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"Can Europe survive China Shock 2.0?"

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Episode Summary:

As China searches for markets to absorb its excess exports, it has increasingly directed much of that manufacturing overcapacity toward Europe, hollowing out the continent's industrial capacity. Ryan Hass and Jon Czin are joined by Constanze Stelzenmüller and Kari Heerman to examine how Europe reached this point, what it can do to safeguard itself and advance its economic growth, and whether it can unify behind a solution.

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HASS: Hello, you're listening to *The Beijing Brief* from the John L. Thornton China Center at Brookings, part of the Brookings Podcast Network. My name is Ryan Hass, director of the China Center.

CZIN: And I'm Jon Czin, the Michael H. Armacost Chair in the China Center. *The Beijing Brief* is a biweekly podcast focused on unpacking the forces shaping US-China relations and China's political, economic, and technological ambitions.

HASS: So while the United States was putting up protectionist walls and waging a trade war with China, China has redirected much of its exports towards open markets, including in Europe. Chinese exports to the EU have increased 89% since 2015, quadrupling the trade deficit. Because of this China shock 2.0, Europe risks losing hundreds of thousands of jobs from deindustrialization.

Already, German industry is losing around 10,000 jobs a month, and its industrial sector is being hollowed out. President Macron of France went so far as to say that Chinese exports are, quote, "literally killing a large part of Europe's industry."

CZIN: So given that backdrop, there are three questions we really want to tackle here today. Number one, how did Europe come to find itself in this position? Number two, what should Europe do to protect itself from the broad scale deindustrialization? And number three, what will it actually end up doing?

HASS: With us today to help us unpack these questions are two of our longtime Brookings colleagues and friends. The first is Constanze Stelzenmüller, who is director of the Brookings Center for the United States and Europe, and a leading expert on German, European, U.S., and transatlantic foreign and security policy and strategy.

CZIN: And we're also joined by Kari Heerman, senior fellow and director of trade and economic statecraft at Brookings. Kari previously served in a variety of senior economic roles across the U.S. government, including in the U.S. Trade Representative, the State Department, and the White House Council of Economic Advisors. And most recently, she has the misfortune of being my new, new neighbor. She brings deep expertise on trade policy, industrial policy, and economic security. So Kari, thanks for joining us, so you don't have to hide from me in our neighborhood Safeway.

HEERMAN: Happy to be here. Thanks, Jon.

[2:02]

HASS: So guys, let's start with a scaling question. On a scale of one to 10, how severe is the shock that European industries face from China's surge of exports? Kari, we'll start with you.

[2:14]

HEERMAN: How severe is the shock? Well, I would say, in terms of duration, we're probably at a a nine or a 10. In terms of one instance, we're probably at a seven or an eight. We're very accustomed in the world to having to deal with import shocks, the sudden loss of something that we need, but export shocks of this magnitude are something really different.

HASS: Constanze?

[2:34]

STELZENMÜLLER: I was kind of waiting for your question number four, which is, how is all of this Germany's fault? But, on your actual question, I would say seven to eight because yes, it's dire, but I don't think it's completely irreversible. I do think there are things we can do, and I hope we will discuss those.

[2:50]

CZIN: So before we get to that part of the story, we want to go back in time and talk a little bit about how Europe's perceptions of China have changed over time. Right? In the 2000s, Europe saw China as a strategic partner and an engine of global growth, which was kind of the widespread conventional view, including here in the United States. When did we start to see a shift really in Europe's perceptions of China?

[3:09]

STELZENMÜLLER: I'd say there are four phases since China joined the WTO in 2001, so 25 years. The first one, as you say, Germany, like pretty much the rest of Europe, saw China as an enormous engine and opportunity for for economic growth, trade, and investment.

And that in fact, all of that happened. But they also assumed, of course, that increasing interdependence with the global economy would change China's political system. The German phrase for this was *Wandel durch Handel*, change through trade. And as with Russia, that assessment proved to be slightly too optimistic.

Second phase was, I think, beginning in 2015 when Beijing published its famous Made in China 2025 strategy. And people realized that there, you know, this was not so much about reciprocity, and not about China changing, but about China changing Europe and to its advantage.

Which is also something we had seen with Russia. Right? Exact same process. And the European firms and policymakers realized they were being subjected to unfair market practices, and then I think the the high point of that came with the Chinese acquisition of the KUKA Robotics factory in in in Germany.

