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POLICY BRIEF

HARD, FAST, AND WHERE IT HURTS: LESSONS FROM UKRAINE-RELATED SANCTIONS FOR A TAIWAN CONFLICT SCENARIO

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SUMMARY

- China's leader Xi Jinping has long affirmed that the "reunification" of Taiwan with the Chinese mainland is "inevitable". One of the worst-case scenarios for such a "reunification" is a Chinese maritime blockade of the island, followed by a full-scale military invasion of the territory.
- To prepare for this far from certain scenario, the EU and its member states need to start weighing their economic statecraft options against China, including financial sanctions and trade measures. In doing so, they can draw valuable lessons from the extensive sanctions they have been imposing on Russia since 2014.
- If a Taiwan crisis happened, it would be crucial for the EU and its allies to get deterrence right. EU sanctions threats could be game-changing, as Beijing has probably not priced in such measures. Sanctions threats would also need to include the most draconian measures that the EU could conceivably impose on China.

- China has spent years insulating itself from financial sanctions through “de-dollarisation”, “de-SWIFTing”, and the development of digital currencies. This means that Europe’s strongest leverage probably lies in trade measures targeting China’s access to the EU market.

- Western sanctions on China would have a huge impact on G7-EU economies. This implies that the EU and its allies would need to accompany economic statecraft measures with a concerted campaign to get both the private sector and the general public on board, as well as fight against likely Chinese disinformation about the impact of sanctions.

Introduction

The year is 2028, and Western intelligence services have reached an alarming conclusion. Credible sources suggest that China is about to impose a maritime blockade around Taiwan – a step that intelligence officers believe will precede a full-scale invasion of the territory.

Western leaders can hardly claim that they were blindsided. Ever since Xi Jinping had become China's leader in 2012, he had repeatedly stressed that "reunification" between Taiwan and the Chinese mainland was "inevitable". He had gone on to affirm that such a "reunification" was an integral part of his plans for the "rejuvenation of the Chinese nation". Xi's threats had crystallised in 2023, when American intelligence services believe he had ordered Chinese military forces to be ready to invade Taiwan by 2027.

As the world braces for impact, the European Union and its 27 member states scramble to assess their economic statecraft options. They know that the EU is not prepared for a Taiwan conflict scenario; the bloc has a longstanding tendency to hope for the best and ignore the worst until it happens. But all is not lost. The EU and its member states have plenty of experience pursuing their foreign policy aims through economic statecraft tools, including financial sanctions, trade restrictions, and export controls. Crucially, they can derive insights from the extensive sanctions that they have been imposing on Russia since Moscow's illegal annexation of Crimea in 2014.

European policymakers know that the stakes are enormous. Imposing sanctions on China would have profound global consequences: the country is the second largest economy in the world and the EU's second biggest trade partner. Ideally, the threat of sanctions would alter China's plans before an invasion of Taiwan took place. However, such a positive outcome is far from guaranteed. EU leaders recall that Western sanctions threats did not dissuade Russia's president Vladimir Putin from starting an all-out war against Ukraine in February 2022.

In Brussels and European capitals, policymakers need to answer two questions. First, what is their economic leverage against China? And, with that in mind, what are the bloc's (realistic) sanctions options?

This policy brief presents insights from Ukraine-related sanctions for a Taiwan crisis scenario, focusing on the trade and financial measures that are the most likely to change

China's calculus. It argues that, in this far from certain scenario, EU sanctions threats could help convince Chinese leaders that the costs of an invasion are higher than those they have already priced in. It then sets out how the bloc has huge leverage over China in the form of access to the EU's wide market, before spelling out options for the EU to get the private sector and wider public on board with its sanctions effort.

The brief's sole focus is economics, eclipsing the military and geopolitical dynamics of a Chinese aggression against Taiwan. Of course, sanctions are only one piece of kit in the Western diplomatic toolbox; military deterrence would provide a crucial complement to economic statecraft signals. The report assumes, for the sake of simplicity, that the global geopolitical landscape would be made up of three blocs: a G7-EU coalition (building on solid co-operation among G7 members on Ukraine-related sanctions); a China-aligned camp (including China, Russia, Iran, North Korea, and other proud members of the international coalition of the rogues); and everyone else.

The brief assumes cooperation on sanctions between the EU and other G7 economies. The EU is the G7 actor that is least likely to impose sanctions on China in a Taiwan aggression scenario. If the bloc and its 27 member states are on board (EU sanctions require unanimity), then it is safe to assume that everyone else from the G7 grouping is. This does not mean that collaboration between like-minded allies would be entirely smooth sailing. The US would likely press the EU to go for even more stringent sanctions than the bloc is ready to stomach, but this brief outlines why the bloc should resist such calls.

The potential trigger for EU sanctions against China is a matter of fierce debate that falls outside the scope of this brief. There is also much speculation as to whether the EU would ever impose sanctions on China, even in the extreme scenario of a full-blown invasion of Taiwan. This brief therefore does not examine low-intensity scenarios, such as China's potential "salami-slicing" tactics that seek to achieve huge territorial gains around Taiwan through a succession of small events. This strategy is unlikely to trigger meaningful EU sanctions.

