



EU ECONOMIC SECURITY: CONFRONTING THE DUAL CHALLENGE OF CHINA AND THE US

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SUMMARY

Donald Trump's return to the White House has hit the EU like a tornado. Until the end of 2024, concerns about trade dependencies remained primarily focused on imports from China. However, the US' increasingly aggressive stance towards its trade partners has shifted attention to EU exports, demanding urgent and far-reaching adjustments.

Consequently, the EU must confront a dual challenge posed by both China and the US. This should serve as a lesson that achieving EU economic security requires a comprehensive approach. It is not just about imports and exports but also about cross-border investment linkages and the slow yet undeniable shifts in the global monetary system that shape how trade and investment take place. While the EU has been expanding its policy toolkit for a less benevolent global environment, many of the fundamental assumptions underpinning its economic framework – such as a stable rules-based system, free markets and reliable alliances – no longer hold.

In this new reality, developing new instruments alone will not be enough. The EU faces critical political choices, from its commitment to the WTO to the creation of a genuine EU industrial policy and the necessity, rather than the mere aspiration, of deepening its single market and turning its focus inward. These decisions will shape the foundations of its economic security in the years ahead.



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1. INTRODUCTION

The term ‘economic security’ has gained significant global traction in recent years. Much like ‘strategic autonomy’¹, it is a broad concept with various interpretations, often employed to justify new policies and strategies. While the two concepts are sometimes used interchangeably, they are related but different. One can think of economic security as the foundation of open strategic autonomy, to the extent that being able to make decisions independently cannot be achieved without ensuring economic security first. At the same time, open strategic autonomy promotes actions such as diversification, increased domestic capabilities and external partnerships that are instrumental for achieving economic security.

Broadly, economic security encompasses policy strategies at the intersection of safeguarding against major economic disruptions and protecting national security². This includes defence against potential risks arising from international economic linkages – such as trade and financial ties – whether these risks stem from external shocks, like Covid-19, or deliberate actions by foreign governments³. These issues are especially relevant today, given the dual pressures of deep economic integration through trade, foreign direct investment and supply chains, alongside increasing geopolitical tensions. Some governments overtly leverage economic dependencies and, at times, economic coercion to achieve political objectives.

This growing focus on security stems from three key structural changes, all of which pose significant challenges for the EU. *First*, the US-China trade war, Russia's full-scale war against Ukraine and, more recently, US threats to resort to tariffs have all severely weakened the multilateral trading system. The EU, with its very high degree of openness and its full commitment to World Trade Organization (WTO) principles, finds itself in a unique and vulnerable position. Trade dependencies can be exploited as powerful tools, and growing disregard for WTO principles creates an uneven playing field where competition becomes increasingly difficult.

Second, technology is widely recognised as a key driver of both economic success and geopolitical power. There are growing concerns that the EU is falling behind the US and China in this area, as highlighted by the [Draghi report](#). Development and access to key technologies are crucial both for competitiveness and economic security.

1 See Alcidi et al. (2023) for a review of the concept's evolution.

2 See Pisani Ferry and Zettlermayer (2024) for a more detailed explanation.

3 See European Commission (2021 and 2022).

Third, while there is no full consensus on how to achieve the green transition, technological progress is universally acknowledged as a critical factor. This underscores the need for investments in technology – investments that cannot be made by the private sector alone.

In this context, economic security has taken centre stage in the EU debate and is expected to work as an umbrella principle defining future EU strategies and actions across different areas.

Economic security is closely tied to trade de-risking and can entail very different approaches, ranging from the simple diagnosis of risks associated with external linkages (vulnerabilities) and how to manage them, heavy government interventions in the economy through industrial policy, to resorting to unilateral trade policy measures, outside of WTO principles. All of them are becoming increasingly frequent.

In particular, the US' growing use of the national security card to justify violating WTO principles and its actions since 2018 to dismantle its dispute settlement are substantially reducing the WTO's powers and its credibility. More deeply, the US' tariffs, first on its key trading partners – China, Canada, Mexico and the EU – and then on the rest of the world, have shaken the entire global system. A series of announcements on shocking tariff rates, followed by walk backs and changing narratives, have led in turn to temporary suspensions and a period of high uncertainty, highlighting clearly that the era of free trade in a multilateral system is now over.

Canada immediately announced and implemented countervailing tariffs against the US. China has refused to negotiate, which has led to a full-scale trade war. While reciprocal tariffs announced on 2 April against other countries were suspended for 90 days, tariffs on China were increased. China remained defiant and reacted forcefully. At the time of writing, the US and China have imposed reciprocal tariffs of 145% and 125%, respectively, on most goods.

The EU, however, has chosen a different approach. It initially reacted — more symbolically than substantively — by reinstating the measures it had introduced in 2018. These measures were subsequently suspended to allow breathing space for negotiations. The EU proposed to Trump a comprehensive EU-US free trade agreement to eliminate all tariffs on both sides. Nevertheless, there was never any real follow-up on this suggestion. The EU has maintained its threat of more substantial retaliatory measures if no agreement is reached (see Section 3). Now the question is whether the EU *can* and *should* remain the absolute defender of free trade. The unpleasant reality is that in the current geopolitical tensions, retaliation may be politically unavoidable, even if it is economically dubious. This raises a fundamental dilemma for the EU.

Another important consideration relates to the linkages between trade and industrial policy. They shape a country's economic structure and competitiveness. Trade policy governs how domestic industries interact with the rest of the world through agreements and measures that either facilitate or restrict trade exposure and opportunities. Industrial policy, on the other hand, focuses on strengthening domestic capabilities. Economists have long debated how necessary industrial policy is as a policy instrument. However, it has recently gained renewed attention, including in the EU, particularly following its resurgence in the US under the Biden administration. Much like tariffs, industrial policy is likely to be a key feature of the future policy landscape.

In a context of heightened geopolitical tensions, one would expect increased domestic coordination between the two policy areas to achieve economic security and boost self-reliance. Strategically, this should entail building domestic strength first and then using trade policy to defend it or leverage it globally. However, currently, the US focus is only on tariffs to limit imports. It is far from certain that restricting access to foreign goods will trigger domestic reindustrialisation, instead of shortages of supply.

The EU has taken the opposite approach — commitment to free trade and WTO principles combined with a strong aspiration for an EU industrial strategy, though with limited tools. Security concerns have prompted policymakers to propose relocating the production of certain goods deemed strategic within national borders and to redouble efforts to secure supplies or strengthen ties with countries considered aligned. With this approach, until 2024, China was the country the EU wanted to derisk itself from and this was the main driver of EU industrial policy considerations. However, Trump's return has made the reality far more complex. A variety of US policies, including those beyond trade, are causing great concern about whether the EU can still count on the US as a reliable partner.

From a domestic perspective, while there is no doubt that when national security concerns arise, they become a top public policy priority everywhere, it must be acknowledged that de-risking, reducing import dependencies and relocating industries can come with significant economic inefficiencies and public costs. Attempting to establish domestic production in sectors where access to essential raw materials is limited, or where a comparative advantage is lacking, leads to higher production costs, higher consumer prices, and heavier burdens on public budgets — all with no guarantee of successfully rebuilding key capabilities. The economic and political implications of such policies must be carefully evaluated before governments fully commit to walking this path.

The remainder of this In-Depth Analysis paper is structured as follows: the next section examines key policy initiatives in the US and China that have heightened trade tensions and created challenges for the EU. Section 3 expands the concept of dependency beyond

trade and looks at cross-border investment, exploring its links to trade and ongoing shifts in the global monetary system, and puts forward considerations about their implications for the EU. Section 4 reviews the EU's policy toolbox and explores potential options for EU trade and industrial strategies. Finally, Section 5 presents some conclusions, emphasising the need for an integrated approach to economic security and potential EU policy responses.

2. A CHANGING GEOPOLITICAL AND GEOECONOMIC LANDSCAPE

In recent years, US and Chinese approaches as global economic actors have shifted significantly, evolving along two primary trajectories. These trajectories have common elements despite the differences in the two countries' political, social and economic systems. First, both nations have increasingly adopted confrontational stances, prioritising their national interests over multilateral cooperation. This shift has been marked by policy measures that often clash with WTO principles. Despite remaining members, both countries have implemented unilateral policies, from tariffs and trade restrictions to investment controls, bypassing WTO dispute resolution mechanisms and eroding the organisation's role as a neutral arbiter of global trade disputes.

Second, each nation has integrated economic strategies that prioritise (national) security and technological dominance alongside traditional economic goals. For the US, this has involved expanding domestic industrial policies, such as the CHIPS Act, which aims to reduce dependency on Chinese semiconductor production and more recently, an extremely aggressive trade stance. Similarly, China's 'Made in China 2025' and its Belt and Road Initiative (BRI) seek to secure critical resources and supply chains while advancing Chinese technological and economic influence globally. This focus on national security and resilience has increasingly shaped the nature of their policies, influencing investment flows, regulatory standards and the movement of critical technologies.

This shift completes a complex landscape of rising geopolitical tensions intensified by ongoing conflicts in Ukraine and the ongoing violence in Palestine, which risks sparking a broader crisis in the Middle East.

These geopolitical and geoeconomic frictions are compounded by a challenging macroeconomic environment. Over the past few years, the EU and the global economy have been on a rollercoaster ride – inflation, which was subdued in 2019, surged into double digits by 2022, while interest rates swung from historic lows to rapid increases. While economic conditions stabilised during 2024, many countries, including EU countries, face pressing needs for fiscal consolidation to manage elevated debt levels and sustain long-term financial stability.

These needs contrast sharply with rising demands for active government intervention in the economy. Calls for industrial policy to secure supply chains, safeguard key sectors, foster technological independence and invest in defence are becoming more frequent, driven by security concerns. This tension between fiscal constraints and the push for economic security measures will likely shape policy agendas and popular concerns in the coming years, as governments grapple with balancing economic stability and security amidst an increasingly fragmented global order.

The significant deterioration of the global growth outlook, driven by the US tariffs, is going to make it even more difficult to strike the right balance.

From an EU perspective, adapting and responding to the changing attitudes of China and the US, the EU's two main trade and investment partners, will be key to managing the challenges of a more multipolar and less multilateral global system and for defining its economic security strategy.

2.1. A MORE INWARD-LOOKING AND LESS RELIABLE US

The US' shift towards a more inward-looking policy approach has become increasingly clear for about a decade. This shift has been driven by both main US political parties, even though the start of the second Trump administration is greatly magnifying this trend.

While 'America First' became synonymous with the first Trump administration and defined a new yardstick for an inward-looking US, the US had already shown earlier signs of withdrawing from its role of benevolent hegemon. The Biden administration's Inflation Reduction Act (IRA) and tariffs against China are prominent examples, among others, of a shift towards putting domestic economic objectives above international commitments (See Box 1 for an overview of recent US measures).

Box 1. Overview of recent US initiatives and measures to strengthen its economic security

Over the past few years, there have been several initiatives under different administrations. They reflect the US government's multifaceted approach to strengthening its economic position, securing critical supply chains and addressing domestic and international economic challenges. These initiatives have impacted international trade and financial linkages in a complex and varied way, influencing global markets, investment flows and international economic relationships, including with the EU.

Tax Cuts and Jobs Act (TCJA 2017): *Corporate Tax Reduction:* Lowered the corporate tax rate from 35% to 21%, making the US a more attractive investment destination. This has had mixed effects on trade and financial linkages, including increasing inward investment and capital repatriation (which was very substantial in 2017-18).

Export Control Reform Act (ECRA, 2018): ECRA revived many provisions of the expired Export Administration Act (1979), tightening controls on emerging and foundational technologies to address competition with China and security concerns. The US has implemented stringent export controls on advanced technologies to prevent them being accessed by adversaries, particularly China. This includes restrictions on semiconductors, telecommunications equipment and other critical technologies, impacting global tech supply chains and trade flows.

