

US–China Rivalry and European Strategic Autonomy in the post-Covid Global Economy

by Paolo Guerrieri



ABSTRACT

The world economy has changed profoundly over recent years. The US–China conflict dominates today’s international stage. Given these shifts in the international economic system the EU is being forced to strengthen its own position in the world. A more autonomous foreign economic policy strategy will require not just an international component but a domestic one too. In three broad priority areas the EU has much potential for strengthening its global role. First, a broader and more effective EU trade policy and foreign investment strategy is needed, especially to manage relations with the US and China. Secondly, the past excessive dependence of European growth on external demand and trade surpluses should be reduced as it is a source of vulnerability. Thirdly, it will be necessary to reduce the Union’s widening technological gap with the US and China regarding the digital technologies of the fourth industrial revolution.

US foreign policy | China | European Union | Foreign trade | Transatlantic relations

keywords

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by Paolo Guerrieri*

1. Profound shifts in the international economic system and the global role of the European Union

The world economy has changed profoundly over recent years owing to the decline of the multilateral order, the great power rivalry between the United States and China, and the deterioration of global economic interdependence.¹

The economic and social impact of covid-19 has made clear the extreme vulnerability of the world's population to a range of threats, from pandemics to climate change to digital wars, and so on. All these threats are global and can only be addressed and/or solved by global cooperative action. But there is a very real risk of an international systemic vacuum, in which there is no provider of public global goods. As we have seen during the global response to covid-19, global economic governance has never been so essential, but it is also extremely hard to implement.

Today's international stage is dominated by the US–China conflict, which has anything but diminished since the transition from Donald Trump to Joe Biden in the White House. The risk that this strategic confrontation degenerates will remain extremely high for the foreseeable future. For instance, we might see a general economic decoupling from China, a policy that would come with extremely high

¹ Douglas Irwin, "The Pandemic Adds Momentum to the Deglobalisation Trend", in *Vox*, 5 May 2020, <https://voxeu.org/node/65585>.

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costs and incredibly small benefits.

As the largest trading bloc in the world, the European Union is especially exposed to the US–China struggle, and it has an interest in avoiding any degeneration that would lead to further weaponisation of international economic relations. The EU cannot simply wait to see how this conflict ends: that would risk diminished influence and commercial damage.²

It follows that rebuilding global economic governance and avoiding beggar-thy-neighbour policies is a key tenet of the European agenda in this age of multipolarity. The strengthening of a new multilateral framework, one that can promote economic integration and cooperation between countries as well as supply global public goods (relating to public health, climate change, digital governance, for example), is therefore vital to European interests.³

In response to the profound shifts taking place in the international economic system the EU should strengthen its presence in the world. What has been achieved in the past is no longer sufficient. In this regard, European Commission President Ursula von der Leyen has said many times that it is inevitable to strive for an increasing level of European strategic autonomy, and that the Union must adopt a “more assertive” foreign policy stance.⁴

The EU’s trade policy is a powerful and effective community instrument, so much so that it has often been used as leverage in pursuit of the EU’s geopolitical aims. However, to meet the difficult and uncertain challenges that will arise in a world that has been so dramatically shaken by the pandemic, relying on trade policy alone will not be sufficient. A comprehensive foreign economic policy strategy, one that can be autonomously implemented by the EU across multiple levels over the years to come, will require not just an international component but a domestic one too. The economic transformations characterising the post-covid-19 world will reinforce this important link between the front-line role the EU must play on the world stage and the need to relaunch sustainable growth and convergence internally.

In concrete policy terms, developing a strategic autonomy that gives the EU a bigger international role could mean many things. Here it will suffice to focus on three broad priority areas in which the EU has much potential for strengthening its global role. First, a broader and more effective EU trade policy and foreign investment strategy is needed, both to manage relations with the US and China

² Mark Leonard et al. “Redefining Europe’s Economic Sovereignty”, in *Bruegel Policy Contributions*, No. 9 (June 2019), <https://www.bruegel.org/?p=31321>.

³ Paolo Guerrieri, “A New Multilateral Agenda After Covid-19: The Role of the EU”, in Mario Telò (ed.), *Reforming Multilateralism in Post-Covid Times*, Brussels, Foundation for European Progressive Studies (FEPS), 2020, p. 178-185, <https://www.feps-europe.eu/resources/publications/773>.