If the EU decides to impose sanctions on China, then it means that the bloc believes the situation around Taiwan is serious. The stakes are enormous: a conflict around the island could lead to a third world war – a global catastrophe of unprecedented severity, with cataclysmic human consequences. As such, it is pointless to ponder whether Western firms would lose contracts in China (this is certain); how much EU economies would suffer (a lot); or if European consumers would still be able to buy the latest iPhone (no one would care).

Learning lessons from Ukraine-related sanctions

Over the past years, the word "sanctions" has become a catch-all term for a variety of measures that have little in common with one another. Some sanctions are mostly for signalling purposes and have little impact in the grand scheme of things. Such measures include asset freezes for individuals and companies that are engaging in illicit activities, such as human-rights abuses in China's western province of Xinjiang. These sanctions have a mostly symbolic value and therefore fall outside the big-picture scope of this policy brief.

What's relevant here is taking a look at those sanctions that seek to inflict economic pain on their target in a bid to convince (or compel) it to change its behaviour. In an ideal world, threats of such measures would be enough to deter their target from doing bad things (a process known as "sanctions deterrence"). In most cases, however, mere threats are unsuccessful. In turn, sanctions typically seek to degrade the ability of their target to continue to engage in illicit actions, such as slaughtering civilians (Syria), engaging in nuclear proliferation (North Korea), or sponsoring terror groups (Iran).

Lessons learnt from Ukraine-related sanctions hold valuable lessons for Taiwan conflict scenario.

Sanctions deterrence remains useful

Russia's full-blown invasion of Ukraine in February 2022 came as a surprise to supporters of sanctions deterrence.[1] On paper, Western sanctions threats ticked all the obvious boxes. For starters they were clear: in late 2021 the United States and its European allies began to mention specific sanctions options, including measures that would target major Russian banks, Russia's sovereign debt, and the country's access to Western technology. The proposed measures also seemed severe. They were (at the time) the most draconian options on the Western sanctions menu. This led believers in sanctions deterrence to assume that Putin would eventually back down and order the troops that he had amassed at the Ukrainian border back to their barracks.[2]

Sanctions deterrence champions were proved wrong, but there is an important caveat to this analysis: the sanctions that Western countries eventually imposed on Russia were far more draconian than those contained in the initial threats. Powerful EU measures to curb Moscow's oil and gas exports to the bloc, for instance, were not part of the bloc's sanctions deterrence packages. It is impossible to know whether the risk of losing access to the EU oil and gas markets would have changed the Kremlin's calculus. But omitting severe measures, which the

EU eventually imposed, from initial sanctions threats defeats the point of deterrence.

China's leaders know full well that trying to force Taiwan into "reunification" with the mainland would come at a huge price. The amounts at stake are eye-popping. Bloomberg Economics, the research unit of the Bloomberg group, reckons that a conflict around the island could shave about 10 percentage points from global GDP growth (a hit equivalent to nearly twice that of the covid-19 pandemic in 2020) and up to 17 percentage points from China's own GDP growth (in the year of an invasion). If Beijing were on the verge of attacking Taiwan, then it would mean the Chinese leadership has accepted the risk of incurring such costs.

This does not imply that sanctions deterrence cannot work. What it means is that, to succeed, sanctions deterrence needs to convince Chinese leaders that the economic costs attached to an aggression are higher, and crucially longer-lasting, than those they have already factored in.

In a Taiwan conflict scenario, Western sanctions deterrence would stand its best chance if it involved references to the most extreme measures that the EU and its allies would conceivably be willing to impose on China. Of course, including the most powerful sanctions possible in initial threats is hard to achieve in practice: the EU's willingness to cut down on Russian fossil fuels was at least in part due to Moscow's decision, several months into the war, to turn off the gas tap to Europe. This highlights the value for policymakers of adopting a pessimistic stance when sketching out potential sanctions options and assuming that seemingly unthinkable worst-case scenarios will happen.

EU sanctions deterrence could be game-changing

Conventional wisdom is that the US is the world's strongest sanctioning power. That assertion is certainly true in most instances. But after the full-scale invasion of Ukraine, it was EU sanctions that probably alarmed Moscow the most. This is because Russian policymakers likely did not expect the EU to impose measures as stringent as a ban on Russian seaborne oil imports. A second insight from Russia sanctions follows: Europe's adversaries usually do not expect the EU to get its sanctions act together, let alone go for powerful measures.

Russian leaders had solid reasons not to factor in potential EU sanctions as they were preparing to invade Ukraine. In 2014 the bloc had imposed only mild measures on Moscow following Russia's annexation of Crimea and its backing of separatist rebels in eastern Ukraine. (The 2014 vintage of EU sanctions on Moscow mostly included individual sanctions on Russian persons and firms that had ties to the Kremlin.) Eight years later, the Kremlin

probably also assumed that it wielded huge leverage over the EU, which relied on Russia for 30-40 per cent of its fossil fuel imports. Finally, Moscow likely did not expect that the 27 EU member states would manage to unite on sanctions, let alone for an extended period.

The Kremlin's miscalculation has proven a painful one for Moscow. Data from the Kyiv School of Economics show that, between December 2022 and June 2024, Western sanctions lowered Russian oil export earnings by $78.5bn (or about five months of average monthly oil export earnings in 2021). The EU ban on seaborne Russian oil imports was the largest driver of these losses. On top of that, the EU's decision to cease all imports of Russian gas by 2027 means that energy giant Gazprom has lost its biggest client, likely for good. This has been an unpleasant development for Moscow: in 2023 the state-owned gas company recorded a $6.8bn loss – its first since 1999.

