [https://espas.secure.europarl.europa.eu/orbis/system/files/generated/document/en/mpoc\\_no\\_2\\_madeinchina\\_2025.pdf](https://espas.secure.europarl.europa.eu/orbis/system/files/generated/document/en/mpoc_no_2_madeinchina_2025.pdf)

medical devices.<sup>41</sup> In March 2017, the *New York Times* cited both the EU Chamber of Commerce's report on *Made in China* and the report of the Mercator Institute for China Studies as a plan to dominate not only the Chinese market, but also the most profitable segments of the global supply. Fast forward to 12 January 2025, when the *New York Times* reported on China's record trade surplus of nearly \$1 trillion over 2024. Lax domestic demand, despite the newest stimulus programme, and overcapacity in many manufacturing sectors are reflected in the record trade surplus.

### **DERISKING AND SHRINKING**

The end of China's high growth period coincides with mounting demographic pressures on the economy, and consumer demand has so far failed to replace some of the investment-driven growth. The exportation of the Chinese policy problems to international markets in the form of largely state-supported exports of goods are a threat for domestic producers in both the US and the EU, but also in the Global South. The US is slightly better positioned to protect itself due to lower energy prices and a relatively young workforce, but most of its manufacturing industry has moved to Mexico or elsewhere, and structural import dependencies will persist. To avoid trade deflection via Free Trade Agreement countries, these countries face trade barriers from the Trump Presidency, too. The EU may also be forced to take a different view on its own trade agreements, which can be used as a gateway into the EU to avoid CBAM and/or other trade barriers. Some relocation of Chinese manufacturing has already taken place to other countries.

After 2018, FDIs from advanced Asian and Western countries declined, indicating increasing geopolitical risk, policy uncertainties and lower growth expectations, while Chinese FDIs in the same countries also declined.<sup>42</sup> Although Chinese FDI in the EU declined – certainly compared to the high levels in 2016 – they were concentrated in 2023 on the EV value chain, with Hungary a main recipient, followed by Germany and France.<sup>43</sup> Also, Chinese investments in certain non-aligned countries declined, while investments in geopolitically more aligned countries increased. The reshoring of Chinese companies is reflected in a declining trade surplus with the US since 2016, and growing trade flows from countries like Vietnam. In addition, the expanding economy made the construction sector one of the engines of Chinese economic growth until the early 2020s, building infrastructure, factories and residential properties. However, this sector is now in a downturn. The lower growth

41 European Union Chamber Of Commerce In China, *China Manufacturing 2025, Putting Industrial Policy Ahead Of Market Forces*, 2017.

42 IMF, Asia Pacific department, *China's foreign direct investments: inward and outward*, IMF eLibrary, 30 august 2024, <https://www.elibrary.imf.org/view/journals/002/2024/276/article-a004-en.xml>.

43 Chinese FDI in Europe: 2023 Update, Rhodium Group, 6 June 2024, <https://Rhg.Com/Research/Chinese-Fdi-In-Europe-2023-Update/>.

of the Chinese economy also affects other industries, such as chemicals, cement, and steel.

In the oil processing and chemical industry, countries such as Saudi-Arabia invested in refining and petrochemicals, alongside the Chinese State oil companies. China wanted to become self-sufficient in refining and petrochemicals but recently announced a coming cap on refining capacity by 2027, related to its EV sales drive and projected lower demand for gasoline and diesel.<sup>44</sup> Based on this projection, it is expected that refineries will become more focused on chemical feedstocks production or may have to find export markets for its surpluses. The changing market for transportation fuels due to growing electrification of passenger cars, combined with the growing international market for feedstocks (PP, PE, PU), challenges existing refineries to adjust their operations to change the output mix. They can reach about 40% feedstock production with adjustments, while Saudi-Arabia's Aramco claims that it can build a new oil refinery with 70-80% chemical feedstock output.<sup>45</sup>

The position of Saudi-Arabia and the United Arab Emirates (UAE) to become major exporters of both low carbon energy (green and blue) and in oil to chemicals is another major challenge to EU petrochemical industries but could also be a source of derisking from China when basic products cannot be produced in the EU and have to be imported.<sup>46</sup> With an improvement of the investment climate in the EU, it might be attractive for Saudi Arabia to invest when trade barriers become higher and facilitate the feedstock change.

The chemical and pharmaceutical industry in the US, China and EU delivered substantial value added to their economies.<sup>47</sup> The US has the advantage of relatively low energy prices and may be in a better position to withstand competition from Chinese surpluses and new production facilities in the Middle East. This will apply at least to the US East Coast, and maybe less so for the West Coast, depending on the ability to easily pass through the Panama Canal. The performance of the US chemical sector improved substantially due to the shale revolution, which led to lowered American gas prices in the 2010s and increased investments in chemicals.

With the main construction boom in China coming to an end, Chinese steel exports are increasing again, particularly flat products, implying a widening gap between

44 John Richardson, China's Petrochemicals Capacity Growth: A New Normal Of Much Greater Uncertainty, Icis, 15 July 2024, <https://www.icis.com/Asian-Chemical-Connections/2024/07/Chinas-Petrochemicals-Capacity-Growth-A-New-Normal-Of-Much-Greater-Uncertainty/>.

45 John Richardson, Petrochemicals After The Supercycle: Revised Scenarios, Icis, 18 July 2024, <https://www.icis.com/Asian-Chemical-Connections/2024/07/Petrochemicals-After-The-Supercycle-Revised-Scenarios/>.

46 Gunther Maihold, A New Geopolitics Of Supply Chains, The Rise Of Friend-Shoring, Swp Comment, No. 45, July 2022, [https://www.swp-berlin.org/Publications/Products/Comments/2022c45\\_Geopolitics\\_Supply\\_Chains.Pdf](https://www.swp-berlin.org/Publications/Products/Comments/2022c45_Geopolitics_Supply_Chains.Pdf).

47 Douglas Thomas, Annual Report On The U.S. Manufacturing Economy: 2024, Nist Advanced Manufacturing Series 600-16, <https://nvlpubs.nist.gov/nistpubs/ams/nist.ams.600-16.pdf>.

imports and exports and a rising export share of production.<sup>48</sup> The main export markets are Asian countries and the Middle East (pipes) to India, Saudi Arabia, UAE, Vietnam, South Korea, Indonesia and Thailand, with a share of just over 50%. More exports to the EU may follow the announcement of trade restrictions by the Trump Administration, although China's corporations are under pressure.<sup>49</sup>

The end of China's construction boom was followed by a surge in investments in clean tech without a restructuring of the sectors in trouble. Due to oversupply, competition in China is fierce and profit margins are under a lot of pressure, despite its exports. According to the *Financial Times*, Chinese corporate profits have declined three years in a row, and about a quarter of the listed companies are reporting losses.<sup>50</sup> Also, producer price deflation played a role. The poor performance of the state-owned enterprises, often tasked with geopolitical and social roles, is a burden on China's fiscal resources and may not be sustainable. To be sure, China's fiscal deficit grew to 7.1% of GDP in 2024 and government debt to 61.3%, as fiscal revenues as a share of GDP declined from about 30% to 23%.<sup>51</sup>

Since summer 2024, China has been preparing for protecting itself against trade policies from the second Trump Administration. Propping up consumer spending, the reduction of local government debts and a looser monetary policy should help stabilise the domestic economy, while shoring up relations with the Global South and others as a long-term investment to strengthen its own sphere of influence and use them for indirect trade flows.<sup>52</sup> The restructuring of the Chinese economy and industry's role may take time – time that EU industry may not have.

