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What Could a Geoeconomic EU Look Like in 2020?

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The need for the EU to respond and position itself in the deepening geoeconomic competition between the Great Powers has initiated a policy reorientation that is slowly attempting to break down the barriers between economic and security concerns. But how can a more geoeconomic EU ensure an integrated approach to economic, technological and security policy that allows it both to manage new risks and also retain the principles of openness and cooperation?

Getting a geoeconomic EU right will require a strategy which defines and operationalises the notion of 'European economic sovereignty'. This would support the EU and Member States in managing the increasing tension between openness and protection in [illegible] reinforcing resilience to economic coercion and strengthening its role in emerging technology-security governance and diplomacy.

GEOECONOMIC FORCES

The new Commission President von der Leyen's by-now notorious declaration of a *Geopolitical Commission* could have also employed a more appropriate choice of words: a *Geoeconomic European Union*. This would appreciate three realities: (1) the centrality of the economic domain for power and security competition; (2) the EU's economic power potential via regulation and its market; and (3) the Commission's need to cooperate with Member States (MS) – as the EU – to develop European power.

The return of Great Power competition has witnessed trade regulation and state intervention in the economy that is increasingly driven by geopolitical ambition and not strictly by market-oriented calculus. For the centres of economic power in Beijing and Washington, the economic infrastructure (institutions, rules, standards, [illegible] primary venue for [illegible] pursue a range of objectives, the issue of technological leadership – with its implications for national and economic security – has crystallised into the key battleground.[1]

The concept of *geoeconomics* does not only describe the use of economic instruments for geopolitical benefit (a statecraft)[2] but also alludes to the transforming relationship between the state and the market and between economics and security. China, for its part, employs an extensive industrial policy programme to support domestic innovation in strategic technology sectors and transfers (or otherwise acquires) foreign technology from competitors by various means. Beijing also makes extensive use of its economic statecraft to influence (or coerce) private and public actors to align with its political agenda while promoting its technology, standards and rules for global adoption (e.g., via the Belt and Road Initiative or BRI).[3] The United States, meanwhile, increasingly restricts access to its technology and domestic market for political or security gains, tarnishes multilateral rules and structures, and (re-)elevates economic sanctions as a primary instrument to attain geopolitical goals.[4]

The EU has so far struggled to adapt to this geoeconomic order.[5] Should it? This is not a binary question. Yes, European interests are best governed by multilateral, rules-based and power-cancelling legal structures. European interests are also most achievable when cooperating with other powers: the United States by default, other powers when interests converge.[6] But when international structures, multilateral or bilateral, are crumbling, more assertive action in defence of EU interests becomes a second-best but necessary insurance policy.

Regulatory Power

That is not to say that the EU has been absent from geoeconomics. The power to shape third countries' regulations (e.g., environmental or labour protections via trade agreements)[7] and the operations of private firms (e.g., via technical standards requirements for access to the single market[8]) is well-documented (and notorious in some places). Beyond easing trade for business, this regulatory power can, under certain circumstances, produce beneficial geopolitical value.

For example, data privacy rules under the EU General Data Protection Regulation (GDPR) may play a fundamental role in shaping how modern digital economies do business and protect the security of citizens. Third countries and firms may feel compelled to adopt similar standards of protection or else suffer restrictions on trading data across borders. With data as a critical enabling input in emerging technology such as artificial intelligence (AI),[9] its regulation – for which the EU, United States and China hold different views – has risen to strategic importance in the geoeconomic competition.

In other words, the adoption of certain EU standards, voluntary or not, is an expression of the EU's power to shape a contested global order. This power might not only translate into strengthening Europe's economic competitiveness (e.g., global adoption of EU car standards) but, ideally, also promote European values (e.g., standards regulating face-recognition technology; ethics of AI) and European security (e.g., 5G network standards). The GDPR's data trade rules and other regulations can offer geopolitical benefit to the EU by producing spheres of influence, though not all standards are of strategic importance. Shaping the standards around sanitary treatment of bananas may be neat, but it hardly offers geopolitical benefit.

The 2018 *EU-Asia Connectivity Strategy* – on paper, a comprehensive trade, investment, finance, development, infrastructure and foreign policy scheme – also offers this potential on paper: to compete with other powers (China's BRI; Russia's Eurasian Economic Union or EEU) not only for commercial gain (e.g., tapping into booming Asian markets) but also to set the digital and physical standards that shape development in Eurasia. In turn, this rulemaking offers avenues for promoting EU interests, values and security abroad.