It is impossible to know whether Moscow would have changed course in Ukraine if Kremlin decision-makers had known that EU sanctions would inflict huge damage on Russia's state coffers. Yet Moscow's misfortunes still hold a lesson for EU policymakers: ahead of an invasion of Taiwan, Beijing would fully price in the costs of retaliatory sanctions from the US. However, Chinese leaders would likely assume that they could deter the EU from going down the sanctions road (for instance, China could spell out how it would retaliate against potential EU sanctions and seek to fuel divisions between EU member states).

This means that EU sanctions deterrence could be game changing in the run-up to a conflict around Taiwan. Clear threats from the bloc would signal to Beijing that the costs of an aggression are even higher than those that the Chinese leadership already expects. Of course, this reasoning assumes that Beijing believes European threats are credible. Russia's experience in this regard may well prompt Chinese leaders to think twice before brushing off Europe's warnings. For sanctions deterrence to work, the EU will also have to ensure its threats hit China where it hurts.

China's sanctions-proofing efforts could make financial measures moot

In 2023, trade turnover between Russia and China reached $240bn, surging by a whopping 26 per cent in just one year. Western officials have little doubt that at least part of this rise is due to growing Chinese shipments to Russia of dual-use goods (that is to say, products like semiconductors that have both civilian and military uses), in breach of American and European sanctions. The US, the EU, and their allies can do little to curb such flows. Obscure Russian and Chinese banks that do not use Western financial channels or currencies handle

the related financial transactions, shielding them from potential US or EU penalties. This lays bare how Moscow's and Beijing's efforts to reduce reliance on Western financial channels increasingly weigh on the effectiveness of sanctions.

The United States' and the EU's ability to impose sanctions on their adversaries derives from the primacy of Western currencies (like the US dollar or the euro) and financial channels (like SWIFT, the global messaging system that connects the world's banks). It therefore makes sense that Russia, China, and their partners are fast developing innovations that seek to curb their reliance on Western financial tools. These states are focusing their efforts on three areas: de-dollarisation (and to a lesser extent de-euroisation), the development of alternatives to SWIFT, and the creation of digital currencies that do not rely on Western financial mechanisms.

Russia initially focused its de-dollarisation efforts on diversifying the composition of its central bank's reserves. In 2018 the Central Bank of Russia liquidated most of its holdings of US Treasuries, for the eye-popping amount of $81bn. This pushed the US dollar-denominated share of Russia's reserves to below 15 per cent (from around 40 per cent previously). The move proved to be a prescient one. After Russia's full-scale invasion, Western countries managed to freeze only about half of Moscow's foreign-exchange reserves as part of their sanctions packages; the other half was denominated in non-Western currencies or in gold, out of reach of sanctions. The war has turbocharged Russian de-dollarisation efforts, which now extend to cross-border trade. Since February 2022 Russian businesses have been ditching Western currencies in droves: they now send invoices for three-quarters of their global transactions in rouble or renminbi, up from around one-fifth before the full-scale invasion.

Similar trends are noticeable in China. The composition of China's $3.2trn in foreign-exchange reserves is a state secret, but in 2018 a Chinese government report hinted that de-dollarisation efforts were already well under way in that field. The document suggests that the US dollar-denominated share of China's reserves stood at just 58 per cent in 2014 (down from 79 per cent in 2005), diminishing the bite of a potential Western freeze of these assets. It is safe to assume that this share is even lower now. Like Russia, China is also doubling down on de-dollarisation in the trade sphere. Chinese firms now settle more than half of their cross-border trade transactions in renminbi, up from zero in 2010. In turn, the IMF estimates that less than half of China's global trade is now invoiced in US dollar, down from 90 per cent in 2010. (These data include transactions with Hong Kong and broadly match Chinese official figures.)

The development of alternatives to SWIFT represents a second area for the sanctions-proofing efforts of the international coalition of the rogues. China leads the way in the field with CIPS,

a homegrown alternative to SWIFT. The mechanism handles only a fraction of SWIFT's turnover. However, for China's leadership, that is beside the point. What matters to Beijing is that CIPS already connects nearly 1,600 banks globally (including most financial institutions in Europe and America), providing China with a backup plan if the country were to lose access to SWIFT. (Experts disagree as to whether CIPS is a full-fledged alternative to SWIFT, as the Chinese system currently partly relies on the Western mechanism. China's rapid efforts to develop CIPS mean that by 2028 this may no longer be a relevant consideration.)

Digital currencies are a third field for sanctions-proofing endeavours. Since 2019 Beijing has been pushing for the domestic adoption of the e-yuan, a digital currency issued by the Chinese central bank that netizens can store on their mobile phones. The currency has no link to Western jurisdictions, immunising it from sanctions. Beijing's plans in the digital currency field extend beyond Chinese borders: over the past years, China has begun to trial mBridge, a system that could eventually allow Chinese firms to settle cross-border trade with a digital currency. Again, China's reasoning seems mostly defensive. The purpose of both the e-yuan and mBridge is not to dethrone the US dollar or SWIFT. Instead, the mechanisms complete China's long-term efforts to develop backup solutions if the country were to lose access to Western currencies or financial channels.