⁴ European Commission, *Von der Leyen Commission: One Year On*, Luxembourg, Publications Office of the European Union, December 2020, <https://op.europa.eu/s/pq8P>.

and for maintaining international openness and cooperation. Secondly, the past excessive dependence of European growth on external demand and trade surpluses should be reduced as it is a source of vulnerability. Thirdly, it will be necessary to reduce the widening technological gap with the US and China regarding the fourth industrial revolution. For a large polity such as the EU, the credibility of an assertive foreign economic policy is not sustainable in the medium- to long-run without a strong competitive economy that can support it.

2. An assertive international trade policy

Creating an assertive international trade and investment policy is the first challenge facing the EU. This requires a more effective management of transatlantic relations with Biden's America, after the dark years of Trump. It also requires responding to the challenge of China by means of a greater and more effective degree of reciprocity. Finally, to promote an open global trading system, it will be necessary to retain strong trading relations with the rest of the world, as has been with all major Asian countries, as well as with Africa and Latin America.

The Biden presidency does not mean the US–EU relationship will not be fraught with problems and disagreements, but it does offer the EU an opportunity to relaunch bilateral transatlantic relations. The many ties with the US, such as common democratic values and a defence/security alliance, remain crucial European assets that need to be defended. At the end of 2020, the Commission put forward a plan for the future of transatlantic relations that moves in the right direction. This plan would see a renewal of relations with the US on many fronts, starting with the environment, trade, and technology.

In global climate action, the EU should take the lead since it is already at the forefront. If a global alliance proves difficult to achieve in the short term, the EU should favour a climate coalition between a group of like-minded countries with similar approaches, including the US. The EU should take full responsibility for the initiative of a Carbon Adjustment Border Mechanism, with the caveat that this should comply with World Trade Organisation (WTO) guidelines to avoid triggering protectionist dynamics.⁵

As to trade and investment, the EU–US June deal to end a 17-year dispute over aircraft subsidies to Airbus and Boeing and suspend the related punitive tariffs was a positive step toward more cooperative relations. The possibility of new large-scale bilateral trade agreements such as the failed Transatlantic Trade and Investment Partnership launched during the Obama presidency is most likely out of question, however. The Biden Administration is not interested in new trade agreements,

⁵ André Sapir, "The European Union's Carbon Border Mechanism and the WTO", in *Bruegel Blog*, 19 July 2021, <https://www.bruegel.org/?p=44080>.

given the strong domestic bipartisan opposition to these issues. However, there remain opportunities for partial agreements on individual sectors and on products where there are potential mutual benefits.

Finding consensus with the US as regards technology transfers and regulations will remain very tough, since this area will determine the result of the global strategic leadership battle between the US and China. The EU will be increasingly expected to take side, as shown by the case of the 5G mobile technology. Further problems between the EU and the US regard EU regulations of digital services. At the end of 2020, the European Commission has released three new acts – Digital Governance Act, Digital Services Act and Digital Markets Act – with the goal of regulating its digital markets and looking for a European “digital sovereignty”.⁶ The prevailing perception in the US of the European Commission’s proposal to date has been of measures specifically targeting US companies in Europe and discriminating against US digital champions.

Despite their differences, however, the US and EU have far more to gain by working together to regulate digital services and invest in the technologies of the future than dividing and clashing with each other. Since the legislative process to implement the new EU’s regulatory framework is expected to take several years, these Union’s proposals could offer an opportunity in many ways for a comprehensive transatlantic discussion as the United States attempts to define a new US approach toward regulation of data and digital services.

More so since digital technology is a fundamental battleground in the geopolitical competition with China. As we will explain below, US and EU have a shared interest in containing China, which seeks to export abroad its autocratic model of digital governance and regulation. In this perspective, the US–EU Trade and Technology Council, as launched at the transatlantic Summit in Brussels on 15 June, is an opportunity to build a common approach to regulations that reflect shared interests and values.

