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Open strategic autonomy and the new geoeconomics: consequences for EU trade policy

Institute for International Trade

Executive Summary

The policy challenge: Under the banner “open strategic autonomy”, the European Commission is pursuing a bundle of economic policy measures aimed at managing Europe’s global interdependence. The European Union (EU) is adapting to the global power competition in the economic policy arena by shoring up its own “geoeconomic” competitiveness across a range of policy areas, ranging from new trade defence and anti-coercion instruments to mechanisms for screening security threats and state-sponsored investment subsidies in foreign investments and acquisitions.

Europe’s open-ended autonomy agenda has exposed divisions among the Member States on how to manage the risks of geoeconomic interdependence while not undermining the trust in the multilateral rules-based trading system on which the EU has thus far thrived. More recently, Europe has gone beyond purely defensive measures, looking over its own capabilities

of projecting geoeconomic influence abroad, with powerful sanctions and export controls, at one end of the spectrum, and with commerce-linked tools, such as supply chain controls and a carbon border adjustment, at the other.

Europe must prepare for an age of reshoring and nearshoring, which promises to challenge as well as recalibrate Europe’s internal political economy concerning the economic power balance between north and south, debtor and creditor, net exporter, and net importer.

The policy response: With the EU’s shares of global economic output and global technological innovation falling, there is a concern that its influence in the world is on the same trajectory. In its new trade strategy, Europe is turning to diplomacy and cooperation. The EU-US Trade and Technology Council serves to foster a common approach to digital transformation based on “shared democratic values”, while the new “Global Gateway” connectivity strategy based on EU social and environmental values rivals China’s Belt and Road Initiative. It is now looking at its network of bilateral trade and investment agreements, the most extensive in the world, to achieve cooperation with “likeminded nations”. The Commission is also developing a new EU industrial policy that will support geoeconomic resilience in the private sector.

This policy brief puts Europe’s geoeconomic turn in context to make the case that while the EU is proving capable at global economic power play,



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the shift towards autonomy is having intra-EU repercussions. In fact, the open strategic autonomy paradigm exposes core differences in political traditions and attitudes to state intervention among its Member States. Europe must prepare for an age of reshoring and nearshoring, which promises to challenge as well as recalibrate Europe's internal political economy concerning the economic power balance between north and south, debtor and creditor, net exporter, and net importer.

Introduction: Europe's "open strategic autonomy"

Europe and the Goeconomic Paradigm Shift

Ahead of taking up office as President of the European Commission, Ursula von der Leyen—now famously—pledged in 2019 to lead a 'geopolitical Commission'.¹ During the three years prior to that pledge, the world had experienced a goeconomic awakening, with the future of the post-World War II international order becoming increasingly uncertain. Under the administration of U.S. President Donald Trump, Europe's political and economic dependency on the United States had come to appear more as vulnerability than as mutually beneficial interdependence. The more adversarial U.S.–China economic relationship post-2017 exposed EU vulnerability to supply-chain disruption, which was further illustrated by the 2020–21 supply chain disruptions related to the Covid-19 pandemic.

Under the label "open strategic autonomy", the European Commission has been pursuing a bundle of economic policy instruments and policy adjustments aimed at better equipping the EU and its Member States to manage Europe's interdependence with the rest of the world.² The reference to "strategic autonomy" is borrowed from the realm of security and defense policy and signifies the aim to avoid a situation in which dependency on non-EU countries might constrain the EU and its Member States from making autonomous policy decisions. The creatively added prefix "open" is meant to reaffirm Europe's continued commitment to market liberalism and the multilateral rules-based order and to dispel suspicions that its pursuit of strategic autonomy portends isolationism or autarky.

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Updating Goeconomic Defenses

The EU's core defenses against goeconomic coercion comprise measures to counter economic coercion arising from international trade dependencies, as well as the risk of coercion, forced technology transfers and economic espionage inherent in foreign direct investments.

As of mid-2022, the European Commission is pursuing a legislative proposal to introduce a new **anti-coercion instrument**. The instrument would authorize the Commission to take countermeasures against non-EU countries implementing or threatening economic coercion towards the EU or its Member States for non-economic geopolitical goals.³ Such coercive policies interfere with the policy autonomy of the EU or the targeted Member States and can take the form of trade and investment restrictions of diverse kinds, as illustrated by the Chinese trade embargo on Lithuania late 2021. The anti-coercion instrument aims to deter non-EU countries from using economic statecraft to bring about a change of policy in the EU. It would allow the Commission to impose trade, investment, or other restrictions as countermeasures against such external policy interference.

