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THE EU'S QUEST FOR GEOECONOMIC POWER

PURSUING OPEN STRATEGIC AUTONOMY

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- The EU is adapting its policy toolkit under the heading of 'open strategic autonomy', which combines the Union's market-liberal preferences with more assertive economic policies.
- While the EU is largely deploying defensive measures to protect itself from unfair trade practices and economic coercion, it is also increasingly moving towards a more strategic use of economic tools.
- The EU's economic defence capabilities include initiatives to improve competitiveness in key strategic sectors (such as cloud computing, semi-conductors, and pharmaceuticals) as well as instruments to deter, block or retaliate against distortive or coercive measures by other powers.
- The strategic policies of the EU include trade and investment instruments for economic 'binding', such as the new 'Global Gateway' initiative, as well as means for leveraging the attractiveness of access to the single market to promote the EU's norms and interests.
- The EU's recent sanctions against Russia demonstrate the Union's coercive capabilities in the economic domain, and its potential as a geoeconomic power.

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INTRODUCTION

The EU has traditionally put great faith in economic globalization. It has been organized around the relative separation of the economic and security policy realms, a focus on shared economic gains and a positive view of interdependence. The prevailing perspective has been that as states open their economies and specialization takes effect, not only will economic efficiency improve, but states will also come to abandon power politics in favour of cooperation and integration into the liberal, rules-based order. This set-up served the EU well in the post-Cold War era, which saw a deepening of economic liberalization along with the proliferation of international economic agreements.

However, the rise of geoeconomics and the return of geopolitics has put the EU in a difficult bind. Russia's longstanding hybrid interference in the EU and military aggression in Ukraine shows how interdependence cannot be trusted to pacify international relations. Both China and the United States have also been using trade and investment policies as instruments to achieve strategic and security goals. Instead of catalyzing cooperation around mutual gains, the external dependencies of the EU and its member states risk being leveraged by outside powers for power political ends.

The EU's recent historic sanctions against Russia have put economic instruments at the centre of geopolitics. Together with the United States, the EU is attempting to off-set Russia's traditional geopolitics with a unified geoeconomic strategy.[1] By isolating Russia economically, the EU inflicts major pain on Russia without having to confront it militarily. Russia's ability to sustain any long-standing military aggression is weakened by the looming financial crash that Western sanctions catalyze. At the same time, it sends a strong signal to other potential aggressors of the dangers of resorting to geopolitical means.

The challenge with this approach is its decoupling effects, and with that the loosening of economic influence over the longer term. Overextending the use of sanctions may also precipitate an unraveling of globalization as states begin to protect themselves from vulnerability to sanctions and the broader dangers with interdependence.[2] The EU itself has in recent years initiated a set of new policies to hedge against the risks posed by interdependence. A key challenge for EU policymaking is to calibrate sanctions in a way that does not endanger broader trust in economic interdependence outside Russia. Simultaneously it needs to gear up its own resilience without resorting to undue protectionism that would further damage the rules-based trading system on which the EU has thrived.

It is against this context that the ongoing debate around the need to develop the EU's 'open strategic autonomy' should be understood. Under this label, the European Commission is pushing a number of policy initiatives that would allow the EU and its member states to protect and promote their norms and interests while preserving the liberal and multilateral character of the EU economy.

This Briefing Paper analyzes the way that the EU is attempting to adapt to the rise of geoeconomics by surveying the bundle of new policy instruments carried out under the banner of open strategic autonomy. The paper shows how the EU is largely deploying defensive measures to protect itself from unfair trade practices and economic coercion, while also increasingly weighing options for a more strategic use of its economic toolkit, such as the Global Gateway initiative or supply chain controls. The new geoeconomic reality is changing the European Commission's mindset, as shown by its stronger willingness to throw the EU's economic and regulatory weight behind its actions in global politics.

MANAGING INTERDEPENDENCE

Apart from the recent urgency to confront Russia, behind the broader adjustment of the EU's policies is the recognition that the Union needs to be able to better manage its interdependence with the outside world.[3]

1 Wigell, Mikael (2022), 'The carrot and the stick: Geo-economics and Russian revisionism', https://engelsbergideas.com/essays/the-carrot-and-the-stick-geo-economics-and-russian-revisionism/.

