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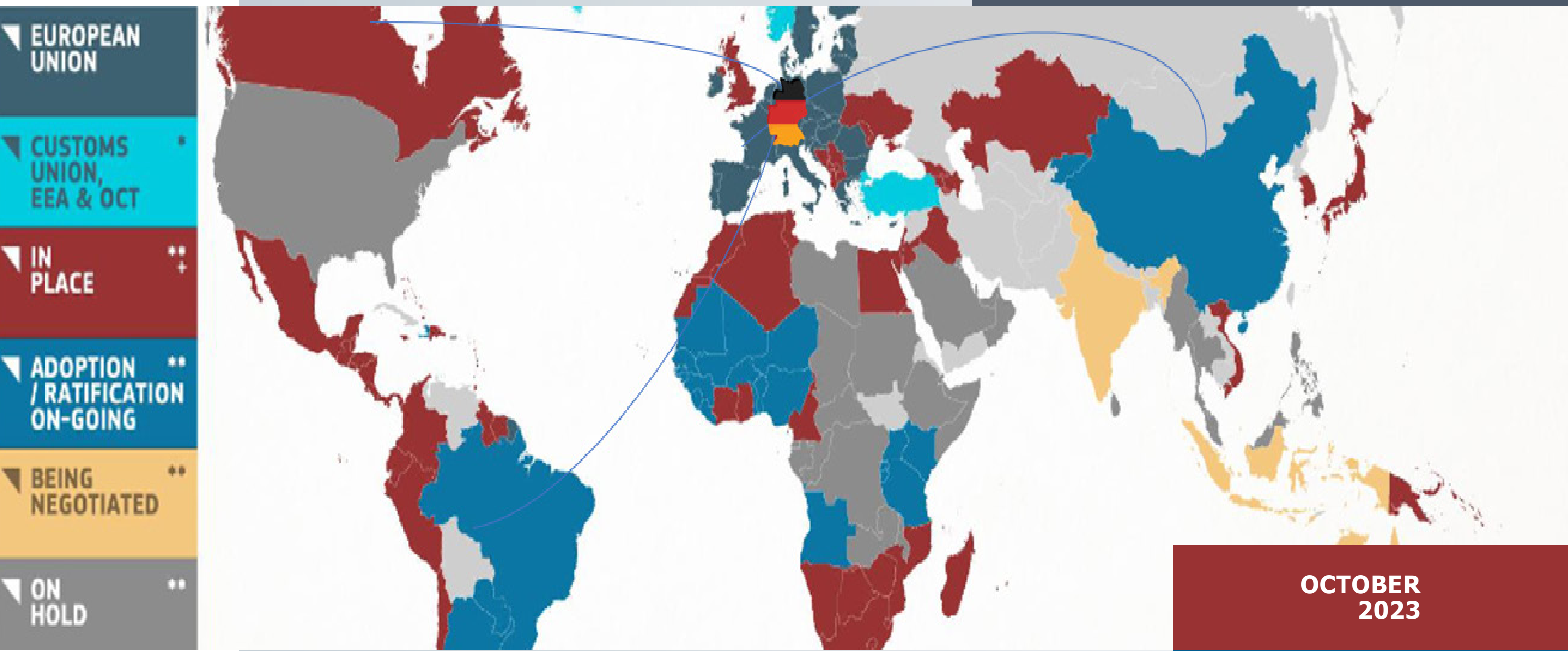

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Towards a New European Trade Strategy in Times of Geopolitical Upheaval

The German Perspective

Klemens KOBER

The Study Committee on Franco-German relations (Cerfa)

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The views expressed in this paper are those of the author only.

Abstract

As one of the most successful trading blocs, the EU sees itself confronted with the erosion of the global rules-based trading system and trade becoming increasingly weaponized. The ongoing US-China decoupling and the Russian war in Ukraine have reinforced the debate about European sovereignty and economic security, with wide-ranging consequences for the EU's economic model and its trade relations with third countries. Recalibrating the degree of the EU's economic openness involves new approaches on multilateralism, bilateral trade agreements and autonomous trade instruments. This paper looks at how Germany as an internationally highly interconnected country is directly affected by all these developments and thus tries to both adapt its own position and help shape a new European trade strategy. This will be of high relevance for both the new European Commission and European Parliament after the European elections in 2024.

Table of Contents

Against the backdrop of increasing weaponization of trade: a shift toward Open Strategic Autonomy?

