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Navigating Geopolitics, Industrial Policies, and Technological Upheavals

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Roadmap

- Differences between industrial policies in the EU, China and the US
- Strategies of European firms, drawing on interviews
- Case study of the automotive industry for Europe
- During the discussion: Implications for policy

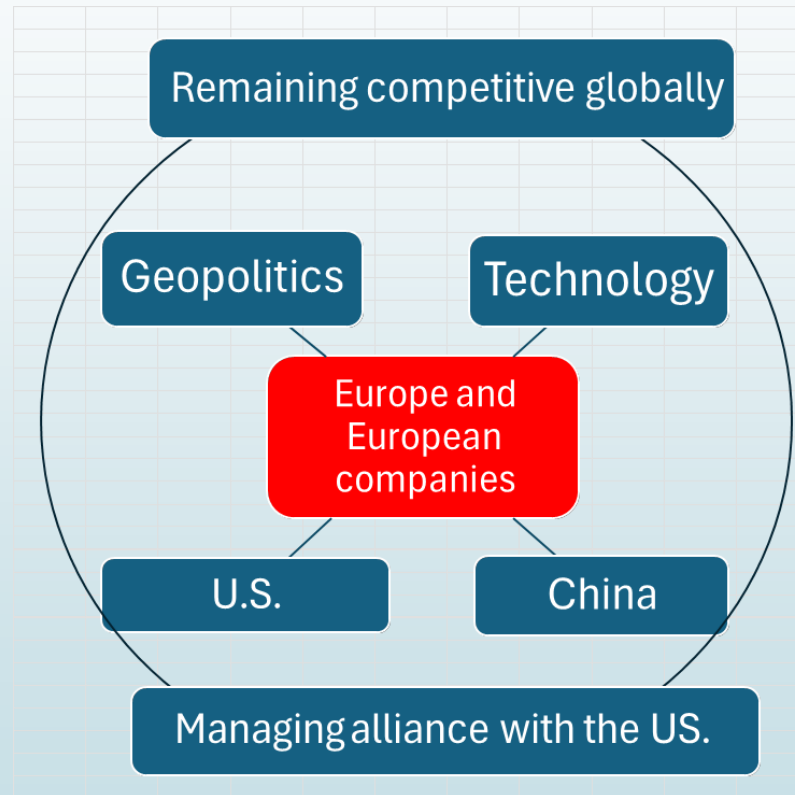
Industrial Policy: Development, Competitiveness, National Security, and Economic Statecraft

- Strategic focus areas include, development, resilience, reducing dependencies
- Long-term industrial policies aim to enhance competitiveness and national security
- Increasingly, industrial policy as a tool of statecraft (in addition to tariffs, sanctions, export controls, and investment restrictions).
- Global European companies in China face geopolitical, technological, and economic challenges
- China and US geo-politics use economic statecraft that targets trade, technology, and supply chain resilience
- Uncertainty about future actions impacts strategies of China-invested European companies.

Europe's Dilemma

- In many areas Europe is no longer a global industrial, financial and technological leader, trailing the U.S. and increasingly China.
- European companies' global competitiveness might warrant partnerships with U.S. and/or Chinese companies.
- European companies are faced with the negative effects of economic statecraft
- To ensure that statecraft and industrial policies not only make political and strategic sense, but do not unduly undermine development and prosperity taking into account the interests, viewpoints and strategies of globally operating firms is essential.

Europe Dual Shock: Geopolitics and Technology



European companies in China (e.g.):

- Germany: 6000
- France: 2000

EU tariffs votes:

Position	Countries
In Favour	Italy, France, Poland, Netherlands, Ireland, Latvia, Lithuania, Estonia, Bulgaria, Denmark
Against	Germany, Hungary, Malta, Slovenia, Slovakia
Abstain	Belgium, Croatia, Czech Republic, Greece, Spain, Cyprus, Luxembourg, Austria, Portugal, Romania, Sweden, Finland

Industrial Policy - Key Focus Areas

CHINA: Key Focus Areas

- Emphasis on AI, the metaverse, and emerging technologies.
- Strategic logic includes cumulative, infrastructural, and dependency-focused sectors.