Then came 2019, the European Union's strategic assessment, the one that you just referred to implicitly, where it said China is, as of now, a partner, a competitor, and a systemic rival, which is promoting alternative models of governance.

And the the developments that were reinforcing this were the, you know, increasingly unfair practices by the Chinese, very strategic investments in physical and digital infrastructure in Europe, Huawei being case in point, unfair trade practices, cyber espionage, human rights violations in Xinjiang and in Hong Kong.

And then the fourth phase, I think, begins with Russia's full scale invasion of Ukraine in 2022, where it becomes increasingly clearer, we're now in the fifth year, that the Chinese are not just aiding, abetting, but really in full support of this, and, and that the Russians, in fact, would not be where they are without really important Chinese support. And the realization on top of that, that the Chinese are willing to weaponize the dependence that we now have on them for political purposes.

And that is, I think, the where we are now.

[5:26]

HASS: So Kari, we often talk about China shock 2.0. How how would you define that as a term?

[5:32]

HEERMAN: There's a couple of good publications that define it pretty well. The the dimensions of it are threefold more or less. I would say they're in terms of size, strategy, and support. So first in terms of size, I mean, now China is the world's largest manufacturer. It's not coming from the margins of global manufacturing, and it's increasing its share in total but also in expanding the set of industries closer to higher tech industries where they're competing more head-to-head with firms in the U.S. and Europe and elsewhere in the developed world.

And so the thing that is important about the size of this is that when you have a competitor of this size, you're not just affecting individual firms, but you're shaping global markets by your presence, and that's a really important element of the the size factor.

And so what happens then is countries just start to conclude they can't simply adjust to market outcomes, when they're faced with this kind of a competitor. They have to think about preserving industrial capacity.

In terms of strategy, this isn't just export-led growth. This is coming from the, concept of dual circulation that I'm sure you all can much better explain than I can. But the idea of dual circulation fundamentally undermines one of the the bargains that is implicit in the post-war trade system, which is that countries are gonna become both bigger producers and larger consumers as they develop. You're gonna compete more in the export markets, but you're also going to see larger export markets to send your competitive exports to.

Instead, China's explicitly seeking to become more self-reliant while remaining deeply integrated in everyone else's markets and expanding their share into export markets. And this means that countries can't rely on openness alone. And they start to place greater emphasis on resilience, diversification, and economic security and those kind of things that Constanze was just mentioning.

And then the third piece of it is support. Chinese firms compete with very substantial state-directed support, subsidies, finance, industrial policy, all kinds of forms of government backing. And this isn't just applied neutrally across a broad swath of, you know, to support industries more broadly, but in a way that really is driven to accumulate market power. And that is to have a greater and greater share of global production, of global trade, and the sectors where this has been targeted have been emerging technologies, industries of the future, strategic industries associated with security and many other things.

And so that really raises the question of whether this combination of state support and the enormous scale shaping competitive outcomes, but also in ways that broadly open markets just can't offset. So, governments again are turning to their own industrial policies, trade defense measures, and investment in strategic industries in response to this.

[8:22]

HASS: Constanze, is there anything that you would like to add to that definition? And while I have you, let me just also ask, do you view Germany as the epicenter of China shock 2.0 in Europe right now? And how do you see, you know, this metastasizing outwards from there?

[8:37]

STELZENMÜLLER: Okay. That's a lot of different questions, and they're actually quite complex. But let me, let me try and grapple with that.

It's not as though Europe hadn't been hit by China shock 1.0, right? That affected Europeans as well. What's different about this round is that it is far more severe, and it's devastating advanced industrial sectors like automotive machinery, chemicals, pharmaceuticals, green energy with immense job losses and those have political consequences. Right?

In other words, the magnitude of the shock, and the magnitude of of the sectors affected is much greater. And these are sectors in which especially the Germans thought had, you know, had a 50-year-long advantage they thought. And the Germans, it has to be said, were slower to comprehend and to to react to these developments because they were more open. Right? They were more exposed to this Chinese strategy than any other European economy.

And something that I think also needs to be understood for for non-European listeners and viewers is that, Germany is for better or for worse, the economic powerhouse of Europe. All its neighboring economies are in interdependent with it. And so if bad things happen in the German economy, that immediately has knock-on effects in the rest of Europe, and some of them could be even more severe than in Germany.