But the lack of explicit funding channelled through the Strategy is further complicated by an unclear narrative and by the marginal attention the Strategy received beyond Brussels (not even reaching EU capitals). Scaling public and private investment to infrastructure projects is one thing. Unlocking their geoeconomic potential is another. The latter requires the definition of strategic objectives, political steer and engagement. For all the unease felt about China's BRI in parts of Europe, there is much to learn from its public diplomacy. A geoeconomic EU should ensure that all actors adopt a political narrative of connectivity. Formulating this together with Tokyo (which itself has been mustering a multi-layered geoeconomic strategy as part of its Free and Open Indo-Pacific vision) under their new connectivity partnership could help the EU strengthen this dimension.

A Geoeconomic Reorientation

While regulatory power can be a powerful tool to shape the international order, its greatest strength is also its weakness: it is based on market principles. With other powers pursuing geoeconomic action which seek to traverse or manipulate market logics (e.g., strategic investments, industrial policy, tariffs), plus Europe's shrinking market and innovation base, the thrust of geoeconomics today has shifted to entangle economic, technology and security competition between Great Powers more broadly. A widening of the EU's geoeconomic play is therefore necessary if the Union is to remain an economic power broker. The 2019 EU-China Strategic Outlook communication partly acknowledged this turned-page by designating China as 'cooperation partner', 'economic competitor' and 'systemic rival'.

The EU investment screening legislation that entered into force last year stands among the first of these policy reorientations. It sent an important global signal that the EU acknowledges security risks associated with (mainly) China's strategic investment strategy to acquire critical technology and infrastructure. The regulation provides for an EU framework for reviewing foreign investment on grounds of 'security or public order' by offering coordination and cooperation mechanisms to MS – which remain responsible for review and blocking decisions.

In addition to the mere advisory role for the Commission, however, the EU-consensus also failed to capture the economic security aspect of foreign investment, which could, for instance, consider investments' impact on innovation and productivity in strategic sectors (factors introduced by, e.g., Canada and Australia).[10] Ultimately, only an EU-level review tool able to consider EU-wide vulnerabilities to foreign investment can effectively respond to new security risks that traverse economic, technology and security concerns.

The 5G/Huawei network saga, though far from settled, also indicates a slow reorientation. Yes, the canyon between economic (cost-efficiency; fear of retaliation) and security concerns (spying; loss of control; industrial policy) remains a significant hurdle to a strategic approach. But the EU managed to build some bridges. In a 2019 EU-coordinated risk assessment report, MS agreed that both technical risks (e.g., 'bad code' in software) and political risks (e.g., overdependence; legal framework in 5G supplier's home country) are critical factors for assessment, together creating a 'new security paradigm'.

On that basis, the Commission's recently published Toolbox of Risk Mitigating Measures offers national authorities a vast set of actions to manage this new security challenge. While MS have discretion as to how exactly they implement the policy (especially concerning the interpretation of political risk), the Commission toolbox tells a clear story: when assessing 'high-risk vendors' such as Huawei, not only technical standards but also political factors demand consideration (e.g., is that provider headquartered in a country with inseparable commercial and security activity; without adequate rule-of-law standards or with intrusive national security laws?). It provides MS with the opportunity to exclude high-risk vendors like Huawei.

A Geoeconomic EU in 2020: Getting it Right

These measures are a foot in the door for a geoeconomic EU. But Europe requires a more strategic approach to the mounting challenges at the intersection of economics, technology and security in the triangular relationship with Washington and Beijing. The big strategic task for Europe is not to regard these issues as isolated events. The structural changes in the international order require an overarching reorientation towards the other powers and towards the tools that are necessary for defending European interests.

This reorientation of EU geoeconomic policy is captured by the notion of European economic sovereignty, building on President Macron's 2018 call for European sovereignty[11] and its different echoes (digital, technological, economic, defence) in Brussels and beyond. But its operationalisation remains scattered. Without a strategic frame, the risk of uncoordinated, antagonistic policies is even higher than is already the case.

In 2020, a new edition of the EU Global Strategy[12] could, for instance, develop this concept as a sub-strategy – part of a wider Grand Strategy that positions Europe in the Great Power competition. Cooperation and push-back, with both Beijing and Washington, can and should co-exist. The strategic direction, of course, must not be decoupling, nor trading in growth and innovation for unrealistic sovereignty objectives. Understanding the second- and third-order effects remains a critical exercise when operationalising economic sovereignty, e.g.: What are the costs/benefits of restrictive trade and investment measures on long-term EU economic growth and innovation? What are the diplomatic costs/benefits of more assertive action?

Ultimately, Europe's economic sovereignty is dependent on continuous technological innovation, open trade and investment channels and non-confrontational relations with the Great Powers. To that end, Europe's research and development capacity, education, strategic investments into key enabling technologies and value chains, the enforcement of fair competition, as well as reform of the WTO and deepening bi-/plurilateral cooperation are critical to a geoeconomic EU.