Tariffs and trade policies (particularly against China, 2018 – ongoing): The first Trump administration initiated a trade war with China in 2018, when the US imposed tariffs on Chinese goods, leading to retaliatory tariffs by China on US goods. This has disrupted global supply chains, increased costs for businesses and affected trade balances. The US imposed additional duties of 10% and 25% on

certain imports of aluminium and steel products going into the US (from all countries – including the EU, Canada and Mexico) following so-called Section 232 investigations carried out by the US Department of Commerce. It concluded that importing these products threatened US national security and subsequently recommended action to restrict imports. The US removed the Section 232 tariffs on steel and aluminium imports from the EU in 2022.

Section 301 Tariffs (2018)⁴: These tariffs targeted Chinese goods in response to unfair trade practices concerning intellectual property theft and forced technology transfer, which significantly impacted bilateral trade and prompted companies to reconsider their supply chain strategies. The Biden administration retained most of these tariffs.

Section 301 Tariffs (four-year) Review, 2024: In May 2024, under the Biden administration, the US Trade Representative announced a review of Section 301 tariffs, proposing significant tariff hikes on strategic goods imported from China. Most tariffs took effect in 2024, with some delayed until 2025 or 2026 to allow importers time to adjust. While most goods face a 25% tariff, semiconductors, solar cells, syringes and needles have a 50% duty, and electric vehicles (EV) 100%. The affected product categories are valued at USD 8.1 billion in 2023 imports. Key targets include non-EV lithium-ion batteries (USD 10.8 billion), semiconductors (USD 2.32 billion), and EV lithium-ion batteries (USD 2.29 billion). These tariffs, particularly on EV batteries, complement the IRA's stringent EV tax credit conditions, intended to shift EV supply chains away from China. The 25% EV battery tariff reduces the likelihood that US automakers will bypass IRA tax incentives in favour of cheaper Chinese components. This tariff escalation aimed to signal to US firms in key sectors that relying on Chinese imports has a clear time limit while signalling to China and other trading partners the sectors where the US market will become increasingly restricted. This move came as a response to the high degree of US dependency on China's imports and its quest to seek alternatives. However, it is currently unclear whether these measures will remain in place or will be replaced by general tariffs – which seems to be the second Trump administration's preferred approach.

Economic sanctions against Russia (2020): In response to geopolitical developments, including the illegal annexation of Crimea (2014) and the full-scale invasion of Ukraine in 2022, the US has imposed increasing economic and financial sanctions on Russian entities – above all banks – and individuals. These sanctions have broad implications for global financial linkages and trade with Russia but also triggered adjustments in the global monetary system.

Executive Orders and policies on critical supply chains (2021): The Biden administration issued several Executive Orders to assess and improve the resilience of critical supply chains, such as semiconductors, batteries, critical minerals and pharmaceuticals. These initiatives are designed to reduce dependency on foreign sources, particularly from geopolitical rivals, and to secure domestic manufacturing capabilities.

Bipartisan infrastructure law (Infrastructure Investment and Jobs Act), 2021: Significant investments in US infrastructure, including transportation, broadband and energy systems, to enhance trade logistics and improve the overall business environment for both domestic and international investors.

⁴ Section 301 tariffs are trade measures imposed by the US under Section 301 of the Trade Act of 1974. This section grants the US Trade Representative the authority to investigate and act against foreign countries that violate trade agreements or engage in practices deemed unfair or discriminatory to US commerce.

Inflation Reduction Act (2022): Includes significant investments in renewable energy and green technologies, which can impact global supply chains and trade in energy-related sectors. It aims to reduce US dependence on foreign oil and promote the domestic production of clean energy technologies, potentially impacting global energy markets.

International Emergency Economic Powers Act (IEEPA, 2025 measures): The Act authorises the US president to regulate international commerce after declaring a national emergency in response to any unusual and/or extraordinary external threat to the US. The second Trump administration has utilised the Act to impose tariffs on imports from Mexico, Canada and China including a 25% tariff on products from Mexico and Canada (with a 10% tariff specifically on Canadian energy resources) and a 10% tariff on all Chinese imports, with the stated purpose to protect domestic industries and address trade imbalances. Tariffs on Mexico and Canada were initially paused to bolster border enforcement.

Extension of the 2017 Tax Cuts and Jobs Act and strengthened export controls (2025): The second Trump administration announced that it would be extending the Tax Cuts and Jobs Act and its individual and estate tax elements that expire in 2025, supposedly aimed at attracting US capital back to the US. It is also enacting stricter regulations on exporting sensitive technologies (export control) and imposing sanctions on nations deemed security threats.

Fair and reciprocal tax plan (2025): The second Trump administration announced a plan to tackle the US trade deficit, which involves raising tariffs against all its trade partners to retaliate against taxes, levies, regulations and subsidies that Washington considers unfair. This would also include non-tariff barriers, like the EU's VAT and the digital services tax.

Multiple tariffs against all countries in the world (2025): see below.

Since the beginning of his second term, President Trump has intensified his threats to impose tariffs and other trade measures on all US partners, citing a range of sometimes conflicting objectives – including protecting national interests, responding to foreign trade barriers, generating US federal revenue and addressing trade deficits. The tariff announcements seem to reflect both a genuine intent to reshape international trade norms in a lasting way and a strategy to leverage concessions during negotiations. This is proven by the fact that while some threats were not implemented or were scaled back, the enforcement of many measures, along with the increasing number of additional actions and retaliatory responses, points to a global fundamental shift towards protectionism and a dramatic increase in policy uncertainty. Tables 1 and 2 provide a summary of the US tariffs and the retaliatory measures taken by targeted countries.

Table 1. US tariffs since the start of Trump's second term

Status	Target country	Description
Announced, 1 February	Canada, Mexico and China	Tariffs and end duty-free <i>de minimis</i> treatment of low-value packages from these countries.
On hold for 30 days, 3 February	Canada ⁵ and Mexico	Purpose: to secure borders and reduce trafficking.
In effect, 4 February	China	10% on all imports and ends <i>de minimis</i> treatment.
Announced, 13 March, planned for April	Global	Reciprocal Trade and Tariffs Memorandum: A plan to counter nonreciprocal trading arrangements.
In effect, 4 March	Mexico	25% on all imports.
In effect, 4 March	Canada	25% on all imports, lower rate for energy.
In effect, 4 March	China	Additional 10% on all imports.
Partially suspended, 6 March	Canada and Mexico	Relieve for goods that fall under the USMCA trade agreement.
In effect, 12 March	Global	25% on aluminium and steel.
26 March	World	25% tariffs on automobiles and certain automobile parts, with special tariff exemptions for USMCA-compliant imports.
Planned, April	Global	Unspecified tariff on agricultural products.
Planned, April	Global	Unspecified tariff on foreign-produced cars.
Threatened, 13 March (currently on hold)	EU	200% on EU alcohol imports.
US announces reciprocal tariffs, 2 April	World	Differentiated rates equivalent to the ratio of US deficit/US imports divided by two. 10% is the baseline rate applied to all countries.
Reciprocal tariffs go into effect, 9 April	World	Country-specific tariff, ranging from 1% to 74%, on imports from nearly all countries that have a goods trade surplus with the US.

⁵ Canada tried to negotiate to avoid US tariffs. A series of measures to secure the Canada-US border has been put in place to tackle illegal migration and fentanyl trafficking, in the hope of meeting Trump's concerns.

Temporary suspension of reciprocal tariffs, 9 April	World	Differential tariffs paused for 90 days; 10% applied to all countries, additional tariff increase for China.
Announced 10 April	China	145% on all goods.
Announced: tariffs on electronics temporarily paused	World	20% of electronics, including from China

Source: [Alcidi et al. \(2025\)](#), based on: [Peterson Institute for International Economics](#), Financial Times, European Commission. Last update: 15 April 2025.

Table 2. Overview of the retaliatory measures against the US

Status	Country retaliating	Description
Announced, 1 February	Canada	Two rounds of tariffs targeting US exports, including orange juice, peanut butter, wine, spirits, beer, coffee, appliances, apparel, footwear, motorcycles, cosmetics, and pulp and paper.
In effect, 4 March	Canada	25% tariffs on CAD 155 billion worth of imported goods from the US, announced on 1 February.
4 March (in effect on 10 March)	China	Tariffs on US soybeans, chicken, wheat, corn and cotton products, sorghum, pork, beef, seafood, fruits, vegetables, and dairy products. Antidumping investigation into US optical-fibre products, 10 US companies being added to the unreliable entity list, 15 companies facing export controls, and a ban on imports of Illumina's gene sequencers.
12 March (in effect on 1 April)	EU	Restoration of the EU's 2018 'rebalancing' tariff packages (US iconic products).
12 March (in effect by mid-April)	EU	Additional package of new countermeasures on US exports will come into force by mid-April (to be defined).
12 March	Canada	25% on a list of US goods including steel products, aluminium products, tools, computers and servers, display monitors, sport equipment, and cast-iron products.
Announced (10 March) and then suspended (11 March)	Canada	Ontario announced a 25% surcharge on electricity exports to Michigan, Minnesota and New York (in response to US tariffs on steel and aluminium). This was suspended after

		Trump threatened a 50% tariff on the country's aluminium and steel.
9 April, EU announces retaliation	EU	Retaliation against steel and aluminium then paused on 10 April.
11 April, coming into effect on 12 April	China	125% retaliatory tariff on all US imports.

Source: Ibidem.

Unlike the current administration, the Biden administration mostly focused on industrial policy. President Biden's IRA probably represents the most important example of industrial policy in advanced economies targeting climate objectives while attempting to promote domestic industry. It consisted of vast amounts of tax credits for low-carbon investments, some being for manufacturing and industry (namely the sectors where trade plays an important role). The tax credits offered through the IRA have been a powerful incentive as they provide a direct revenue stream, thus immediately improving the investment case for certain low-carbon technologies. The IRA's cost for the period 2023-2032 is estimated at around USD 1 trillion⁶, about 100 billion a year, and was [projected](#) to generate around 850,000 jobs annually across industries. With the change in the administration and the rejection of climate targets, the IRA's future is now uncertain. Repealing or restricting the IRA – the latter being the most likely option, as some energy tax credits have contributed to employment growth in certain states and will remain⁷ – could be easily agreed upon by Congress raising further political uncertainty on investments, both domestic and foreign.

While the IRA had clear domestic objectives and was not directly targeted against the EU or other US partners, its potential unintended effects on foreign investments raised concerns in the EU and certainly questions about the need for a similar large-scale EU industrial policy. As events continue to unfold, the reality is that there is limited evidence that the IRA resulted in major investment flows from the EU to the US and what evidence there is seems to point to just a few short-term effects (see Box 2).

⁶ See estimates from US Department of the Treasury.

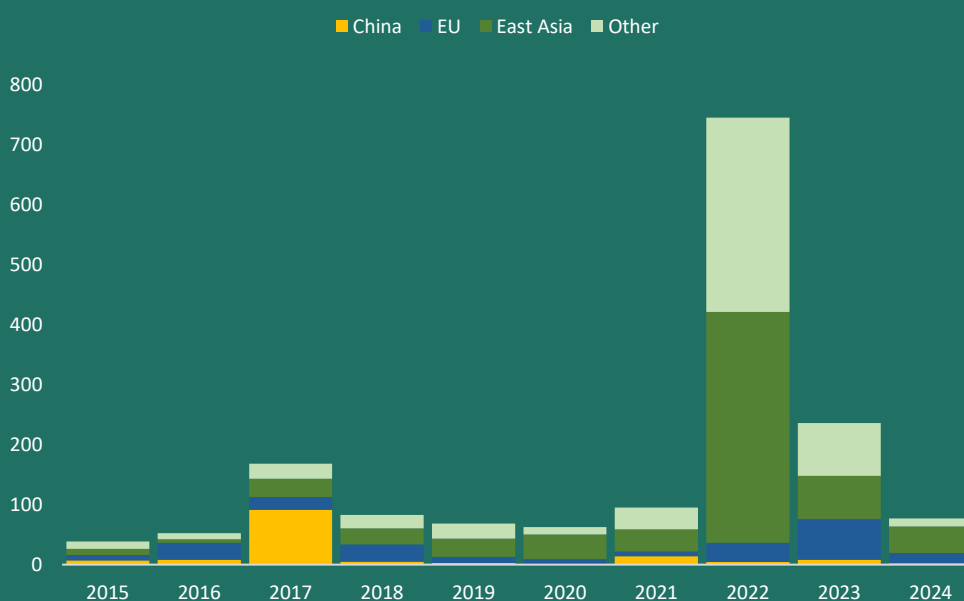
⁷ A full repeal is not excluded to facilitate the adoption of the TCJA, whose losses of tax revenue would be compensated by cuts in IRA tax credits.