2 Fjäder, Christian; Helwig Niklas; Wigell, Mikael (2021), 'Recognizing "geoeconomic risk": Rethinking corporate risk management for the era of great-power competition', FIIA Briefing Paper 314, https://www.fiia.fi/en/publication/recognizing-geoeconomic-risk.

3 Helwig, Niklas (ed.) (2021), *Strategic Autonomy and the Transformation of the EU*, FIIA Report 67, https://www.fiia.fi/en/publication/strategic-autonomy-and-the-transformation-of-the-eu.

The EU's defensive and strategic policies and instruments

Defensive policies	Strategic policies
Internal reforms and investments	Economic binding
Deepening of the single market (*under debate*) Competition policy reform (*under debate*) Industrial policy update European Chips Act (*proposed*) Important Projects of Common European Interest (*IPCEIs*)	External regulatory effects (the "Brussels effect") EU–US Trade and Technology Council Free Trade and Investment Agreements European Neighbourhood Policy The Global Gateway
Countering external coercion and distortion	Promoting values and interests
Foreign direct investment screening Trade defence instrument Blocking statute Foreign subsidies instrument International procurement instrument Enforcement regulation Anti–coercion instrument	Restrictive measures Human rights sanctions Due diligence/supply change controls Export controls European Green Deal/Carbon Border Adjustment Mechanism (CBAM)

Figure 1. The EU's defensive and strategic policies and instruments
Source: The authors' own compilation

Tensions in the Sino–US economic relationship coupled with the Covid-19 pandemic heightened concerns about the EU's dependence on global supply chains. Instead of only repeating the positive mantra of globalization, the concept of strategic autonomy spilled over from defence matters to the EU's external relations more broadly. The need to better weigh the opportunities of global interdependence against its risks took centre stage.

In particular, the EU's trade and investment relationship with China has come into focus. In 2019, the European Commission conceded that despite being an economic partner, China is also a strategic competitor and systemic rival. Member states, such as Germany, which had previously stressed the opportunities from a trade and investment liberalization process with China, grew increasingly worried about Chinese control of critical and strategic industries, such as robotics, microchips, and rare earth metals. Human rights concerns also began changing the relationship, with the Comprehensive Agreement on Investment put on the back burner in early 2021 after the EU had targeted China for human rights abuses in Xinjian and Beijing's counter-sanctions.

The need to manage interdependence is visible in the EU's latest trade and economic initiatives (Figure 1). This does not signify any EU isolationism. Instead, the new initiatives reflect a weighing approach with which the EU seeks to hedge against the risks associated with being an open market economy, while also making more deliberate use of the EU's interdependence with others. It is reflected in the creative coining of the EU's concept of open strategic autonomy, which combines more self-assertive policies with the market liberal and rules-based principles of the European integration process. For that, the EU pursues defensive policies to protect itself from geoeconomics, as well as strategic instruments that aim at leveraging the EU's economic power to promote its interests and norms.

THE EU'S NEW 'ECONOMIC DEFENCE CAPABILITIES'

In order to avoid a situation in which the EU is overly dependent on external economic actors and constrained in its sovereignty to make autonomous decisions, the EU has begun to ramp up its economic defence capabilities, although policy differences persist between member states. A first line of defence has to do with internal reform and investment to make the EU economy more

competitive and resilient. Here a major debate concerns the single market. With support from more market-liberal member states, the European Commission is looking to increase the EU's edge in the ongoing geoeconomic competition by promoting industrial and digital strategies that further liberalize the single market. At the same time, initiatives have also been floated that follow a more market-interventionist philosophy, such as the Franco-German call for an EU competition policy reform to foster 'European champions'. The idea is for the EU to relax its rules on mergers to create globally competitive enterprises in direct response to China's heavily subsidized giant companies. However, this raises eyebrows in the more market-liberal member states, which prefer policies that benefit the "next Spotify" rather than the "established Siemens". The path to a more globally competitive single market is thus not a straight line, but rather characterized by substantial policy debates.