The anti-coercion instrument is meant to be applied in accordance with international law, not necessarily according to the disciplines of WTO law. Many types of coercive measures are simply not addressed by WTO disciplines. For example, if an authoritarian state orders domestic travel agencies to stop tourism to a particular EU Member State to exert coercion on that state, WTO disciplines would not be effective in counteracting such informal actions.⁴ In that respect, the instrument can be viewed as a complement to the EU **blocking statute**, an instrument introduced already in the 1990s to protect EU companies from the extraterritorial effect of non-EU sanctions, notably those of the United States. The blocking statute was updated in 2018.⁵

In the area of investment policy, the EU's **FDI screening regulation** aims to give the EU a coordinating role around the screening of investments carried out by some Member States, which allows states to restrict inbound investments on grounds of security or public order.⁶ The regulation that took full effect in 2020 mandates information sharing and cooperation between Member States but neither authorizes the European Commission

to screen investments itself nor obliges Member States to introduce screening mechanisms. Nevertheless, by requiring all Member States, including those who do not have screening mechanisms, to participate in “cooperation mechanisms” that apply to cross-border investment screening cases, the regulation fosters awareness and dialogue among the Member States on the risk of geoeconomic coercion related to investments. This risk is particularly relevant in areas of strategic importance for the maintenance of critical societal functions, such as critical technologies, critical infrastructure, supply of critical inputs, sensitive information, and the media.

While the anti-coercion instrument and the blocking statute address outright attempts at geoeconomic coercion, the FDI screening regulation targets the *risk* of coercion, specifically in the area of investments. Another set of policy instruments is directed towards third-country trade and investment practices that are distortive. Such practices are *de facto* coercive insofar as they systematically weaken the EU economically, including its strategic industries and firms, and thus undermine the EU’s ability to make autonomous decisions. To address such distortive trade and investment practices, the updated EU **enforcement regulation** came into effect in 2021 to improve the EU’s and its Member States’ ability to respond to third countries’ restrictive or discriminatory trade and investment practices that violate international rules.⁷ The update extends the scope of EU countermeasures to services and certain trade-related aspects of intellectual property rights. To impose countermeasures under the regulation, the EU must obtain a favourable ruling in dispute settlement in the WTO or under the relevant international trade or investment agreement.

This contrasts with the EU **trade defence instruments**, which were updated in 2017 and complement the enforcement regulation.⁸ The trade defence instruments address “unfair trade practices” and empower the EU, in line with WTO law, to act unilaterally against dumping and subsidized imports without first bringing proceedings before the WTO.

Given the dysfunction of the WTO, the EU is currently pursuing two additional instruments aimed at addressing distortive trade practices, which could have a coercive impact on EU policy. The first of these

is the EU **foreign subsidies regulation**, which levels the playing field between EU state aid rules and third-country subsidies.⁹ As such, the regulation extends beyond WTO disciplines on subsidies to address distortive subsidies, whereby a non-EU country subsidizes foreign acquisitions of EU companies or gives subsidies to a foreign company to obtain public procurement contracts in the EU. Expected to be adopted in 2022, the regulation empowers the European Commission to screen investments and prevent non-EU countries from granting unfair advantages to foreign companies in the competition with EU companies that are already subject to more stringent public subsidy rules.

With respect to public procurement generally, the new EU **international public procurement instrument**, adopted in June 2022, will regulate non-EU businesses’ access to EU public procurement markets based on reciprocity.¹⁰ If a non-EU country does not agree to improve market access opportunities for EU businesses, goods, and services and to grant EU businesses reciprocal market access to such country’s public procurement and concession markets, the EU will be able to limit access to EU public procurement markets. This reciprocity means that the instrument is both a defensive tool against non-EU countries’ distortive policies and a coercive tool by which the EU can exert diplomatic pressure on non-EU countries to open their markets. To the latter extent, the instrument is not only about safeguarding policy autonomy in a strict sense but also about pursuing the EU’s external trade agenda.

This core set of policy instruments of the “open strategic autonomy” policy agenda is complemented by a second layer of policy measures aimed at encouraging the organic development of EU industrial capabilities in strategic sectors.

Addressing Europe’s Geoeconomic Vulnerabilities

In 2021, the European Commission launched its updated “**New Industrial Strategy for Europe**”, reflecting the experiences of shortages in the supply of critical inputs during the critical stage of the Covid-19 pandemic, as well as an openness to incentivizing reshoring and nearshoring in certain sectors.¹¹ The strategy identifies six critical areas (raw materials, active pharmaceutical ingredients, lithium

batteries, hydrogen, semiconductors, and cloud and edge computing) to be reviewed for dependencies and resilience in EU supply chains.

To operationalize the New Industrial Strategy, the European Commission proposed revised state-aid derogations under its Communication on “**important projects of common European interest**”.¹² This communication sets criteria for member-state support of projects that contribute to EU strategic objectives and has been applied in the battery and microelectronics sectors, as well as in research and development.