Box 2. The IRA's impact on manufacturing reshoring in the US⁸

The US government has been actively encouraging and promoting reshoring activities through the IRA, the Chips Act and the Infrastructure Bill, which all contain policies that aim to protect and promote local supply chains and production ([Reshoring Initiative, 2023](#)).

Such policies raise the question of whether new dynamics are emerging around US inward FDI and the impact of investment originally coming from the EU. To document whether this is the case, we trace reshoring activities in the US and new FDI in manufacturing sectors. The analysis primarily builds on data and industry reports provided by the Reshoring Initiative, a private repository tracking reshoring activities and FDI by US-headquartered companies and foreign companies shifting their production or sourcing from offshore back to the US. Based on the dataset, over the past decade, the EU has consistently been a source of reshoring to the US, without being the dominant player. East Asian (and other) countries appear to have played a much more significant role, especially in 2022 and 2023 (see Figure 1). However, capital investment in the US originating from the EU is still relevant. Investment counts for a substantial share of US inward investment from the EU, 23% and 47% in 2022 and 2023, respectively.

Figure 1. Capital investment in the US related to FDI and reshoring (USD billion)



Source: Alcidi et al. (2025) based on the US Reshoring Initiative database.

Note: East Asia includes Japan, South Korea, Taiwan and Korea. Data for 2024 is available until June and is annualised.

Such capital investment appears to be mostly motivated by the benefits offered by returning to the US, with government incentives at the forefront in 2017-18 and 2022, possibly referring to the residual benefits of the 2017 Tax Cuts and Jobs Act, and the immediate benefits offered by the IRA in 2022. The factors pushing investment from the EU to the US appear mostly business-related,

⁸ This box is based on Alcidi and Shamsfakhr (2025).

except in 2022, when supply chain interruptions, most likely associated with Russia's aggression against Ukraine, played a major role. Since 2020, 'green considerations' appear to be an increasingly relevant push factor for companies operating in the EU, possibly pointing to costs stemming from the EU's regulatory framework and, on the other side, the tax credits and subsidies for clean energy, electric vehicles and green technologies included in the IRA.

Overall, it is extremely challenging to give an accurate assessment of the IRA's impact on reshoring activities and new manufacturing FDI in the US. Nonetheless, a marked increase in the magnitude of capital investment occurred in 2022 and 2023, likely due to US policies. The change not only concerns the EU but also Asia, which appears to have been more significantly impacted. More importantly, it remains to be seen whether these impacts will last. Preliminary data for 2024 point to a clear slowdown in capital investment plans, which raises doubts about the IRA's sustained capacity to attract foreign capital or repatriate capital investment towards US manufacturing.

While the US' increasingly proactive attitude, either through industrial and trade policies, remains bipartisan and domestically focused, Trump's second term has jolted governments and businesses with its aggressive approach towards long-standing trade partners and traditional allies. From the EU's perspective, this evolving landscape demands adaptation and a comprehensive reassessment of its position regarding the US.

2.2. AN INCREASINGLY ASSERTIVE AND PROACTIVE CHINA

The Chinese plan to reduce its dependencies on foreign countries was planned long before the escalation of global trade tensions – and its plan possibly contributed to it. In 2015, China put forward the 'dual circulation strategy', which embedded the idea of China becoming self-sufficient. The dual circulation strategy is a two-pillar approach aiming at spurring domestic demand ('internal circulation') and, at the same time, supplying export markets ('international circulation'). So, on the one hand, the country sought to improve its ability to participate in global trade, finance and technology, but on the other hand, to strengthen domestic consumption, production and technological capabilities to promote self-reliance.

This strategy was accompanied by the launch of China's industrial policy masterplan, 'Made in China 2025'. Trump's push for a trade and technology war against China possibly made the dual circulation strategy more appealing to China's leadership. It was created to insulate the domestic market from the rest of the world by eliminating any bottlenecks in terms of natural resources or technology, and to achieve self-reliance by relying on China's enormous domestic market.

Since then, as geopolitical tensions have grown, China has increasingly moved away from the West. Its attitude towards Western economies has become increasingly assertive and,

in some cases, even openly contentious. This has been the case *vi-à-vis* the US, but a few episodes have also served as a warning for the EU.

In August 2020, Chinese courts issued decisions – known as ‘anti-suit injunctions’ – preventing companies with high-tech patents (known as standard-essential patents) from effectively protecting their technologies in non-Chinese courts, including EU courts⁹. Since December 2021, China has applied discriminatory and coercive measures against exports from Lithuania and against EU exports containing Lithuanian content or components¹⁰. (see Box 3, for more details). In 2023, China restricted exports of gallium and germanium, chip-making materials, to the EU. China produces about 98% of the world’s Gallium. A trade dispute between China and the EU was opened in 2024. As part of its investigation, in July 2024, the European Commission provisionally concluded that the battery electric vehicles (BEV) value chain in China benefits from unfair subsidies, which directly threatens EU BEV producers, and it has explored possible ways to resolve the issues identified in a WTO-compatible manner. Following a positive Qualified Majority Vote in October 2024, in which Germany and four other Member States voted against the duties, with twelve members abstaining, the Commission obtained the mandate to impose countervailing duties (CVDs) of up to 35.3% on these Chinese EVs, on top of the EU’s standard 10% tariff on imported cars. The CVDs apply to approximately EUR 10 billion in annual imports (as of 2023), and even if their macroeconomic impact on the EU economy remains limited, they marked a significant shift in EU policy *vis-à-vis* China.

In response, China has launched anti-subsidy and anti-dumping investigations into EU exports of cognac, pork and dairy, and has indicated it may reduce its foreign direct investment in EV manufacturing within the EU. The EU has initiated consultations with the Chinese government to resolve the dispute, as it must do under the WTO Subsidies and Countervailing Measures Agreement. Under WTO rules, China cannot retaliate unless it challenges the EU measure and a dispute settlement panel rules in its favour.

As noted by [Garcia-Herrero](#), China’s reaction to the EU’s duties appears even more assertive than its response to the higher tariffs imposed by the US and Canada on Chinese EVs (though China has initiated an anti-dumping investigation into Canadian rapeseed as well).

9 See here for further details.

10 Ibidem.

Box 3. China's increasing resort to economic coercion and trade retaliation

Diplomatic tensions between China and **Lithuania** escalated significantly in 2021 when Lithuania allowed Taiwan to open a Representative Office in Vilnius, under the name 'Taiwan' rather than 'Taipei.' This move was seen by China as a challenge to its 'One China' policy, which considers Taiwan an integral part of China. In response, China implemented *de facto* trade embargoes on Lithuania to force it to change its stance on Taiwan and to dissuade other countries from following Lithuania's example. Lithuanian goods were reportedly blocked from entering Chinese ports or faced customs delays and rejections, effectively halting Lithuanian imports into China. Chinese companies were discouraged from doing business with Lithuanian firms. Chinese authorities also pressured multinational companies with operations in China to cut ties with Lithuanian suppliers or face difficulties in the Chinese market. In support of Lithuania, and to protect the EU internal market, the EU initiated a case against China at the World Trade Organization (WTO) for violating international trade rules.

This was not the first case in which China adopted trade coercion measures in response to actions considered not politically aligned with Beijing's viewpoint or to pursue its foreign policy more generally.

Tensions between China and **Australia** have escalated in recent years, particularly after Australia called for an independent investigation into the origins of the Covid-19 pandemic in April 2020. This was seen by China as a direct challenge and led to a series of retaliatory economic measures. China imposed substantial tariffs on Australian goods, notably on barley (an 80.5% tariff) and wine (up to 218% in anti-dumping and anti-subsidy duties). Australian coal faced import restrictions, leading to a significant decline in shipments to China. Additionally, China suspended imports of Australian beef from several major abattoirs, citing regulatory issues. Australian goods, including timber and lobsters, faced increased customs inspections and delays, effectively impeding their entry into the Chinese market. China issued informal guidance to state-owned companies to avoid purchasing Australian products, which had an impact on sectors including coal, cotton and copper.

In 2016, **South Korea** decided to deploy the US Terminal High Altitude Area Defence (THAAD) system to defend itself from North Korean missile threats. China opposed this deployment, arguing that the system's radar could be used to spy on its territory. In response, it restricted group tours to South Korea, significantly impacting South Korea's tourism industry. Chinese authorities increased inspections and regulatory hurdles for South Korean companies operating in China. Chinese broadcasters reduced the number of South Korean TV shows and movies shown on Chinese television. The South Korean conglomerate that provided land for the THAAD deployment faced boycotts and the closure of its Chinese stores. The South Korean government subsequently faced internal pressure over the economic fallout.

In 2010, it was **Norway's** turn. The Norwegian Nobel Committee awarded the Nobel Peace Prize to Liu Xiaobo, a Chinese dissident. China was displeased, viewing this as a direct interference in its domestic affairs, and imposed unofficial trade restrictions on Norwegian salmon exports, among other economic measures, and bilateral diplomatic relations were significantly downgraded.

In 2013, the **Philippines** brought a case against China to the Permanent Court of Arbitration over territorial disputes in the South China Sea. In 2016, the court ruled in the Philippines' favour, a decision China rejected. China imposed restrictions on the import of Philippine bananas and other

fruits, citing quarantine issues. It advised its citizens against travelling to the Philippines, affecting the tourism industry.

In 2010, a Chinese fishing boat collided with Japanese Coast Guard vessels near the disputed Senkaku/Diaoyu Islands. **Japan** detained the boat's captain, leading to heightened tensions. China temporarily halted exports of rare earth elements to Japan, which are crucial for Japan's tech industry. Japan released the captain, and the rare earth export ban was lifted, but the incident highlighted the vulnerability of global supply chains.

In addition to broad coercion measures, China's decision to **restrict exports of gallium and germanium** to the EU is closely linked to the broader geopolitical and economic context. In recent years, the US, with the support of some of its allies, including the EU, has implemented stringent export controls targeting China's semiconductor industry. In late 2022, the US introduced comprehensive export controls to prevent Chinese firms from accessing advanced chipmaking technologies. These controls included restrictions on exporting semiconductor manufacturing equipment and advanced chips used in supercomputers and AI.

The EU, while having its own policies, has shown signs of aligning more closely with US measures, particularly in the context of semiconductor technologies and critical supply chains. It has expressed concerns about overreliance on China for critical raw materials and technologies and has been working on strategies to bolster its own semiconductor industry and diversify supply chains. In July 2023, China announced restrictions on gallium and germanium exports. The measure was seen as a retaliatory measure, which highlights China's control over the supply of critical materials, which are essential for producing semiconductors and other high-tech applications. Western countries' dependence on Chinese materials thus gives China a powerful bargaining chip in negotiations and geopolitical discussions.