This all means that by 2028 threats of measures targeting China's access to Western financial channels or currencies would be unlikely to alter Beijing's calculus around Taiwan, as Chinese leaders are making fast progress towards financial self-sufficiency. Moscow's ability to quickly ditch Western currencies after its full-blown invasion of Ukraine will serve as further reassurance for Chinese leaders that such a move is possible under extreme scenarios.

Gradual sanctions escalation could be counterproductive

In 1796 British scientist Edward Jenner had a wild theory: he believed that implanting a small quantity of typically mild cowpox in humans would render them immune to often fatal smallpox. Jenner based his guess on an intriguing observation: milkmaids who had previously caught cowpox appeared to be immune to smallpox. To test his theory, Jenner inserted cowpox scabs into the wounds of an eight-year-old boy before exposing him to smallpox. Nothing happened. Inoculation with benign cowpox had made the boy immune to deadly smallpox.

More than two centuries later, Western leaders are inadvertently engaging in an economic version of Jenner's process: sanctions inoculation. Such a process happens when Western states implant a small, harmless quantity of sanctions into a given country, helping their target become immune to more powerful measures. Two examples from Ukraine-related

sanctions illustrate how Western sanctions inoculation may turn out to be counterproductive.

The "de-SWIFTing" of Russian banks provides a first example of sanctions inoculation. In March 2022 Western leaders had hoped that this measure would deal a blow to Moscow, pushing the country into financial isolation as Russian financial institutions would be unable to process international transfers. The reality was less dramatic. Instead of going for a (severe, smallpox-like) Russia-wide disconnection from SWIFT, the EU and its allies opted for a (mild, cowpox-akin) strategy of disconnecting only seven Russian banks from the network. In turn, Russian firms were able to reroute transactions through one of the hundreds of financial institutions that remained connected to SWIFT. In parallel, Moscow doubled down on efforts to connect to China's CIPS mechanism, building long-term immunity (or sanctions antibodies) against a full de-SWIFTing of all Russian banks; the number of Russia-based participants in CIPS has roughly doubled since 2022. Of course, many of these banks were probably planning to join CIPS anyway as part of Moscow's sanctions-proofing efforts. Yet the de-SWIFTing of seven of their competitors likely added urgency to such plans.

Russia's efforts to assemble a Western-proof, shadow fleet of oil tankers provide a second illustration of how targets can acquire long-term sanctions immunity. In early 2022 ships that had ties to G7 and EU economies (for instance because they were insured by a G7 or EU-based company) shipped more than 80 per cent of Russian seaborne oil. This share has now dropped to just 11 per cent, for good reason: vessels that have zero link to G7 or EU economies can freely transport Russian oil above the $60/barrel price cap that Western countries started to impose on Russian oil exports in December 2022. Moscow's investment in a dark fleet of oil tankers has put the majority of Russian oil shipments out of reach of the price cap, highlighting how sanctions targets can adapt and build long-term immunity against such measures. For Moscow though, this process has not been a cheap one; since late 2022, Russia has spent nearly $9bn to assemble its shadow fleet of oil tankers.

Gradual sanctions escalation would therefore probably be pointless in a Taiwan-conflict scenario. Large economies can adapt to mild sanctions and become immune to tougher ones when Western countries do not go for full-force measures immediately – a process akin to sanctions inoculation. This means that if deterrence fails and EU policymakers choose to impose sanctions on China, then they should go hard and fast. Ideally, they should also prioritise imposing measures that Beijing would struggle to adapt to. Otherwise, China would likely incur only temporary economic damage, which it would be able to gradually brush away as it builds long-term antibodies against tougher measures.

The EU and its allies can't engineer a balance-of-payments crisis in China

In March 2022 the US, the EU, and their partners came up with a bold plan: they were going to engineer a balance-of-payments crisis in Russia through a freeze of the country's central bank reserves. The logic was that the freeze would complicate Moscow's efforts to prop up its currency, pay for imports, and reimburse external debt. This was supposed to prompt a sharp depreciation of the rouble against Western currencies, fuelling inflation and tipping Russia into a financial crisis. After just a few weeks, it was clear that this plan had failed. Moscow's continued sales of oil and gas meant that the country's current account remained firmly in surplus, supporting the central bank's efforts to replenish its coffers with (unfrozen) reserve assets.

To make matters worse, more than two years later like-minded allies still argue over what to do with Russia's foreign-exchange reserves. Disagreement over this issue has become a transatlantic irritant, with the French and German governments (among others) balking at the American idea to confiscate the frozen reserves and use them for Ukraine's reconstruction. Meanwhile, policymakers from non-aligned economies shake their heads in disbelief as they follow the twists and turns of the Russian reserves saga: many of them have serious reservations about the soundness of plans to confiscate Moscow's assets, probably because they fear that they may be next in line.[3]

The lesson here is that it is almost impossible to engineer a balance-of-payments crisis in a country that runs a huge current account surplus. EU-G7 threats to seize the Western-denominated portion (or what is left of it, amid Beijing's sanctions-proofing efforts) of China's foreign-exchange assets would therefore be unlikely to alter Beijing's calculus around Taiwan. Before an invasion, such threats would probably prompt China to liquidate its Western assets in a rush, a move that would not be in the interest of G7 economies. After an invasion, Chinese leaders would be unlikely to lose sleep over an actual freeze of their reserves. Even a partial loss of access to G7 and EU markets would be unlikely to flip China's $800bn current account surplus into a deficit. Paying for imports would be Beijing's main immediate issue, but sanctions-proofing means that China could turn to non-Western financial channels and boost cross-border trade in renminbi. From a broader perspective, a G7-EU freeze of China's assets would also reignite global debates about the soundness of such a move. This would not be the best way for G7 and EU capitals to court non-aligned economies.