But the reality of the thin line between protection and protectionism, between cost and benefit, between supporting and stifling innovation, cannot be an argument for the status quo ante either. Rather, it should be an argument for developing a strong framework for EU economic sovereignty that allows the Commission and MS to better manage the tension between openness and protection across different policies. On that basis, a geoeconomic EU could expand its promotion of rules, standards and international cooperation while also strengthening its resilience to economic coercion and reinforcing its role in emerging technology-security governance and diplomacy.

Resilience to Economic

The return of overt economic coercion as a favoured policy instrument in Washington and Beijing stands among the most visible denials of EU economic sovereignty. Take China's threat to punish EU firms operating in China, should Huawei be excluded in Europe. Or the still-looming threat of US tariffs on European cars and other goods.[13] Such coercive threats are at odds with the EU's interest in upholding the principles of international trade rules and independent policymaking. Strengthening European resilience to economic coercion by offering a credible deterrent and by signalling costs of retribution more directly are an important aspect of a geoeconomic EU.

In trade policy, a recent reform proposal for the EU Enforcement Regulation was a step in the right direction. It will allow limited retaliatory trade sanctions in defence of EU rights even in the absence of multilateral dispute settlement (i.e., a WTO court-of-appeal ruling).[14] The Trade Barriers Regulation, meanwhile, allows the Commission to enforce (unilaterally) EU trade rights brought to its attention by EU business. But the Commission received little political or conceptual backup to use this instrument – which acts similarly to US Section 301 – more assertively in the face of a crumbling WTO dispute settlement, American coercion, or Chinese protectionism. The new Commission's post of a Chief Enforcement Officer should, in accordance with MS, develop a methodology and communication strategy, signalling to third countries in a clear, consistent and credible manner the costs of unfair trade tariffs and barriers.

In the financial realm, the US dollar's centrality in the global financial network gives Washington unparalleled powers to choke off access to this network and sanction private actors via secondary sanctions. In the past year alone, European actors operating in Iran (Joint Comprehensive Plan of Action of JCPOA), Cuba (Helms-Burton) and the Baltic Sea (Nord Stream II) found themselves on the receiving end of US financial coercion or complied with demands in fear of sanctions.

For secondary sanctions targeting EU private actors, the goal of decreasing the exposure to a weaponised US dollar should remain a long-term EU objective. The JCPOA episode and Europe's ambition to keep Teheran committed to the deal after the US withdrawal demonstrated the EU's vulnerability when transatlantic interests do not align. The INSTEX[15] mechanism, which attempted to protect mainly humanitarian trade with Iran (e.g., food, medicine) from US secondary sanctions, did not really work. But even if INSTEX's limited scope included the oil trade – the heart of the US sanctions regime – evasion from sanctions in a dollar-dominated global financial system is currently impractical (INSTEX and its customers themselves could be sanctioned; there is also the issue of overcompliance of private actors).

In the long run, only strengthening the role of the euro as a geoeconomic-power tool by deepening structural, economic and monetary reforms (e.g., completion of the banking union; a common deposit insurance; financial service integration via capital markets union; a pan-Eurozone safe asset) is a viable strategy.[16] But in the short term, structures like INSTEX can raise (mainly) the political costs for Washington to impose sanctions and should thus receive sufficient backing from the EU and MS.

Technology-Security Governance and Diplomacy

The US-China technological leadership competition has opened a fierce debate in Washington about regulatory control regimes around investments, supply chains and exports. Creating new rules and standards around the technology–security nexus will likely become a new form of transnational governance and diplomacy. It will be crucial for a geoeconomic EU in 2020 to retain its seat at the table and be able to co-influence these evolving structures according to European interests and values.

The investment screening regulation and 5G process have been first steps for the EU in this new governance domain. But further questions arise: e.g., which other supply chains of critical technologies/infrastructure could be vulnerable to, for example, third-country control of key input suppliers? If we have identified 5G as one such vulnerable infrastructure, how do we go about assessing EU supply-chain security more structurally and in closer coordination?

While addressing such security issues remains a MS competence, an EU body comprising experts from the business, foreign policy and intelligence community could function as a coordination and information-sharing platform. Similar to the 'Economic Security' divisions in Japan's and the United States' National Security Secretariat/Council, the body – absent a European Security Council – could analyse relevant information and plan strategic economic policy scenarios. Similar to the EU 5G report and toolbox, this exercise could develop common standards/methodologies for the assessment of EU supply-chain security on the basis of an EU economic sovereignty strategy.

Meanwhile, export controls[17] are gaining critical currency in Washington. While their scope and application remain contested and largely undecided in DC, Europe cannot afford to wait on the sideline for the results. Technological decoupling is not in Europe's interest. The negative effects of broad-scope trade restrictions on Europe's innovation capacity are likely to outweigh any security gains. Controls, if any, should thus be drawn as finely and narrowly as possible and clearly linked to technology with concrete implications for security.