What the Chinese are now doing is competing directly in these sectors where the Germans thought they had a, you know, an unmatched global expertise, especially in these, not just the, sort of the big automotive concerns like the, the big four or five German automotive companies, but all these small SMEs, small and medium enterprises, who are referred to as hidden champions because they had exquisite boutique capabilities that nobody else could emulate. And the Chinese have strategically moved into that and are pushing the Germans not just, sort of, out of the competition, but they're forcing the Germans to produce in China, and they're forcing the Germans out of other global markets. Right?

So it's it's really not just the bilateral relationship. It affects the rest of Europe, and it's affects Germany's trade relations with the rest of the world. And that is, that's dramatic, and the context for this is an energy crisis in Germany that was set off by the Russian full-scale invasion, and which in turn compounds structural weaknesses in the German economy because of demography, a reluctance to innovate, bureaucratic hindrances, the sort of balkanization of the European single markets in in important respects that made German industry really unwilling to understand what was going on and, and sort of incapacitated it from reacting for the longest time.

One, one final point, if I may. Industry isn't united on this. There are some German companies that by now are basically Chinese, like BASF, the the chemicals giants. Right? The, the SMEs, the the global champions have been much more wary and much more alarmist about this for a long time.

[11:36]

HASS: So I've been in conversations with Chinese counterparts where their basic response is, Look, this isn't about cheating or subsidies or anything else. This is about us working harder and innovating better than our European competitors. Why is that wrong? What what would either of you say to to that argument that they make?

[11:55]

STELZENMÜLLER: Well, you know what? I don't think that's wrong. Right? I think if we, you know, we're all good sort of democrats and market capitalists here in this room, and I think those are the rules of the road that we have learned. Right? And the Chinese are biting... are, are beating us and biting us, with our own methods.

But they're using some other methods that are slightly less fair. Right? Like espionage, coercion, political pressure, and and that's, I think, where the objections become legitimate. We do need to get back at some point to the the differences within Europe. You had raised that, but maybe we can leave that for a little later.

CZIN: I think what we're, what we're getting at is, you know, there there are these unfair, non-market practices, some of which you elaborated earlier in your comments, but there's also the harsh reality, and I I was just having this conversation with a colleague the other day who who has close eyes both on industry in the United States and in China, and he was saying, Look, there are these unfair practices, but we may also have to come to grips with the fact that these companies are also just really good and really competitive.

STELZENMÜLLER: Yeah.

[12:52]

CZIN: Right? So Kari, you know, from from your perspective as a former policymaker, you know, what are the most problematic activities? And what really is distinct about this aspect of the China challenge from just normal kind of commercial competition?

[13:07]

HEERMAN: Yeah. To the extent that China is becoming more productive, more innovative in a market system, that's a that's a bonus. Right? The way that markets work are you are faced with some competition, and you have to adjust to survive. And if that's where we are, then we are gonna need to accommodate that.

Unfortunately, I think two things are are occurring that do not reflect those things. One is just the massive amount of state support that is directed at specific industries means that there starts to be a a severing of the link between the supply signal and the demand signal. So the firms that adjust are the competing firms. They're not the firms in China because the firms in China can be sustained by state support. So that link, that that correction, that competition is broken.

Second thing is the accumulation of market power that China pursues or or has. They have been demonstrated that they're willing to use it to gain commercial advantage otherwise or to gain other kinds of strategic advantage, and that puts us in a really different position. We're not in this sort of neutral market-based competition frame.

[14:15]

HASS: Let's shift a little bit from diagnosis of the problem to prescription of what we think Europe should do or what tools are available to it. And just to sort of set the baseline, is there anything that is negotiable between Europe and China on this problem, or is this fundamentally a question of whether or not Europe finds the will to act to protect itself against this surge of of Chinese exports?

[14:42]

STELZENMÜLLER: All right, let me start. Look, it's very clear that Europe has real work to do to put itself in a position of bargaining strength. Right? That is the order of the hour. But it does have things that it can do, and I'm sure we'll get to that. It also, I think, has by now understood that it will not change China's model of governance and that it has very little leverage to change China's strategic intentions.

But it's notable, and this is something that European analysts of comparative Russian-Chinese behavior have always noticed. Putin's Russia has always had an interest in a chaotic, dysfunctional, illegitimate Europe because that makes Russian, you know, secret service kleptocracy look better. Right?