48 China Steel Exports Report 2023, Us Department Of Commerce, International Trade Organisation, <https://www.Trade.Gov/Data-Visualization/China-Steel-Exports-Report#:~:Text=China%20is%20the%20world's%20largest,Countries%20and%20territories%20in%202022>.

49 Noah Smith, The Pettis Paradigm And The Second China Shock, 16 January 2025, [https://www.Noahpinion.Blog/P/The-Pettis-Paradigm-And-The-Second?Publication\\_Id=35345&Utm\\_Campaign=Email-Post-Title&R=6g77v&Utm\\_Medium=Email](https://www.Noahpinion.Blog/P/The-Pettis-Paradigm-And-The-Second?Publication_Id=35345&Utm_Campaign=Email-Post-Title&R=6g77v&Utm_Medium=Email)

50 China Corporate Profits Set For Third Year Of Declines, Ft, 13 January 2025.

51 China Fiscal Outlook, Fitchratings, Special Report, 17 May 2024, <https://www.Fitchratings.Com/Research/Sovereigns/China-Fiscal-Outlook-17-05-2024>

52 Yun Sun, China's Trump Strategy, Beijing Is Preparing to Take Advantage of Disruption, Foreign Affairs, 6 February 2025.

## 5 GRAPPLING WITH NEW CURVE BALLS

The post-Paris confidence of the EU, which led to the far-reaching European Green Deal<sup>53</sup> with its aim of ‘striving to be the first climate-neutral continent,’ slowly evaporated after 2022, despite the regulations to strengthen Europe’s net-zero technology manufacturing ecosystem and the RePower EU acceleration plans.<sup>54</sup> The trade war between the US and China and the supply line disruption during the corona crisis had already intensified the focus on resource dependency and industrial strategy, while the Russia-Ukraine war led to a renewed focus on EU (energy) security and shoring up defence industries.<sup>55</sup> Yet, 2024 marked an important mood shift regarding the speed with which the energy transition could be realised and the competitive position of industry secured in a changing international environment.

Despite the discussion on strategic industries and the need to help energy-intensive industries to decarbonise, numerous reports on critical import dependencies, strategic autonomy, strategic industries, and the Draghi report, the 2024 regulation allows for the establishment of Regional Innovation Valleys to create or maintain the necessary industrial ecosystem in strategic value chains. The translation of this resolution into member state action, also in the Netherlands, remains a ‘work in progress’<sup>56</sup>, while other policy priorities dominate political agendas.

Protection from imports with a heavy carbon footprint was vested in the jack of all trades, the Carbon Border Adjustment Mechanism (CBAM). The pre-emptive switch of China from exporting intermediary products to finished products, such as EVs and PVC, is a first signal that CBAM might not be as effective as thought and too outdated to stop Chinese dumping sooner rather than later to protect European industries. CBAM includes cement, iron, steel, aluminium, fertilizers, electricity and hydrogen, but in state-led economies, these rules can easily be circumvented by

53 The European Green Deal, [https://Commission.Europa.Eu/Strategy-And-Policy/Priorities-2019-2024/European-Green-Deal\\_En](https://Commission.Europa.Eu/Strategy-And-Policy/Priorities-2019-2024/European-Green-Deal_En)

54 Regulation (EU) 2024/1735 Of The European Parliament And Of The Council Of 13 June 2024 On Establishing A Framework Of Measures For Strengthening Europe’s Net-Zero Technology Manufacturing Ecosystem And Amending Regulation (EU) 2018/1724 (Text With EEA Relevance), [https://Eur-Lex.Europa.Eu/Legal-Content/En/Txt/Pdf/?Uri=Oj:L\\_202401735](https://Eur-Lex.Europa.Eu/Legal-Content/En/Txt/Pdf/?Uri=Oj:L_202401735)

55 Strategic Compass For Security And Defense, 18 March 2024, Progress Report, [https://www.eeas.europa.eu/sites/default/files/documents/2024/strategiccompass\\_2ndyear\\_report\\_0.pdf](https://www.eeas.europa.eu/sites/default/files/documents/2024/strategiccompass_2ndyear_report_0.pdf); And Martin C. Libicki, What Makes Industries Strategic, The Institute For National Strategic Studies, Mc Nair Papers, Number 5, November 1989, <https://www.files.ethz.ch/isn/23415/Mcnair05.pdf>.

56 Kamerbrief verwerkingscapaciteit kritieke grondstoffen, <https://open.overheid.nl/documenten/cd2dede2-8c1f-4f6e-8ea8-077bf373cda7/file> and Ton Bastein (TNO), Elmer Rietveld (TNO), Ivan Vera Concha (TNO) and Amrish Ritoe (Number Three), Verwerking van kritieke grondstoffen in Nederland, Naar een plan van aanpak, September 2024, <https://app.1848.nl/document/tkapi/526206>

rigging up a 'phantom' carbon price system (pay out and claw back operations). The application of CBAM to the larger chemical industry may also be complicated because of the approximately 350.000 registered chemicals used in many different end-user products, making tracking the carbon footprint impossibly arduous or open for gaming. Imports of steel have shifted to imports of products using steel (such as cars), while re-exports from third countries are also playing a role in circumventing EU policies. Moreover, in refining, simple refineries are rewarded by CBAM because of their lower scope 1 emissions compared to those of a complex refinery, even though they produce more carbon-intensive byproducts, and complex refineries have lower scope 3 emissions. Given the greater focus on EU security, competitiveness of refineries in the US, China, the Middle East and India – less burdened by EU regulations and lower energy costs and having national support schemes – may expedite refinery closures in the EU and make mobility fuels and plastics, in addition to important minerals,<sup>57</sup> another area of fragility.

In commodity metals, China is making sure that its processors are positioned best (subsidies) for obtaining, for instance, the best zinc ore concentrates, which allow for co-producing germanium. This leaves the EU smelters with less-rich concentrates and the potential inability to serve the defence industry with germanium, used, for instance, in infra-red, glass Fiber and radar systems and other make industries that use zinc in their products. Also, Dutch mineral processing is exposed to this so-called reverse dumping<sup>58</sup> by China, compounding the disadvantage of high electricity and network costs for future investment. Once Dutch/EU mineral processing disappears, it will not come back, and imports from elsewhere will be necessary.

Recently, the EU did impose trade measures to compensate for unfair practises or subsidies (EVs, UCO, and possibly also procurement of health equipment), but more is needed when China keeps exporting its surpluses in the same way and at the rate as in 2024. This will become more urgent when the US does decide to impose substantial trade tariffs and other trade measures, leaving the EU and some other countries exposed as the go-to places. In that case, the EU must be ready and prepared to impose its own measures. CBAM alone will not be enough because many of the products that cause issues now do not fall under CBAM or because of the loopholes in the arrangement. The Corporate Sustainability Reporting Directive (CSRD)<sup>59</sup> may be another instrument that ends up increasing the cost of operating in

57 Dependencies, Risks And Measures Regarding The Use Of Critical Raw Minerals Within The Dutch Defense Industry Strategy Areas, Berenschot For Ministry Of Economic Affairs And Climate, Final Report 12 June 2024, <https://open.overheid.nl/documenten/5071847d-1059-4192-ad52-7706681d05e4/file>.