2.3. WHAT DOES IT MEAN FOR THE EU AND ITS TRADE LINKAGES?

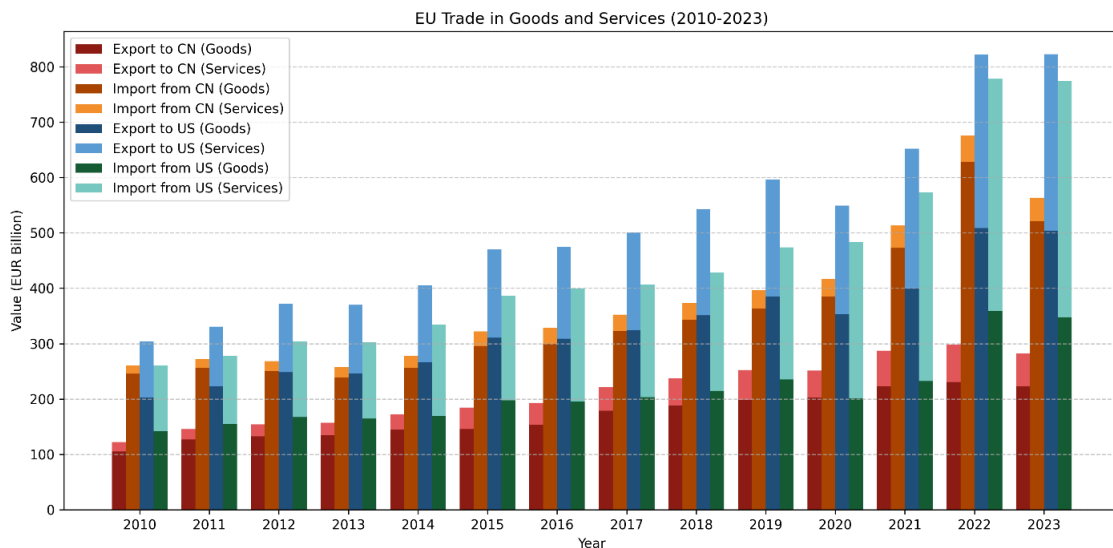
Such recent developments make it more necessary than ever to consider the EU's strategic autonomy and economic security, both of which are also becoming more difficult to achieve due to escalating geopolitical risks. The EU's deep level of trade integration in the global economy, which has driven its prosperity for decades, has been transformed into a source of dependency, which can be weaponised against it, thus making the EU potentially very vulnerable.

China's increasingly assertive approach to global trade has heightened concerns about its reliability as a trade partner. The country has repeatedly demonstrated its willingness to use economic coercion and trade retaliation, risking supply chain disruptions and restricted market access. In response, the EU has relied on limited trade measures that are part of the WTO framework. However, some Member States question this approach's effectiveness. Germany, along with other Member States, remains heavily exposed to its deep ties with China, particularly in the automotive sector, and fears both economic retaliation – which has been explicitly threatened by China – and losing access to China's

cutting-edge EV technology. This reluctance is a clear example of the tension between economic security and maintaining crucial trade relationships.

Data for 2023 point to a decline in EU imports of goods from China, as well as a mild decline in EU exports, but China remains by far the largest EU import market for goods (more than EUR 500 billion, which accounts for almost two-thirds of EU-China trade, (see Figure 2). The EU's import concentration from China is even higher than the US¹¹ and this did not change in 2024. China [General Administration of Customs](#) data for 2024 suggest a small rise, about 1.6%, in EU-China trade, despite the various disputes and global market uncertainties.

Figure 2. EU bilateral trade: EU-China and EU-US imports and exports of goods and services, EUR billion, 2010-2023.



Source: Eurostat.

The EU's growing concerns about key trade partners' unreliability also apply to the US. In 2023, EU-US trade in goods and services reached EUR 1.6 trillion (see Figure 2), more than doubling over the past decade – highlighting the sheer scale of economic integration. The EU's trade (import and export) concentration in the US is notably higher than in China.

¹¹ Almost a quarter (23%) of the EU's total goods imports come from China, while Chinese imports to the US are smaller in size and declining. According to US statistics, imports from China fell from 21.6% in 2018 to 13.4% in 2024 following the imposition of tariffs. However, over this period, the discrepancy between US import data and Chinese export statistics has widened significantly. In 2023 alone, there was an estimated USD 100 billion in 'missing' US imports. While US data indicate a decline, Chinese export figures suggest that US imports from China have actually increased. Clark (2025) suggests that the gap can be partly explained by trade rerouting through third countries, fictitious Chinese exports to exploit VAT rebate benefits and under-invoicing US imports to reduce tariff duties. However, the most significant factor appears to be the de minimis exemption, which has allowed small-value Chinese goods to enter the US duty-free with minimal documentation.

The US is by far the largest destination for EU goods exports, surpassing EUR 500 billion in 2023. This is why the current US administration's aggressive threat of expanding US tariffs poses increasing challenges to the EU.

It should be noted, however, that the EU is the largest US export market for services. In 2023, the EU imported EUR 427 billion of services from the US, mostly consisting of charges for the use of intellectual property (e.g. licensing and franchise fees, royalties and technology and software rights) and business services.

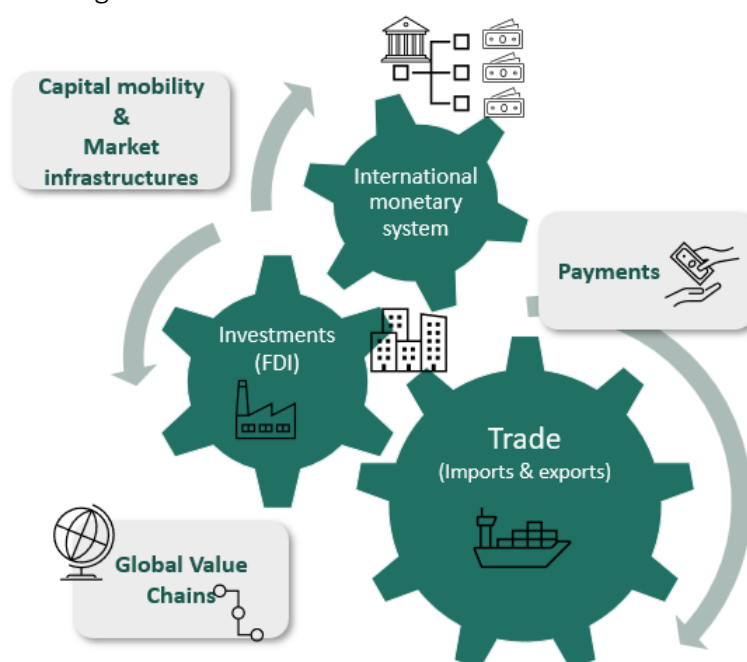
After more than half a century of the US being Europe's key trade and investment partner, the shift toward protectionist measures and industrial policy is straining transatlantic economic ties, forcing the EU to dramatically reassess its trade strategy¹². In the current global environment, it seems that the EU will have to navigate between competing economic blocs and the dual challenge of China and the US, which is not only limited to trade.

¹² While defence is beyond the scope of this CEPS In-Depth Analysis paper, the Trump administration's overtures towards Russia and its diplomatic clash with Ukraine, while reducing its commitment to NATO, have further strained transatlantic relations.

3. BEYOND TRADE DEPENDENCIES

As noted earlier, a thorough assessment of the risks facing the EU requires a broader view than just trade dependencies. This means that trade, FDI and the shape of the international monetary system should be systemically examined (Figure 3).

Figure 3. Global linkages.



Source: Author's elaboration.

First, in a globalised world, trade is closely interlinked with cross-border investments, particularly FDI¹³, which play a key role for multinational enterprises and are at the core of how global value chains function. Through horizontal FDI, companies invest abroad to access new markets, leading to trade in final goods. Through vertical FDI, firms fragment their production across borders, increasing trade in intermediate goods, and through export-platform FDI, companies invest in one country to serve multiple markets, affecting regional trade flows. Though the reasons remain unclear, FDI patterns are changing and may also have various impacts on trade. Such changes may be amplified by policies. In

13 According to Cadestin (2018), multinational firms roughly account for one-third of global output and GDP, and half of global exports and their foreign affiliates are particularly active in exporting (more than MNE headquarters and domestic plants). Trade still seems to be their preferred entry mode to serve foreign markets with trade larger than sales by foreign affiliates. Most multinational firms are engaged both in horizontal and vertical investments and are attracted to countries for several reasons, ranging from access to large markets, lower costs and access to knowledge and technologies, but also specific financial and tax legislation. Despite its importance, research in this area is still scant due to limited data availability. The OECD database on multinational activities across countries and industries is the only one.

the current context, it cannot be guaranteed that FDI will not become the target of protectionist measures.

Second, the current heavily decentralised global production system relies on the functioning of the international monetary system and its market infrastructures. The latter determines payment systems, capital mobility and financial integration (which affects both trade financing and multinational firms' ability to effectively allocate resources), and financial market infrastructure and banking networks (which defines intermediaries' role in facilitating cross-border investments and trade transactions). Access to international credit, trade finance and investment banking services is crucial for firms operating across multiple jurisdictions. The international monetary system also shapes global liquidity and the role of reserve currencies. While a Western-centred system in which the US dollar plays a dominant role defines the current international monetary system, shifts away from this are happening.

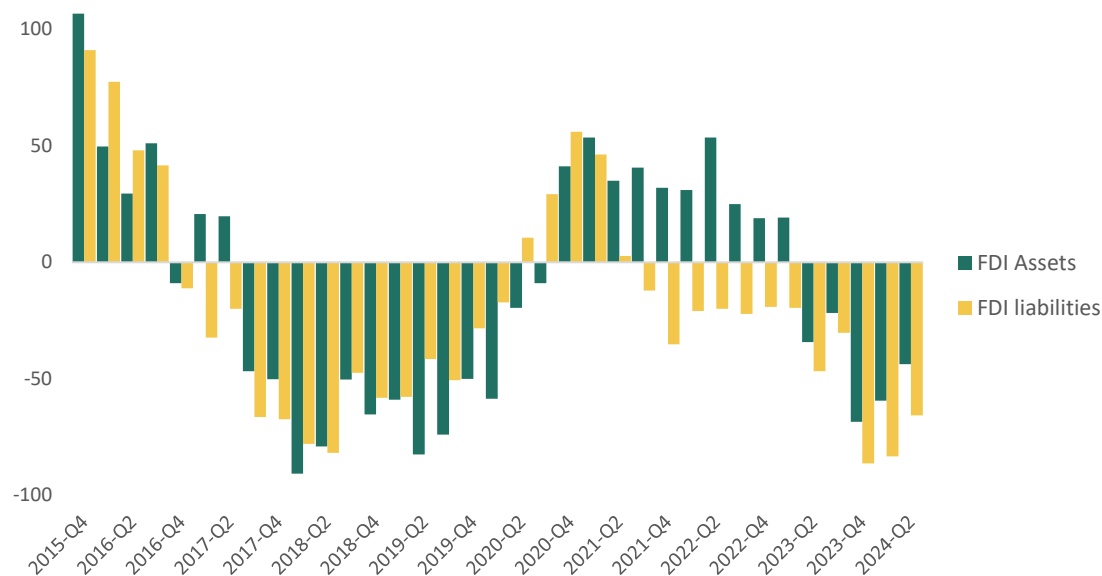
3.1. FADING US FDI

When looking at FDI, the US is undoubtedly the most important destination for EU FDI and as a source of FDI into the EU, setting a strong financial interdependence between these two economies (see Box 4 for a comparison with China). It is estimated that more than 10 million people in the EU and US are employed by the foreign affiliates of EU and US companies¹⁴. However, recent trends in EU-US FDI point to shifting dynamics, both inward and outward investments (see Figure 4).

Since 2017, EU and US-based companies have been steadily divesting from each other's markets, as reflected in the negative FDI flows (the negative green bar in Figure 4). The decline in EU FDI has been particularly pronounced since 2018, with a brief recovery around 2021 before turning sharply negative again, indicating a significant wave of divestment.