The Chinese are actually extremely interested in the functionality of the single market. Right? Because that gives them, it gives them scale and access. Right? So so there is a difference in takes on the kind of Europe that they need. Now, the Chinese clearly think, right, they can have one while undermining the other, right, while undermining political functionality, unity, and so on.

But I think the the thing that we should make a point of here is that the Chinese do need access to the European market. The Chinese do have their own structural vulnerabilities, and that is, in my view, where the space for negotiations resides. All right? That's a very hard-nosed realist take on where we are, but I think what I'm seeing is is Europeans converging on that.

[16:13]

CZIN: And Kari, from your perspective, I mean, what, what are the available trade tools that Europe has at its disposal to kind of realize that latent leverage. These these things aren't cost-free when you impose them. What are the trade-offs that are involved? This is a conversation you and I have a lot around these issues.

[16:29]

HEERMAN: Yes. Tools exist. Europe has, you know, the traditional trade remedy kind of tools, anti-dumping and countervailing duties. They're also developing a suite of additional tools, more calibrated to the kind of challenges they're facing with China. I would say that in thinking about this problem, rather than focusing on the tools, I think about the problem, and I think Europe needs to define the problems that it's facing because many of them kind of get bundled together as a China problem. But they're facing subsidized competition, sudden import surges, unequal access to each other's markets, security risks from import dependence , and it's sort of a deeper competitiveness issues more broadly.

Each of these things need specific instruments. Most of them exist in some form, but maybe aren't appropriate for the scale, maybe aren't appropriate for the lack of transparency in the policy coming from China, aren't appropriate for the scale, they're, you know, designed to address a specific problem when it's really an industry level problem. So I think first deciding what the problem is and then the tool that matches it, is what what Europe really needs to be thinking of.

But you're exactly right. And, Jon, I guess I have taught you one thing, or I think you probably already knew it, that these things are are costly. They are costly, both in terms of, you know, there isn't unlimited fiscal resources, and in fact, fiscal resources are deeply, deeply under pressure. And some of these involve fiscal outlays.

But also, you know, dedicating your economic tools and your economic strategy to offsetting competition from China rather than growing your own economy, that's a little bit of a different problem. And so you might not end up with as strong as economic outcomes if you don't define the problem that you're facing really well and be very strategic about how you address it.

[18:19]

STELZENMÜLLER: Can I, can I sort of zoom out on that and with a more geopolitical take? I think what we're looking at and what Europe has to face is that we're seeing the end of its model of globalization. Right? An open Europe in an open globalized world, which sort of paradoxically isn't to say that there is no more independence or that we can in fact achieve autonomy or even autarky.

That's not on the cards. We will just have to move to a completely different way of managing an interdependence that is deepening and that is marked by tensions and hostility.

So the other geopolitical angle to this is that Europe is facing aggressive systemic revisionism from three great powers: Russia, China, and the United States, each in their own way attempting to reshape the international order, including the international economic order, with dire consequences for Europe's capability to act, its agency.

And as Kari was just saying, it is not possible for us to sort of manage this, you know, this set of four goals: cheap goods, industrial employment, decarbonization, and strategic autonomy. Right? Trying to move from point A to point B, as I've just described, will bring great costs, and those costs have to be distributed fairly, legitimately. And that will, you know, generate real economic, social, and political tensions that, that are going to be a huge challenge for us going forward.

Which is why the question of growth in Europe, right, innovation, and the ability to compete becomes absolutely central to European survival from this moment.

[20:13]

HEERMAN: Can I just add one thing there too? I mean, I think something that's really important to be thinking about in this setting is that we shouldn't overlook the strengths of the market system that we have, and rather lean into those rather than try to replicate a system that is closed. And so from my point of view, the overriding objective of a lot of the the changes that must be made in this context is to try to do things that preserve competition as much as possible rather than protect from competition. Try to prevent, competition being undermined by a state led economy and eliminating competition.

[20:50]

CZIN: Constanze, I want to pick about on on a thread that you were already getting to, I think, in your, in your comments, which is about not just the geopolitical external politics around this, but the internal politics. Right? I was very struck recently, I had a European colleague who talked about how politically unpalatable some of the choices are facing European governments in dealing with China shock 2.0, and he had a very pithy way of putting it. He said, "Look, for the German government, they can either screw their producers or they can screw their consumers." Right? Prices are gonna go up for one or the other if we implement some of the, some of these trade measures.