58 Interview With Representative Of Dutch Industry, 23 January 2025, Referring To The Practice Of Offering Government Supported Low Smelter Rates To Attract The Best Resources For Their Smelters At The Detriment Of Competitors.

59 Directive (EU) 2022/2464, 14 December 2022, [https://eur-lex.europa.eu/legal-content/en/txt/pdf/?uri=celex:32022l2\\_464](https://eur-lex.europa.eu/legal-content/en/txt/pdf/?uri=celex:32022l2_464)

the EU: witness the January 2025 report of BusinessEurope,<sup>60</sup> as it also applies to non-EU corporations with subsidiaries in the EU with a certain turnover. Sourcing commodities or semi-finished products may become harder, narrowing the market (further) and stimulating processing elsewhere and the export of final products instead. Gaming the trade protection and the Green Deal regulations may become another impediment for EU industry to become more competitive in the short and medium term. The European Peoples Party (EPP Group) posted a call for a change in *Fit for 55* to reduce the regulatory burden on the EU car industry and allow for more flexibility to achieve Green Deal targets in the run-up to the new EU plans for industry.<sup>61</sup> The issue is that China should be pressured into reforming its economy, just as Japan was in the late 1980s, to rebalance its trade and domestic economy sooner rather than later.

The war in Ukraine has led to a reorientation of military equipment production in the EU and the UK. With the peace dividend no longer there, the European members of the North Atlantic Treaty Organisation (NATO) are rapidly increasing their spending on defence. At the same time, they are urging defence industries to increase their European production capacities. These industries require long-term commitments for procurement from European governments, while demand for all sorts of (preferably domestic) manufactured parts and finished products in the value chain is bound to grow as a result. The defence products value chains, which had suffered from attrition before, need to be organised anew to fit the expected type of warfare. Many basic industries are part of this security value chain. A mismatch in time, with one sector growing and others shrinking, may present the defence industries with a declining domestic capacity to procure from EU industries. Procuring from less-friendly countries goes against the strategic autonomy of the EU and does little to remedy the short-term perils of EU industry.

The focus on security also repositions the importance of oil refineries, particularly those that are connected to the NATO pipeline system to deliver the needed fuel for tanks, trucks and planes. Strategic liquid fuel storage is also an important part of this value chain and the ability to quickly send out fuel to where it is needed. Ports that fulfil a function in the defence supply lines will have to maintain their capacities and, perhaps, expand them for future use. The same applies to steel, mineral processing, a wide variety of chemicals, and large and small manufacturing industry, needed for the energy transition and security-related industries.

60 BusinessEurope, Reducing Regulatory Burden To Restore The Competitive Edge, 68 Proposals For The Reduction Of Regulatory Burden In 2025, [https://www.bussinesseurope.eu/sites/buseur/files/media/reports\\_and\\_studies/2025-](https://www.bussinesseurope.eu/sites/buseur/files/media/reports_and_studies/2025-)

61 Let's Not Abandon The Automotive Industry, 23 January 2025, <https://www.eppgroup.eu/newsroom/let-s-not-abandon-the-automotive-industry>

In addition to coal, oil and natural gas, steel and certain chemical products also fall within the dependencies in the energy-intensive supply chains. The integration of chemicals or steel or other minerals into many other manufacturing sectors and end-products, as well as the importance of understanding the economics of co-production, are often underappreciated in discussions on strategic industries or, perhaps, better strategic industrial ecosystems. On page 6 of the 2019 Masterplan for energy-intensive industries, the interconnections of many industrial sectors are aptly visualised (see Annex Figure B), showing the complexity of determining the strategic value of certain (parts) value chains for future economic strength.<sup>62</sup>

The EU debate on strategic industries<sup>63</sup> has not (yet) resulted in a departure from the previous approach to open international markets or in a readiness to intensify combatting unfair practises and subsidies that undermine the uneven playing field in the Single Market.<sup>64</sup> Moreover, given the use of a wide variety of subsidies and support in competing countries, a trade policy tool may only be partially effective. Furthermore, the high energy costs, the regulatory burden and the substantial taxes and levies (among which are CO<sub>2</sub> costs) for industry, compared to those of China and the US, fail to draw investors into the EU and create investment uncertainty among foreign-owned industries in the EU about upgrading their operations.

## A PAUSE IN OPEN-MARKET THINKING

The EU and China are relatively resource-poor and need to import energy and other raw materials. Also, the US imports certain more-concentrated raw materials. In an open, less politicised, economy, these are more easily sourced from other countries if everyone applies the same policies and practises, and the institutional arrangement of the markets does not hinder trade, investments and market entry. In general, trade barriers to energy and raw materials are very low or non-existent, while those on semi-finished and finished products are higher. The WTO ensures the most-favoured nation principle on tariffs, but non-tariff barriers (including organisational or institutional issues in market organisation, local ownership requirements, subsidies, cheap loans, etc.) and state aid can create unfair competitive practises. Tackling unfair competition issues can be arduous, particularly when the geopolitical

62 Masterplan For A Competitive Transformation Of EU Energy-Intensive Industries Enabling A Climate-Neutral Circular Economy, Report By The High-Level Group On Energy-Intensive Industries, 2019, <https://Op.Europa.Eu/En/Publication-Detail/-/Publication/Be308ba7-14da-11ea-8c1f-01aa75ed71a1/Language-En>

63 A New Industrial Strategy For Europe, Com (2020) 102 Final; Updating The 2020 New Industrial Strategy: Building A Stronger Single Market For Europe's Recovery, Com (2021) 350 Final, P.5, [https://Commission.Europa.Eu/Document/Download/9ab0244c-6ca3-4b11-Bef9-422c7eb34f39\\_En?Filename=Communication-Industrial-Strategy-Update-2020\\_En.Pdf](https://Commission.Europa.Eu/Document/Download/9ab0244c-6ca3-4b11-Bef9-422c7eb34f39_En?Filename=Communication-Industrial-Strategy-Update-2020_En.Pdf) And SWD (2021) 352 Final, <https://Eur-Lex.Europa.Eu/Legal-Content/EN/TXT/PDF/?Uri=CELEX:52021SC0352>.

64 COM (2021) 350 Final, [https://Commission.Europa.Eu/Document/Download/9ab0244c-6ca3-4b11-Bef9-422ceb34f39\\_En?Filename=Communication-Industrial-Strategy-Update-2020\\_En.Pdf](https://Commission.Europa.Eu/Document/Download/9ab0244c-6ca3-4b11-Bef9-422ceb34f39_En?Filename=Communication-Industrial-Strategy-Update-2020_En.Pdf)



powers are involved, and the damage is often done by the time the issue is resolved. In the 2010s, the world entered a period of more economic policy competition and rewriting of the international economic mores.

