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the Rupture: Strategic Dependencies,
the Second China Shock and
the Future of the WTO**

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Abstract

The international economic order is undergoing a structural rupture. Economic interdependence is increasingly weaponised, the binding force of multilateral trade rules is eroding and a second China shock is hitting Europe's industrial core in capital- and technology-intensive sectors. This article argues that the EU should not abandon openness but recalibrate its trade policy. Drawing on recent geoeconomic research, we propose criteria for identifying strategic dependencies and identify seven such dependencies for the EU. We assess trade policy responses to the second China shock and outline a pragmatic WTO reform agenda built on open plurilateralism, a rebalancing of most-favoured-nation treatment and reciprocity, and plurilateral resilience agreements against economic coercion. A deeper Single Market remains the EU's most important source of geoeconomic strength.

JEL: F13, F15, F51, F52, F53

Keywords: geoeconomics, strategic dependencies, China shock, WTO reform, plurilateral agreements, economic coercion

Introduction

The international economic order is undergoing a deep structural transformation.¹ After decades of decline, the number of cross-border military conflicts is rising again, and large economies are competing for technological supremacy because it promises both economic and strategic advantages. The binding force of international trade law is waning. Several countries, including the world's largest economies, increasingly resort to opportunistic unilateral measures such as tariffs, export restrictions and subsidies, frequently justified on grounds of national security. At the 2026 World Economic Forum in Davos, Canadian Prime Minister Mark Carney characterised this not as a gradual transformation but as a “rupture” in the conditions underpinning globalisation (Carney, 2026).

A defining feature of this development is the strategic use of economic interdependence for geopolitical ends, or “weaponized interdependence” (Farrell & Newman, 2019). Trade policy is increasingly subordinated to a security logic. Recent geoeconomic research shows that economic power derives from asymmetric dependencies and from control over central nodes in global networks. What matters is therefore not only the size of an economy and the gains from trade it generates, but also its position within international value chains and infrastructure networks (Mohr & Trebesch, 2025).

The EU has felt this pressure directly: through US tariff threats in 2025 and their partial implementation in the highly asymmetric “Turnberry agreement”, through ongoing US investigations into allegedly unfair EU trade practices, and through Chinese export restrictions on critical raw materials. At the same time, the multilateral architecture has been weakened by reform deadlock, a dispute settlement system that functions only partially and a growing number of unilateral measures. Even after the United States' departure from central WTO principles, around 72% of global goods trade still takes place on a most-

¹This article is a condensed English version of the report entitled “Europäische Handelspolitik im weltwirtschaftlichen Umbruch” from July 2026 by the Scientific Advisory Board at the German Federal Ministry for Economic Affairs and Energy (BMWE). The views expressed are those of the authors.

favoured-nation (MFN) basis (WTO, 2026). Yet the erosion of the system threatens the binding force of its rules for all participants.

A second development is of particular relevance for Europe: a structural competitive shock from China, often referred to as the “second China shock” (Tordoir & Setser, 2026). Whereas the first China shock mainly involved import competition in labour-intensive industries, Chinese firms are now advancing into the capital- and technology-intensive sectors that form the core of European industry – machinery, chemicals, automobiles and electrical engineering – and hold strong positions in batteries, renewable energy and digital industries. Foreign trade has, at the same time, ceased to be a reliable engine of growth for Germany.²

In this environment, free trade is no longer taken for granted in mainstream European policy debate (Felbermayr & Braml, 2024). This article addresses five questions. First, should trade policy help reduce the EU’s strategic dependencies, and if so, how? Second, how can trade policy and the Single Market strengthen Europe’s resilience to geoeconomic pressure? Third, how can the EU improve its capacity to respond when other states deploy geoeconomic instruments? Fourth, can the multilateral trading system be developed further despite reform blockages, so that the benefits of open markets are preserved as far as possible? Fifth, how can trade policy help turn the second China shock into an impulse for productivity and innovation?

The renaissance of geoeconomics

Geoeconomics studies the strategic use of economic instruments – trade, investment and finance – to pursue geopolitical objectives. Its roots run deep. Adam Smith (1776) defended England’s Navigation Acts against the Dutch by arguing that “defence is of much more importance than opulence”, and a later literature on optimal tariffs analysed how large countries can raise their welfare at the expense of smaller ones (Johnson, 1953). The foundation of modern geoeconomic thinking is Hirschman’s (1945) concept of asymmetric interdependence: economic power stems less from absolute size than from unequal dependence. The less dependent partner can exploit a relationship politically, and states can deliberately shape trade structures to create such asymmetries.