And you also alluded to the the the variety of views, not just in the business community and politically within Germany, but more broadly across Europe. How do you see that playing into all this, and what are the key kind of fissure points?

[21:29]

STELZENMÜLLER: Let me, let me start with the latter point because that's really important for for people listening and, and watching this podcast. The Chinese have behaved differently in different regions of Europe, and that has resulted in different assessments, different relationships, and different policy prescriptions. Although I will also say I think that those are converging very rapidly because the Chinese very often overplay their hand. And in fact, they're doing so now.

So let me explain what I mean by by the divergences. For the Germans, this is about industrial decoupling. Right? We've leaned all into China. We need to lean back without leaving. Very complicated because we've leaned in far more broadly than with Russia, where it was really all about buying fossil fuel energy, and we didn't really buy goods from Russia. They bought some from us, but that was minimal consumer goods.

For France, this is about industrial policy and strategic autonomy. They're far less exposed to China than the Germans are. Southern Europeans have been subjected to very, very strategic Chinese investments in physical and digital infrastructure; the famous ports, right, the Port of Piraeus in Athens, which in fact the Germans told the Greeks to to sell during the Eurozone crisis. Right? So we had a, we had a hand in there too.

The Eastern Europeans are really alarmed by the overt Chinese support for Russia, as I was already mentioning. And the Nordics are concerned about the digital aspect, infrastructure resilience, and of course in the increasing Chinese presence in the Arctic, and around sort of pipelines and installations in the North Atlantic and the North Sea.

You would think that that would really fragment Europe, and you could over the past decade really watch the Chinese very carefully deploying different sort of means of coercion or diplomacy to keep things separate. That's no longer working simply because Europe is now, you know, basically at the center of a perfect storm with Russian aggression in the east, with a increasingly menacing Chinese presence in the north, or at least with the Nordics. I mean, it's not, it's, it's not kinetic at this point, but it's certainly, not friendly.

You have a situation in the Middle East of potentially escalating and broadening war that could have massive impacts for not just the Eastern Mediterranean, but the entire south of Europe. And you have an American administration that is making predatory grabs for islands in the North Atlantic that other islands are looking at and saying, "Should I join the EU or not?" Like, as Iceland is doing now.

[23:52]

So that, that means that perceptions are converging. Right? And that there is a real, I think the, the, these are all drivers for the Europeans to consider their security holistically. Right? And to consider China's behavior holistically, right, because everything is merging.

The European Commission recently was tasked by all the member states, right, to come up with options. The only state that that didn't join in that was Spain, in that tasking. And the the the Financial Times and other other media have, have been reporting that the French and the Germans have been in negotiations about this, and the Germans and under Chancellor Merz are moving towards a French position of of greater protectionism and greater use of anti-coercion instruments.

I think we need to come back at some point to the question of mechanisms. Right? Of options. I think there's, there's more, what what Kari laid out is, is really very good, we we could go a little more into that. But that's where we are with Europe.

Obviously, all of this is exacerbating both the fiscal and the political bandwidth problem across Europe. You are seeing, especially in the UK and France and in Germany, a surge of extremist parties, not only, but mostly the hard right, who are surging on a message of establishment politics aren't working. They're impoverishing you, they are making you less secure, and only we, only we can solve it. We we all know that quote. Right? Only I can solve it.

And based on the polling we're seeing, that's, that's effective. Right? The the Brits have just elected their seventh prime minister in a decade. After the previous one won in a landslide. The French are going to have elections in the spring of next year where the hard right looks extremely, you know, in in in pole position. And and it's entirely possible that Marine Le Pen would would win at least the first round, if not the second. But that's I'm I'm slightly more doubtful about. And Chancellor Merz is genuinely struggling with traditional politics, which is what he thought he was going to be doing when he when he was elected. And we are in a very different world, and it's and it's really hard.

[26:12]

HASS: So as I'm listening to this conversation, you know, I'm hearing Europe confronts extraordinary geopolitical challenges and internally extraordinarily complex domestic political challenges, and that bandwidth is limited.