As the Covid-19 pandemic hit Europe, calls inside the EU became more vociferous for reshoring manufacturing as a way to enhance the EU's standing in the geoeconomic rivalry. In the context of its industrial policy update, the EU conducted in-depth reviews on six critical areas (raw materials, active pharmaceutical ingredients, lithium batteries, hydrogen, semiconductors, and cloud and edge computing) to identify potentially problematic dependencies in its supply chains, but also areas where others have dependencies on the EU. Few EU imports were found to be a cause for concern, undermining the voices calling for more drastic state intervention and self-sufficiency. However, as the microchip shortage in 2021 exemplified, shortages in some of the sectors can have detrimental ripple effects through industries. European Commission President Ursula von der Leyen therefore proposed a "European Chips Act" with the aim of increasing the EU's technological sovereignty. The idea is in line with previous policy measures to address strategic dependencies, emphasizing diversification of supply chains in cooperation with like-minded partners, but also stockpiling and pooling member states' resources for Important Projects of Common European Interest (IPCEIs) in next-generation cloud computing, hydrogen, low-carbon industry, pharmaceuticals, and a second IPCEI on cutting-edge semi-conductors.

Another line of defence concerns the countering of external economic coercion and distortion. Herein, the potential security risks related to foreign investment were already recognized earlier. With a strong push from Germany, France and Italy, the Commission proposed an EU-level framework to monitor foreign direct investment in 2017. The proposal was preceded by a sharp increase in Chinese investment in the European tech sector. Unlike the US, the EU's mechanism, which became fully operational in October 2020, doesn't directly imply limiting Chinese investment, but is rather the EU's internal tool for information sharing and creates certain minimum requirements for member states' investment screening. It also applies to all foreign investment that could undermine the continent's security regardless of its origin. Nonetheless, it sent a clear signal to other countries that the EU is serious about mitigating its geoeconomic risks.

In the past few years, there have been several other initiatives designed to protect the EU's interests by limiting access to EU markets, reinforcing the message that the EU is more willing to also use unilateral action in defending its geoeconomic interests.[4] In 2018, the EU sharpened its trade defence instruments to better protect the EU industry from dumped and subsidized imports. The same year, the EU's updated blocking statute came into force as an effort by the EU to protect its companies from the extraterritorial effect of US sanctions. The latest initiative was announced in May 2021 when the Commission proposed a new instrument to address distortive foreign subsidies in the EU's internal market, bringing competition tools to the trade policy arena. When adopted, the regulation gives the European Commission tools to investigate third states' contributions of public resources to companies, in order to prevent them acquiring an unfair advantage in the competition with European companies already subject to more stringent public subsidy rules.

Perhaps the most revealing case of the EU's shifting balance between free trade and state intervention was the agreement reached by the Council in June 2020 after nine years of debate on a new procurement instrument. Once in force, the new International Procurement Instrument (IPI) is meant to give the EU a stronger hand in negotiating to open third countries' government procurement to European business. If reciprocity in market access is not reached by increasing openness in the third country, it will be reached by the EU limiting the access of the country in question to the EU's public procurement markets.

In February 2021, the EU's beefed up enforcement regulation came into force, enhancing the Union's ability to impose countermeasures against third countries

4 Gehrke, Tobias (2021), 'Threading the trade needle on Open Strategic Autonomy', in Niklas Helwig (ed.) *Strategic autonomy and the transformation of the EU* (2021), FIIA Report 67, https://www.fiia.fi/en/publication/strategic-autonomy-and-the-transformation-of-the-eu.

when they violate international trade rules. The scope of the EU's countermeasures was extended for the first time to include services and certain trade-related aspects of intellectual property rights (IPRs), giving the EU more leverage to pressure the US as well by potentially targeting its big tech companies.

However, the enforcement regulation gives the EU powers to act only when it obtains a favourable ruling in the WTO or in its bilateral agreements' dispute settlement. It does not adequately address the rapid use of economic coercion, as exemplified by the Chinese trade embargo on Lithuania late last year. In December 2021, the Commission presented a proposal for a new anti-coercion instrument that would make it possible for the EU to apply trade, investment or other restrictions towards any third country that is interfering in the policy choices of the EU. The intention of the legislation is that, once in place, it would already deter foreign powers from economic meddling. The Commission assures that any counter-action would be in accordance with international law despite acting outside the WTO.