With the “end of history” optimism of the late 20th century, the topic receded within economics, as conflict logics were assumed to have been superseded by the gains from trade. Where geoeconomics was studied, stylised game-theoretic models prevailed, for instance the analysis of sanctions as a bargaining game in which trade restrictions serve as credible threats (Eaton & Engers, 1992).

The recent literature integrates strategic behaviour into empirically grounded quantitative trade models. Thoenig (2024) and Mayer et al. (2025) combine international bargaining with trade “in the shadow of war” and quantify the link between trade integration and conflict risk. Clayton et al. (2026) use global input-output networks to show that countries in central positions of production networks possess disproportionate leverage, for example by withholding critical inputs. Liu and Yang (2025) show that geoeconomic power can be derived from, and quantified with, asymmetric import dependencies. A compact metric is the ratio of losses in the target country to those in the country deploying a measure, referred to here as a trade benefit ratio (TBR) or trade hurting ratio (Gersbach et al., 2025). A high ratio indicates that a country can use geoeconomic instruments at low relative cost to itself.

Recent episodes – US export controls on semiconductors, Chinese restrictions on rare earths and the 2019 Japan–Korea trade dispute – show that geoeconomic instruments usually impose noticeable costs on the countries that use them as well, and that targets respond by diversifying, with varying success (Mohr & Trebesch, 2025). Because such instruments are deployed under considerable uncertainty about the target’s reaction and adaptability, geoeconomic power is often revealed only through its use. In

²Since 2022, the contribution of net exports to German GDP growth has been predominantly negative.

April 2025, the United States and China raised bilateral tariffs to more than 100% within days. Simulations with the KOF trade model indicate that the US would have suffered substantially larger real output and income losses than China, chiefly because of greater direct and indirect US dependence on Chinese intermediate goods (Gersbach et al., 2025); see Hinz et al. (2026) for further analyses of aggregate losses for the US. The escalation was quickly reversed – consistent with an experiment that revealed the actual balance of leverage.

The policy implication is that trade and investment relationships should be assessed not only in terms of welfare and distribution, but also with respect to their influence on potential geoeconomic strategies at home and abroad. This requires transparency about a country's strategic dependencies.

Strategic dependencies of the EU

The EU's position in the world economy

Protectionism has increased considerably worldwide since 2008 (Evenett et al., 2026). The EU itself maintains significant tariff and non-tariff barriers, especially in agriculture, and is planning or expanding measures with trade-restricting effects, including steel safeguards, the Carbon Border Adjustment Mechanism (CBAM), the Corporate Sustainability Due Diligence Directive and the Deforestation Regulation. Its relative economic weight is declining: its share of global GDP is now below 15% (Eurostat, 2025), and demographics and the catch-up of emerging economies make further relative decline likely. China is among the most important goods trading partners for many economies and is the largest bilateral goods trading partner for some of them. The Single Market generates substantial welfare gains (Felbermayr et al., 2022), but it remains fragmented. Divergent labelling and packaging rules, territorial supply constraints, a fragmented transport sector and home-biased public procurement raise trade costs within the EU and also hamper trade with third countries (Fontagné & Yotov, 2024; Cerdeiro & Rotunno, 2026).

Criteria for identifying strategic dependencies

Open markets always create dependencies. They are the logical counterpart of specialisation, without which there would be no gains from trade. They become relevant for trade policy when they are asymmetric and there is an incentive to use them as an instrument of power. We propose five criteria: (1) *high supplier concentration*, i.e. a product is sourced predominantly from a single country; (2) *low short-run substitutability*, i.e. alternative suppliers or substitutes cannot be mobilised quickly after a negative supply shock; (3) *chokepoint structures*, i.e. control over central nodes in global networks such as maritime straits, internet exchange points, submarine cables or clearing and messaging systems in international payments (Farrell & Newman, 2019) – a form of vulnerability that is often invisible in trade data;³ (4) *high economic relevance*, i.e. the good or service is essential for consumption, production or investment; and (5) *a risk of use as a geopolitical instrument*, which is low if deploying the instrument would cost the acting country more than the target. A dependency qualifies as strategic if criteria 2, 4 and 5 are met together with either criterion 1 or criterion 3.

Tools to operationalise these criteria include risk-based approaches (European Commission, 2021), market share and substitutability analyses (Arriola et al., 2024; Flach et al., 2021), product-level welfare cost indicators (Consonni & Magerman, 2026) and network analyses of chokepoints (Elliott et al., 2022). Criterion 5 additionally requires estimating the damage a deploying country would inflict on itself, which trade benefit ratios capture.