About the taxation of large American companies, the so-called GAFAM (Google, Apple, Facebook, Amazon, and Microsoft), Europe and the US have long had fundamentally different views on how much and where the US Big Tech should pay taxes. Many European countries rightly believe tech companies can avoid paying their fair share of taxes and have thus either proposed or implemented a digital services tax (DST). It is a tax on gross revenue streams of large digital companies, mostly US companies. The United States perceived the DST as discriminatory and

⁶ European Commission, *Proposal for a Regulation on European Data Governance (Data Governance Act)* (COM/2020/767), 25 November 2020, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020PC0767>; *Proposal for a Regulation on a Single Market for Digital Services (Digital Services Act)* (COM/2020/825), 15 December 2020, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020PC0825>; *Proposal for a Regulation on Contestable and Fair Markets in the Digital Sector (Digital Markets Act)* (COM/2020/842), 15 December 2020, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020PC0842>.

has responded with retaliatory tariff threats.

Hopefully, the G7 and G20 agreements for a global minimum corporate tax and new rules on where the biggest multinationals are taxed (the location of their consumer or users), which needs formal approval by the Organisation for Economic Cooperation and Development (OECD) by the end of the year, could reduce trade friction and remove a major obstacle to transatlantic cooperation.

As for public goods, and specifically cooperation on global health, there is a strong need for the EU and the US to cooperate so that supplies of Western vaccines to the developing world, initially to Africa, are stepped up.

To sum up, the EU must exploit the opportunity to relaunch economic relations with the US while maintaining its own identity. In this regard, there is no contradiction between a renewed transatlantic agenda and an EU greater strategic autonomy.

3. A common strategy towards China

Economic and trade relations with the Asia-Pacific region and particularly with China will be of fundamental importance for the EU in coming years.

The EU's attitude towards China has profoundly changed. For a long time, it reflected a "business first" mentality, which drove every European country to prioritise trade and investment relations with Beijing. Today, there is a European awareness that, besides being a commercial partner of primary importance, China is a systemic rival, a special competitor that is using state capitalism, supported by generous subsidies, to achieve industrial and technological supremacy at world level.

In addition, Beijing's international economic strategy has become much more assertive and intrusive.⁷ Since the great economic and financial crisis of 2008–2009, China has pursued a policy of massive expansion abroad through huge foreign investment and the Belt and Road Initiative. The content of Chinese growth has also significantly changed, with massive investment in high-tech digital technologies and artificial intelligence bringing China's economy into direct competition with those of the US and major European countries. In addition, the covid-19 crisis, by revealing the EU's excessive reliance on China in many strategic sectors such as pharmaceutical ingredients, has outlined the urgency for a plan to reduce such a dependence.

⁷ David Dollar, Yiping Huang and Yang Yao (eds), *China 2049. Economic Challenges of a Rising Global Power*, Washington, Brookings Institution Press, 2020.

The EU should formulate its own policy towards China to achieve greater bilateral reciprocity. It should cooperate with China over common public goods, such as the fight against climate change, global health and cybersecurity. While the EU shares many US concerns, for example over market access, forced technological transfers and security threats surrounding Beijing's nationalistic behaviour, US and EU interests and goals do not coincide in other areas, such as economic integration with China and the wider Asia-Pacific region. The provisional conclusion of a Comprehensive Agreement on Investment reached between the EU and China in December 2020, after seven years of negotiation, has proved this. Nor should the EU agree to the "decoupling" plan from China that the Trump Administration vigorously pursued and the Biden Administration has so far confirmed.

It should be stressed that this approach is not at odds with the fact that the EU should coordinate with the US when negotiating with China on many issues. There is no doubt that the EU and the US must insist upon greater reciprocity in their relationship with China, as the current huge asymmetry in market access is no longer sustainable. As for such key issues as Chinese subsidies and state-owned enterprises, negotiations must continue at plurilateral level within the WTO. If China continues to practise unfair trade and refuses to participate and/or to recognise a deal achieved at WTO level, unilateral sanctions against Beijing could be adopted by the EU and other partners.

Looking forward, the EU should be part of a transatlantic front that converges on a common platform of claims against China. This would substantially increase the bargaining power of both the EU and the US. But to form a united front, a compromise should be achieved in which the EU and the US move towards one other, moderating the most extreme differences in their approaches. A hard-line approach will make it impossible to confront shared global challenges.