Harnessing the power of the EU market

Ahead of a potential conflict around Taiwan, the EU should send clear and severe sanctions threats in a bid to convince Beijing that the costs of an invasion are higher than those that China has already priced in. To show that its threats are serious, the bloc could also put a major Chinese state-owned bank, such as China's Construction Bank (CCB) or the Industrial and Commercial Bank of China (ICBC), under financial sanctions. The EU would likely do this in collaboration with the US and other allies, sending Beijing a message of G7 unity. If deterrence fails, then the bloc should go hard and fast on China.

Market access is Europe's best leverage. China's sanctions-proofing efforts mean that measures targeting China's access to Western financial channels are unlikely to change Beijing's calculus around Taiwan. If the EU resorts to gradual sanctions escalation (or inoculation), it runs the risk of supporting Chinese efforts to build long-term immunity to financial sanctions. In addition, it would be nearly impossible for the EU and its allies to engineer a balance-of-payments crisis in China through a seizure of the country's central bank reserves.

This leaves one economic statecraft option for EU policymakers: curbs on China's access to the European market – for a prolonged period of time. Sanctions evasion will happen, but giving way to US calls for secondary sanctions would not be in the best interest of the bloc.

Leverage access to the EU market

China's economic model relies on the export of manufactured goods. Each year Chinese firms churn out as much stuff as their counterparts in the US and the EU combined. Yet the country's reliance on exports as a driver of growth may well be its Achilles heel. Exports account for nearly 20 per cent – a large share by global standards – of China's GDP, with nearly 40 per cent of these going to G7-EU economies. In turn, a whopping 100m jobs in China depend on foreign demand, including at least 45m from G7-EU economies. Despite Beijing's efforts to deepen trade ties to emerging economies, G7 and EU countries account for China's largest trade surpluses, for a total of $612bn in 2023 (compared to a $281bn surplus with emerging economies[4]). In short, China cannot afford to lose access to all G7 and EU markets at the same time.

Blanket bans on Chinese imports would be hugely painful for the EU. Many European industrial firms rely on Chinese intermediary inputs and machinery to operate, with such goods accounting for around 60 per cent of EU imports from China. Instead, EU policymakers

could adopt – in collaboration with G7 partners – measures that target imports of non-critical, finished consumer goods, which account for around 30 per cent of EU imports from China. Such sanctions could take the form of import bans or prohibitively high tariffs (above a 50 per cent tariff rate, trade flows for the targeted goods would likely stop). The EU could prioritise targeting two sectors – electronic/electrical gadgets and low-end goods – with such trade measures.

Electronic and electrical gadgets include a wide variety of products like smartphones, kettles, consoles, ovens, fridges, and other such devices. A drop in the supply of these goods would be manageable for Western consumers, at least for a while. But for China, joint G7-EU measures curbing the shipments of these products would be hugely painful: in 2023 shipments to G7 and EU countries of electronic and electrical goods accounted for around 13 per cent of Chinese exports.[5] Nearly half of these purchases came from the EU, making shipments to the bloc critical for Chinese firms operating in these sectors.

Low-end goods represent another sector for potential G7 and EU trade measures. Western media headlines typically focus on China's high-tech advances, but exports of more mundane items like textiles, footwear, and toys are also critical for Beijing; low-end goods account for around 9 per cent of Chinese exports. This is a second area of leverage for G7 and EU economies, which absorb around three-quarters of China's exports of low-end goods (or about 7 per cent of China's total exports).[6] Again, the EU's buy-in for such measures would be critical: nearly 40 per cent of Chinese shipments of clothes, shoes, and toys to G7 and EU economies make their way to the bloc.

Focusing on these two sectors is just one illustration of how the EU can work with its G7 allies to design trade measures that would deal China a serious blow but have only a moderate impact on European economies. The losses for China could go beyond those implied by a 20 per cent (13 per cent for electronic/electrical products and 7 per cent for low-end goods) cut in the country's exports. Chinese firms would likely struggle to find alternative buyers in non-G7 or EU economies amid the global economic downturn that a conflict around Taiwan would create. This suggests that some Chinese businesses would go bust, fuelling unemployment and threatening social stability. Conflict-related maritime disruptions in Asia would also compound the impact of trade measures. (Trade could stop at the onset of a conflict, making trade measures moot. Western deterrence therefore needs to make it clear that G7 and EU trade measures would be long-lasting.)

China's retaliation against potential G7 and EU trade measures falls outside the scope of this brief. Yet a quick look at the structure of EU-China trade relations suggests that retaliatory trade measures from Beijing would be less painful for the EU than they would be for China,

for at least two reasons. First, China absorbs 9 per cent of EU exports, mostly for manufactured goods. This is certainly a lot. But EU exports to China are more than two times smaller than shipments to the US, making the American market far more critical than the Chinese one for EU exporters. In any case, China is unlikely to sever all imports from the EU. For instance, Chinese firms bought around $23bn in EU-made medicines last year, with such goods likely to be critical staples for Beijing in a conflict. Second, Chinese export bans on goods that G7 and EU trade measures would not target, such as intermediary inputs and machinery, would certainly be painful for EU manufacturers. However, such bans would also further curb China's export revenues – making them an unappealing option for Beijing.