³Farrell and Newman (2019) additionally describe a “panopticon effect”: control over central nodes can provide access to confidential information.

Sectoral and systemic dependencies

Strategic dependencies can be sectoral, relating to specific goods, inputs or technologies, or systemic, arising from integration into infrastructures, networks or platforms that matter for large parts of the economy simultaneously. Outside the military and security domain, we identify seven strategic dependencies of the EU – four sectoral and three systemic (Table 1). All concern economically relevant areas in which massive disruptions would severely affect daily life and/or substantially reduce output. The threat potential of geoeconomic instruments is typically greatest when they affect daily life directly through price increases or shortages; production disruptions tend to materialise with a lag. Many further vulnerabilities can be mapped onto these categories. Artificial intelligence, for instance, combines dependencies on advanced semiconductors, cloud infrastructure and global data ecosystems. Other vulnerabilities, such as dependence on imported fertilisers and animal feed in the agri-food system, meet the criteria to a lesser extent.

Table 1 Strategic dependencies of the EU

Type	Dependency	Main source of vulnerability
Sectoral	Critical raw materials and their refining	Strong geographic concentration of extraction and, above all, processing; limited substitutability
Sectoral	Semiconductors	Fragmented, complex value chains with chokepoints in advanced manufacturing and specialised equipment
Sectoral	Energy	Remaining import dependence on fossil fuels and photovoltaics; new dependencies in hydrogen, batteries and their inputs
Sectoral	Pharmaceutical ingredients and critical medicines	Production concentrated in Asia; China is key for starting materials and intermediates. India is also important for active ingredients and generics; very high dependence on Chinese supplies for some products
Systemic	International finance and payment infrastructure	Dominance of the US dollar; control of key payment and messaging nodes outside the EU
Systemic	Digital infrastructure and platforms	Reliance on non-European cloud services, platforms, operating systems and devices; control over data and algorithms; lock-in
Systemic	Maritime logistics and transport networks	Dependence on strategic sea lanes and major ports, e.g. the Strait of Hormuz during the war between the US and Israel on one side and Iran on the other

Source: Authors' classification, based on Gersbach (2026).

The EU between the United States and China

The overall importance of the supply chains linking the EU, the US and China has changed little in recent years, with one exception: direct US goods imports from China have fallen markedly and are increasingly routed through third countries (Ossa, 2026). Geoeconomic fragmentation tends to reorganise rather than reduce interdependence; trade is rerouted and production networks are adjusted through foreign direct investment, creating indirect dependencies (Mayer et al., 2025). Actual interdependence between rivals may therefore be considerably greater than bilateral trade data suggest. This limits the effectiveness of simple decoupling strategies and implies that the EU should analyse geoeconomic risks along entire value chains.

Two further observations are important. First, the EU's ties with both powers generate substantial prosperity on both sides. A hypothetical symmetric 30% increase in EU–US trade barriers would cause welfare losses of similar magnitude for both economies; the bilateral trade benefit ratios for manufacturing, alone or combined with services, are close to one from the EU's perspective (Gersbach et al., 2026).⁴ Sector-specific instruments, however, can produce strongly asymmetric losses, and both

⁴This does not imply that the EU or the US have no incentive to impose unilateral tariffs to improve their terms of trade. But if both chose tariffs as best responses to each other, the resulting equilibrium would leave both worse off – the prisoner's dilemma that trade agreements are designed to solve (Bagwell & Staiger, 1999).

the US and China may accept economic costs in exchange for geopolitical gains vis-à-vis their rival. Second, the US and China also have strategic dependencies. The US imports 80% of its rare-earth magnets and more than 90% of some important medicines from China; achieving autarky in the affected goods would require roughly doubling US output in the relevant sectors (Anderson et al., 2026). Compared with the EU, however, both powers have fewer strategic dependencies, could react faster to shortages and are far less exposed at the systemic level.