These developments illustrate the fact that there is growing awareness in the EU of the risks stemming from the geoeconomic environment and its potential harm to the EU's sovereignty. To deal with these risks, the EU is showing a new willingness to leverage the internal market policies. How this should be done specifically and where to strike the right balance between state intervention and a more liberal market-oriented model is under debate between the member states. At the same time, the EU is also balancing between two potentially contradictory strategies: defending the multilateral rules-based system and resorting more to unilateral action. As the quest for this new balance continues, the EU's approach to economic defence remains undefined.

THE EU'S STRATEGIC USE OF ECONOMIC POLICIES

In addition to defensive measures, the EU is contemplating ways to leverage its economic power more strategically in its relations with external actors. While the EU has seldom explicitly tried to position itself as a geoeconomic actor, it has exceptional potential for connecting other countries to its economic sphere. The EU has an extensive network of bilateral trade agreements, it is the world's largest donor of development aid, and it is widely considered to have an unmatched ability to influence third countries' regulation. Yet this regulatory power outside of the EU's borders (also called "the Brussels effect"[5]) is mainly achieved through market mechanisms through which global companies, not the EU itself, export the EU's rules around the world as it is cheaper for them to apply the same rules globally. With the EU's share of the global economy now shrinking, the concern is that this global influence based on the large size of the internal market will diminish, especially as much technological development is taking place outside the Union.

The EU's new trade policy strategy, published in February 2021, identifies the need for the EU to strengthen its regulatory influence by developing cooperation. This need is further amplified by the EU's interest in incentivizing nearshoring to diversify its supply chains, which would need to be supported by the alignment of certain rules and standards. However, it remains unclear what the practical implications of this new-found interest in regulatory cooperation are, and whether the EU is willing to develop new models of cooperation for other countries to extend the benefits of the EU's internal market and bind them to the EU's regulatory sphere. Herein, the EU-US Trade and Technology Council can be interpreted as a new means of fostering a common approach to standards connected to the digital transformation. The motivation behind this transatlantic coordination mechanism is not restricted to economic liberalization, but to seeking closer economic cooperation to be able to compete with China on the basis of "shared democratic values".

The EU's bilateral trade and investment deals have considerable strategic potential. Through these deals, the EU has mainly been promoting economic objectives, but at the same time the EU's network of free trade agreements (FTAs) has the effect of binding other states more closely to the Union and its rules and norms. Yet while the EU recognizes this strategic element of the FTAs, the steering effect often remains partial. In December 2020, the EU reached an agreement in principle with China on a new investment deal, the Comprehensive Agreement on Investment (CAI). The investment agreement was mainly pursued to further the EU's economic interests largely independent of any strategic reasoning. Only after the negotiations were concluded did a heated debate ensue inside the EU on the geostrategic impact of the agreement. The EU has always been more strategic in its approach to the countries geographically closest to the Union. Through its enlargement and the European Neighbourhood Policy (ENP), the EU has made it economically

5 Bradford, Anu (2020), *The Brussels effect*, Oxford University Press.

attractive for neighbouring countries to align with EU rules and norms.[6]

Considering the EU's market and regulatory power, and reluctance to use coercive means, geoeconomic binding appears to be a smart approach for the Union. However, the EU needs to recognize the inherently competitive nature of such an approach.[7] In the case of China's Belt and Road Initiative, the EU is still struggling to form a clear response, raising questions about its ability to advance its geostrategic interests – or even identify the underlying goals. The most ambitious EU response to Chinese aspirations was adopted in December 2021 with the presentation of the 'Global Gateway'. This EU framework aims to support infrastructure projects in partner countries and in line with the Union's environmental and social values. Its establishment can already be interpreted as a sign that the EU is willing to insert its principles and values into the global market.[8] Yet the EU's connectivity strategy also showcases how taking a more tactical approach to its "binding agenda" is causing an internal conflict, with member states pushing for a more geopolitical use of the EU's partnership instruments, while the Commission prefers to keep development goals and EU norms at the centre of its partnership programmes.