Accept evasion will happen (and resist calls for secondary sanctions)

Evasion is as old as sanctions, and trade measures tend to be leaky. If the EU bans the import of some Chinese goods, then it is inevitable that murky firms will quickly set up shop to help Beijing skirt these measures. Circumvention networks would likely focus on the covert re-export of Chinese goods to Europe via non-sanctioning economies. Sanctions evasion networks would not find it too hard to come up with a list of potential hubs for their illicit activities; there is no chance that non-aligned economies would follow the G7-EU lead and impose sanctions on China. Experience from Ukraine-related measures suggests that Turkey, Serbia, the United Arab Emirates, Kazakhstan, and Azerbaijan could count among the main suspects. China's neighbours Mongolia and Vietnam would also be obvious candidates.

To their chagrin, wannabe sanctions busters would quickly find out that circumventing trade measures on China is easier said than done. First, the sheer scale of Chinese exports to Europe means it is implausible that China could fully dodge these measures. EU imports of kettles, fridges, lamps, TVs, sneakers, clothes, teddy bears, and other electronic/electrical or low-end goods top several hundred billion US dollars every year. Hiding all such shipments would be difficult. Second, customs officials exist to control EU imports. This suggests that measures curbing China's access to the EU market would be easier to implement than sanctions limiting exports from the EU to Russia of, say, tiny microchips that fit nicely in a carry-on suitcase.

This still begs the question of what the bloc could do in practice to prevent and tackle the inevitable attempts to circumvent sanctions. Calls to beef up the implementation of Ukraine-related sanctions have proven a popular buzz line since February 2022. This sounds great in theory, but it is hard to figure out what it entails in practice.

In a Taiwan conflict scenario, the bloc should focus its efforts on targeting financial institutions that process transactions related to sanctions evasion. This is due to two factors. The first is that covert shipments of Chinese goods to Europe would almost certainly involve a Western bank, meaning that China's sanctions-proofing efforts would not shield the related transactions. The second is that it is probably more effective to target banks than middle people or firms engaging in sanctions evasion. This is because it is typically harder to be granted a banking license than it is to set up a front company.

The EU could use two tactics to help bring financial institutions into line. The gentler one would entail visits from government officials to banks engaging in either outright sanctions evasion or (more likely) borderline business. Such friendly chats about the dangers of doing business with the international coalition of the rogues worked wonders in the 2010s when the US sought to convince Western financial institutions to cut ties with Iran. [7] The less friendly version of this strategy entails imposing sanctions on such banks or withdrawing their license, effectively putting them out of business. Other financial institutions would quickly get the message that sanctions evasion is a risky endeavour, sending a "chilling effect" throughout the sector.

The million-dollar secondary sanctions question

A conflict scenario around Taiwan would almost certainly fuel calls for EU secondary sanctions on China. Only the US imposes such measures, which force all firms around the world to make a choice between doing business with either America or the targeted country. Despite the need to go hard and fast on China, the EU should resist US pressure to go for secondary sanctions in a Taiwan conflict scenario.

There are three main reasons for this. First, China's sanctions-proofing efforts mean that tracking transactions between China and non-aligned economies would be almost impossible as payments would likely be routed via CIPS or in e-yuan. Second, EU requests for non-aligned economies to make a choice between the Chinese and Western markets may yield unpleasant surprises; China is the first trading partner of most countries around the world. Third, secondary sanctions on China would risk undermining the effectiveness of G7-EU trade-related measures on China. With access to G7 and EU markets curtailed, China would seek to re-orient its exports towards non-sanctioning economies. If, at the same time, secondary sanctions reduce ties between G7-EU markets and non-aligned economies, then their demand for Chinese goods will rise mechanically – supporting China's efforts to find alternative export destinations.

That the EU should resist calls for secondary sanctions does not mean that the bloc would have zero options to convince developing economies to not get too cosy with China (or facilitate sanctions evasion). One creative possibility for G7-EU policymakers would entail twisting the arm of central banks in non-aligned economies through threats to cut off access to G7 currency swap lines. In doing so, the US Federal Reserve (Fed), the European Central Bank (ECB), the Bank of Japan (BOJ), the Bank of Canada (BoC) and the Bank of England (BoE) would leverage the pre-eminence of G7 currencies in global financial markets (more than 80 per cent of global trade is invoiced in the British pound, Canadian dollar, euro, US dollar, or yen). Such threats could target those non-sanctioning economies, such as Argentina, Egypt, and Saudi Arabia, that are both heavily dollarised and keen to welcome Chinese foreign direct investment. This measure would not amount to secondary sanctions: it would allow a certain degree of tolerance for economic ties between non-aligned nations and China, while making it clear that too much closeness to Beijing comes with serious risks.

