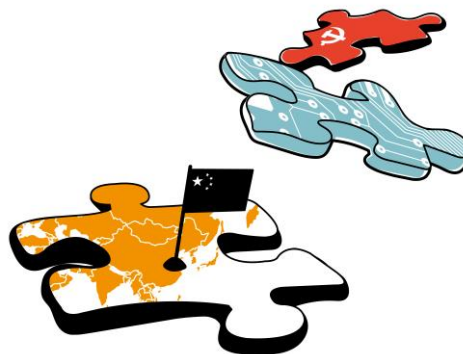


JUNE 27, 2024

# MERICS China Essentials



## CONTENTS

TOP STORY .....	2
EU and China agree to EV tariff talks, but have high bars to clear to reach a deal.....	2
METRIX.....	3
TOPICS.....	3
China and the Philippines spar dangerously in the South China Sea.....	3
Xi gathers military leaders to assert his and CCP's need for total loyalty .....	4
China cements its competitive position in the continuing space race with the US.....	5
MERICS CHINA DIGEST .....	5



**MERICS**

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## TOP STORY

### EU and China agree to EV tariff talks, but the bar is high for a deal

Brussels and Beijing have agreed to discuss the EU's planned tariff increases on electric vehicles imported from China. The talking points are not yet certain, but Beijing would have to clear a very high bar to fully resolve what the EU deems unfair support to EV makers, which is part and parcel of China's economic model. China's Minister of Commerce Wang Wentao and European Commission Executive Vice President Valdis Dombrovskis held a video call on June 22 in which they set the stage for negotiations.

The EU tariffs, ranging from 17.4 percent to 38.1 percent on top of the existing 10 percent rate, aim to offset China's subsidies and other state support for EV makers and are set to take effect on July 4. The Europeans have made it clear that "any negotiated outcome" would need to resolve the underlying "injurious subsidization" that benefits China's EV makers. Negotiations will also take place in light of China's threats to raise levies on imported European pork and dairy, as well as on cars with engine capacities of 2.5 liters or more.

An investigation of China's subsidies by Brussels encompassed a wide range of support measures. These included subsidies for production and consumption, as well as central and local government help – cheap loans, extensive tax relief and write offs for research and development, cheap or free land. The Commission is also investigating upstream suppliers for these same kinds of support that can also help to keep EV prices low.

Some of this state support could be rolled back by Beijing, but much of it has become integral to China's economic model and would require major structural reforms to undo. It is possible that China could commit to resolving at least a portion of the issues in a negotiated settlement and the EU agree to reduce the tariff rates commensurate with those reforms. But a complete resolution to the underlying issues could take years.

There are other ongoing investigations into China's subsidy regime in areas like steel pipes and airport security scanners. Brussels is also using its International Procurement Instrument (IPI) to investigate China's medical device procurement and the struggle of European companies for market access, which could affect China's medical device makers' access to European procurement markets. It isn't clear if these investigations will be included in talks, but how the EU handles these EV tariff negotiations with Beijing will set the tone for how the two players deal with the fallout of future investigations.

**MERICS analysis:** "Beijing has good reason to make significant concessions to the EU as it is the only major market that remains largely open to China's EVs," says **Jacob Gunter**, MERICS Lead Analyst. "European leaders facing challenges at home might be tempted to seek a settlement, but that could come at the price of selling European interests short rather than standing firm to protect the common market. Europe needs to seek either long-term and verifiable concessions from Beijing or remain steadfast in pursuing current measures to build credibility for addressing other market distortions."