¹⁴ See European Council (2024).

Figure 4. EU FDI flows: assets (outbound) and liabilities (inbound) *vis-à-vis* the US, 2015Q4-2024Q2 (billion EUR).



Source: Eurostat, Balance of Payments data.

Note: Moving average over four quarters. The FDI liabilities refer to US residents' investment in the EU or their purchases of liabilities issued by EU residents. Negative values imply US residents' divestment from the EU. FDI assets refers to FDI investment abroad (purchases of foreign assets) by EU residents. Negative values correspond to EU residents' net sales of foreign assets in the quarter.

The underlying causes of this trend remain unclear but two key interlinked factors are worth considering. *First*, while FDI has traditionally been linked to real economy investments, the expansion of multinational corporations – responsible for the bulk of FDI flows – has made these investments behave more like portfolio investments¹⁵. This has increased their volatility and sensitivity to intra-group financial needs. *Second*, the first major US divestment wave coincided with a significant policy shift, namely the 2017 TCJA, which incentivised profit repatriation to the US, leading to an estimated return of over USD 600 billion in 2017 alone.

While the TCJA does not directly explain the second wave of divestment, other changes in tax policy may be relevant. The Dutch national bank reported that in Q3 2023, Dutch financial holdings and companies reported high levels of negative direct investment transactions (captured by the green bar in Figure 5 above), which often involve divestments or the repayment of loans between business units of the same multinational. The total value of these transactions, only for the Netherlands, amounted to about EUR

¹⁵ See P. Lane (2024) on the changing nature of FDI.

310 billion (sales¹⁶). Most of these transactions involved Dutch financial holding companies and special purpose entities (SPEs), which are typically part of multinationals. Such a large change may indicate adjustments in the international business structure of multinationals. One possible explanation for the negative FDI assets is the introduction of the global minimum tax of 15% on multinationals' profits that has been applied in the Netherlands. This tax rule, introduced by about 140 countries at the start of 2024, may have prompted companies to review their international corporate structures. Interestingly, as not only assets but also liabilities are negative and of about the same amount, it is likely that reported transactions mainly relate to business units used for conduit activities. This is why such a change will likely not have a large impact on the real economy.

Box 4. EU-China and EU-US FDI stocks: A different scale of integration.

The cumulative value of EU FDI stocks in China stood at EUR 177 billion in Q1 2024. In contrast (at the end of 2023), the EU's FDI stock in the US was EUR 2.437 billion, about 13 times larger, building on their being open to each other for much longer but also evidence of their high degree of integration.

The cumulative value of Chinese FDI stocks in the EU stood at EUR 143 billion in Q1 2024, while (at the end of 2023) the US FDI stock amounted to EUR 2.299 billion. This accounts for most of the FDI stocks held by the rest of the world in the EU (30.9%) and is about 16 times the value of Chinese investment. EU FDI flows to China reached EUR 6.4 billion in 2023 – a decrease of 29% compared with 2022. The top three sectors were the automotive sector, basic materials and machinery. Chinese FDI flows to the EU amounted to EUR 4.7 billion in 2023, a decrease of 10% compared with 2022. The top three sectors were the automotive sector, health, pharmaceuticals and biotechnology, and ICT technology.

Source: Based on Eurostat and [Durá and Vandermeeren \(2024\)](#)

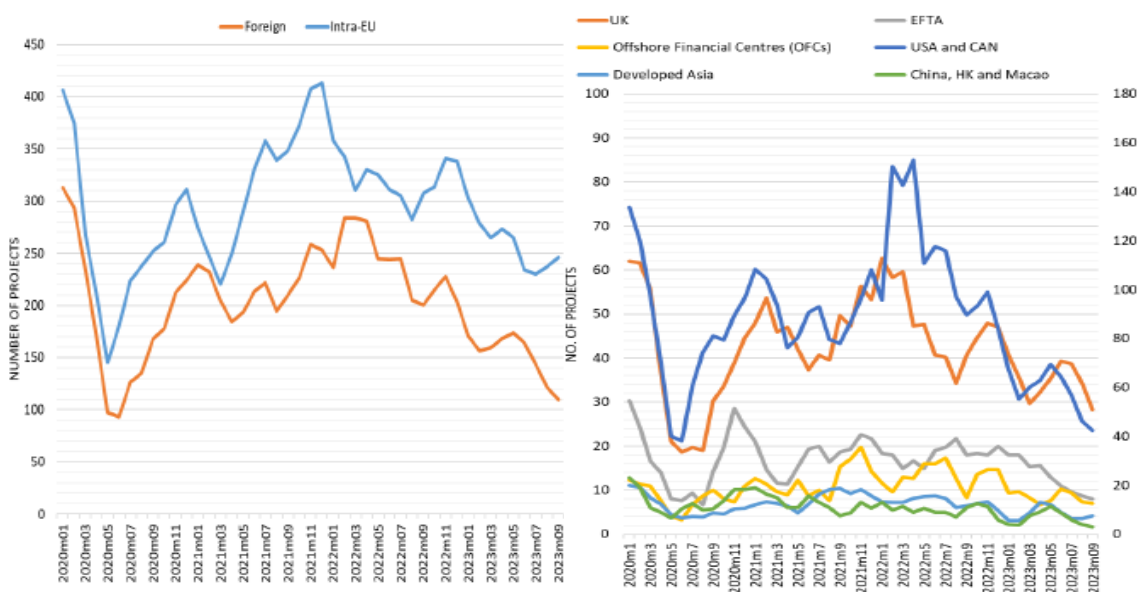
Greenfield FDI is a stronger indicator of investment activity directly linked to the real economy. However, tracking reliable data – especially in terms of value – remains challenging. The number of new projects indicates a clear downward trend in foreign greenfield investment in the EU since late 2021 (see Figure 5, left panel), aligning with official aggregate statistics.

A country breakdown by investor origin highlights the US (and Canada) as key contributors to this decline (see Figure 5, right panel). This suggests that not only FDI intra-group

¹⁶ The Netherlands is one of the top countries globally with the largest direct investment positions. For a more detailed analysis of EU FDI, see Alcidi et al. (2025).

operation but also its real-economy component is on a downward trajectory, raising concerns about the EU's attractiveness for foreign investment.

Figure 5. Greenfield FDI project, total (left panel) and by the investor's country of origin (right panel)

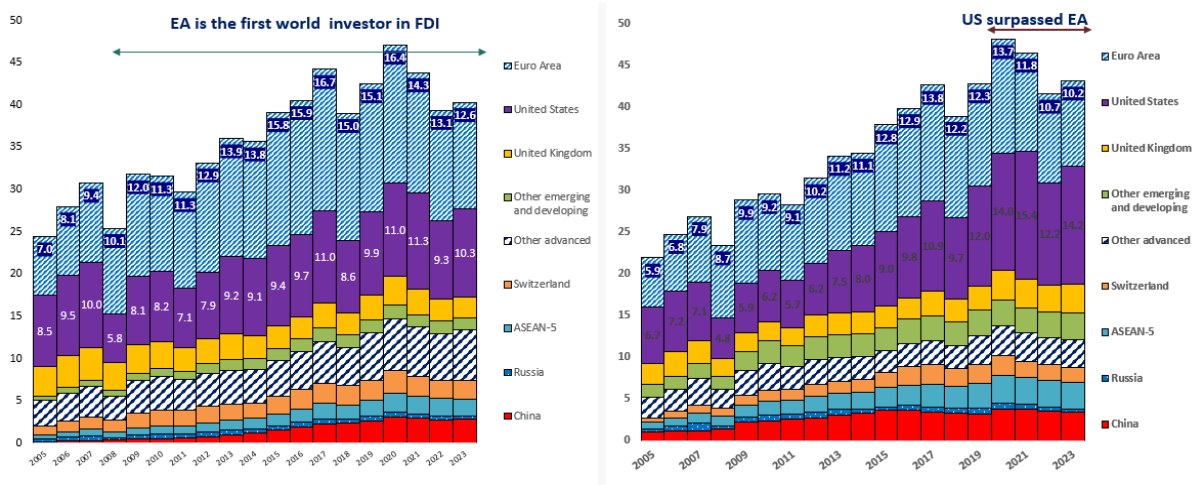


Source: [JRC \(2024\)](#), Figures 7 and 9, pages 6 and 8, respectively.

For more than a decade, the euro area¹⁷ has been the global FDI hub. However, 2023 marks the end of a decade of the euro area's world primacy in FDI, both as a destination and as a source of foreign investment (Figure 6).

17 These data are not available for the EU as a single entity (excluding intra-EU stocks). However, since the UK's exit from the EU, the euro area serves as a reliable proxy for the EU when analysing global FDI trends.

Figure 6. Euro area FDI outflows (assets, left panel) and inflows (liabilities, right panel), % world GDP



Source: IMF, Balance of Payments data.

While this new development is primarily driven by the decline in US FDI flows, it raises broader questions about the EU's future attractiveness for foreign investment.

This concern is further reinforced by the steady decline of Chinese investment in the EU. After peaking in 2016, Chinese FDI – both acquisitions and greenfield investments – has dropped significantly, averaging only a few billion euros in recent years¹⁸. While this decline might suggest waning investor interest in the EU, it also reflects growing scrutiny from European governments. Concerns over technology transfers, national security and the acquisition of strategic infrastructure have led to a more cautious approach towards Chinese investment¹⁹.

This dynamic illustrates the key dilemma of balancing openness to foreign investment to drive innovation with the need to safeguard the EU's strategic interests in an increasingly complex geopolitical landscape.

A last point worth noting is that FDI – in particular, greenfield FDI – can be closely linked with trade patterns and can trigger macroeconomic impacts. To illustrate this, consider the operations of a US multinational such as [Eli Lilly](#). The company has made substantial FDI in the EU – specifically in Ireland – to manufacture high-value products, which are primarily exported to the US. The exports are so large in value that they drive Ireland's trade surplus and substantially contribute to the overall US trade deficit *vis-à-vis* the EU. However, if tax policies create incentives for profit repatriation, the company may choose to transfer earnings back to the US. If these repatriations are substantial, they would

18 Durá and Vandermeeren (2024).

19 See Box 6 for the EU FDI screening.

appear as US FDI divestment from EU assets in aggregate statistics. This example highlights how trade and investment flows are deeply interconnected, how tax policy can have far-reaching economic consequences and how the actions of a single multinational company could lead to wider macroeconomic impacts.

3.2. China's search for an alternative to the West-centred monetary and financial system

China's assertiveness has been pursued in ways other than trade policy. It has attempted in various ways to redefine the international monetary system and create an alternative to the current one dominated by Western infrastructures and actors, and the dollar as the dominant reserve and invoicing currency.

According to the [ECB \(2023\)](#), data on global payments through SWIFT up to December 2022 showed that the USD accounted for around 50% of global payments, while the euro stood at approximately 30% (when accounting for intra-EU trade). The yuan, by comparison, represented less than 5%. Changes in trade invoicing are usually costly and take time (due to a strong path dependence), but are certainly not impossible, especially in the current geopolitical climate where political considerations increasingly outweigh those of economic efficiency. The financial sanctions imposed on Russia have undoubtedly served as a warning for countries that view the US as hostile while providing China with a major opportunity to promote a bigger international role for the yuan – a goal it has pursued for around a decade with very limited success thus far. These developments pose an open challenge to US dominance in the international monetary system.

When Russian banks were banned from using the SWIFT international banking system, effectively cutting them off from global financial networks, and the Russian Central Bank's reserve assets abroad were frozen, China agreed to increase yuan-rouble trade. This enhanced its economic influence over Russia while reducing or even eliminating the dollar's role in the two countries' economic partnership.