But the time to act is now. And I guess the question is whether or not you guys have a view on whether or not Europe will be able to elevate this issue to the top or near the top of its priority list and form a sort of collective front in dealing with the surge of Chinese exports into Europe. Or accept the status quo and sort of a gradual, steady, continuing hollowing out of European industry from this point forward.

Kari, why don't, why don't we start with you?

[27:02]

HEERMAN: Yeah. I, I don't think it's one or the other. I think that Europe, like the United States and many of our longtime allies that have been facing this challenge will find a a way through that won't be the the the best possible way. You can see a lot of action in Europe. I I think already probably the time to act isn't now, but the time to act has passed.

But there's that quote that says, "The best time to plant a tree was 20 years ago. The second best time is today." And I think Europe is definitely following that that maxim by working on a a number of policy tools, , figuring out how to use them, proposing them. So I I think they are acting, they are thinking about what the remedies ought to be, but they are very much thinking, in my view, more defensively than offensively.

And I also think that the the real asset that Europe has is the same one that the United States has long had and many of our allies, which is the the only way to offset China's scale is our own, but it's our collective scale. And moving away from long-held, principles of the international trade system is is very very difficult. More difficult for me perhaps than anyone else, but certainly has objectively been difficult for for Europe to do. The sets of rules and principles that have underpinned the post-war trading system have provided a great deal of prosperity and a great deal of growth. But they face a a a fundamental challenge from China's model.

So I think getting out of the way to figure out ways to leverage the collective strength of of the Western economies is something that Europe's going to have to figure out how to do, even though it's angry with the United States, even though it's not got the same model as Japan and Korea. And that is going to be a really big challenge, and it's a big challenge for the United States as well. In the current political environment, I don't know how far that can go.

[29:01]

STELZENMÜLLER: This sets out perfectly what I was going to say. Thank you, Kari. Let me just start off by way of reminder, right, that you could have said the very same things about Europe when the Russians invaded Ukraine on February 24, 2022. That the Germans were cooked because they were so dependent on Russian energy, and that the rest of Europe was cooked as well. As it turned out, the Germans uncoupled from Russian fossil fuel imports with astounding speed, and paid a high price for it, and and tried to distribute those among producers and, and consumers.

Although they did, you know, they did a little bit of substitution, they did a lot of subsidies, and of course they raised prices for the neighbors, their European neighbors, and that created political friction. So it was by no means cost-free.

And while Europe is still importing some Russian fossil fuel energy because for some, especially the landlocked states, it's impossible to do, frankly, we are in a completely different position there. Right? That that is important. And I say that because it shows that Europe is capable of a nation state level and collective level political response when things get really urgent. And from what I'm seeing about European debates, which I track really closely, we are very much at this point. Right?

It is unfortunately more complicated because as I was saying earlier, we're talking about the entirety of the European economic model and not just its energy model. So the the the scope of the and size of the challenge is just so much bigger.

The other thing that we haven't mentioned yet and that is important, on the point of scale, the European Union has been concluding trade agreements, free trade agreements, with the rest of the world like there's no tomorrow, Right, with all of the continents except I think Antarctica but, you know, we'll leave that out. The MERCOSUR treaty with Indonesia, with Australia, with India.

I mean, this is astounding. It used to be if you'd had one of those agreements you would have had 100,000 Germans rioting in the streets objecting about labor conditions. Right? And now these things are just being signed and waved through. In other words, the European Union is reshaping the global trading order in ways that would've been thought completely impossible.

So those are two data points, right, about what is possible when people are genuinely alarmed.

[31:20]

That brings me to my third point, which is what do we actually need to do? And that comes, that, that's where the scale problem, right, becomes an intra-European one. And that's where I mention Mario Draghi and Enrico Letta. Both previous Italian prime ministers who in 2024 published reports saying essentially—I mean, they're really worth reading, although extremely wonky, even for political nerds like me. Basically what they're saying is we will not survive this moment of massive unprecedented external pressure, right, and internal structural and demographic weaknesses unless we commit to certain aspects of further integration.

But they note not political integration, so, so not, you know, majority votes, but economic and energy integration. Right? Banking union, capital markets union, energy grid integration, that kind of thing. The so-called 28th regime, which is really trying to create a regulatory regime that is Europe-wide rather than country to country. As you can imagine, the most legalistic countries like mine are trying to undermine that, but I think it is absolutely, you know, that, there's incontrovertibly where we are heading. So that is something that I think people now understand is in our future and we need to do.