### Media coverage and sources:

- Reuters: [China wants EU to scrap EV tariff plans as talks start](#)
- Politico: [China, EU agree to start consultations on electric-vehicle subsidies](#)
- SCMP: [China and EU agree to talks on planned electric vehicle tariffs](#)

## METRIX

# 28.2

This is the percentage by which foreign direct investment (FDI) in China fell in the first five months of 2024 compared to the same period a year earlier. The country's economic downturn has increased its need for foreign capital. But domestic problems, deteriorating relations with the United States, Japan and Europe, and Western efforts to "de-risk" ties to China are clearly causing more investors to rethink their strategies. (Source: [Bloomberg](#))

## TOPICS

### China and the Philippines spar dangerously in the South China Sea

**The facts:** Tensions in the South China Sea between China and the Philippines are rising rapidly, creating a significant risk of escalation. A Chinese Coast Guard ship on June 17 intercepted and rammed a Philippine Navy mission resupplying a military contingent stationed on the Second Thomas Shoal, off the Spratly Islands. According to statements and a video released by Manila, Chinese Coast Guard personnel armed with knives and axes boarded the Philippine Navy vessels and injured crew members. It was one of the worst recent confrontations in a long-running territorial dispute over the atoll. It lies within the Philippines' 200-mile exclusive economic zone and hosts a small Philippine military contingent aboard a now crumbling, intentionally grounded naval vessel, the BRP Sierra Madre. But this conflicts with China's claims to most of the South China Sea.

**What to watch:** The Philippines is a US treaty ally and has the backing of other regional allies like Japan, raising the stakes for China. The Philippines' President Ferdinand Marcos said Manila would likely view any loss of life through Chinese actions as an act of war – and possibly invoke its mutual defense treaty with Washington. Despite the high risk of escalation, Beijing is unlikely to change its strategy. It is accusing Manila of being a US pawn and responsible for the tensions. This creates a volatile situation that could escalate quickly. Potential trigger points abound – from accidental loss of life during one of the now regular incidents to the moment when the Sierra Madre finally disintegrates.



**MERICS analysis:** “Beijing seems to be counting on the Philippines backing down if the pressure gets too high,” says **Helena Legarda**, MERICS Lead Analyst. “But Manila is refusing to give in and is rallying considerable international support. China’s tactics are backfiring and also increasing the risk of a military conflict in the South China Sea.”

**Media coverage and sources:**

- IISS: [Keynote address at the 2024 Shangri-La Dialogue by President Marcos](#)
- People’s Daily (CN): [China Coast Guard statement on the June 17 confrontation](#)
- AP News: [Philippine officials say Chinese forces seized 2 navy boats in disputed shoal, injuring sailors](#)

### Xi gathers military leaders to assert his and CCP’s need for total loyalty

**The facts:** Xi Jinping recently gathered about three hundred of the People’s Liberation Army’s (PLA) top brass to assert the need for their absolute loyalty to the Chinese Communist Party (CCP) and to himself as commander in chief. After many months of intense anti-corruption campaigns in the military, the Central Military Commission Work Conference met from June 17 to 19 in Yan’an, where the CCP gained strength before taking power under Mao Zedong in 1949. Xi used a speech to the military-only conference to underscore the need to fight corruption and to bemoan problems with discipline and ideological loyalty in the military. The attending officers then spent two days studying Xi’s speech and his political writings, and toured what Xi called the “sacred revolutionary base” of Yan’an to invoke “revolutionary spirit.”

**What to watch:** A three-day conference for military leaders about the need to strengthen CCP leadership in the PLA sends a clear signal: Xi remains concerned about their loyalty and readiness to follow his personal command and that of the party. Anti-corruption campaigns in the military have seen numerous top generals – including officers in the nuclear-missile-equipped Rocket Force – detained and minister of defense Li Shangfu disappear from public view. Xi’s recent efforts suggest that more purges are likely to follow, making way for more Xi loyalists at the top of the Chinese military.

**MERICS analysis:** “Xi has initiated reforms to modernize and streamline military command to be ready to ‘win wars’,” says MERICS Lead Analyst **Nis Grünberg**. “But his main concern remains securing the PLA’s absolute loyalty to the CCP – and with that his personal command. He has overseen waves of anti-corruption operations in the military over his decade in power and he looks set to launch more in the coming months.”