EUROPE: Strategic independence

- Focus on critical areas like raw materials and digital technologies
- Balancing defensive strategies with innovation in energy and EVs

US: Competitive resilience and targeting adversaries

- Protecting industrial strengths and innovation leadership
- Sanctioning enemies and countering China's technological rise

Strategies of European Firms: Survey Results

How essential must China remain to the company?

% of companies

Very essential	23%
Essential	42%
Neutral/do not know	13%
Unessential	6%
Very unessential	17%

Explaining Degrees of Decoupling: Survey Results

Regression company background variables with decoupling from China

- Company size positively correlated with diversifying from China
- The more mainland Chinese staff, the more severe they expect the impact on performance of diversification or relocation to be
- Financial, IT and other services sectors smaller intention to diversify
- Same for real estate companies
- Company business outlook – a compound variable – is the most statistically significant variable correlated with staying, relocating or diversifying. Company strategies remain driven by business rather than politics
- Investments outside China often complemented by investing in China
- Many companies not able to move away without heavy price

Evolving Multiple Strategies: Interview Results

- Strategies range from (1) a full withdrawal from China to (2) ringfencing China operations, (3) limiting further exposure to China, (4) diversifying supply chains or production to other countries, or (4) doing nothing at all
- “China-for-China” and diversification away from China often complement each other rather than being alternative strategies
- China is becoming ever more important as a hub of innovation and R&D that global companies find hard to cut themselves off from, which adds to the attractions of China-for-China and export of high-value added from China
- No “tipping point”, and problems have less to do with what happens in China than the US’s weaponization of relations with China
- Decoupling by governments is likely to speed up internal delinking of the operations of firms in China rather than make them “follow the flag” of their governments and fully withdrawing from China

Case study: European Automobile Industry

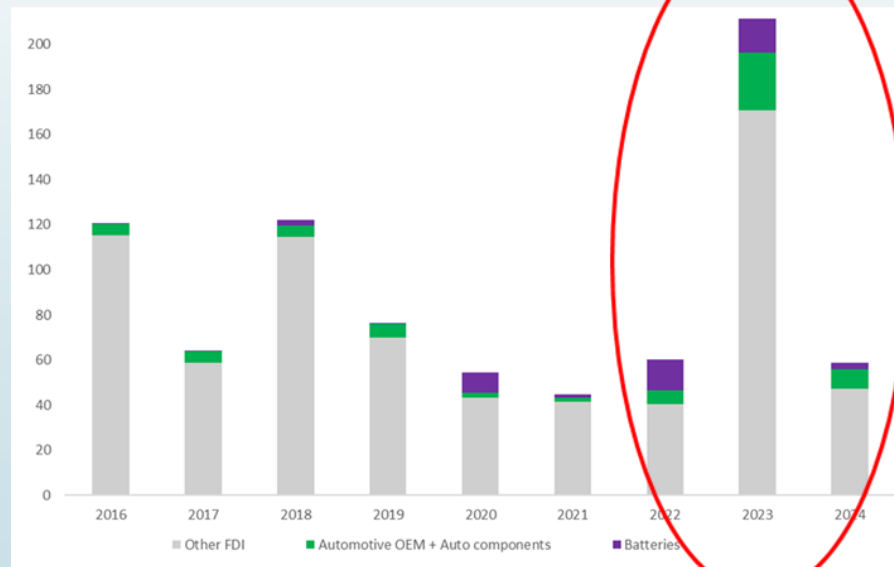
- Europe has significant trade surplus in EVs globally, but deficit with China
- Stiffening competition from Chinese EVs in Europe and overseas
- EV production shifting to the U.S. due to federal incentives
- European automakers deeply affected by tensions between US and China, as well as by the evolving industrial policies in major economies
- The global EV sector is responding to rising protectionism in all three major trading blocs (US, China?, EU), leading to a realignment and localization of production and sales

Case study: Technological Leadership in EVs

- These challenges are compounded by rapid advancements in EVs, AI and autonomous driving—where U.S. and China have the lead over Europe.
- New technologies need significant investment and expertise. European automakers are trailing behind American and Chinese competitors
- Cost advantages in China are significant, because of high levels of vertical integration dominance in global battery production and scale of production
- By no means just a Chinese story: Shanghai giga-factory catalyzed the local EV ecosystem and popularity of electric vehicles in China
- European automakers enhance R&D in China to remain competitive. Collaborative efforts with Chinese partners are crucial, although European teams often face a skills gap in IT compared to their Chinese counterparts