China needs international markets to help restructure the economy away from its heavy reliance on construction and manufacturing to more consumer demand driven products and services. The surpluses in cleantech compared to domestic demand are a case in point that its manufacturing capacity, also given the expected demographic changes and impact on labour and consumer markets, may have to restructure in the future.<sup>65</sup> Much will depend on the availability of export markets and the absence of protectionist trade measures. China, thus, has a strong interest in keeping international markets open for its exports (directly and indirectly) and being able to adjust its manufacturing capacity over a longer period to domestic and export demand, while maintaining dominance of the supply lines – ownership matters in a geopolitical world.

The Trump Administration has communicated its plans to increase the barriers of trade with China.<sup>66</sup> The anticipation of new trade measures, in addition to steel and aluminum, by the US should also rattle the EU. In the event of US trade barriers going up, the EU – but also emerging markets such as India, Brazil, etc. – will be swamped with more Chinese exports seeking a market. The absorption capacity for Chinese products in the EU and elsewhere will come at the detriment of domestic producers. Chinese reshoring to countries with trade agreements with the EU is problematic when the state support practises continue.

Unless China is willing to substantially restrain exports, a response from the EU and other countries might be unavoidable, with each country erecting trade barriers and increasing the pressure on others to follow suit. The EU may no longer be able or allowed to play both sides of the US-China dispute. Instead, member states may have to decide on a strategy to defend their own industrial base, without becoming beholden to either of the two powers.

65 China's Ev Overcapacity Is Inevitable, China's Local Governments Have A Strong Interest Ensuring The Survival And Success Of Local Car Companies – Regardless Of Market, The Diplomat, 6 August 2024, <https://thediplomat.com/2024/08/chinas-ev-overcapacity-is-inevitable/>; Q+A: The Global Trade War Over China's Booming Ev Industry, Carbon Brief 28 August 2024, <https://www.carbonbrief.org/qa-the-global-trade-war-over-chinas-booming-ev-industry/>; Shuaizhang Feng, Jingliang Lu, Akiko Terada-Hagiwara, Wen Qi, A Closer Look At Causes Of Youth Unemployment In The People's Republic Of China, Adb Brief No. 247, June 2023, Asian Development Bank.

66 China's Currency Hits 16-Month Low On Tariff Fears, FT 8 January 2025; Donald Trump's Tariff Threat Adds To Fears Over China Growth, FT 19 December 2024; Trump Promises Trade Tariffs On Day One Of His Administration, FT 28 November 2024; Year In A Word: Tariff, FT 31 December 2024; Us Impossible Choice On Trade And Tariffs, FT 1 January 2025; Henry Farrell, America Should Think Twice Before Replacing Sanctions With Tariffs, FT 19 September 2024; America First Trade Policy, White House, 20 January 2025, <https://www.whitehouse.gov/presidential-actions/2025/01/america-first-trade-policy/>.

Some of today's issues remind us of the 1970s and 1980s, when Japan experienced its high growth and large trade surplus period of the early 1970s' dispute between Europe and the US.<sup>67</sup> Thus, the type of rebalancing that is needed is not a new phenomenon. What is new is the size of the Chinese overcapacity, which may result in a period of geopolitical and economic sabre rattling between large economies.

## 5.2 CHANGING TACK?

The Draghi report is focussed largely on longer-term structural internal ailments of the EU economy, innovation, and energy sector. However, urgent short-term matters are also arising in redressing the external imbalances to gain time for the policy reforms needed here. The window of opportunity to maintain the most important parts of the EU industrial base is shorter than the proposed remedies in the Draghi report imply. Once disinvestments start, the solid- looking Jenga tower will weaken and instigate other disinvestments, causing industrial ecosystems to unravel and collapse.

The Competitive Compass for the EU,<sup>68</sup> presented on 29 January 2025, is a first response to the Draghi report and the unfolding geopolitical battle for international markets. It aims to: "(...) safeguard the EU's future as an economic powerhouse, and investment destination and a manufacturing centre, a resolute European response is urgently need. What is at stake for Europe is not just economic growth, but the future of its model. (...) The Compass' goal is to nurture Europe's innate strengths, harness its resources and remove the barriers at the European and national level." Regarding the higher energy costs in the EU, the Netherlands should take note of the passage on page 9: "[S]ome cost components can be mitigated as they are determined by inefficiencies in the design of network tariffs and taxation or a lack of energy market integration." The communication reads as "a fault confessed is half addressed," but the question remains whether the EU and the member states can muster the same urgency in adjusting their approach to the new circumstances. The discussion is only beginning, while the water is already up to the necks of many industries.

The EU focus on CBAM as the main trade balance policy instrument, for instance, may be over-optimistic on its delivery. The Draghi report also concluded that it is easy to circumvent. The EU's economic focus is currently defined mainly by the Green

67 The Japanese Trade Surplus Was Also Countered With Trade Restrictions To Enforce Policy Reforms. In The 1990s Japan Entered A Period Of Slower Growth And Deflation And Many Of The Disputes With The Us And Eu Disappeared. European Countries Had Benefitted From The Bretton Woods System And Were Disciplined By The Us De-Facto Devaluation In 1971 When They Employed Trade Tariffs To The Amount That Currencies Needed To Re-Adjust To Reflect The Economic Balance.

68 COM (2025) 30 Final, Communication From The Commission To The European Parliament, The European Council, The European Economic And Social Committee And The Committee Of The Regions, A Competitive Compass For The EU, [https://Commission.Europa.Eu/Document/Download/10017eb1-4722-4333-Add2-E0ed18105a34\\_En](https://Commission.Europa.Eu/Document/Download/10017eb1-4722-4333-Add2-E0ed18105a34_En)

Deal as the leading leitmotiv for engagement with countries outside the EU. Member states may also have concerns about economic growth, employment, regional disruption due to concentrated economic activities and their fiscal balance. Particularly when large member states are involved, pressure on the EU Commission to act may increase (for instance, to lift the coming ban on combustion engines). Depending on the trade measures by the Trump administration, the EU may have no other option but to follow suit, even though it is not the most efficient solution for the world's imbalances in trade of goods, services and capital. The geopolitical bark of the Trump Administration to usher China into submission – as well as the EU and any other country trying to colour outside the American “lines” (i.e., economic rule set) – may start a long period of economic warfare.

The WTO has been struggling to discipline certain state-led economy member states to adhere to the rules because the uneven playing field is hidden in the organisation of the economic system. It is important that current accounts are in synch with fundamentals to avoid disruptive rebalancing.<sup>69</sup> China had 24 years to comply, and its argument that it is a developing country rings more and more hollow in the trade and environmental fora. The problem is that China can rely on quite a lot of support from countries in Africa and elsewhere to fend off attacks on its privileged position. Therefore, for such a move to work, for the EU, much will depend on the countries of the Organisation for Economic Development and Cooperation (OECD) to agree on joint actions.

## TRADE BALANCES

Looking at the EU-US and US-China trade balance, we see several developments that explain the immediate trade actions by the second Trump Administration.<sup>70</sup> The first Trump Administration's trade actions toward China led to a decrease in the trade account deficit in US-China trade, but an increase in the deficit with Mexico and Canada due to reshoring.<sup>71</sup> This might explain, after a review is completed, Trump's announcement on Inauguration Day of a 25% tariff on trade with these

69 Michelle Ca'Zorzi, Alexander Chudik And Alistair Dieppe, Thousands Of Models, One Story, Current Account Imbalances In The Global Economy, Working Paper Series, No. 1441, June 2012, <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1441.pdf> And Theo Aphecetche, Maria Bianchi And Guergana Stanoeva, Global Imbalances: False Alarm Or Genuine Source Of Concern?, Economic Brief 074, November 2022, [https://economy-finance.ec.europa.eu/document/download/c37ea376-8ec8-49e0-9bbe-efaf95ac9aaf\\_en?filename=Eb074\\_en.pdf](https://economy-finance.ec.europa.eu/document/download/c37ea376-8ec8-49e0-9bbe-efaf95ac9aaf_en?filename=Eb074_en.pdf).