A geoeconomic externality

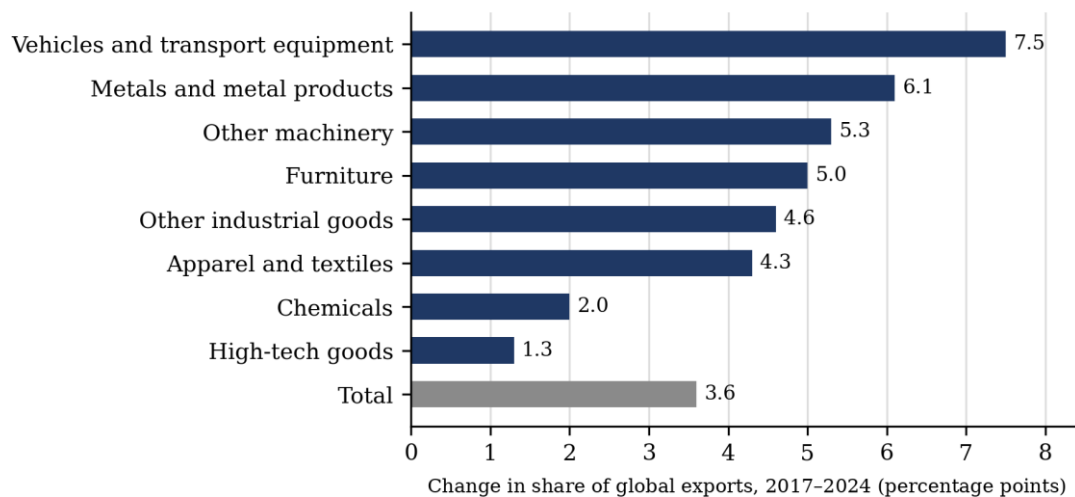
Firms take geoeconomic risks into account when organising their supply chains. But they do not fully internalise the effect of their sourcing decisions on aggregate security of supply, and they may expect state support in a crisis. This *geoeconomic externality* can justify targeted public action to reduce strategic dependencies, both to deter coercion by third countries and to strengthen the EU's own room for manoeuvre. Such dependencies can only be reduced slowly. Reactive measures include instruments such as the Anti-Coercion Instrument and faster crisis governance at EU level. Preventive measures include strengthening Europe's bargaining power by deepening the Single Market and the capital markets union, industrial policy in critical sectors such as that initiated by the European Chips Act, and trade policy instruments such as diversification tariffs (Felbermayr, 2026). This article focuses on trade policy. Beyond reducing vulnerabilities, a forward-looking strategy should also create conditions under which European firms become indispensable suppliers of critical goods, technologies and services, thereby strengthening the EU's own geoeconomic leverage.

The second China shock

From the first to the second shock

The first China shock – the surge of Chinese import penetration after China's WTO accession in 2001 – put pressure mainly on labour-intensive industries and caused regionally concentrated job losses in the US (Autor et al., 2013) and southern Europe (Branstetter et al., 2019), with potential political consequences (Colantone & Stanig, 2018). In Germany, aggregate employment effects were much less pronounced than in the US, although import-competing regions also experienced losses (Dauth et al., 2014). General equilibrium analyses show that the first shock generated substantial aggregate welfare gains, albeit unevenly distributed and accompanied by concentrated adjustment costs (Caliendo et al., 2019).

The second China shock marks a qualitatively new phase. China's goods trade surplus has recently reached well over USD 1 trillion (Tordoir & Setser, 2025). China now accounts for roughly 29% of global manufacturing value added, compared with about 17% for the US and less than 6% for Germany. Its export market share gains are broad-based and particularly pronounced in sectors targeted by industrial policy (de Soyres et al., 2026; Figure 1). China produces around 75% of all new electric vehicles worldwide. Its electric car exports doubled in 2025 compared with the previous year, and almost 60% of electric cars imported into the EU from third countries in 2025 came from China (IEA, 2026).

Figure 1 Change in China's share of global exports by sector, 2017–2024

Source: de Soyres et al. (2026); authors' illustration.

Wingender et al. (2024) show that increasing Chinese competitiveness in electric vehicles creates adjustment costs for the EU and that protectionist responses can increase these costs. Possible explanations for China's competitive position include state support, economies of scale and technological learning. Labour costs, although much lower than in Germany, are not the main source of the price advantage of Chinese EVs (IEA, 2024). Competitiveness rests on an integrated industrial base along the entire value chain, including world-leading battery manufacturers and a dominant position in the processing of critical raw materials (USGS, 2026). In terms of theory, state support can be modelled as a reduction of fixed and variable costs in a heterogeneous-firm framework that expands entry and exports (Melitz, 2003), while control over upstream sectors creates additional cost advantages downstream (Antràs & Chor, 2013). Together with large capacities, this makes long-lasting global price and competitive adjustments likely.

The evidence suggests that the second China shock is systemic rather than sectoral: it affects entire industrial ecosystems along value chains, and China is simultaneously a competitor and a key supplier of inputs. Classical adjustment mechanisms appear not to be working sufficiently. The renminbi is not freely convertible, and IMF staff estimates suggest that it was undervalued in the reference year, within a range of 12% to 21% (IMF, 2026). The shock also hits export-oriented emerging economies, intensifying competition in Europe's export markets and raising the risk of protectionist responses worldwide.