The German satirist Kurt Tucholsky stated[1] in 1931: "As far as the world economy is concerned, it is intertwined." This once seemingly obvious observation is increasingly being challenged by a great upheaval in geoeconomic relations – with big implications for both the EU and Germany. Calls to reduce economic interdependence in favor of economic independence keep growing louder around the globe. The EU and its member states are one of the founding pillars of the rules-based global trading system; the European economy is highly interconnected globally. So is Germany. The EU has so far focused on making use of the global division of labor and promoting it. Yet this model was never unquestioned and has increasingly come under stress: the multilateral rules-based system in the form of institutions like the World Trade Organization (WTO) has been slowly eroding, and protectionist tendencies increased globally after the 2007 financial crisis and through the ongoing US-China decoupling. The Covid-19 pandemic and the Russian war in Ukraine have highlighted vulnerabilities of global value chains.

The 2016 US election in particular prompted the EU to advance a more strategic reflection on how to position itself globally. The current EU *leitmotiv* "Open Strategic Autonomy" (OSA) and a new economic security strategy are still subjects of much discussion but mark a clear shift away from previous trade strategies. Together with stronger industrial policies, they stand for a more state-interventionist approach in the economic sphere: trade is becoming increasingly weaponized, triggering countries to analyze trade ties through the lens of "strategic dependencies". "De-risking" is the new EU pathway to reshape global value chains in strategic sectors and to diversify and secure relevant trade relations. This includes both unilateral measures in the realm of trade defense and sustainability, and cooperation with partners through trade agreements. Germany, as an internationally highly interconnected country, is directly affected by all the above developments and thus tries to adapt its own position and help shape

1. K. Tucholsky, "Kurzer Abriss der Nationalökonomie", *Die Weltbühne*, September 15, 1931, p. 393.

a new European trade strategy, which should be a high priority for the upcoming European Commission and European Parliament after the 2024 European elections (in the same year as the US presidential elections).

The EU's and Germany's role in global trade

GERMANY AS A MOTOR FOR THE TRADE CHAMPION EU	
Number of consumers in the EU	440 millions
EU's share in world imports and exports	14%
EU's rank in global manufacturing goods trade	2nd
Number of EU jobs supported by EU exports	38 millions
Share of jobs in the EU depending on EU exports	1/5
Percentage of jobs in Germany depending on exports	27%
Germany's rank in per capita exports	16 (ahead of the US with 49 or China with 76)
Germany's rank in global exports or imports	3
Germany's trade openness ratio	89,4% (the highest of the G7)
Germany's trade surplus in 2022	127.6 bn EUR (the highest within the EU)

Global trade is central for both the European Union (EU) and Germany economies and their respective policymaking. Since the creation of the European Customs Union in 1968, the Common Commercial Policy is decided at the European level; this has turned the EU into a major negotiating power, given the size of all the member states' economies combined. To better understand the potential impacts of economic security strategies, it is useful to recall the importance of the international division of labor for the EU, and *vice versa*.

According to a recent DHL study, Europe is the most globally connected region; it includes, 8 of the 10 most globally connected countries (including Germany).[2] It is the top trading partner for around 80 countries (the US is the same for around 20 countries). Combining goods and services, the EU was the world's greatest goods and services trader in 2021 (16%). EU exports support 38 million jobs; one in five jobs in the EU depends on exports. In 2022, 49% of the EU's exports used the Euro, while 42% of imports did so.[3] Intra-regional merchandise trade represented 65% of Europe's world trade in 2022 – the highest level compared to other world regions.[4] The US and China together account for one-third of EU foreign trade.

Top 10 EU Trading Partners 2022

Trade	Export	Import
USA: 16%	USA: 20%	China: 21%
China: 15%	UK: 13%	USA: 12%
UK: 10%	China: 9%	UK: 7%
Switzerland	Switzerland	Russia
Russia	Turkey	Norway
Norway	Japan	Switzerland
Turkey	Norway	Turkey
Japan	South Korea	South Korea
South Korea	Russia	Japan
India	Mexico	India

2. S. Altman and C. Bastian, "DHL Global Connectedness Index 2022", DHL, February 2023, p. 7, available at: www.dhl.com (last accessed, September 17, 2023).
3. "Extra-EU Trade by Invoicing Currency", Eurostat, May 2023, available at: https://ec.europa.eu/ (Last accessed, September 17, 2023).
4. "World Trade Statistical Review", World Trade Organization, 2023, p. 11, available at: www.wto.org (last accessed, September 17, 2023).

Globally, the EU ranks first in both inbound and outbound international investments. In 2021, 36.2% of global inward investment was located in Europe (€14.5 trillion), while it accounted for 42.2% of global outward investment stocks (€15.6 trillion).[5] In 2021, the EU was a net investor, as the flow of foreign direct investment (FDI) abroad was €262 billion higher than the level of inward investment. Major FDI partners were the USA and UK (see Annex 1), accounting for half of both outbound and inbound EU FDI. China accounted for only 0.9% of inbound FDI and 2.5% of outbound FDI.