For the EU to be able to defend this interest, it must be a powerful broker in technology diplomacy. The current proposal for the modernisation of the EU export control regime, already adopted by the Commission in 2016, could advance a common EU position as a new baseline for EU action. But the proposal has not gained enough traction in the Council. Europe is already at the receiving end of fierce technology diplomacy (e.g., Washington campaign to block the sale of Dutch chip-manufacturing technology to China[18] or Beijing throwing its weight behind the Huawei charm offensive in the EU). [19] If the MS are not to be ground up, the EU must be equipped with a common position and strategy.

EU technology diplomacy should aim to build trust and cooperation in multilateral institutions, such as the Wassenaar Arrangement, OECD, G7/20, and international standards organisations, and plurilateral arrangements, such as the EU–US–Japan Trilateral Agenda. Bilateral platforms, including the regulatory cooperation channels with the US, Japan, Australia or Canada should also be used as avenues. Integrating different diplomacy and regulatory streams that already exist with partner countries – such as on investment screening, export controls and technical standards cooperation – could provide new structures for economic, technology and security cooperation.

CONCLUSION

The EU's geoeconomic potential is significant. But power potential does not necessarily translate into power projection. Getting a geoeconomic EU right means ensuring continuous technological innovation, open trade and investment channels, a global level playing field and non-confrontational relations with the Great Powers, while defining the rules and managing the risks from economic and technological interdependencies. An economic sovereignty strategy that develops a risk spectrum at the intersection of economics, technology and security and clearly positions European interests in the triangular relationship with Washington and Beijing would be a meaningful step towards that goal in 2020.

ENDNOTES

[1] See, for example, US strategic documents (2017 National Security Strategy, 2018 National Defence Strategy) and legislative texts (2018 'FIRRMA' and 'ECRA') or China's 'Made in China 2025' strategy [2] https://icct.nl/wp-content/uploads/2018/10/eu-ct-evaluation-v7-final.pdf
[2] R. Blackwill and J. Harris (2016). *War by other Means. Geoeconomics and Statecraft*. Belknap Press.
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[4]*Financial Times* (13 December 2019). 'Worlds apart: how decoupling became the new buzzword'; E. Rosenberg & D. Cohen (2019). *Strengthening the Economic Arsenal. Bolstering the Deterrent and Signalling Effects of Sanctions*. Centre for a New American Security (CNAS) Policy Brief, December 2019.
[5]A. Roberts, H. Choer Moraes, V. Ferguson (2019). 'Toward a Geoeconomic Order'. *Journal of International Economic Law* 22(4
[6]S. Biscop (2020). *Strategic Choices for the 2020s*. Security Policy Brief No 122 02/2020. Egmont Institute
[7]See, e.g.: J. F. Morin et al (forthcoming). *Environmental provisions in trade agreements: Defending regulatory space or pursuing offensive interests?*; E. Schmieg (2018). *Labour Clauses for Sustainability? Colombian Trade Agreements Exemplify Potential and Limits*. SWP Comment Nr 15, April 2018
[8] A. Bradford (2020, forthcoming). *The Brussels Effect: How the European Union Rules the World*. OUP
[9] H. C. Moraes (2020, forthcoming). *The Geoeconomic Challenge to International Economic Law: Lessons from the Regulation of Data in China*
[10]Huotari & Kratz (2019). *Beyond investment screening. Expanding Europe's toolbox to address economic risks from Chinese state capitalism*. Bertelsmann, Rhodium and Merics.
[11] President Macron's Initiative for Europe: A sovereign, united, democratic Europe. *France Diplomatie*.
[12]S. Biscop (2019). *The Power to Engage: Giving Punch to a new EU Global Strategy 2020*. Security Policy brief No 114. Egmont Institute. September 2019
[13]By means of US unilateral trade instruments, e.g.: Section 232 of the 1962 US Trade Expansion Act; Section 301 of the 1974 US Trade Act
[14] Limited to countries that do not agree to the 'interim arrangement' the EU co-sponsored at the WTO in response to the United States' blockage of the WTO Appellate Body (dispute settlement mechanism) and its subsequent paralysis.
[15] Instrument in Support of Trade Exchanges (INSTEX) is a European special-purpose vehicle (SPV) established in January 2019 in order to facilitate transactions in limited sectors with Iran and to avoid breaching US sanctions
[16] M. Greenwald (2019). *INSTEX: The Future of the Euro*. Harvard Kennedy School Belfer Center for Science and International Affairs, Analysis & Opinions.
[17] US Export Control Reform Act of 2018 (ECRA); US Export Administration Regulations (EAR) or 'Entity List'.
[18] Reuters (6 January 2020). *Trump administration pressed Dutch hard to cancel China chip-equipment sale: sources*.
[19] *New York Times* (27 December 2019). 'Blocked in US, Huawei Touts 'Shared Values' to Compete in Europe'.

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