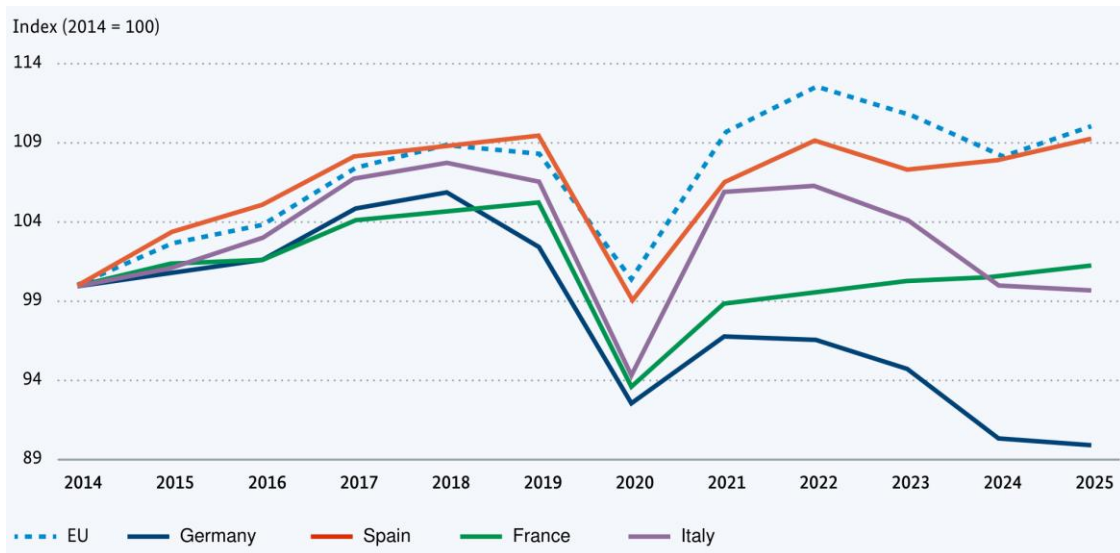
How much of Germany's industrial weakness is due to China?

Germany is particularly exposed because of its export orientation, its sectoral specialisation and its close ties with China, which, together with the US, is its most important trading partner in goods. In automobiles and machinery, China is both a major sales market and an increasingly competitive – in some respects superior – supplier (Matthes, 2026). At the same time, Germany depends heavily on Chinese inputs such as batteries, electronic components, pharmaceutical ingredients and critical materials (Flach et al., 2021). Competition and dependence thus coincide.

If China's advance merely reflected shifting comparative advantage, one would expect weaker export dynamics in some German industries to be offset by stronger dynamics elsewhere. Instead, export momentum is declining and industrial production has fallen markedly since 2018 (Figure 2). Caution is nonetheless warranted. EU industrial production trended upwards until around 2022, while Germany performed much worse than the EU average and several Central and Eastern European member states did better. Germany's weakness is also broad-based across sectors and cannot be explained primarily

by its industrial structure (Scheiblecker, 2026), pointing to the importance of location factors, cost burdens and domestic obstacles. Moreover, industrial production in Germany has developed less favourably than real industrial value added, suggesting structural change towards higher-value segments and possibly a shift of activities into services (Lehmann & Wollmershäuser, 2025). However, recent evidence indicates sharper output declines in those German industries whose product portfolio overlaps most with China's (Tordoir & Setser, 2026). This suggests that increasing competitive pressure from China has contributed to the recent decline in German industrial production, although the size of this contribution cannot yet be reliably quantified.

Figure 2 Industrial production in the EU and selected member states, 2014–2025 (index, 2014 = 100)



Source: Eurostat (2026); reproduced from Figure 5 of the German report.

Trade policy responses to the second China shock

The Japanese challenge to the US car industry in the 1980s offers a historical parallel. Productivity gaps between Japanese and US producers, including suppliers, were large and triggered considerable adjustment pressure; the superior production technology reached the US largely through Japanese “transplants”, i.e. foreign direct investment (Baily & Gersbach, 1995). The US also obtained “voluntary” export restraints (VERs) from Japan. These raised prices in the US and induced Japanese exporters to shift towards higher-quality vehicles (Feenstra, 1984). Substantial rents were transferred to Japan, and US consumers bore the welfare losses (Berry et al., 1999).⁵ VERs bought time for adjustment but were economically inefficient. They are not a suitable instrument for the second China shock and would, moreover, fall outside WTO rules.