The other thing is, as Kari was saying, is defending at, against, you know, overt market distortion by state-subsidized companies by by the Chinese. I mean, there we have tools, and we just need to be able to use them more offensively. We need to do things like investment screening. We also probably need to just rebuild strategic industries, especially in defense and space, which I however see us doing, and the Germans are are very much, I wouldn't say we're leading in that, but we're one of the one of the big the big three certainly.

And finally just, you know, managing decline honestly. In other words, letting industries go that can't be saved. Right? That, that is, that is probably the most painful conversation because there are jobs associated with it that, that have direct connections to voting patterns. Right? And that's where where I think a political leader needs to be brave and honest with voters, and that's where a great deal of the political risk of this situation resides.

[33:32]

CZIN: That's really interesting. I appreciate your your optimism. I want to pick up one thread on this because as you're talking about all this, I'm trying, you know, I'm putting on my hat as a former CIA analyst and thinking about how this looks from Beijing's perspective, right, and how they see this.

You know, and I was very, uh, struck by a comment I heard from a Chinese colleague, an academic who's usually pretty measured, last year, where I asked him about this, about, you know, pushback from, from the Europeans in the face of this onslaught and and China shock 2.0. And he sounded less like an academic and more like Tony Soprano in his response, and he said, "You know, what are the Europeans gonna do about it? Who’s gonna help them? You?" Looking at us collectively in the room from from from Washington.

And I think that gets to, you know, kind of the nature of the challenge. I mean, you know, to kind of try to summarize what we’re saying, b- like from my perspective, there’s kind of three tiers to this challenge. Right? Number one, can Europe get its act together and act in act in concert? And it seems like what you’re saying, Constanze, is that you’re, you’re somewhat optimistic that they can actually do that.

STELZENMÜLLER: I’m saying there is examples of us doing it and that seemed entirely improbable even to our friends.

CZIN: And the point’s very well taken.

STELZENMÜLLER: And they’re recent.

[34:35]

CZIN: Right. And the second point then is, and I think this is very much on the Chinese mind is even if the European Union can instantiate some of these measures, right, can they withstand the blowback from China? Because I think they’re feeling very good after getting the Trump administration to walk down from its tariffs that they can, they can squash these efforts by the European and and push them pretty hard with their with their own countermeasures if they really get into this.

And I’m thinking about what you’re saying in terms of the domestic political scene. Right? I could imagine a world in which Beijing thinks we’re dealing with a bunch of weak European leaders—

STELZENMÜLLER: —absolutely—

CZIN: —across the board. Right? And, you know, Europe kind of has one of two options. Either they stick with the status quo because they can’t get their act together, right, and that’s good for us. Or they do, and then they get involved in a costly trade war, and these relatively enfeebled European leaders go away, and who ends up winning? It’s going to be those far right parties, right, that maybe will not be equipped or willing to go toe-to-toe with China in the event of a costly trade war.

[35:29]

STELZENMÜLLER: I cannot prove to you that that’s not gonna happen. Right? But I would say to you as well that the European economy is already changing. Right? And it’s changing massively, and that’s because of the war. Right? You are seeing a redirection and to some degree a conversion of German manufacturing away from cars and into defense. And away from relatively sort of low-tech car building and very, very high-tech, rocketry, satellites, weaponry and so on.

And again, if Germany gets this right, that has a massive impact on the neighbors. In the same way that the German economic growth post Chinese WTO accession, right, fueled economic growth in Central and Eastern Europe because the entire car parts industry in Germany migrated to Poland, Hungary, Slovakia, and the Czech Republic, right, this will also have similar migratory effects in Europe.

In that sense, economic interdependence in Europe is actually a good thing. Always supposing, you know, that the Germans don't make political mistakes, for which I'm not willing to put my hand into the fire. But but let's, let's I think dig in on this point of of the Chinese saying, "Ah, you know, I mean, we're the winners here. They, they don't have a chance."

HASS: I would just say that the European economy is changing, but so too is the Chinese economy.

STELZENMÜLLER: Yeah.

HASS: The Chinese economy is becoming increasingly dependent upon exports as its engine of economic growth. And as protectionist walls in the United States go up—

STELZENMÜLLER: —the European market–

HASS: —those exports need to go somewhere else. And Europe is becoming a central recipient of of Chinese exports, which are essential to sustaining its growth. And so I I hope that as we sort of advance this conversation and come back to it in the the months to come, that we also, you know, keep an eye on the fact that that China also has dependencies as well, and that Europe has significant leverage in this conversation.