There is also a discussion on the extent to which the EU can use the attractiveness of its market as a coercive lever to advance interest and values internationally. The most tangible example of this development remains the EU's sanctions policy. Already in the 2010s, the EU's restrictive measures took a qualitative leap. EU sanction regimes used to be limited in scope, addressing mostly democratic backsliding and armed conflicts in third states. By now the EU's sanctions regimes are used in promoting a variety of goals, including nuclear non-proliferation or cyber deterrence. Following the recent Russian invasion of Ukraine the EU showed it is able to introduce biting sanctions with a devastating economic impact on the Russian economy and significant costs at home.

At the same time, the EU is considering a more comprehensive push for human rights and environmental standards abroad through tighter control of international supply chains. National legislation already exists in some member states and for some sectors they require companies to practice due diligence regarding labour and environmental standards towards their foreign suppliers and subsidiaries. In March 2022, the European Commission tabled a proposal for an EU-wide due diligence legislation and even considers a complete ban on goods produced with forced labour. EU export controls on dual-use goods are another way of addressing human rights abuses abroad with the help of trade policy. Five years after the first announcement, the EU updated its export control box in summer 2021 to improve its response to evolving security risks and emerging technologies.

The European Green Deal is not only an attempt to become a global standard-setter on the energy transition. It also triggered a discussion on the extent to which the EU should use coercive economic instruments to push for green goals. The risk of carbon leakage and the reallocation of CO2-intensive production outside of the Single Market led the Commission to propose the introduction of a Carbon Border Adjustment Mechanism (CBAM) in July 2021.

Using the EU's Single Market to push politics and values abroad does not come naturally to the EU. This is a result of its deep commitment to international trade liberalization and strong dependence on international markets. The new agenda also sometimes sits uncomfortably with the EU's obligation to sustain the rules-based international order and multilateralism. Accordingly, the EU is meticulously trying to keep sanctions or trade tools in line with UN and WTO rules. However, the heavy sanctions adopted against Russia show the EU's capabilities in wielding the economic stick and its potential as a geoeconomic power when confronted with a unifying threat.

CONCLUSIONS

In reaction to the rise of geoeconomics, the EU and its policies are currently in a process of transformation. The EU's trade and economic policies had been mostly guided by market principles and the ambition to upload the European experience of a border-free single market to the global scale. With the great-power rivalry unfolding, the EU sees itself forced to adopt the economic playbook of other big powers, to soften its market principles and to follow more interventionist policies. The EU's adoption of defensive and strategic policies is the result that can be observed.

While the blatant violation of international norms pushed the EU to impose far-reaching sanctions on

6 Wigell, Mikael (2016), 'Conceptualizing regional powers' geoeconomic strategies: Neo-imperialism, neo-mercantilism, hegemony, and liberal institutionalism', *Asia Europe Journal 14* (2), pp. 135–151, https://link.springer.com/article/10.1007/s10308-015-0442-x.

7 Wigell, Mikael; Scholvin, Sören; Aaltola, Mika (eds.) (2018), *Geo-economics and power politics in the 21st century: the revival of economic statecraft*, Routledge.

8 Karjalainen, Tyyne (2022), 'The EU's Global Gateway: Building connectivity as a policy', FIIA Working Paper 127. https://www.fiia.fi/en/publication/the-eus-global-gateway.

Russia at short notice, the overall adjustment process remains slow, as international power politics does not come easy to the EU. After all, the idea to depoliticize economic policies and put them in the hands of the supranational, technocratic European Commission was at the very foundation of the European integration project. While this setup enabled the "Brussels effect" and gave EU regulations a global pull, the impact remained largely economic with little intention to wade into geopolitics. Given these path dependencies, the changes in the EU's trade policies as a part of the 'open strategic autonomy' agenda are significant. Whether efforts to defend EU member states against economic coercion by China – or the previously unmatched engagement in preparing very tough sanctions against Russia in anticipation of the invasion of Ukraine – there are signs that the European Commission is in the process of changing its role from that of 'technocratic regulator' to 'geopolitical actor'. The basis of this is a new understanding and willingness in Brussels of the need to actively manage the EU's economic interdependence. /