70 America First Trade Policy, 20 January 2025, <https://www.whitehouse.gov/presidential-actions/2025/01/america-first-trade-policy/>

71 China's Top 10 Imports Before The Trade War And The Near-Shoring Myth, Forbes, 21 January 2025, <https://www.forbes.com/sites/kenroberts/2025/01/21/chinas-top-10-imports-before-the-trade-war-and-the-near-shoring-myth/>

two countries, while a review of China's compliance with the agreement from the first Trump Administration will determine new actions.<sup>72</sup>

The ten countries that export more than import to the US are China, Mexico, Vietnam, Germany, Ireland, Japan, Canada, Taiwan, South Korea and India.<sup>73</sup> The energy crisis lowered the Euro Area current account surplus in 2022, but the surplus increased again in 2023 and 2024.<sup>74</sup> The EU's share in US imports in 2024 was larger than that of China, Canada and Mexico.<sup>75</sup> The US total export and import balance with the Netherlands and Belgium reflect a growing US surplus due to higher energy imports from the US since 2022.<sup>76</sup> Interestingly, Foreign Direct Investments into the US have increased substantially, while those in China and Germany declined substantially.<sup>77</sup>

As a result of the policy instructions from the White House, a lively discussion has emerged among economists about the effectiveness of trade policy measures, whether they are unilateral or smart. In response to the *Foreign Affairs* article of 27 December 2024 by Michael Pettis – *How Tariffs can help America, Economists have Drawn the Wrong Lessons from the Failures of the 1930s*<sup>78</sup> – they suggest that one should also look at the impact on exchange rates and fiscal balances, as well as the appetite of China to reform, considering what they call the 'second China shock'.<sup>79</sup> It is the sheer size of China's economy, first as an engine of growth and now as an engine of growing imbalances, that raises most concerns.

72 America First Trade Policy, 20 January 2025, <https://www.whitehouse.gov/presidential-actions/2025/01/america-first-trade-policy/>

73 New Tariffs Didn't Come On Day One. A Trade War May Not Come Either, Barrons, 22 January 2025, <https://www.barrons.com>

74 Euro Area Current Account, Trading Economics, <https://tradingeconomics.com/euro-area/current-account> And Trump Brings The US Back From The Brink Of Trade War With Canada And Mexico, FT 4 February 2025.

75 Trump Brings The US Back From The Brink Of Trade War With Canada And Mexico, FT 4 February 2025.

76 US Factsheets, Bureau Of Economic Analysis, US Department Of Commerce, <https://apps.bea.gov/international/factsheet/factsheet.html#319>

77 US Share Of Foreign Direct Investment Surges To Record, FT 21 January 2025.

78 Michael Pettis, *How Tariffs Can Help America, Economists Have Drawn The Wrong Lessons From The Failures Of The 1930s*, *Foreign Affairs*, 27 December 2024; Niall Fergusson, *How To Win The New Cold War, To Compete With China, Trump Should Learn From Reagan*, *Foreign Affairs*, January/February Issue 2025.

79 The Pettis Paradigm And The Second China Shock, Will Tariffs Help Rebalance The Global Economy (And The Chinese Economy)?, Noah White, 16 January 2016, [https://www.noahpinion.blog/p/the-pettis-paradigm-and-the-second?publication\\_id=35345&utm\\_campaign=email-post-title&r=6g77v&utm\\_medium=email](https://www.noahpinion.blog/p/the-pettis-paradigm-and-the-second?publication_id=35345&utm_campaign=email-post-title&r=6g77v&utm_medium=email); Paul Krugman And Noah Smith Have A Chat, In Which We Talk About Paul's Departure From The NYT, Substack Writing, Trump, The 1980s, The Future Of Manufacturing, And More!, 27 January 2025, <https://www.noahpinion.blog/p/paul-krugman-and-noah-smith-have>; Paul Krugman Blog, Krugman Wonks Out.

## 6 JENGAFICATION

In the meantime, the discussion in the EU about the lagging productivity, the competitive disadvantage due to high energy costs and the longstanding inability to translate inventions and innovations into flourishing companies continues. The discussion on strategic autonomy does not necessarily have to imply self-sufficiency. When applying trade barriers, they could be linked to a certain market share for EU production as a way to expose EU industry to a certain level of competitive imports. This share may vary among sectors and parts of the value chain. Moreover, protection of local or regional ecosystems, communities and (highly skilled) employment could be factored in, while internal uneven playing fields should be avoided when member states compete for survival of their industries. Contrary to what some believe, the low-carbon economy will not easily rise out of the ashes of the current economy while industries in other parts of the world are not experiencing the same pressures. The current industries produce vital products for the low-carbon economy, be they speciality steel products, feedstocks, chemicals, or other manufactured products. Their asset base, knowledge and capital are needed to maintain the supply capacities for the low-carbon economy but are also important to generate sufficient demand for low-carbon electricity and molecular energy carriers. Unfortunately, demand for low-carbon energy and intermediate and finished goods is not materialising.

Trade measures may not sufficiently protect industries that supply both the EU and international markets. The NW Europe refining and chemical industry would still have to shrink when only the EU market and, perhaps, exports to the US remain. Moreover, the Trump Administration may also target EU exports, leaving only the EU market and smaller markets in the rest of the world, where China is now also a large exporter to these countries. Not an enviable outlook. This will substantially impact the energy-intensive industries in the ARRA-cluster, where many steel, chemical and manufacturing industries are located. Can they rely on EU policy measures to improve the investment climate in an environment where member states may end up competing for survival of their national industries and where larger member states have more of the Commission's ear than smaller ones?

Apart from the inter-EU policy competition and the impact on the uneven playing field for Dutch industry (energy costs and taxation), EU de-industrialisation may also occur due to higher energy costs compared to those of China and the US, the relatively small scale of EU industries compared to newer facilities in China, India and/or the Middle East, the lack of demand for low-carbon intermediates and final

products, and the impact on innovation (attrition) due to lower demand in general in the downstream part of the various value chains. They add up to a critical combination of weaknesses in the international arena.<sup>80</sup> The priority should be to make the EU and, more importantly, the Netherlands attractive for investments again.

With Trump's second inauguration, the EU is under increasing pressure to create a more conducive business climate and reduce the regulatory burden to lure investors back to the EU.<sup>81</sup> The EU's green agenda has, so far, not resulted in the anticipated flurry of investments in clean tech, hydrogen or carbon capture, and American investors currently label the EU as 'uninvestable.' Ursula von der Leyen promised far-reaching simplification of sustainable finance and due diligence rules, but perhaps more needs to be done to match the Trump Administration's drive on 'tax and rule-cutting agenda' and China's state support for industry and gaming of trade. The alternative is to slide into de-industrialisation that will seriously weaken the European and Dutch value chains needed for the energy transition. Such Jengafication<sup>82</sup> should be warded off, one way or another.