4. A revitalised multilateral network

The EU has a vital interest in avoiding fragmentation of the global trading system. Rather, it should strive for governance of asymmetric economic interdependencies and the strengthening of multilateral frameworks. In this regard, the weakening of the WTO is a growing challenge,⁸ and the EU should play a constructive role in reforming and modernising the trade body, which has many problems and unresolved issues. Reforms must address, to mention only the most significant issues: the voting system and the arrangements for countries' representation; the regulation of subsidies; the distortions associated with state enterprises; excess capacity in some sectors and antidumping practices; the competence of the Dispute Settlement System. These are all shortcomings that currently make

⁸ Bernard M. Hoekman and Petros C. Mavroidis, "Preventing the Bad from Getting Worse: The End of the World (Trade Organization) as We Know It?", in *EUI Working Papers RSCAS*, No. 2020/06, <http://hdl.handle.net/1814/65965>.

opportunism possible on the part of many countries, first and foremost China, and they need to be eliminated or at least significantly reduced.

Defending a multilateral trading system in no way excludes effective policies and strategies in bilateral negotiations. The EU must therefore continue to consolidate and develop its complex and sophisticated network of bilateral agreements, starting with Japan and the other countries of the Asia-Pacific region, intensifying trade negotiations of the kind that have been successfully concluded in recent years. In this vein, it is enough to mention the agreements reached with Canada, South Korea, Japan, Vietnam, Singapore, and the Mercosur countries (Argentina, Brazil, Paraguay, and Uruguay), these being just the most important. In this regard, the trade integration that has been under way in the Asia-Pacific region in recent years and the free trade agreement (Regional Comprehensive Economic Partnership) signed on November 2020 by China and other 14 Asian countries mean that the EU's network is even more strategically important.

In addition, the EU will have to increase its capacity to involve third-party countries, similarly to what the US did in the past and China is doing today. The EU is the largest provider of development aid in the world, but its distribution is fragmented and without a coherent overall strategy. To this end, it will be necessary to review and revise such instruments as the Association Agreements and Cooperation and Development Aid. An initial step should be bringing order, coordination, and simplification to the jungle of channels of intermediation.⁹

This could facilitate a new European initiative towards Africa, a continent destined to play a front-line role in the twenty-first century about the future of the planet. In recent years, China and other countries (Japan and the Arab Gulf states) have engaged in massive economic and commercial penetration of that continent. Some individual European countries are already there, especially France, but a unified EU presence is missing.¹⁰

Finally, it should be remembered that the EU has often used bilateral trading agreements to promote its own environmental and social standards abroad. In this respect, it will be essential to give a greater role in future trade agreements to the principle of fair trade as opposed merely to free trade. This means that more proactive and effective policies at the domestic level are required, policies that will allow most workers and enterprises to enjoy a more equitable share of the conspicuous benefits of fair trade besides a mitigation of the costs inevitably associated with it.

⁹ Organisation for Economic Cooperation and Development (OECD), *OECD Development Co-operation Peer Reviews: European Union 2018*, Paris, OECD, December 2018.

¹⁰ United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2020. International Production Beyond the Pandemic*, Geneva, United Nations, 2020, <https://unctad.org/webflyer/world-investment-report-2020>.

5. The role of the single market in economic growth

Links between the internal and global dimensions of the EU's strategic autonomy involve that the Union will have to reconfigure the export-led growth model that it has pursued in the last two decades.¹¹ This was based on enormous trade surpluses with the rest of the world. These persistent current account surpluses will no longer be sustainable in a world economy that is increasingly dominated by fragmentation and the US–China conflict. Furthermore, they will be a source of vulnerability in the medium and long term.¹²

EU macroeconomic policies will have to reduce excessive dependence on external demands and increase the contributions made by domestic demand to the growth of the EU. The Union's huge and rich internal market has hitherto been little exploited, and an opportunity to take immediate steps in this direction will be offered by the investments that are linked to the 750 billion euro Next Generation EU and the European Green Deal, as well as the digitalisation goals of the European Commission's post-covid growth strategy. Another useful instrument will be the completion of the single market for services with the creation of a common European space for research and innovation. Of course, this does not imply that exports will not continue to represent a fundamental component of the EU's development – just that the latter will not be driven by net exports.