China has been trying for years to create a SWIFT alternative. The [Cross-Border Interbank Payment System \(CIPS\)](#) was proposed in 2009 and launched in 2015 to provide an alternative international payment system that relied on China's yuan, connecting onshore and offshore accounts with participating banks without relying on the USD for transactions. While the initiative has not been very successful until now, it has been replicated by others. Notably, to overcome Western sanctions, Russia's central bank created the System for Transfer of Financial Messages (SPFS), which solely uses domestic services and technologies to conduct transactions. Increasing trade with Iran, which began after the invasion of Ukraine, has led to meetings between the Iranian and Russian central banks and plans to combine the SPFS and its Iranian analogue, SEPAM.

Ahead of the 2024 BRICS Plus Summit in Kazan, a new cross-border payment system called [BRICS Pay](#) was proposed by Russia and potentially backed by China. Furthermore, Iran, Brazil, Argentina and Bangladesh have made headway in de-dollarisation and using the yuan for trade. While it remains challenging to accurately track currency usage, there have been a growing number of declarations by some BRICS Plus members to explore using their currencies for international trade and cross-border payments and to seek alternatives to the dollar and euro.

The Chinese yuan is mounting a challenge to the dollar's dominance. According to data from China's State Administration of Foreign Exchange, in March 2024, the volume of China's outbound and inbound cross-border payments made in yuan outstripped those made in US dollars. Meanwhile, the euro's role remains minimal and continues to decline. Given China's importance in global trade, these trends are likely to be reflected in global statistics soon.

All these initiatives, though still limited in reach, signal a broader push towards financial independence.

The yuan still faces significant limits as an international currency. China's government maintains capital controls and the yuan is not fully convertible – its exchangeability into other currencies remains conditional. Since 2005, China has operated a managed floating exchange rate system, where the currency is no longer pegged to the dollar but is influenced by central bank interventions in the foreign exchange market, which entails higher exchange risks. From an economic perspective, these features make the yuan a weaker alternative to the dollar and the euro. All the same, geopolitical considerations, far more than economic efficiency, are now driving the ongoing shifts in the global currency landscape.

Finally, regional financial architectures are emerging, challenging the traditional Western-led institutions such as the IMF and World Bank. Institutions like the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB) are providing alternative sources of financing, reducing reliance on US-backed financial institutions. These organisations offer funding for major infrastructure and development projects, particularly in Asia, Africa and Latin America, where demand for investment is high.

3.3. WHY DO FDI AND THE SHAPE OF THE INTERNATIONAL MONETARY SYSTEM MATTER FOR THE EU?

While trade dominates much of the current debate on the EU's relations with China and the US, a broader perspective is necessary to understand the full scope of economic interdependencies. In a world where complexity defines global relations, focusing on trade alone risks overlooking equally critical factors, particularly those related to investment flows and technological exchange, as well as the global economic order in which the EU operates.

First, EU-US FDI flows are undergoing significant shifts, with increasing instances of divestment – which, while less worrisome than official statistics suggest, seem to also apply to greenfield investment. If this trend persists – or expands to other countries – it could have profound implications for trade, technological progress and the EU's broader economic ambitions.

- **The trade-investment nexus:** as illustrated above and supported by emerging evidence trade and FDI are increasingly interlinked, driven by the role that multinationals play in shaping production systems and value chains. Foreign divestment could serve as a leading indicator of declining trade volumes. If multinational corporations reduce or withdraw their investments from key markets, supply chains may reconfigure, reducing overall trade flows.
- **The role of FDI in the twin transition:** FDI has long been a critical channel for technology and knowledge transfer, playing an essential role in both the digital and green transitions. Given the EU's ambition to lead the fight against climate change, FDI flows are crucial to fostering innovation in clean energy, sustainable manufacturing and advanced digital infrastructure. An open question is whether the EU can achieve its twin transition goals at the necessary scale and speed without external investment.
- **EU investment gaps:** can EU domestic savings fill the void? Closing investment shortfalls purely through domestic savings may prove to be an illusion. Given the EU's current large-scale needs, while public and private EU capital plays a key role in financing green and digital initiatives (but there is a lot of room for improvement), foreign investment has historically provided both scale and expertise. A decline in FDI could exacerbate the EU's investment gap, making it more challenging to achieve strategic objectives from clean energy deployment to next-generation semiconductor production.

Second, a key aspect of successful trade transactions is being able to rely on secure and stable payment systems. Uncertain currency settlements and shifts in the global financial

architecture should also be closely examined. Over the past few years, the weaponisation of international linkages has focused on trade but payment systems and the US dollar's international role have also been used (e.g. through Western sanctions against Russia). Asia's gradual efforts, led by China, to reduce its reliance on the US-dominated system and develop alternative international monetary and financial structures tend to go unnoticed due to the slow pace of such transitions and the attention being given to more immediate geopolitical shifts. However, these developments are gradually reshaping globalisation, steering it towards a more multipolar economic order. This trend can have significant implications for the EU, given its deep integration into the current US-dominated system.

- **The challenge to the dollar's dominance:** The expansion of initiatives to reduce dependence on the dollar, often in cooperation with countries in the 'Global South' and BRICS economies, signals a strategic attempt to reduce reliance on the US-dominated financial architecture. However, the greatest challenge to the dollar's dominance – and Western-dominated global financial infrastructure – may originate from inside the US. For decades, the US dollar's status as the world's only true international currency relied on the Fed's independence and credibility and was underpinned by America's economic and geopolitical power. Donald Trump's trade war and other policies are dramatically threatening these foundations. China may be more prepared than other countries to offer alternatives. The EU will have to adapt to this change and be prepared for the risk that the dollar-centred system, which the EU currently considers a public good, may not be such anymore.
- **Global financial fragmentation and the EU position:** The EU has long relied on the stability and efficiency of the dollar-based system for trade, investment and financial transactions. However, if a more fragmented, multipolar financial order emerges – where competing currency blocs coexist – this could create both risks and opportunities for the EU. On the one hand, increased monetary fragmentation could introduce new transaction costs and financial instability. On the other, it may open space for the euro to play a larger international role, particularly if the EU strengthens its financial autonomy and deepens the integration of its capital markets.
- **Geopolitical and economic implications:** The weaponisation of the international monetary system, particularly through sanctions and restrictions on access to dollar-based transactions, has underscored the vulnerabilities of a system concentrated around a single currency. As China and other economies seek alternatives, the EU must carefully navigate this evolving landscape. Strengthening the euro as an international currency could enhance the EU's financial sovereignty.

However, a currency's wider adoption cannot be unilaterally imposed in a market economy. Changes will require more trade diplomacy but, ultimately, the outcome will depend on the choices made by private actors.

While these shifts are still in progress, their cumulative effect is likely to erode the dominance of Western financial institutions and the dollar, leading to a world where financial power is distributed across two economic centres, possibly unwilling to offer a public good. This transition will have profound implications for trade, investment and geopolitical stability, forcing the EU and other global players to rethink their economic strategies in an increasingly bipolar – or even multipolar – landscape.

4. THE EU POLICY TOOLBOX FOR ECONOMIC SECURITY

In such a complex and rapidly evolving geopolitical and geoeconomic landscape, a critical question arises: What can the EU do to protect its interests, enhance economic security and ultimately achieve greater strategic autonomy? As power replaces rules, the EU, which lacks the full sovereignty of a nation-state, finds itself in a vulnerable position. EU Member States can play a crucial role in ensuring that the EU, as an institution which enables collective action, is a source of strength, preventing internal rifts from undermining its resilience and influence.

That said, over the last few years, the EU toolbox to support its economic security has grown. The recently proposed [EU Competitiveness Compass](#), which defines the EU's strategic framework for the current mandate, is key to enhancing the EU's global economic standing. While focusing on cleaner and more equitable growth, with the need to innovate and restore its manufacturing basis, security takes centre stage and emphasises the need for Europe to adapt to new challenging realities.

4.1. RECENT DEVELOPMENTS IN THE EU TOOLBOX

As a response to the IRA (as well as the impact of the energy crisis and Russian war against Ukraine), in February 2023, the Commission published the [Green Deal Industrial Plan](#), a strategy for 'enhancing the competitiveness of Europe's net-zero industry'. Among other initiatives, it includes the new regulatory framework on net-zero technologies (Net Zero Industry Act, NZIA) and critical raw materials (Critical Raw Materials Act, CRMA), as well as a revision of existing state aid rules (see Box 5). This combines with the earlier announced CHIPS Act, which entered into force in 2023, and the Important Projects of Common European Interest (IPCEIs), already in place since 2018.

Box 5. EU instruments and measures to promote competitiveness and resilience

CHIPS Act, 2023: The EU CHIPS Act is a legislative initiative aimed at strengthening Europe's semiconductor industry to reduce dependency on non-EU suppliers and enhance the bloc's technological resilience. Adopted in 2023, the Act focuses on scaling up production, research and innovation in the semiconductor sector, with the ambition of making Europe a global leader in advanced chip manufacturing. It mobilises around EUR 43 billion in combined public and private investment to support semiconductor projects across the EU, drawing from both EU and national budgets and involving partnerships with the private sector. This initiative aligns with similar efforts, such as the US CHIPS and Science Act, in reinforcing semiconductor supply chains

The Net-Zero Industry Act (NZIA), 2023: NZIA can be seen as most directly responding to the US IRA, even though the current legislative proposal looks very different and builds on EU strengths and (legal) capacity to regulate the internal market. Some parts of the NZIA, such as provisions on permitting, access to funding and regulatory sandboxes, can be viewed as trying to address red tape

in the economy and simplify processes. It also includes a proposal to have minimum domestic production targets for strategic net-zero technologies, though there is still no agreed list of strategic net-zero technologies. Finally, funding is still unclear. The European Parliament supports using at least 25% of ETS auction revenues to support the NZIA's objectives. This would not necessarily lead to additional cleantech financing in Europe, as EU Member States by and large already spend most of their ETS revenues on objectives considered in line with EU climate goals.

Critical Raw Materials Act (CRMA), 2023: The CRMA aims to secure the supply of CRMs to support the manufacturing of net-zero (and digital) technologies. Along with a proposal setting out conditions and benchmarks for developing domestic mining and recycling capacity in the EU, the Act comes with an EU CRM strategy on trade diversification, international cooperation, coordination of finance, skills and R&D, and identifies a subgroup of 'strategic raw materials' that are highly important for strategic (green) applications. Crucially, the Act does not mobilise new resources but provides for a European Critical Raw Materials Board (Member State representatives and the Commission) to coordinate existing financing mechanisms.

Revised state aid rules – Temporary Crisis and Transition Framework, 2023: Building upon the Temporary Crisis Framework adopted in the wake of Russia's war against Ukraine, the new Temporary Crisis and Transition Framework gives Member States more time before they need to actively support the deployment of renewable energy technologies and industrial decarbonisation while expanding the scope of eligible schemes to those supporting clean tech manufacturing and critical raw materials projects. The framework allows for more flexibility in allocating national budgets and a more generous form of state aid if a Member State can credibly demonstrate that additional aid is necessary to avoid investments from being diverted away from the EU (so-called matching aid). The latter can be viewed as an explicit response to the extensive subsidies offered through the IRA.

Important Projects of Common European Interest (IPCEIs): The concept of IPCEIs was formally introduced in 2014 as part of the European Commission's state aid rules to foster large-scale, cross-border projects that address significant market or systemic failures within the EU. The first IPCEI project was approved in 2018 for microelectronics, followed by significant projects in batteries in 2019 and 2021. The IPCEIs are large-scale, cross-border initiatives that support strategic sectors critical to the EU's competitiveness and economic resilience. These projects are developed jointly by several Member States and involve close collaboration between governments and private companies to drive innovation and fill key gaps in areas where private investment alone may fall short. IPCEIs allow participating countries to allocate state aid – often prohibited by EU competition rules – without violating EU internal market laws, if the projects meet specific criteria and contribute to the European common good. IPCEIs focus on areas where Europe aims to strengthen its position, such as clean energy, semiconductors and microelectronics, battery production and pharma.