Countervailing duties are different. Under the WTO Agreement on Subsidies and Countervailing Measures, they are permissible when specific subsidies and resulting material injury, or a threat of material injury, to the domestic industry can be demonstrated. Recent EU practice follows this approach: countervailing duties were imposed on battery electric vehicles from China after an investigation concluded that the Chinese value chain is heavily state-subsidised and threatens injury to European producers (European Union, 2024).⁶ Greater use of targeted anti-subsidy measures is a central option.

⁵From the US perspective, import tariffs with the same quantity and price effects would have been preferable, since the scarcity rents would have accrued to the US Treasury as tariff revenue rather than to Japanese producers.

⁶Chinese producers may also respond to EU countervailing or anti-dumping duties by offering price undertakings, as foreseen in the Commission’s guidance on battery electric vehicles (European Commission, 2026).

Foreign direct investment plays a complementary role, including investment by more productive Chinese firms, as in Hungary or Spain. Ideally, the adjustment efforts of incumbent firms – which also compete with Chinese producers in China itself – combined with additional FDI induced by market conditions and anti-subsidy measures will strengthen the EU’s industrial base. Because such catch-up takes time, further options are debated, ranging from fiscal and exchange rate measures by the Chinese government to strengthen domestic demand, to much tougher EU industrial and trade policies. VERs and local content requirements (“Buy European”) are inefficient protective instruments: they weaken rather than strengthen domestic adjustment incentives and promote FDI and technology transfer at best indirectly. They would also take the EU outside the WTO framework. A European Industrial Accelerator Act could accelerate investment in strategic industries through faster permitting, better coordination and simpler regulatory procedures. If it abandoned equal treatment of imported and domestically produced goods and violated the national treatment principle (GATT Article III), it would become a protectionist instrument and could trigger countermeasures.

Active public promotion of Chinese FDI does not appear advisable for Germany, as such investment typically seeks locations with favourable labour costs, regulation and labour supply. Market-driven investment, by contrast, can foster technology transfer and help secure industrial capacity, provided it does not affect security-relevant areas. Existing innovation support instruments should be examined with a view to accelerating technology transfer through voluntary joint ventures and joint research and development projects.

The crisis of the WTO and a pragmatic reform agenda

Why the WTO principles still matter

In the modern theory of trade agreements, unilateral tariff setting ignores terms-of-trade externalities imposed on foreign producers and leads to inefficiently high barriers; agreements such as the GATT/WTO are institutional solutions to this dilemma (Bagwell & Staiger, 1999). Two principles underpin the system. Most-favoured-nation (MFN) treatment reduces the complexity of negotiations, limits discrimination and the exploitation of market power, protects the value of negotiated concessions and stabilises expectations for investment and value chains. Reciprocity limits free-riding, enhances political feasibility and allows governments to implement domestic liberalisation – the main source of gains from trade agreements – through international commitments.

Early empirical work found no significant trade effect of WTO membership (Rose, 2004), but subsequent research has revised this conclusion. The effects are large but uneven (Subramanian & Wei, 2007), and structural gravity estimates show that membership significantly increases bilateral trade, with positive spillovers to non-members (Larch et al., 2025). The welfare gains are substantial and heterogeneous across countries (Felbermayr et al., 2024).

Under geopolitical rivalry, cooperation remains possible as long as states still attach weight to economic welfare (Mattoo et al., 2024). MFN continues to curb discriminatory terms-of-trade manipulation, acts as an anchor against full fragmentation and allows plurilateral agreements to be multilateralised later. It also reduces uncertainty and administrative costs; the 2025 US tariff policy has demonstrated the additional costs of trade policy uncertainty and complexity (Abberger et al., 2026). Large economies nevertheless have strong incentives to deviate from MFN in order to pursue geopolitical goals, exploit dependencies or promote strategic industries. Reciprocity therefore gains importance as a mechanism to keep cooperation politically viable. In an era of rivalry, the WTO system is not self-stabilising; its survival requires institutional adaptation.