Germany as driving force for EU trade

The German economy is highly export-oriented; 27% of its jobs depend on exports; for manufacturing, the share is 56%. At the same time, Germany has scarce resources and is dependent on imports – especially regarding energy. Globally, Germany ranks 16 for per capita exports, ahead of the US (49) and China (76). While only 1.1% of the global population are German, Germany represented 7.3% of global exports in 2021. It is number three in global exports and imports. As regards the trade openness ratio, Germany has the highest ratio in the G7 (89.4% in 2021).[6] China, the US and the Netherlands were Germany's main trading partners in 2022; 52% of German foreign trade took place within the EU.[7] Germany had the largest goods trade surplus in the EU, valued at €127.6 billion in 2022 – Germany's lowest surplus in 22 years (mainly due to the high costs of energy imports).[8] Germany also has a trade surplus in services trade. Yet its exports-to-GDP ratio (50.3%) was lower than the EU average (55.9%) but remarkably higher than that of the US (11.7%) and Japan (21.5%).

5. "World Direct Investment Patterns", Eurostat, July 2023, available at: https://ec.europa.eu/ (last accessed, September 17, 2023).
6. "Fakten zum deutschen Außenhandel", Federal Ministry for Economic Affairs and Climate Action, July 2022, p. 1, available at: www.bmwk.de (last accessed, September 17, 2023).
7. "Außenhandel Die Volksrepublik China ist erneut Deutschlands wichtigster Handelspartner", Destatis, 2023, available at: www.destatis.de (last accessed, September 17, 2023).
8. "International Trade in Goods", Eurostat, September 2023, available at: https://ec.europa.eu/ (last accessed, September 17, 2023).

Top 10 German Trading Partners 2022

Trade	Export	Import
China: 10%	USA: 10%	China: 13%
USA: 8%	France: 7%	Netherlands: 8%
Netherlands: 8%	Netherlands: 7%	USA: 6%
France	China	Poland
Poland	Poland	Italy
Italy	Austria	France
Austria	Italy	Belgium
Switzerland	UK	Norway
Belgium	Switzerland	Czech Republic
Czech Republic	Belgium	Austria

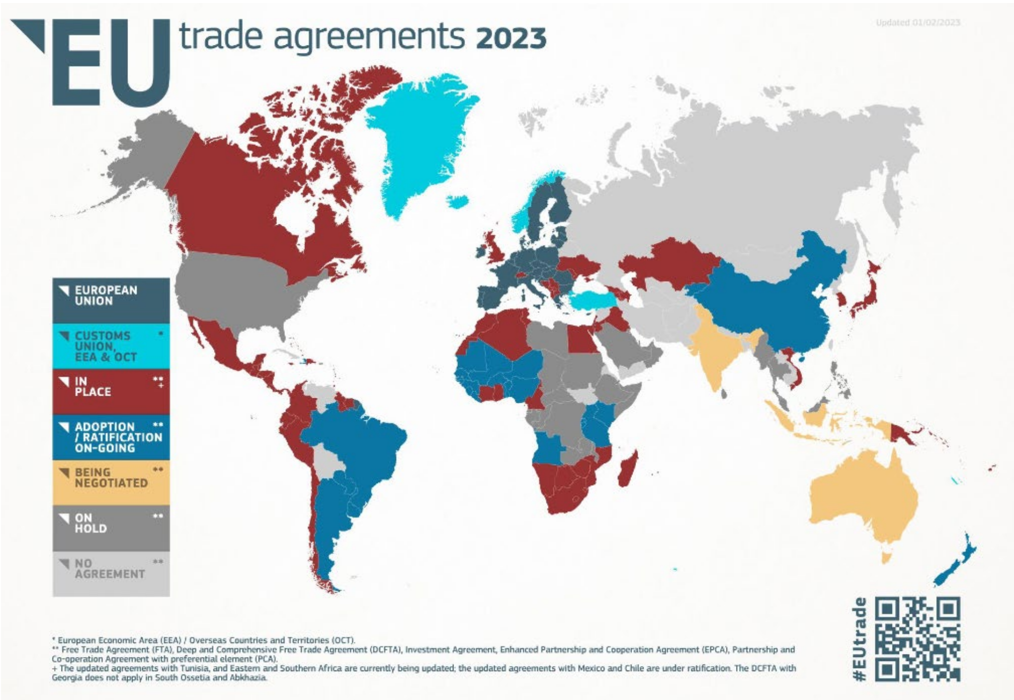
In 2021, 41,601 German companies had invested nearly €2 trillion abroad (see annex 2), employing almost eight million workers; 45% of this FDI stayed within the EU. At the same time, 17,370 foreign companies had invested €900 billion in Germany, accounting for more than three million jobs; 64% of this FDI originated in the EU.

Germany is a driving force for EU trade which has implications for EU's trade policymaking.