[37:23]

STELZENMÜLLER: That, but that's exactly the point that I wanted to make. Right? Europe is an unusually valuable consumer market for for China. It's especially important for China's excess goods, right, which are being produced as a result of China's subsidies, which are actually a weakness of the Chinese economic model. And we are a key alternative to the United States. Right?

So arguably, what you're looking at is a weaponizable interdependence, where the Chinese have significant vulnerabilities that they're glossing over with remarks like the ones that you were quoting.

And so there is leverage there for Europe if it wants to use it and is capable of of coming to the unity of using it. And again, my impression also from, you know, watching, listening to Chinese officials at the Munich Security Conference, is that the Chinese are not that good at reading us, are not

CZIN: It's not their strong suit.

STELZENMÜLLER: And no, it's not a strength very clearly. That's visible even for a non-China expert like me. And that is something they have in common with the Russians. Right? And you could see the Europeans looking at this and saying, Wait and see. Right? So that I think is, is really important.

The Chinese overplaying their hand has in fact helped to unify Europe in the same way that Russian aggression has helped to unify Europe. And of course, the Trump administration policies are doing the same thing.

So there is something happening there. Again, I'm not saying that this couldn't all go belly up. Of course it could. Right? But I'm seeing sort of real attitudinal shifts. And I'm seeing people booed, right, who say, Oh no, what we really need to do, because if the Russians are mean to us and the Americans are mean to do, we need to have a strategic partnership with China. And the response usually is, You must be out of your mind.

HASS: Good luck with that.

STELZENMÜLLER: I'm sorry, I'm hogging the airways, or airwaves, Kari.

[39:02]

HEERMAN: I mean, I agree that there is urgency and that there is, you know, a a a real risk to both economic and physical security inherent in in the way this is unfolding. I would just say that designing our economic system and our economic policies around security, instead of opportunity and prosperity, means we're gonna have lower standard of living. And some of that is imposed on us by the very fact that we're facing the challenge that we're facing. But boy, I really hope we can do it in the smart way to limit those losses as much as possible, and understand that we are balancing, certainly, both an economic and security threat in the environment. But we're also facing a lot of domestic socioeconomic challenges.

The industries that you were talking about, Constanze, and many, many more are facing challenges from new general purpose technologies unfolding around us. And so we do need to think about multiple things when we're thinking about how to design economic policy, not just the vulnerability inherent in interdependence involving a a strategic competitor or adversary or however you political scientists want to put it.

[40:12]

STELZENMÜLLER: Can I say two things about that? One, it would obviously be better if Europeans and Americans could work together on this. This is what Rush Doshi and Kurt Campbell referred to in a *Foreign Affairs* piece as "allied scale." Right? It is self-evidently the better way to do this. And as we're now seeing in the debates about the about the U.S.' role in European defense it is very clear, at least to observers like me, that in security and defense we remain interdependent in ways that this administration is not really willing to acknowledge.

In other words, decoupling from Europe is not really an option, not least because the U.S. also needs Europe as a market for its defense goods in order to be able to buy at at good prices for its own armed forces. My first point.

The second point is, if my proposition is right, that we are looking at not a decoupling or de-risking, but at managed interdependence, we may be looking at an economic version and security architecture to match of mutually assured destruction. An economic security M-A-D. Right? Where each side knows that the other side could inflict so much harm and cost on the other that it's not worth it, and that we need to find ways of living together.

Now, is that, is that scenario susceptible to misreadings and miscalculations, especially if what I've just said about how the Chinese and Russians are able to read us or not is true? Yes, and that's that's I think my most significant source of pessimism.

[41:42]

HASS: Yeah, I mean, deterrence is a, is a blend of capabilities and resolve. I think that latter part, the resolve part is in the Chinese minds at least a a question mark.

That will be the exclamation point that we close on. I've really appreciated this conversation, and and it's clarified for me the importance of keeping our eye on the need for growth, dynamism, and competitiveness even as we address issues related to security.

[music]

So thank you, Kari, thank you, Constanze, for lending your wisdom to this conversation, which I'm sure we'll be coming back to again soon.

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