Open plurilateralism as the new operating model

Although consensus is not legally required in every case in the WTO, it de facto governs decision-making and increasingly leads to deadlock (Langhammer, 2026). The WTO should therefore move

towards open plurilateralism, of which the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) is an existing example. Groups of willing members should be able to move ahead in key areas without full consensus, provided that participation is voluntary, benefits are granted conditionally on the basis of reciprocity and agreements remain open to later accession. Such agreements need not be confined to removing trade barriers; they can also cover joint research programmes and the alignment of innovation support. Plurilateral agreements complement rather than displace preferential liberalisation (Chochua et al., 2026; Hoekman & Sabel, 2021). Such agreements should be based on WTO-compatible rules, remain open to further accession and avoid creating permanent exclusive preference clubs. Because institutional blockages currently limit new plurilaterals within the WTO, like-minded countries should not make them conditional on WTO reform and should pursue them outside the WTO where necessary. The WTO, in turn, should develop procedures to dock such agreements and progressively incorporate them into the multilateral rulebook.

Rebalancing MFN and reciprocity

MFN should remain the default, but reciprocity should play a larger role in designing plurilateral cooperation and responding to coercion – for instance, by limiting deeper market opening or joint response mechanisms to states that assume comparable obligations. One possible institutional innovation would be narrowly defined, time-limited and subject-specific geopolitical exceptions within the WTO framework (see also Mattoo et al., 2026). These would allow geoeconomic adjustment to take place inside rather than outside the multilateral system. Any new exceptions must, however, go hand in hand with stronger enforcement of existing rules, so that flexibility does not lead to further fragmentation.

Plurilateral resilience agreements against coercion

Individual states often have limited means to respond to geoeconomic pressure, particularly when dependencies are asymmetric, and uncoordinated or delayed responses reduce the effectiveness of countermeasures. Effective deterrence is thus a collective good: costly for each provider, but broadly beneficial. We propose *plurilateral resilience agreements* that pool and institutionalise response capacity. If a potential coercer must expect that measures against one country will trigger a coordinated reaction by several partners, deterrence increases considerably – provided the commitment to respond is credible. Natural partners are middle powers such as Japan, Canada, Australia, New Zealand, South Korea and the United Kingdom, with accession open to others accepting the rules.

Such club arrangements would combine market-opening commitments with standardised procedures to identify and assess coercive measures, graduated response mechanisms and clear procedural rules that enhance transparency and predictability. Responses could range from joint diplomatic action and consultations to coordinated trade measures, joint diversification and procurement strategies, and support for particularly affected partners, complemented by information exchange and joint assessment of strategic dependencies. Conceptually, these agreements extend the logic of trade agreements from terms-of-trade externalities to the geopolitical externalities that arise from the strategic use of dependencies. To avoid fuelling protectionism, measures must be confined to clearly defined cases of coercion and be proportionate.

Dispute settlement, rule modernisation and development

Without credible enforcement, rules lose practical relevance. A reformed dispute settlement system should remain two-tiered but include clear deadlines, a more narrowly defined scope of review and safeguards against judicial overreach; the Multi-Party Interim Appeal Arbitration Arrangement can serve as a bridge. Dispute settlement should be understood as a backstop rather than a substitute for political agreement, particularly on industrial policy and security-related measures. Rules also need modernising: the MFN logic could justify extending the moratorium on customs duties on electronic transmissions, although no consensus was reached in spring 2026; data localisation requirements that

effectively prevent cross-border services trade should be limited; subsidies and state-owned enterprises require greater transparency and more precise rules, which may in some areas need to focus more on outcomes and competitive effects; security exceptions need guardrails; and rules of origin should be simplified and harmonised, since their proliferation raises costs, especially for SMEs, and enables geoeconomic steering of supply chains.

The WTO should not be overburdened: macroeconomic imbalances call for closer coordination with the IMF. Qualified majorities for procedural decisions could complement consensus, and the WTO's role as a platform for transparency, monitoring and deliberation should be strengthened. Finally, the unfinished development agenda of the failed Doha Round remains a structural obstacle. Greater differentiation among developing countries, longer transition periods, technical assistance and standardised procedures – including for new EU regulations such as CBAM and supply chain due diligence – are needed to prevent sustainability rules from being perceived in the Global South as disguised protectionism.

Policy recommendations for the EU

The EU must pursue three objectives simultaneously: securing prosperity through open markets, reducing strategic dependencies and strengthening geoeconomic resilience. This triad operationalises the guiding principle of “open strategic autonomy” proclaimed by the European Commission in 2021.