Getting the private sector and the public on board

Imposing import bans on Chinese, finished consumer goods would have huge consequences on European firms and consumers. To avoid a backlash from businesses and the public, the EU should consider supporting those firms that will be most affected by sanctions and beef up its public outreach efforts. Chinese disinformation on the effectiveness of sanctions is almost a given, but the EU has options to tackle this issue.

Help the private sector to do the right thing

Since February 2022 Western firms have adopted a wide variety of strategies regarding their presence in Russia. Some businesses, including Siemens, IBM, Ikea, BP, and Maersk, have left the country. However, such firms are the exception: so far most Western companies are staying in Russia. This reflects a widespread view in corporate boardrooms that ties between Western countries and Moscow will eventually improve. [8] Following that logic, many Western executives believe that those firms that will have stayed loyal to the Russian market will stand to benefit from an eventual thaw in relations between Moscow and Western countries.[9]

China's global economic footprint means that a conflict around Taiwan would come with far deeper ramifications for Western companies than the war in Ukraine. It is implausible that firms from G7 economies could continue to work in a business-as-usual fashion on Chinese soil. Asset seizures from the Chinese government would be likely, with at least €460bn in

assets of direct G7 origin at risk. (Retaliation measures from the Chinese government are outside the scope of this brief.) Yet it is also likely that some EU firms would try to find ways to continue doing business with China – a huge market of 1.4 billion consumers that will probably remain critical to global supply chains by 2028.

The EU should not expect the private sector to leave China out of righteousness. The bloc should also avoid micro-managing private firms and remember that business strategies rely on financial considerations, not moral questions. Keeping these two principles in mind, feedback from the private sector about Ukraine-related sanctions suggests that there would still be ways for the bloc to nudge the private sector to "do the right thing". [10]

First, the EU should make sanctions rules as clear as possible. Many businesses report that they are often confused regarding sanctions. This is sometimes a bad faith argument – with representatives from the private sector arguing that, alas, sanctions rules are too obscure to possibly be enforceable. Even so, a quick look at (often perplexing) sanctions legislation suggests that this argument has some merit. Rendering legal jargon intelligible is probably too tall an order. This suggests that the next-best option to deal with this issue could be to boost engagement between EU institutions and member states, on the one hand, and the private sector, on the other. European policymakers could look across the Atlantic for inspiration: OFAC, the US Treasury agency in charge of sanctions, holds regular outreach sessions with business representatives. Such meetings help the business community to forge informal links with government contacts, whom they can approach later on if they need clarification.

Second, EU member states could consider supporting firms that would be the most affected by sanctions, for instance because their business model relies on importing goods from China. Such support packages could look similar to those that most EU member states put into place during the covid-19 pandemic. The economic hit of a conflict around Taiwan would be far higher than that of the outbreak in 2020, supporting the case for some form of financial support for affected firms. Advance preparations for such packages would come with an added benefit: they would boost sanctions deterrence by signalling to Beijing that the bloc is serious about its sanctions plans. There is a catch, though. European policymakers would need to take care to avoid moral hazard; that is to say, taxpayers ending up footing the bill when private firms have made risky bets (this time, on China) and lost. To mitigate this risk, the EU could offer financial support only to those firms that had invested into their sanctions departments well before the onset of a conflict around Taiwan.

Finally, EU policymakers should not lose sleep over Chinese investments in Europe. Conventional thinking goes that these investments give China leverage, as Beijing could order Chinese firms to shed EU-based jobs. The reality may well be less alarming than it looks. Only five ongoing Chinese investments

in Europe are for major amounts (more than €1bn), suggesting that the number of jobs at stake is unlikely to be huge. In addition, most Chinese investments in Europe are in minority stakes, meaning that Beijing would hardly have enough leverage to disrupt operations. In an extreme scenario, EU governments could nationalise Chinese-owned plants. There are precedents for this: in 2022 Germany put the local subsidiary of Russia's Gazprom under state control to protect energy security.

Undertake a serious public outreach effort

In the weeks following the all-out invasion of Ukraine, it was common to hear Western policymakers argue that sanctions would prompt a "collapse" of the Russian economy. In hindsight, such declarations may not have been particularly wise. Initial plans from G7 allies to engineer a financial crisis in Russia were not exactly successful, and Putin fans can now easily claim that Western promises to put the Russian economy on its knees turned out to be fake news. This experience should serve as a cautionary tale in a Taiwan conflict scenario. Given there is zero chance that Western measures could lead to a collapse of the Chinese economy, humility would probably be the best bet for EU policymakers in their public outreach endeavours.

Such efforts should focus on providing the general population with some understanding of what sanctions do, how they work, and what they can or (even more importantly) cannot achieve. There is little knowledge about sanctions among the public. This is a problem. The widespread lack of understanding of how sanctions work makes it easier for the Kremlin to disseminate bogus claims that sanctions do not work and are harming Europe more than they hurt Moscow. Beijing would likely use similar tactics in a Taiwan conflict scenario in a bid to weaken EU public support for such measures.

Tackling sanctions disinformation should therefore represent a final priority area for public outreach efforts. Against all available evidence, Moscow fervently claims that sanctions are ineffective in a bid to divide Europeans and get the bloc to lift these measures. (If sanctions are so useless, then why does Russia care so much about them?). China would probably seek to apply the same strategy in a bid to foster tensions among both G7-EU allies and Europeans. Tackling this issue would be no easy feat: Beijing is a skilled actor for disinformation and intimidation campaigns. Yet the EU has scope to beef up its related institutional framework, for instance by creating a dedicated unit at the European Commission that would oversee efforts to tackle sanctions disinformation.