**Media coverage and sources:**

- People’s Daily: [Xi stresses PLA’s political loyalty at crucial meeting](#)
- SCMP: [Xi Jinping tells top PLA leaders they must eliminate ‘conditions that breed corruption’](#)
- People’s Daily (CN): [Providing a steadfast political foundation for building a strong army \(贯彻落实新时代政治建军方略为强军事业提供坚强政治保证\)](#)



## China cements its competitive position in space race with the US

**The facts:** Cementing its position as an emerging peer to the US in outer space, China has become the first nation to successfully transport samples from the far side of the moon. The Chang'e 6 robotic lunar-explorer mission returned to earth on June 25, 2024, adding to earlier Chinese achievements like its Tiangong program, which in 2022 made it the only country besides Russia and the US to establish a space station. China and the US are both planning to set up lunar bases in the next 10 years. China's planned lunar research station (ISLR) is a cooperation with Russia, which has also allowed the United Arab Emirates, Venezuela and other countries without their own space programs to sign on.

**What to watch:** China has managed to achieve an increasing number of "firsts" in space. Like the first landing on the far side of the moon in 2019, these did not involve technological breakthroughs that placed China ahead of US space agency NASA. However, these successes and China's ongoing cooperation with Russia and emerging economies are challenging US dominance in space. China's progress and worries about ceding space superiority have spurred the US to establish a new armed-services branch, the "Space Force." The China National Space Administration has largely been able to stick to its schedule, in stark contrast to NASA, which has recently suffered repeated delays.

**MERICS analysis:** "China's successes are a sign of how well its centralized system can optimize resources. But they also show how good Beijing is at choosing goals it can achieve without the need for technological breakthroughs," says MERICS Senior Analyst **Antonia Hmaidi**. "This has allowed Beijing to establish itself as a near peer to the US in space, although it is not easy to judge China's abilities exactly. Focusing on its achievements makes it easy to overestimate China but looking only at its technological prowess risks underestimating its potential."

### Media coverage and sources:

- S&T Daily (CN): [These hard-core technologies escort Chang'e 6 back home safely \(这些硬核技术护送嫦娥六号安全回家\)](#)
- The Diplomat: [China's Chang'e 6 moon mission is a game changer](#)
- SCMP: [China calls the US a 'competitor' in moon race for first time, from a position of strength](#)

## MERICS CHINA DIGEST

### [China's Communist Party to hold key Third Plenum on July 15-18 \(Reuters\)](#)

The decision was announced at a meeting of the Politburo, the top decision-making body of the ruling Chinese Communist Party (CCP), the Xinhua news agency reported on Thursday. The meeting focuses on economic policy should customarily have taken place last autumn. The CCP has not given any reason for the delay. (24/06/27)



[China provides emergency relief amid deadly floods \(Reuters\)](#)

According to Reuters calculations, different government departments have allocated 2.344 billion yuan to various cities and provinces over the past several days to help with rescue efforts, planning and relocating those affected. Almost two weeks of torrential rain caused deadly floods and landslides in several parts of the country. (24/06/27)

[Chinese president and Polish counterpart meet for talks to deepen cooperation \(EuroNews\)](#)

Xi Jinping said China was willing to continue its friendship with Poland and promote the bilateral relationship between the two countries to achieve better development and stability in a “chaotic international situation.” Polish President Andrzej Duda said his country would play its part in strengthening the China-EU relationship and invited Xi to visit Poland next year. (24/06/24)

[China threatens death penalty for Taiwan independence “diehards” \(The Guardian\)](#)

Beijing is ramping up pressure over what it deems to be the “crime of secession”. It is threatening to impose the death penalty for “diehard” proponents of Taiwanese independence. Taipei in turn has said China has no jurisdiction over Taiwan and is urging its people not to be intimidated. (24/06/22)

[Germany and China sign declaration on data sharing \(Reuters\)](#)

Germany and China have signed a Memorandum of Understanding on cross-border data transfers. The declaration was signed by Germany’s minister for digital affairs and transport, Volker Wissing, and Zhuang Rongwen, the director of China's Cyberspace Administration (CAC). Transferring data outside of China is a contentious issue for foreign firms operating there. In addition, the EU and US are concerned about the possible security risk of Chinese technology entering their markets and collecting data locally. (24/06/26)



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