80 Some Of The Issues That Are Now Materializing (De-Industrialization And Protectionism) Are Explored In A Model For The UK And The Eurozone. The Results Of The Modelling Exercise Were Startling When Geopolitical (Energy) Shocks Were Included, And American And Chinese Industrial Policies Remain In Place: The UK And Eurozone Economies By 2027 Score Like Emerging Markets!, Hugo Erken, Frank Van Es, Michael Every And Erik-Jan Van Ham, Balance Of Payments -And Power- Crisis, Rabobank, 5 February 2023, [https://Media.Rabobank.Com/M/5a1fc87d97b6a6b6/Original/RR20230203\\_Balance\\_Of\\_Power.Pdf](https://Media.Rabobank.Com/M/5a1fc87d97b6a6b6/Original/RR20230203_Balance_Of_Power.Pdf)

81 Brussels Under Pressure To Curb Green Agenda In Response To Trump, Industry And EU Member States Urge European Commission To Wind Back Sustainability Rules, FT 26 January 2025.

82 Jengafication is named after the game of Jenga, removing blocs from a tower of wooden blocs until its structure weakens and collapses. In this paper it refers to the weakening of deeply integrated industrial value chains when vital parts disappear due to deindustrialisation and negatively impact the business case of the remaining parts of the value chain.

## 7 WHICH WAY FORWARD?

The EU is confronted with a short-term predicament on how to keep its Green Deal agenda alive in the face of competitive imports from China and the American tax, deregulation and trade measures. Instead, the EU should build on the (remaining) strengths of the current industrial base (assets, people, capital) and not destroy it. The Green Deal was supposed to slowly squeeze out industrial carbon emissions and replace them with low-carbon industrial activities. Many policymakers still uphold this benign image of the energy transition and continue to demand more investments, stricter enforcement of ever tighter norms for industry, while industry is struggling with higher energy costs, CO2 prices and taxes, and uncertainty about demand in markets. The stark reality is that capital markets are not buying into the EU avenue of the energy transition. In the face of these many uncertainties, EU industry business models to adapt to 2030 targets do not add up, not only because of the uneven playing field in the EU single market and in international markets, but also because a different reality is transposed on the EU by the US and China, which are in the middle of a serious geopolitical power play.

Unless the EU and the member states can come up with efficient countervailing measures, the EU industry risks being dwarfed and relegated to play in the little league rather than in the major league. The recent flurry of trade agreements may help some, but they do not represent the main markets for EU industrial products; nor do they prevent the EU industry from meeting Chinese state-supported competitors in these markets.

The impact of China's economic expansion on the world economy was sometimes hard to grasp in terms of production volumes and capital allocation, but the impact of the end of its expansion may become devastatingly large and unevenly distributed. The Chinese economy is currently exporting its (state-supported) oversupplies to international markets, risking a strong trade policy response from importing countries to avoid a drastic restructuring of their economies. Even in a collaborative world, this would be a tall order to manage. China has, since the start of the US-China trade conflict, reallocated its foreign direct investments mainly to Asian countries, creating its own circle of friendly partners in anticipation of less-collaborative relations with the US and, perhaps, the EU. The BRICS-group provides them with another set of friendly countries, although it remains to be seen how they will respond when their markets are flooded with more Chinese exports.

Nonetheless, China needs the US and EU markets to shore up its companies' profits, manage its state finances and buy time to restructure without creating social unrest. Perhaps the aggressive stance of the US is the route towards a deal with China on an early restructuring of its economy and reduction of its exports. In that case, the EU should align with the US dealmaking and prevent coming into the Trump Administration's crosshairs themselves (on tech, energy, security, regulation, capital markets and taxation). Also, for the EU, much is riding on the large trade flows with China and the US (see Annex Figure D) in this zero-sum game. This may throw a completely new light on the recommendations of the Draghi and Letta reports and could increase tensions between the states over which way to go forward. A reform of the EU budget could be a first step<sup>83</sup>, rather than starting with piling new debt on member states, without a guarantee of receiving a fair share of the foreseen investments in the tug of war among member states.

Given the external pressures on EU industry, the Dutch government may entertain a leap forward into a low-carbon competitive industrial base by substantially lowering the domestic non-commercial costs for industry. These costs consist of levies, CO<sub>2</sub> and energy taxes, and the administrative burden. Industries should be allowed more choice or flexibility in the route towards low-carbon production to overcome infrastructural bottlenecks and other barriers. The aim should be to create an even playing field in the single market. The Dutch strategic industry push could be part of a national alternative (or moving ahead of the Draghi plan while it can) to finance the energy transition, to narrow the competitive gap in the EU and to become better positioned to ward off the strategic industry and trade moves of China and the US. The Netherlands may even find some support in like-minded member states or Brussels to arrest the slide into deindustrialisation. Once deindustrialization takes hold and industries disappear, other (small and large) industries in the value chain may follow suit. This 'Jengafication' can cause irreversible deindustrialization and a diminishing ability to realise our industrial energy transition and strategic autonomy.

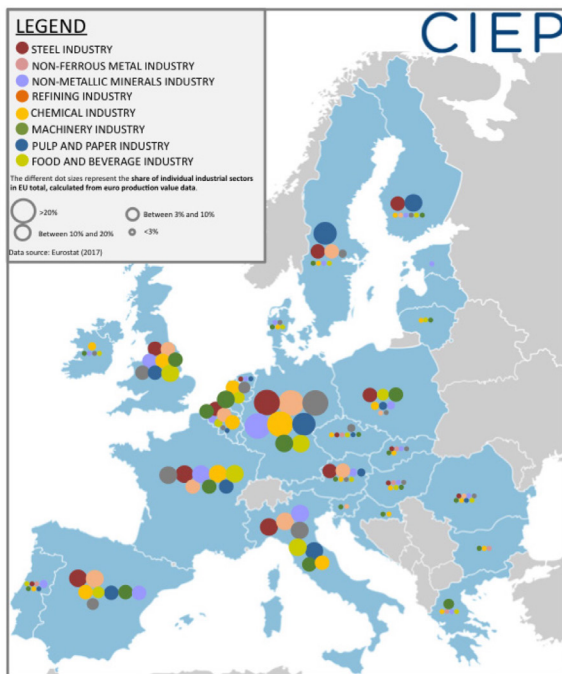
83 EU plans radical budget overhaul handing more power to capitals, FT, 11 February 2025. "It notes that the need to repay costs for Covid-era bonds alone would amount to 30bn a year, or 20 percent of the bloc's spending- an unprecedented financial burden that will force the EU to rethink overall contributions. Any bid to increase the overall budget will probably meet stiff resistance from the biggest contributors to the budget such as Germany and the Netherlands."