Deepening the Single Market. The Single Market is the most important lever for both economic performance and geoeconomic resilience. Felbermayr et al. (2022) find that, at the time of their study, real per capita consumption in Germany would have been 3.6% lower without the Single Market. Persistent fragmentation limits the scaling-up of European firms and dampens productivity and innovation; implicit trade costs within the EU remain well above those between US states (Cerdeiro & Rotunno, 2026; Draghi, 2024). The priority should be dismantling existing fragmentation rather than new regulation: harmonising product rules, applying mutual recognition consistently and enforcing existing law. Regulatory convergence could raise the trade-to-GDP ratio by 10% (Fournier et al., 2014). The potential in services is even greater, as weak services productivity growth explains much of Europe's growth gap with the US (Ebeke et al., 2019); removing non-tariff barriers could raise German gross value added by up to 1.8% (Dorn et al., 2024). Access to the Single Market is also the EU's main source of bargaining leverage: the deeper and larger the market, the stronger the EU's negotiating position. Since Brexit reduced the Single Market by about one-sixth, the EU should explore extending central elements of it to countries for which full membership is not realistic, for instance through customs unions.⁷

Reducing strategic dependencies. The aim is not to avoid strategic dependencies in general, but to reduce critical vulnerabilities where the risk of instrumentalisation is high and mitigation is feasible. First, the EU should intensify diversification through agreements consistent with GATT Article XXIV. Concluding or implementing agreements with Mercosur, India, the United Arab Emirates, Australia, Indonesia, Malaysia and Thailand could more than offset the negative effects of current US tariff policy (Baur & Flach, 2026). Non-aligned “connector” countries such as India, Indonesia, Vietnam, Mexico and Saudi Arabia deserve particular attention. Second, the EU should seek accession to the CPTPP. Third, raw materials partnerships should be expanded, potentially covering investment protection, technology cooperation and sustainability standards. Fourth, the EU should establish a dedicated trade policy intelligence unit that systematically analyses dependencies, network positions and geoeconomic risks. Fifth, instruments to promote supply chain diversification should be examined. General numerical requirements on the number of suppliers are unsuitable, as they could destroy valuable supply

⁷Unlike in a free trade agreement, members of a customs union share a common external tariff. This makes complex rules of origin unnecessary and allows the joint market size to be leveraged externally. It does, however, require democratically legitimised joint decision-making bodies – as with the customs parliament of the 19th-century German Zollverein.

relationships. Diversification tariffs, levied only once imports from a single supplier country exceed a dependency threshold, would instead use price signals to give buyers an incentive to diversify before dependence becomes excessive (Felbermayr, 2026). They can help prevent future dependencies but do little against established monopolies. Such tariffs should, at most, be considered for clearly defined strategic goods and, wherever possible, be embedded in a rules-based multilateral or plurilateral framework.⁸

Strengthening response capacity. Anti-dumping, anti-subsidy and anti-circumvention instruments should be used in a targeted, rule-consistent manner without sliding into protectionism. The Anti-Coercion Instrument should be operationalised through systematic monitoring, transparent decision criteria and clearly defined escalation steps; its primary aim should remain ending or preventing coercion without escalation wherever possible, in close coordination with diplomacy. Decision-making at EU level should be more centralised and faster, and export controls and investment screening should be harmonised and bundled at EU level. Utmost restraint is warranted with respect to local content rules, “Buy European” provisions and VERs. Innovation-oriented cooperation within open plurilateral agreements, by contrast, can accelerate technology transfer, and existing reciprocal access to public procurement markets should be used and developed further.

Building trade policy capacity. The EU should improve its data on global value chains and its ability to detect distortions, circumvention and geopolitical threats early. Stronger enforcement of existing rules is generally preferable to creating new instruments.

Conclusion

European trade policy must be reoriented in an environment shaped by geoeconomic rivalry and the erosion of multilateral institutions. Four fields of action emerge: strengthening the Single Market as the economic base, reducing strategic dependencies in a targeted way, improving geoeconomic response capacity – including measured, rule-based responses to the second China shock – and preserving and developing the multilateral trading system. The EU should act as a reliable anchor for rules-based cooperation, making treaty compliance, transparency and predictability sources of geoeconomic strength. A central element is the joint pursuit of open plurilateral trade and resilience agreements with like-minded partners, independently of WTO reform but designed so that they can later be integrated into the multilateral framework. EU accession to the CPTPP is a promising step in this direction. Trade policy alone cannot carry this agenda; it must be complemented by technology policy and broader macroeconomic coordination. Combined, these elements would allow the EU to preserve its openness, strengthen its competitiveness and resilience, and become an indispensable partner in strategic value chains – thereby enhancing its capacity to act in an increasingly power-driven world economy.

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⁸On 24 April 2026, the EU and the US signed a memorandum of understanding on jointly securing critical raw materials. Coordinated price floors could have effects similar to diversification tariffs. We welcome this initiative and recommend extending it to further partners.

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