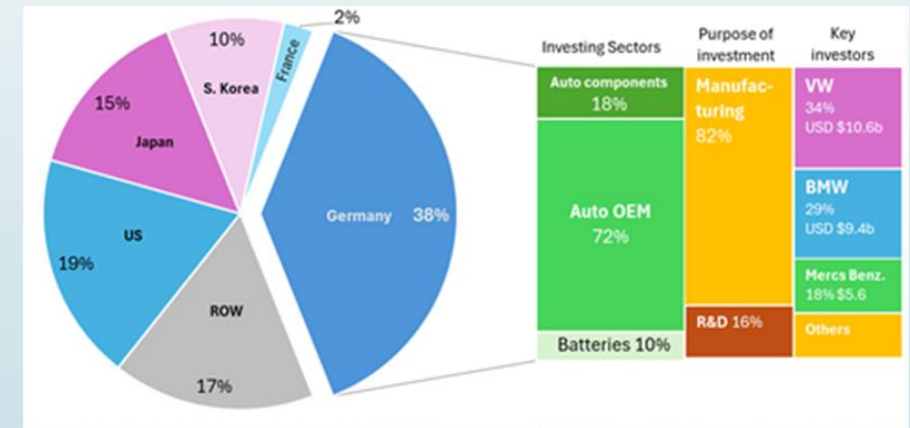
Automotive Investment Announcements (Abroad and in China)

China's greenfield investment announcements
(2016-Aug. 2024)



Source: fDi Markets. Retrieved on Sept 2024

Inward FDI in China for auto OEMs, components, batteries (2016-Aug. 2024)



Source: fDi Markets. Retrieved on Sept 2024. All figures are in \$USD billion. Data does not include M&A.

Case Study: New Generation EVs

- Future of EVs dominated by software-driven innovation: "smartphones on wheels". This underscores importance of decoupling software and hardware lifecycles, allowing for ongoing updates and enhancements
- Autonomous driving models: China and the US are at the cutting edge of hardware, software and standards. European producers must be involved in these markets, including significant investments in collaborations with Chinese firms

Case Study: Challenges for European EV producers

The interplay of geopolitical tensions and market dynamics poses significant challenges for the Europe and the European automobile industry

- Market for EVs in China has become much larger than in Europe
- European infrastructure for EVs and autonomous driving is less developed in Europe,
- Europe does not have China's supporting industrial environment
- Innovation, research, development and design in China are ahead of Europe
- Incorporating Chinese knowhow into production in Europe requires major investments and runs up against technological and regulatory barriers

Policy Options for Europe

The case of global EV sector shows how firms are responding to rising protectionism and rapidly evolving market conditions across major trading blocs. Their strategies lead to a realignment of company production and sales strategies with limited benefits for European operations. This underscores the need for an industrial policy that works with these companies that:

- Emphasizes agility, innovation and selective engagement with China's industrial and innovation ecosystems
- Fosters innovation ecosystems with public-private partnerships
- Enhances supply chain resilience and EU-level policy coherence
- Leverages China's technological advancements
- Reduces barriers in China and Europe caused by data localization requirements, standard-setting practices, intellectual property protection laws, and application of sanctions or extraterritorial laws



Thank you

Balancing Geopolitical Risks and Growth

- While the U.S. pursues an aggressive containment strategy, European policy is centred on “strategic autonomy,” balancing economic competitiveness with defence against geopolitical risks
- Europe's industrial policy needs recalibration, moving from fighting protectionism and building resilience to fostering innovation ecosystems that integrate global advancements, not just in the US but also in China
- While challenging, this approach should seek to prevent deindustrialization by fostering high-value R&D and production capabilities in Europe
- Competing to catch up in existing industries is never easy and often wasteful. In sectors where China is already a leader, Europe's collaboration with China should be motivated by technological cooperation including encouraging technology transfer
- A new industrial policy should take a leaf out of the future-oriented and highly targeted approach of China