Clean Industrial Deal, 2025: A key pillar of the Competitiveness Compass that aims to transform decarbonisation into a growth driver for European industries by lowering energy prices, creating quality jobs and fostering favourable business conditions. The plan emphasises enhancing competitiveness and achieving climate neutrality by 2050, with a proposed 90% emissions reduction target for 2040 to be enshrined in the European Climate Law. Key measures include boosting every stage of production, focusing on circular economy principles to maximise resources, reducing dependencies and enhancing resilience, and positioning the EU as a global leader in the circular economy by 2030. The Deal also involves simplifying regulations to create a more supportive

environment for scaling up the EU's manufacturing capacity for net-zero technologies and products, accelerating the transition to climate neutrality.

Together, these initiatives form an EU policy toolbox designed to bolster competitiveness, resilience and industrial strategy. However, in an increasingly hostile global environment, the EU has also begun equipping itself with other instruments to safeguard its interests against unfair practices that exploit trade, investment and cooperation linkages (see Box 6). As the international trading system continues shifting towards a bipolar and protectionist landscape, the EU must reassess and refine its trade policy tools, ensuring they align with a broader, more strategic approach to industrial policy.

Box 6. EU-Instruments and measures to protect EU economic interests

The EU has developed a range of instruments to safeguard its economic security and resilience in response to growing geopolitical and trade tensions. These tools aim to deter coercive actions, secure critical supply chains and ensure fair competition within the internal market.

Anti-Coercion Instrument (ACI), 2023: The ACI enables the EU to counter foreign governments using economic pressure to influence EU policies. While prioritising dialogue, it allows for countermeasures such as tariffs, import restrictions or public procurement bans. This tool addresses cases like China's trade embargo on Lithuania and could be deployed against economic threats targeting individual Member States. However, its effectiveness depends on Member States reaching an agreement to act, which could cause delays.

Economic Security Strategy and 2024 Trade Package: The EU has introduced measures to mitigate risks arising from economic dependencies and geopolitical tensions. These initiatives focus on:

- *Supply chain resilience:* Reducing risks in critical sectors like energy and technology.
- *Infrastructure security:* Safeguarding physical and cyber infrastructure.
- *Technology protection:* Preventing sensitive technology leaks.
- *Countering economic coercion:* Managing risks linked to foreign trade and investment pressures.

The 2024 package strengthens trade and research security by:

- Expanding FDI screening to protect critical sectors.
- Enhancing export controls on dual-use technologies.
- Securing EU research from foreign exploitation.

FDI Screening Regulation – Revised, 2024: under the Economic Security Package, the EU is tightening controls on foreign investments that may threaten security or public order, particularly in critical industries. The revised regulation mandates all Member States to implement FDI screening mechanisms and introduces common criteria for risk assessment. This responds to concerns over increasing investments from China, Russia and opaque offshore entities in strategic EU sectors.

Foreign Subsidies Regulation (FSR), 2023: The FSR prevents foreign state-backed firms from distorting competition within the EU. It applies to:

- *Mergers and acquisitions (M&A): Companies receiving significant foreign subsidies must notify the Commission.*
- *Public procurement: Firms benefiting from foreign subsidies must disclose financial support for large EU contracts.*
- *Market investigations: The Commission can review subsidies that distort competition and impose remedies like divestments or subsidy repayments.*

Together, these instruments form a comprehensive EU framework to bolster economic resilience, protect strategic industries and ensure fair competition in an increasingly fragmented global economy.

4.2. TRADE POLICY OPTIONS IN A NEW LANDSCAPE

As outlined above, the EU has been proactive in monitoring and investigating unfair trade practices, particularly those involving China, but the US has taken centre stage since the start of the second Trump administration.

The EU's trade policy tools are largely rooted in free-market principles. Deviations from free trade have only occurred in response to unfair practices or market distortions by external actors. The EU's approach to managing risks and 'de-risking' has primarily involved diagnosing economic vulnerabilities, such as assessing global value chain resilience and identifying trade dependencies, and measures to incentivise reducing dependencies in some strategic sectors. To date, the EU's approach has focused more on broad policy guidance than direct market intervention, relying on reactive measures to manage import dependency and diagnostic-based de-risking strategies. These approaches, however, do not provide the same degree of economic protection or strategic leverage seen in the more assertive tactics employed by the US and China.

This raises a fundamental dilemma for the EU. Imitating the US and China's strategies poses a big challenge. A proactive EU stance on trade policy would lead to the further erosion of WTO principles and potentially mark the end of WTO as a relevant global organisation, with a return to an unregulated global trade environment – which would be a major setback for both the EU and global stability.

As the EU is the smallest, most open economy of the three, and with a declining share of global GDP, it has the most to lose from a shift away from free trade and a rules-based system. Finally, it must also be acknowledged that such a shift will impact the single market and the EU's broader structure, which was built on free trade and a rules-based system. Moving away from it implies acknowledging the need for substantial fiscal capacity. Effective trade (and industrial policies, which would inevitably have to follow)

require fiscal support for government intervention in the economy. The EU currently lacks this at the centralised level. On the national level, significant fiscal capacity disparities and competing strategies across Member States could weaken the EU's global position and lead to the deterioration of EU integration and result in economic divergences.

However, the EU's traditional position may prove politically untenable.

The US' growing use of the national security card to justify violating WTO principles and its actions since 2018 to dismantle its dispute settlement have substantially reduced the WTO's powers and its credibility. The purposeful blocking of the WTO's dispute settlement mechanism (see Box 7) is leading affected countries to unilaterally adopt countervailing measures or attempt to negotiate bilaterally (as documented in Tables 1 and 2 above).

Box 7. The paralysis of the WTO trade dispute system

A WTO member wishing to open a trade dispute must follow the Dispute Settlement Understanding process. The primary condition (though not the only one) is a violation of WTO Agreements. In practical terms, this means a member must believe another member has violated, nullified or impaired benefits under WTO rules – common examples include illegal tariffs, unfair subsidies and discriminatory trade practices favouring domestic producers.

Under the WTO dispute settlement process, the complainant first requests consultations with the alleged violator. If these consultations fail to resolve the issue, a panel of experts is convened to examine the dispute and issue a ruling. Both parties can appeal the panel's decision to the Appellate Body, whose ruling is final. A respondent found in violation must comply or face potential retaliation.

The Appellate Body is the WTO's highest authority, composed of seven members appointed by WTO members. Each serves a four-year term, renewable once, and must be an independent, impartial expert in trade law. Appeals are heard by three randomly selected judges from the seven-member panel. However, any WTO member can block a candidate by objecting to their selection. The US has repeatedly done so, citing concerns about judicial overreach. This has caused the Appellate Body to become paralysed, as it lacks the quorum to hear appeals.

The current impasse follows the 2018 decision by the Trump administration to impose 25% tariffs on steel and 10% tariffs on aluminium imports, citing national security. The EU, China, Canada, Mexico, Norway, Russia, Switzerland and Turkey challenged these measures, arguing they were protectionist rather than genuine security measures. The WTO ruled against the US, but it rejected this finding, asserting the WTO lacked authority to rule on national security. In 2018, the US used its veto power to block all new Appellate Body appointments or reappointments. By 2019, there were fewer than three members – not enough to form a quorum. This effectively paralysed the WTO's dispute settlement mechanism. The Biden administration maintained this position, continuing to argue that national security issues are beyond the WTO's purview.

Recognising the WTO's weakened state, the Commission proposed in 2019 to amend the Regulation governing the EU's ability to enforce international trade rules ('the

[Enforcement Regulation](#)¹⁾) The objective was to enhance the EU's capacity to respond to trade disputes by allowing it to suspend or revoke concessions and obligations under international agreements when third countries violate trade rules that harm the EU's commercial interests. The revised Regulation, which came into force in 2021, grants the EU the power to impose countermeasures when trade partners breach international commitments and obstruct dispute resolution mechanisms, thus preventing the EU from obtaining binding rulings in its favour. Trade is an EU, exclusive competence and the EU has some options in its toolbox to navigate trade tensions.

Of course, negotiation is just one of the tools available. One way to reduce the risk of a tariff war is to accommodate Trump's demands. One option that was vaguely explored when tariffs were first announced was to offer a reduction of the EU's 10% tariff on cars to 2.5% – matching the US rate – as part of broader negotiations. However, this was never pursued due to Trump's unwillingness to engage in talks and concerns over potential side effects²⁰. Since the beginning of the new EU political mandate, Trump has never once engaged with the EU institutions. He has thus far only done so with Member States' national representatives, who cannot independently engage in trade negotiations.

Given the situation, on 6 March, as US tariffs went into effect, the EU announced retaliatory measures targeting symbolic US goods with more political than economic significance, like its approach in 2018. Trump's response was swift, threatening a 200% tariff on EU alcohol, specifically mentioning French champagne and wine. As seen in the [Ontario case](#), his goal appears to be extracting concessions but his confrontational stance raises the risk of escalating trade tensions.

While the EU's substantial trade surplus in goods with the US makes tariffs on goods a potentially harmful strategy, the EU's trade deficit in services offers an opportunity for more effective countermeasures. One option being explored in policy circles is imposing a digital services tax or tariffs on US service exports. Given that IT services from US Big Tech firms account for the largest share of US service exports to the EU (as illustrated in Figure 3 above), they could become key targets.

While options are certainly being explored, the wider consequences of escalating a trade war must be firmly kept in mind.

²⁰ The EU imposes a standard import tariff of 10% on passenger cars originating from non-EU countries and supplementary tariffs, up to 38.1%, apply to Chinese electric vehicles. It should be noted that under WTO rules, any tariff reduction must be applied equally to all trading partners. While lowering tariffs for the US might have a limited impact on the EU, extending the same reduction to China could be far more costly.

4.3. EU INDUSTRIAL STRATEGY – WIDENING SCOPE AND CHALLENGES

The debate over industrial policy – whether governments should actively steer economic development – has long divided economists. However, the US' rapid shift towards a more interventionist approach, particularly through measures such as the IRA and the CHIPS Act, has transformed the debate from one of necessity to one of implementation. In this context, the EU has also moved towards a more proactive stance, integrating various instruments to enhance competitiveness within its industrial strategy.

Currently, the EU's industrial strategy operates within the single market's regulatory framework, where the principle of 'no state aid' has traditionally been the guiding rule. This means that direct government subsidies to industries must align with EU competition rules to maintain a level playing field. The assumption underlying this approach was the existence of a rules-based international system, both within and outside the EU. However, this assumption no longer fully holds, as global economic competition increasingly involves aggressive state intervention, particularly from the US and China.

This shift raises fundamental questions about whether the EU's industrial strategy, first announced in 2020 and later supplemented by additional initiatives, possesses the necessary tools to achieve its objectives of strengthening EU competitiveness and resilience. Unlike the US, where federal industrial policy can be centrally coordinated, the EU's approach largely relies on EU-level funding programmes, such as the Recovery and Resilience Fund, the Green Deal and the CHIPS Act. While these programmes are substantial in financial terms – comparable in size to US industrial policy – their implementation is highly decentralised, often reflecting national and regional rather than cohesive EU-wide objectives.

There are signs that this approach may be evolving. For instance, [InvestEU](#) and the recently proposed [InvestAI](#) initiative indicate a growing recognition that industrial policy needs stronger coordination at the EU level. At the same time, and given the limited amount of EU common resources, the temptation among Member States to sidestep EU state aid rules and approve national subsidies for key industries will increase. However, this requires more strategic planning. A prominent example of state aid was the EUR 10 billion in subsidies allocated for a semiconductor manufacturing plant in Magdeburg, Germany. The project is delayed and it is unclear whether it will ever happen. [Northvolt's](#) recent bankruptcy, the Swedish battery manufacturer seen as Europe's strongest competitor to Chinese battery makers, highlights the huge uphill struggle in competing with China, even when benefiting from multiple EU loans.