Furthermore, the emergence of a multipolar monetary regime is very much likely in the medium term because of the growing international role of the renminbi. The euro should, without doubt, be part of that new regime, so it is time to break with the EU's past neutrality on the international role of its currency and create the conditions that favour its greater international presence. To this end, important choices must be made, and complex reforms undertaken. The completion of the banking union and the capital market union is needed, and a safe financial asset for the eurozone should also be pursued. These reforms cannot be delivered overnight and will require strong political support from member states. Whatever the case, it is important that action begins as soon as possible. Without these changes, strategic autonomy will be impossible to achieve.

¹¹ Paolo Guerrieri, "Les politiques européennes et le futur de l'euro", in *Politique Etrangère*, No. 2/2017, p. 81-92, <https://doi.org/10.3917/pe.172.0081>.

¹² Marco Buti and George Papacostantinou, "The Legacy of the Pandemic: How Covid-19 is Reshaping Economic Policy in the EU", in *CEPR Policy Insights*, No. 109 (April 2021), https://cepr.org/active/publications/policy_insights/viewpi.php?pino=109.

6. Common policies aimed at technological competitiveness

In recent years, the EU has suffered from a significant decline in its technological competitiveness, especially when compared with the US and China.¹³ Closing this competitive gap is thus the EU's third important challenge if it wants to play a more autonomous and active role in the post-covid world.

The decline in competitiveness suffered by European countries has affected many sectors that are at the heart of the fourth industrial revolution, such as artificial intelligence, big data and other digital high added value sectors. In addition, the pandemic has highlighted the EU's worrying weakness in the supply of sanitary and pharmaceutical products, revealing that most European countries are heavily dependent on Chinese imports.

Technology is becoming an increasingly relevant factor in determining competitiveness, as well as geoeconomic strength or vulnerability. Advanced technologies will have a key role in shaping the global economic context and the power relations between countries. Therefore, it is vital that the EU increase its innovation and technological capabilities while China and the US are engaged in a battle for strategic dominance. This means that the EU will have to develop a range of policies relating to trade, industry, technology and competition, modernising these areas, and better coordinating them at a European level. The completion of a single market for services and capital market union could spur innovation, as well as enhancing the competitiveness of value chains in the EU.

More adequate defences against acquisitions and inward investments driven by predatory intentions towards European enterprises are also required. An EU screening system for foreign direct investment became operational in October 2020, while Brussels has plans to block takeovers by companies active in the European market but subsidised by non-EU governments. This is most obviously about China. Such instruments should be defensive in nature and could also be used as a deterrent.

Room must also be created for substantial investment in technological projects that are of common European interest, both those that are able to sustain common initiatives (in areas such as health, energy, climate change, security, and the digital economy) and those aimed at the creation of cutting-edge technologies in the most significant fields, from artificial intelligence to cybersecurity.

In short, reinforcing the resilience and industrial sovereignty of the EU requires a common approach to its technological and industrial development, with a much more incisive attitude than has been the case so far. But the EU should not surrender

¹³ European Investment Bank (EIB), *Who is Prepared for the New Digital Age? Evidence from the EIB Investment Survey*, Luxembourg, EIB, April 2020, <https://op.europa.eu/s/pr6>.

to protectionism.¹⁴ Its openness and multilateral trade relations must be defended in such a way as to simultaneously promote the technological enhancement and increased productivity of the member states, by assuring greater reciprocity in relations with its main trading partners.

Concluding remarks

A more autonomous and assertive foreign economic policy on the part of the EU must be based on greater unity among member states. Among the obstacles to the strategic autonomy agenda are the internal divisions within the EU. The US, Russia and China have used, one way or the other, a divide-and-conquer approach to national capitals to weaken the common EU front. From this standpoint, the most pressing problems remain the various expressions of nationalism in the EU and the lack of trust between countries. So that the EU can act differently in the future, it should set up effective common decision-making mechanisms and capabilities as soon as possible. The lack of these has weakened the EU's external role in the past.

Finally, to maintain and further develop trade openness and proceed with the international economic integration of Europe, safeguards for workers and citizens should be strengthened. They want an economic system that is open, certainly, but also one that provides them with benefits and protects them. In this regard, social and welfare policies are needed to deal with the unequal impact of trade and technology. There is much that governments can do, but not much progress has been made. Now is the time for new policies and new measures.

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¹⁴ Richard Baldwin and Simon Evenett (eds), *COVID-19 and Trade Policy: Why Turning Inward Won't Work*, London, CEPR Press, 2020, <https://voxeu.org/node/65536>.

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