Although the mandated reviews under the New Industrial Strategy found few EU imports to be a cause for concern, shortages in some of the sectors could have detrimental effects on industry, as illustrated by the microchip shortage in 2021. As a result, the European Commission tabled a proposal in February 2022 for a “**European chips act**”, which would direct public investments with the aim of lessening the EU’s strategic technological dependencies in the semiconductor industry.¹³

Further reforms that are currently under consideration in pursuit of Europe’s “open strategic autonomy” agenda include reforms to further liberalize the single market in ways that would support EU industrial capabilities and digitalization.¹⁴ Competition law reform that would relax current merger rules and restrictions against the build-up of market concentration is also included.¹⁵ The aim of the latter would be to foster the emergence of globally competitive EU enterprises in response to today’s model of monopolistic competition in the technology sector, as exemplified by the U.S. tech giants, as well as China’s heavily subsidized giant companies. The ideal of a middle ground between perfect competition and monopoly centered on product differentiation and limited market power seems to belong to a bygone era.

Projecting Europe’s Geoeconomic Power Abroad

Ironically perhaps, the combination of economic openness and strategic autonomy makes it impossible to achieve the latter goal by relying only on defenses against geoeconomic coercion. Europe cannot pursue an autonomous climate policy, for example, without extending its

climate regime to third-country imports. Open strategic autonomy is not a policy of self-sufficiency but one of self-defence when needed and proactive external policy, as needed to allow the EU to be a genuine global actor in a contested world. Currently, market access is the EU's main tool for influencing others, one that is effective but limited when dealing with issues such as economic coercion. A broadened geoeconomic policy toolkit is needed to allow the EU to project influence in an increasingly power-based, as opposed to rule-based, world.

In recent years, the EU has ramped up its use of defensive geoeconomic coercion. It has used **restrictive measures (economic sanctions)** to defend the international rules-based order, including in cases of human rights abuse.¹⁶ The EU's unprecedented sanctions against Russia in 2022 aim to offset Russia's hybrid geopolitics with a unified geoeconomic strategy. 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.

Sanctions are complemented by **export controls**, including on dual-use goods, as another way of using trade policy to address human rights abuses abroad and a variety of other geopolitical goals, including nuclear non-proliferation or cyber deterrence. In 2021, the EU updated its export control instrument to improve its response to evolving security risks and emerging technologies.¹⁷

However, sanctions and export control are not the only economic tool used by the EU to lend weight to its non-economic policy aims. The EU has long pushed for human rights and environmental standards abroad through other means, including in its international trade and investment agreements. The EU is currently considering a more comprehensive oversight and regulation **of international supply chains**, similar to national legislation already used by some Member States requiring companies to monitor the labour and environmental standards of their foreign suppliers and subsidiaries. In February 2022, the European Commission tabled a proposal for an EU-wide supply-chain due diligence legislation and is even considering a complete ban on goods produced with

forced labour.¹⁸ While strongly supported by the European Parliament, the scope of the due diligence proposal has been a matter of debate among the Member States, with some arguing that downstream value chains and the financial sector should be excluded. Including downstream would mean that companies would be liable not only for violations of human rights and environmental standards in connection with products or services they procure but also if their own products or services are used in a harmful way, such as with respect to environmental protection or public health. With respect to climate policy, the European Commission proposed in 2021 the introduction of a **carbon border adjustment mechanism** that would discourage the reallocation of CO₂-intensive production outside of the European Union while encouraging non-EU countries to live up to internationally agreed climate commitments.¹⁹

The challenge with using these geoeconomic instruments is their potentially decoupling effects on international trade and investments²⁰ and the risk of a loosening of EU economic influence over the longer term. Expanding the use of sanctions, including human rights sanctions, export control, supply-chain control, and border adjustments, poses a risk of unravelling globalization as countries begin to build resilience against risks of coercion.

Another set of geoeconomic policies and instruments seeks to deepen interdependence. The EU has long recognized its Single Market as its most weaponizable asset, which gives exceptional potential for **market access control** that it can strategically leverage in its relations with external economic actors and third countries.²¹ Since the EU remains committed to openness in international economic relations, access to the single market is controlled by regulation. Given the large size of the EU market, this gives the EU an unparalleled ability to set global standards, build dependencies, and influence third countries' regulation that way (the "Brussels effect").²²



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Policy response: Europe's adaptation to the new paradigm

The Quest for Allies

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.²³ 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.