Given these challenges, it may be worth exploring how national industrial policies, shaped by domestic priorities, could be more effectively guided by common EU considerations.

This could ensure that individual policies contribute to broader EU strategic objectives rather than exacerbating disparities between Member States in terms of industrial capabilities and economic development. A more coordinated approach could also prevent industrial fragmentation and reduce the risk of an uneven playing field, where wealthier Member States have more resources to subsidise key industries than others.

Finally, the emerging debate on European defence policy could prove to be a game-changer for EU industrial strategy. The potential for deeper cooperation in defence-related industries could set new precedents for joint investments, procurement strategies and technological development, with significant spillover effects on other industrial sectors.

Ultimately, the EU's industrial strategy requires a systemic approach, in which a clearly defined long-term vision – or '[North Star](#)' – guides policy choices. Without such a framework, the EU risks falling into a reactive, fragmented approach that may undermine its ability to compete in an increasingly interventionist global economy.

5. CONCLUSIONS AND POLICY CONSIDERATIONS

The analysis of recent geopolitical and geoeconomic developments presented above reveals several nuanced conclusions with significant policy implications. The latter are shaped by a complex interplay of structural shifts in global trade and investment patterns and evolving geopolitical and economic dynamics, as well as political choices within the EU and its Member States.

Economic security requires an integrated approach

Recent developments in global and EU capital flows yield several nuanced conclusions with important policy implications. Each is influenced by a combination of macroeconomic trends, as well as structural shifts in trade, international investment and geopolitical factors.

Addressing these interconnected issues requires a multifaceted and forward-looking policy approach. Expanding intra-EU investment flows by reducing barriers to cross-border financial activities is a crucial step. Efforts must focus on finding out how far the observed decline in FDI reflects structural internal impediments – such as high regulatory barriers, elevated energy costs or fragmented markets – or external factors. Understanding the actual impediments is key to tackling them in a way that will spur investment momentum in Europe.

Revitalising the single market remains at the core of these efforts. Aligning FDI with strategic priorities, such as advancing the green transition and fostering innovation-led economic growth, will ensure that incoming investment generates tangible benefits for the real economy. This alignment also underscores the importance of facilitating technology transfer and strategic partnerships, particularly in key sectors like renewable energy, AI and advanced manufacturing.

Since sanctions against Russia were adopted, efforts to reduce reliance on the US dollar – ‘de-dollarisation’ – have accelerated, especially among emerging market economies. These efforts, spearheaded by China over the past decade with limited success, have gained new momentum through Russia’s active participation and the growing interest of BRICS nations and other countries in seeking alternatives to dollar dominance. Western sanctions against Russia, including the freezing of its foreign reserves, have heightened concerns for nations that perceive the US as hostile, offering China a pivotal opportunity to advocate for the yuan’s internationalisation.

These developments challenge not only the dollar’s dominance but also the stability of the current international monetary system. Profound changes in the global financial architecture can be seen in the rapid decline in the use of the dollar for trade invoicing,

which has only benefited the yuan; the creation of alternative systems for cross-border payments that bypass SWIFT; and discussions about leveraging digital currencies to further reduce dependency on traditional payment systems.

Nevertheless, despite the yuan's recent success, the currency still faces significant limitations compared with a true international currency. China's capital controls and the yuan's limited convertibility are major risks for investors, currently. Furthermore, its managed floating exchange rate regime essentially links it to the dollar, complicating its potential role as a reliable alternative. If the yuan's exchange rate were to be adjusted to absorb the effects of US tariffs, de-dollarisation would only be a superficial achievement.

While the shift towards a more fragmented international monetary and payments system is evident, with China and the yuan at the forefront of alternatives, the difficulties of scaling up the yuan to rival the dollar's global role underscore the complexity of reshaping the international financial architecture, as well as opening a space that could be filled by the euro. Overall, fragmentation could ultimately lead to increased inefficiencies and vulnerabilities in global trade and finance.

Trade policy: the great dilemma

The intensification of geopolitical tensions driven by the US-China trade war, the conflict in Ukraine and rising instability in the Middle East have accelerated global economic fragmentation. For the EU, this presents a fundamental trade-off: reconciling its deep-rooted commitment to openness, a principle enshrined in the Treaty on European Union and a cornerstone for trade and investment, with the pressing need to ensure economic security and strategic autonomy.

The EU's adherence to World Trade Organization principles underscores its commitment to an open, rules-based international order, even if it has increased its deployment of defensive tools to safeguard its economic interests. A prominent example is the FDI screening mechanism, which has been bolstered by recent proposals to extend its scope. These measures aim to address potential threats to critical infrastructure and technologies but they must be carefully calibrated to avoid inadvertently deterring legitimate and growth-enhancing investment. Striking a balance between openness and security is challenging yet essential to sustaining the EU's competitiveness and its integration.

The EU needs to turn more towards its domestic market. For decades, despite many initiatives to build a strong internal market, external trade has remained hugely important. One possible explanation is the intensification of globalisation, which happened during the same period, and the large opportunities offered by expanding global markets. They likely overshadowed the EU single market's potential. However, dynamics are likely to

change, driven by a more hostile outside world and growing global trade frictions, which will highlight the single market's value and potential. This should not be seen as a call to turn inward or for the EU to purposely isolate itself. Rather, there is a strong economic case for rebalancing the EU's growth model, placing greater emphasis on the internal market while remaining open to the world.

Completing the Capital Markets Union (CMU) is a critical priority in this context. Beyond enhancing the EU's financial integration, the CMU offers a pathway to strengthening the bloc's economic stability by insulating it from external shocks. An integrated capital market can diversify funding sources, reduce reliance on foreign capital and better channel investment towards strategic objectives, including the green and digital transitions.

For the EU's trade policy, the political dilemma remains acute. While the economic rationale for adhering to WTO principles and [refraining from retaliation](#) is high, politically, maintaining a passive stance in response to high US tariffs is increasingly difficult. However, as experience has shown, adopting a more aggressive approach risks escalating trade tensions — a risk the EU must carefully weigh. This requires a clear assessment of the potential gains from retaliation, whatever form it might take, as well as its longer-term consequences and how to manage any further escalation. The EU, being highly open to global trade and lacking the centralised power, vast resources and leverage that the US commands, must not treat this as a secondary consideration.

Instead, the EU should explore ways to reinvent the WTO to offer a valid rules-based alternative to a growing power-based approach. A world without rules implies that only those who wield power will be the ones to set the rules. Avoiding such an outcome requires investing in trade diplomacy to diversify trade linkages, particularly with smaller economies and emerging markets. The focus should be on 'swinging' economies, namely those that are not aligned to either the US or China.

EU industrial strategy: all for one, one for all

To pursue economic security effectively, the EU needs to comprehensively reassess its industrial policy. This should involve extending its industrial policy instruments beyond those designed solely for the single market. For instance, exploring how EU funds could be used to support a comprehensive industrial strategy could be beneficial. The idea of an 'EU Sovereignty Fund', although ultimately dismissed, was a good start in the right direction and alternative options should be considered. The current debate about the EU budget's future is very much linked to these considerations.

But this should not only be a task for the EU. Reassessing the EU's industrial strategy also requires a careful evaluation of the national industrial restructuring needed to support

the green and digital transitions. This is something that should be done at national, sectoral and company level.

Finally, a broader consideration. Domestic industrial policies, such as the US IRA, have made global relations more complex and have introduced potentially illusionary effects. By incentivising reshoring and domestic investment in the US towards greening the economy, the IRA had the potential to redirect capital flows away from the EU. Still, the evidence does not point to a sustained or large-scale impact beyond a short-lived immediate effect after the IRA was announced. Furthermore, the new administration is likely to repeal, or at least suspend, many of the IRA support measures, potentially quashing investment plans and causing some actual investments to go to waste. On the one hand, this highlights the need for vigilance and strategic adjustments to ensure the EU stays competitive in a shifting global investment landscape. On the other, it should warn policymakers against the high cost and potentially low impact of erratic policies built on costly subsidies.

Investment and FDI: closing the gap

The EU's traditional role as a hub for FDI is increasingly under strain, reflecting evolving dynamics in global investment and structural hurdles within the EU itself. The persistent trend of divestment by both EU residents and non-residents points to a complex interplay of factors.

FDI, historically tied to long-term commitments in physical and productive assets, has progressively taken on characteristics that are like portfolio flows. This shift is largely driven by the strategies of multinationals, which often employ FDI channels for financial arbitrage – such as exploiting differences in tax regimes – rather than focusing on real economic investment like infrastructure or production capacity. This transformation dilutes the traditional economic benefits of FDI, such as job creation, innovation and technology transfer. As data show, this accounts for a large part of the EU's FDI stock. If this trend is the dominant one in the observed decline of FDI inflows and outflows in the EU, the ultimate impact on the real economy may be limited. This is because such flows are less connected to productive investment but evidence pointing in this direction is not unambiguous.

Another explanation for the decline in FDI flows is a potential loss of the EU's attractiveness as an investment destination, which to some extent is supported by the decline in foreign greenfield investment – though less than official aggregate statistics would suggest. For decades, the EU has benefited from substantial inflows of US FDI, not only for financial purposes but also as a means of fostering strategic partnerships and technology transfer. The same holds true for EU investment in the US, which has

contributed to innovation and economic ties. Thus, a structural decline in FDI could have significant implications for the EU's growth prospects, particularly in the context of a widening investment gap. Unfortunately, this slowdown in incoming capital is especially critical at a time when the EU needs substantial investment in digital transformation, green technologies and infrastructure to maintain its competitive edge.

The EU vs its Member States: internal division mean external weakness

From both economic and geopolitical perspectives, economic security is most effectively pursued at the EU level, rather than through a patchwork of national strategies. A coordinated, Union-wide approach would provide the scale and strategic coherence necessary to compete globally and protect European interests. However, in practice, achieving this unity remains a significant challenge due to deep-seated differences among Member States in economic models, industrial structures and even their fundamental views on national security. These variations shape divergent national priorities, leading to differing levels of engagement in collective EU initiatives.

A key issue is that Member States retain significant control over industrial policy, possessing the financial resources, legal authority and policy instruments to develop their own strategies. Consequently, they often prioritise national interests over EU-wide goals, making economic security a fragmented rather than collective effort. This divergence is further reinforced by political and economic considerations. Many governments remain reluctant to cede industrial policymaking to Brussels, preferring instead to protect their own key sectors and national champions. Some recent examples²¹ illustrate that when national priorities conflict with EU objectives, they can undermine collective action, particularly in areas like trade, investment screening and industrial policy. The reality is that the sum of individual national policies does not equate to a cohesive EU industrial strategy aligned with the bloc's long-term economic security goals. Instead, a fragmented approach risks weakening the EU's ability to compete effectively on the global stage, making it more vulnerable to external economic coercion and reducing its strategic autonomy.

The critical question remains – how can a divided approach among Member States still serve the common objectives of EU economic security? Addressing this challenge will

21 For instance, in 2023, the Dutch government independently imposed export controls on semiconductor technology, citing national security concerns and limiting China's access to advanced chipmaking equipment. This unilateral move, while aligned with broader Western strategic goals, was driven primarily by national interests rather than an EU-wide decision. Similarly, Germany's opposition to EU countervailing duties on Chinese electric vehicles, despite the EU's broader policy direction on reducing economic dependencies on China, underscores the influence of national economic interests.

require not only stronger coordination mechanisms but also a shift in mindset, from economic security as a national concern to a shared European imperative.

Only by aligning national interests with collective, common strategies can the EU develop the necessary resilience and competitive edge to navigate an increasingly uncertain global environment.

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