Boost the chances of sanctions deterrence	▸ Western sanctions deterrence should include references to the most extreme measures that Western allies would conceivably be willing to impose on China. ▸ The EU should send clear sanctions threats in a bid to convince Chinese leaders that the costs of an aggression are even higher than they expect.
Forget about financial sanctions	▸By 2028 measures targeting China's access to Western financial channels or currencies could be moot, as China is making fast progress towards financial self-sufficiency. ▸ In a Taiwan conflict scenario, Chinese firms could likely ditch Western currencies (including the US dollar) and switch to CIPS, the Chinese rival to SWIFT.
Avoid sanctions inoculation	▸If deterrence fails and EU policymakers choose to impose sanctions on China, then they should go hard and fast to avoid indulging in sanctions inoculation. ▸Inoculation happens when Western countries do not go for full-force measures immediately, helping their target build long-term antibodies against sanctions.
Do not go for central bank asset freezes	▸It is almost impossible to engineer a balance-of-payments crisis in a country like China that runs a huge current account surplus. ▸The freeze of Russia's reserve assets has fuelled debates about the soundness of such a move, particularly in non-aligned economies.
Leverage access to the EU market	▸G7-EU policymakers could adopt measures that target imports of non-critical, finished consumer goods, which account for around 30 per cent of EU imports from China. ▸The EU could prioritise targeting two sectors – electronic/electrical gadgets (kettles, fridges, phones) and low-end goods (clothes, toys, shoes) – with such measures.
Accept sanctions evasion will happen	▸To tackle circumvention, the bloc should focus its efforts on targeting financial institutions that process transactions related to sanctions evasion. ▸Despite the need to go hard and fast on China, the EU should resist US pressure to go for secondary sanctions in a Taiwan conflict scenario. ▸Instead, G7 central banks could threaten to cut off the access of their counterparts in developing economies to G7 currency swap lines.
Get businesses and the public on board	▸The EU should make sanctions rules as clear as possible and build informal ties with private sector representatives so they can reach out for clarification. ▸Member state governments could consider supporting firms that would be the most affected by sanctions, for instance because their business model relies on importing goods from China. ▸The EU's and member states' public outreach efforts should focus on providing the population with an understanding of how sanctions work, and on tackling disinformation about the effectiveness of sanctions.

Conclusion

Busy readers who jumped straight from the summary to the conclusion of this policy brief will be relieved to learn that it has only three messages.

The first is that, despite China's sanctions-proofing efforts, the EU has huge economic leverage over Beijing in the form of access to the bloc's wide market. The second is a caveat to the first message: for this leverage to be effective, the EU must prepare and think through

potential Taiwan-related sanctions scenarios – now. In particular, European policymakers need to start discussing potential Taiwan-related triggers for sanctions on Beijing and map out the consequences of a drastic reduction in trade relations with China. The third is that getting the private sector and the public on board with sanctions would be tough, but critical. To achieve such a feat, the bloc needs to think of financial compensation packages for those EU firms that will be most affected by sanctions and seriously beef up its ability to tackle sanctions disinformation.

Overall, this policy brief highlights how creativity is crucial when dealing with sanctions scenarios. Three years ago, a prescient think-tanker suggesting that the EU would eventually ban oil and gas imports from Russia as part of Ukraine-related sanctions would have been considered heretical. The think-tanker would have been right, highlighting how apparently unthinkable measures may quickly become conceivable options in times of conflict.

The author of this policy brief hopes that Taiwan-related sanctions scenarios will seem as far-fetched in 2028 (and beyond) as they do today.

About the author

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Despite these many and varied contributions, all views remain the author's own.

[1] Author's interviews, online and in various EU capitals, 2022-24.

[2] Author's interviews, online and in various EU capitals, 2022-24.

[3] Author's interviews with government officials, online, Spring 2024.

[4] Author's calculations, based on Chinese customs data (http://english.customs.gov.cn/Statics/e1351568-5e17-4534-affd-c369e3506613.html). Emerging economies include ASEAN countries, India, Russia, Latin American economies, and African states.

[5] Author's calculations, based on Chinese customs data (http://english.customs.gov.cn/Statistics/Statistics?ColumnId=1), UN Comtrade (https://comtradeplus.un.org/), and World Bank WITS (https://wits.worldbank.org/CountryProfile/en/Country/EUN/Year/2019). The data are the latest available (usually 2023) while avoiding 2020-22 figures to prevent pandemic-related statistical distortions.

[6] Author's calculations, based on Chinese customs data (http://english.customs.gov.cn/Statistics/Statistics?ColumnId=1), UN Comtrade (https://comtradeplus.un.org/), and World Bank WITS (https://wits.worldbank.org/CountryProfile/en/Country/EUN/Year/2019). The data are the latest available (usually 2023) while avoiding 2020-22 figures to prevent pandemic-related statistical distortions.

[7] Author's interviews; online, US, and various EU capitals; 2020-21.

[8] Author's interviews, online and in person, various EU capitals, Spring 2024.

[9] Author's interviews, online and in person, various EU capitals, Spring 2024.

[10] Author's interviews, online and in person, various EU capitals, Spring 2024.

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