The **EU-US Trade and Technology Council** can be interpreted as a new means of fostering a common approach to standards connected to digital transformation.²⁴ 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".²⁵

The EU's geoeconomic capabilities are complemented by an extensive network of bilateral trade agreements, the world's largest network of bilateral investment agreements, and by being the world's largest donor of development aid. Although the EU has not primarily pursued non-economic objectives through its **bilateral trade and investment agreements**, these agreements have the effect of binding other states more closely to the EU and its rules and norms.²⁶

The EU has always been more strategic in its approach to the countries in its geographical vicinity. Through its enlargement and the **"European neighbourhood policy"**, the EU has made it economically attractive for neighbouring countries to align with EU rules and norms.²⁷ In recent years, this policy has been challenged by China's Belt and Road Initiative, to which the EU is still struggling

to form a clear response. However, in December 2021, the European Commission launched the **"Global Gateway"**, a connectivity strategy aimed at supporting infrastructure projects in partner countries and in line with the EU's environmental and social values.²⁸

Europe's Looming Existential Crisis, or Not?

The rise of geoeconomics and the return of geopolitics has put the EU in a difficult bind. Internally, the EU depends on rules-based openness. Intra-EU economic interdependence is the very essence of the European integration process. Externally, the EU maintains balanced trade and investment flows with the rest of the world. However, individual Member States are dependent on trade with non-EU countries to varying degrees. A risk-balanced approach to external economic interdependence would result in decoupling effects and would further undermine the trust in the multilateral rules-based trading system under which the EU has thrived. After all, "open strategic autonomy" is

a goal, not a reality, precisely because Europe lacks geoeconomic resilience and is heavily dependent on external trade and investments.

As the EU has begun to increase its geoeconomic resilience, deep-rooted differences persist between Member States. Intense debates among the Member States have marred the formulation of the “open strategic autonomy” agenda and the progress on designing, adopting, and implementing the policy instruments resulting from it. The very label “open strategic autonomy” reveals an inherent compromise between those Member States who are more willing to assert the EU’s economic power and those traditionally more committed to market liberalism. Nevertheless, even long-term supporters of ever deepening economic globalization are seeing the world anew in recent years.

From 2016, Member States, such as Germany, which had previously stressed the opportunities from a trade and investment liberalization process with China, have grown increasingly worried about Chinese control of critical and strategic industries, such as robotics, microchips, and rare earth metals. These concerns were given particular attention in connection with the “Made in China 2025” strategy and the Chinese goal to take a leading role of the standardization in critical technologies, notably 5G wireless technology.²⁹ In 2019, several EU Member States decided to exclude Chinese telecommunication vendors Huawei and ZTE from providing equipment for 5G networks, citing cybersecurity concerns.³⁰ Human rights concerns also began changing the relationship, with the China–EU 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.³¹

While both China and the United States have been using trade and investment policies as geoeconomic instruments for some time, it is Russia’s hybrid interference in the EU and military aggression in Ukraine that has most convincingly demonstrated how longstanding interdependence cannot be trusted to pacify international relations. The Russian experience shows that, instead of catalysing cooperation around mutual gains, the external dependencies of the EU and its Member States can be leveraged by outside powers for geopolitical ends.

The Challenge Ahead: Europe’s Overlooked Internal National Economic Power Structure

As discussed, Europe’s capacity to project geoeconomic power is a prerequisite to achieving autonomy without autarky. This in turn implies a willingness to weaponize its economic interdependence with the rest of the world, as recent initiatives to introduce sustainability related supply chain controls, market access controls, and border adjustments (such as carbon border adjustments) illustrate. These measures are not about making Europe self-sufficient but will necessarily result in compliance costs. If those costs cannot be passed on to non-EU exporters, service providers, or investors, doing business abroad will be comparatively less advantageous relative to doing business at home. Moreover, the New Industrial Strategy encourages reshoring and nearshoring in strategic sectors of the economy.

How will reshoring of economic activity affect the balance of economic power in Europe? Will manufacturing migrate from low-cost locations outside the EU to low-cost locations within? If the German industry shifts some of its Chinese imports to, e.g., Spain or Romania, how will that affect the intra-EU growth rates, debt flows, and trade balances? Will reshoring accelerate investment in automation? How will the structure of economic interdependence among the Member States change and will that *shift the balance of politico-economic power* within the Union?

We do not have definitive answers to such questions, but we can be sure there will be winners and losers. Member States that are relatively better at attracting investments in Fifth Industrial Revolution (Industry 5.0) manufacturing,³² for example, through better-funded research, more efficient and reliable legal systems, and the encouragement of risk taking, such as the Netherlands and the Nordics,³³ may be among the winners. But so may those Member States that are able to compete for low-labour cost production.

However, the new industrial landscape of Europe may look like, chances are that the economic relations between the Member States will change. If that change points towards increased levels of economic interdependence among the Member States to offset lower economic interdependence vis-à-vis non-EU countries, the Union will likely be strengthened. But its character may be significantly changed.

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