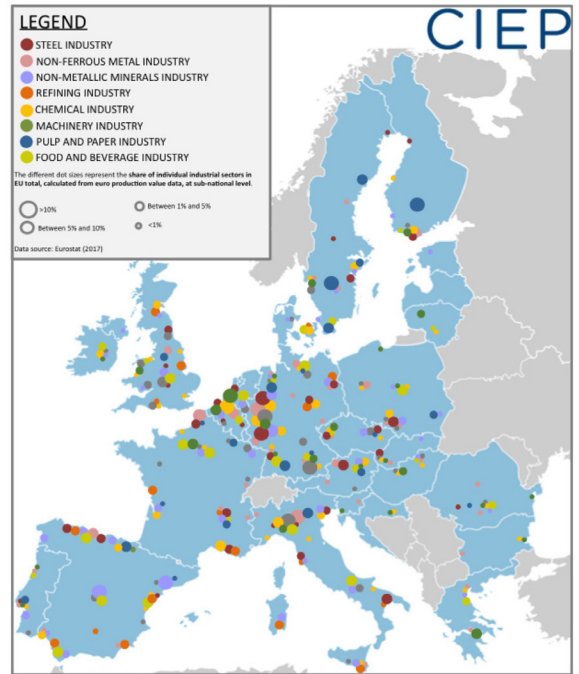
# ANNEX

FIGURE A

## SCHEMATIC DISTRIBUTION OF INDUSTRY IN THE EU



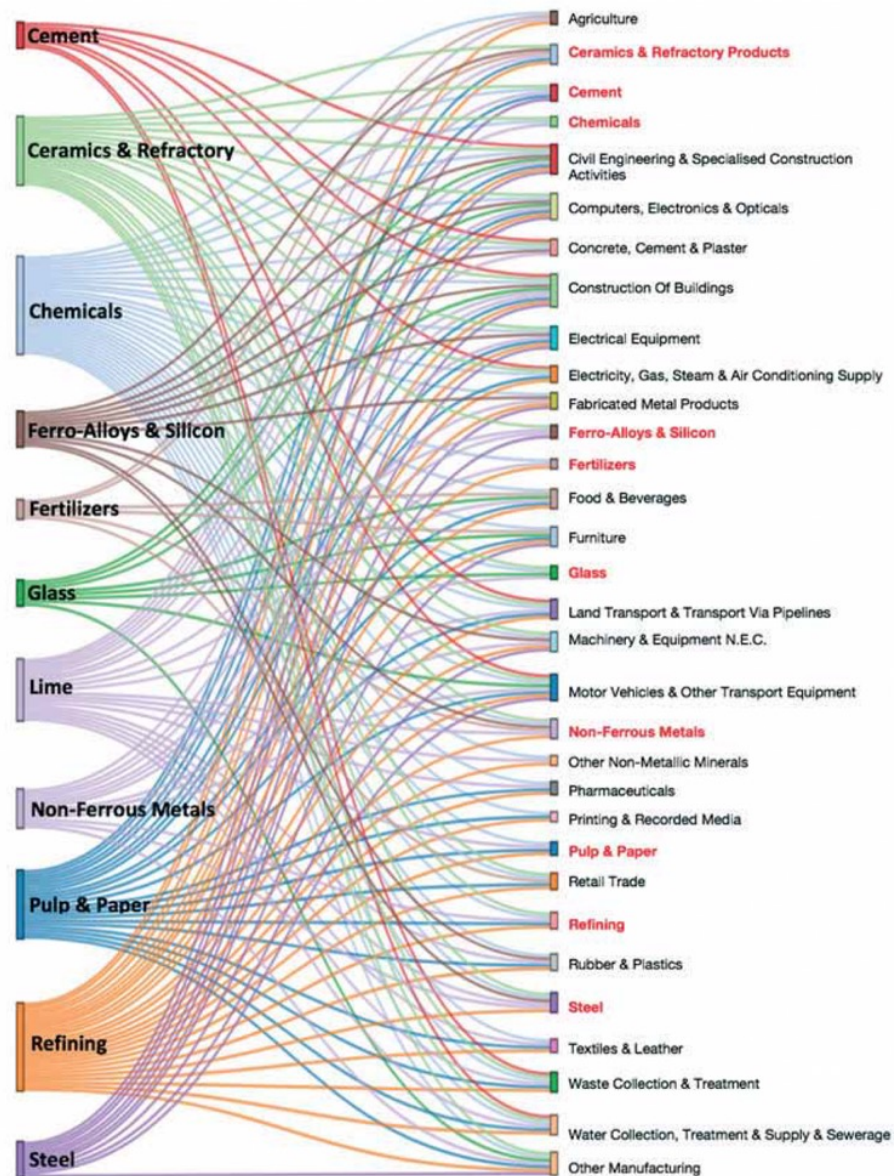
MAP 1 – DISTRIBUTION OF INDUSTRIAL PRODUCTION (EURO VALUE) BY INDUSTRIAL SECTOR, ACROSS EU MEMBER STATES. BASED ON 2015 EUROSTAT DATA. DOT SIZES ARE RELEVANT WITHIN THEIR RESPECTIVE SECTOR.



MAP 2 – DISTRIBUTION OF INDUSTRIAL PRODUCTION (EURO VALUE) BY INDUSTRIAL SECTOR, ACROSS EU MEMBER STATES IN A SUB-NATIONAL BREAKDOWN. BASED ON 2015 EUROSTAT DATA.

Source: Iulia Pisca, European Union Industrial Energy Use with a Focus on Natural Gas, Briefing Paper, CIEP, 2017 no. 3, [https://ciep.energy/media/pdf/uploads/CIEP\\_2017\\_\\_03\\_web.pdf](https://ciep.energy/media/pdf/uploads/CIEP_2017__03_web.pdf)

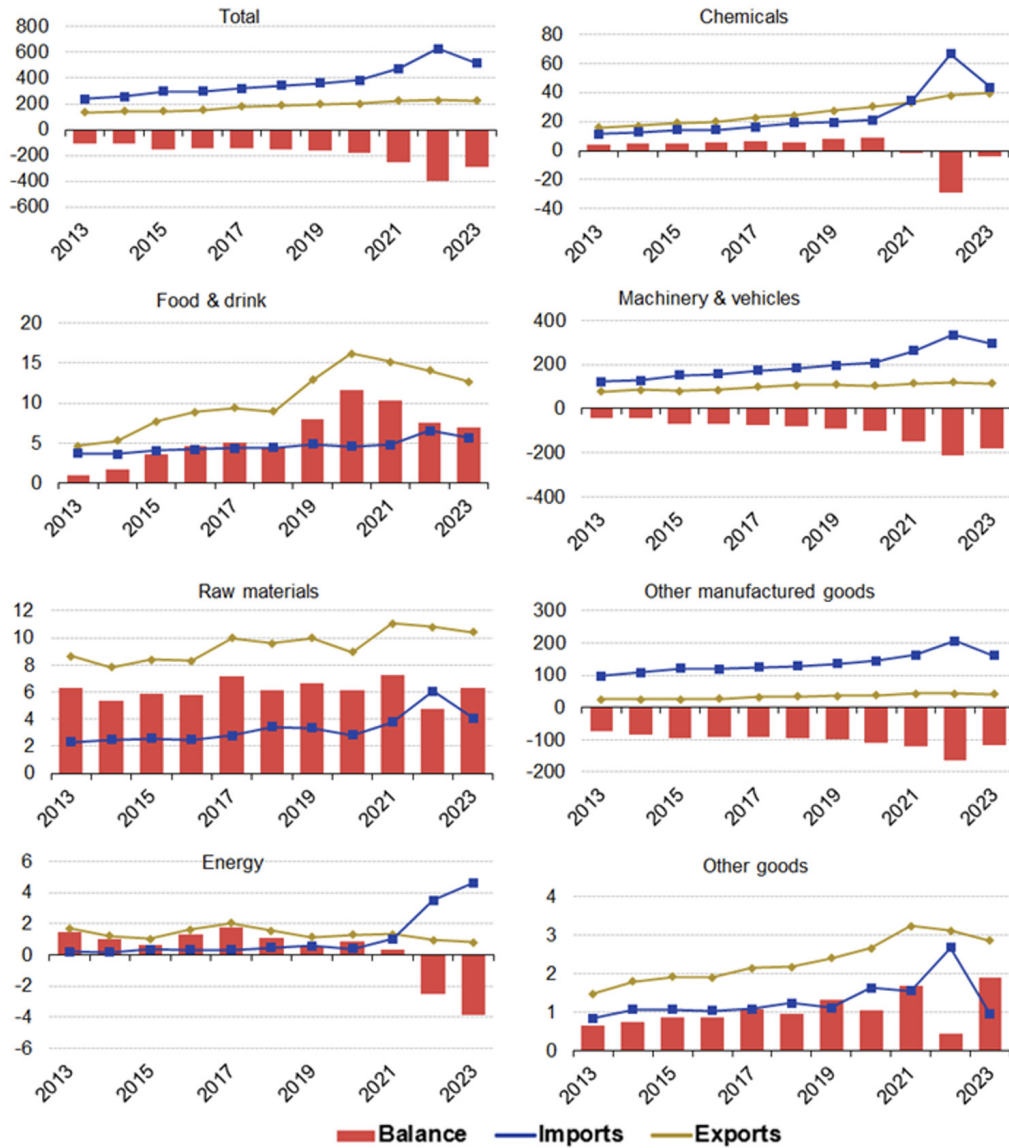
FIGURE B DEEP INTEGRATION OF EU INDUSTRIES



SOURCE: MASTERPLAN FOR A COMPETITIVE TRANSFORMATION OF EU ENERGY-INTENSIVE INDUSTRIES ENABLING A CLIMATE-NEUTRAL, CIRCULAR ECONOMY BY 2050, 2019, [HTTPS://OP.EUROPA.EU/EN/PUBLICATION-DETAIL/-/PUBLICATION/BE308BA7-14DA-11EA-8C1F-01AA75ED71A1/LANGUAGE-EN](https://op.europa.eu/en/publication-detail/-/publication/be308ba7-14da-11ea-8c1f-01aa75ed71a1/language-en)

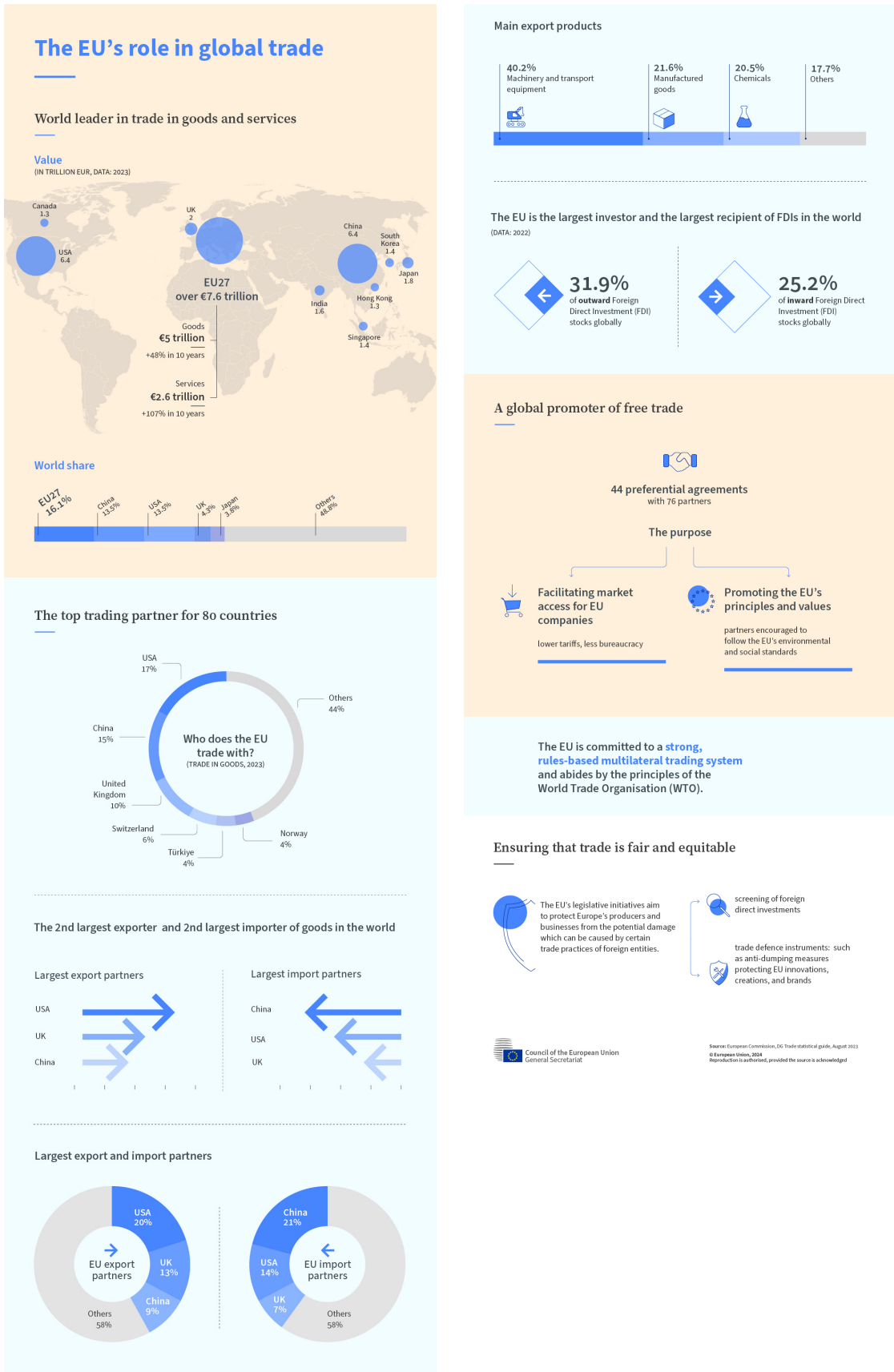
FIGURE C EU TRADE WITH CHINA

### EU trade with China by group, 2013-2023 (€ billion)



SOURCE: CHINA-EU- INTERNATIONAL TRADE IN GOODS STATISTICS, FEBRUARY 2024,  
[HTTPS://EC.EUROPA.EU/EUROSTAT/STATISTICS-EXPLAINED/SEPDF/CACHE/55157.PDF](https://ec.europa.eu/eurostat/statistics-explained/sepdf/cache/55157.pdf)

FIGURE D THE EU'S ROLE IN GLOBAL TRADE



SOURCE: [HTTPS://WWW.CONSILIUM.EUROPA.EU/EN/INFOGRAPHICS/THE-EU-S-ROLE-IN-GLOBAL-TRADE/](https://www.consilium.europa.eu/en/infographics/the-eu-s-role-in-global-trade/)

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