Implications for EU trade policy

Considering the size of its trade at the global level, the EU has a major interest in concluding trade agreements with partners to ensure predictability and to secure a rules-based international trading system and functioning institutions. While expanding global market access and updating the WTO rulebook are still important goals of the EU, since the breakdown of the WTO-Doha negotiations in 2003, the EU like other countries, has been increasingly active in negotiating bilateral trade deals covering especially market access for goods and services, public procurement, intellectual property, and investment. These agreements stabilize trade relations and give businesses competitive advantages through preferential market access – global economic growth is mainly happening outside of Europe – as well as certainty for investing and managing their supply chains. Being confronted with global competition also forces companies to stay innovative, seek efficiency gains, and gives them access to new technologies.

The EU currently has 42 preferential trade agreements in place with 74 partners.[9] Additionally, 64 developing countries are granted preferential access to the EU; 71% of imports entered the EU at zero or reduced tariffs in 2022; for Chinese imports this figure was at 45%, for US imports at 72%.[10] A total of 44% of EU trade is covered by preferential EU trade agreements. The rest, which includes the US, China, and India, is only secured through WTO rules (except for a handful of non-WTO members). The EU's biggest preferential partners are the UK, Switzerland, and Turkey, followed by Norway, Japan and South Korea. Except for the UK, EU trade grew stronger with free-trade agreement (FTA) partners than with other third countries over recent years.



Overview Of EU Trade Agreements 2023[11]

*Sources: * European Economic Area (EEA)/ Overseas Countries and Territories (OCT).*

*** Free Trade Agreement (FTA), Deep and Comprehensive Free Trade Agreement (DCFTA), Investment Agreement, Enhanced Partnership and Cooperation Agreement (EPCA), Partnership and Co-operation Agreement with preferential element (PCA).*

+ The updated agreements with Tunisia, and Eastern and Southern Africa are currently being updated; the updated agreements with Mexico and Chile are under ratification. The DCFTA with Georgia does not apply in South Ossetia and Abkhazia.

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9. "Annual Implementation and Enforcement Report 2022", European Commission, October 11, 2022, p. 3, available at: https://ec.europa.eu/ (last accessed, September 17, 2023).
10. "International Trade in Goods – Tariffs", European Commission, June 2023, available at: https://ec.europa.eu/ (last accessed, September 17, 2023).
11. "Map of EU Trade Agreements", European Commission, February 1st, 2023, available at: https://circabc.europa.eu/ (last accessed, September 17, 2023).

The EU has an ambitious FTA-agenda with quite comprehensive agreements in terms of coverage. Agreements with Chile, Mexico, New Zealand and Kenya might soon be ratified, while negotiations with Mercosur, Australia, Indonesia, India, and Thailand are ongoing. EU trade agreements are more comprehensive than those of many other countries, including on market access and disciplines. In accordance with the EU's multilateral culture, it has been a frequent and successful user of the WTO dispute mechanism. Yet, given the ongoing erosion of this mechanism, unilateral trade defense instruments became more important for the EU. At the end of 2022, there were 177 trade defense measures in place – mostly targeting China, Russia, India, South Korea and the US.[12] At the end of 2021, the EU listed 455 official trade barriers in 65 third countries, most of them in China, Russia and the US.[13]

The German Foreign Trade and Payments Act's first sentence clarifies that international trade is in principle free.[14] Germany has traditionally been a steadfast supporter of the EU's free-trade agenda, as well as robust trade defense measures in especially relevant sectors. Germany was, for example, instrumental in getting the negotiations on the EU-China Comprehensive Agreement on Investment over the finishing line, and blocked the International Procurement Instrument[15] (which allows the EU to link access to its big and quite open public procurement market to third countries doing the same in their respective markets) for many years because it feared it would be closing off the European procurement market too much. Before Brexit, the Council majorities were often rather balanced between "free traders" and "protectionists", allowing Germany to play the role of an honest broker between the two camps. Since Brexit, however, the Council has moved into a more protectionist direction putting Germany in a more difficult spot to decide on a case-by-case basis how far to favor a Franco-German approach or to confront France by vocally joining the free-traders' camp.[16]

The EU's latest trade strategy from 2021 lays down the EU's trade policy goals for multilateral, plurilateral, bilateral and unilateral undertakings. In doing so, it takes account of some of the latest geopolitical

12. "EU Trade Defense Report 2022", European Commission, September 6, 2023, p. 2, available at: https://ec.europa.eu/ (last accessed, September 17, 2023).

13. "Annual Implementation and Enforcement Report 2022", European Commission, October 11, 2022, p. 34, available at: https://ec.europa.eu/ (last accessed, September 17, 2023).

14. "Außenwirtschaftsgesetz", Federal German Government, August 25, 2021, p. 4, available at: www.bmwk.de (last accessed, September 17, 2023).

15. "EU International Procurement Instrument, Briefing", EU Legislation in Progress, European Parliament Research Service, November 2022, available at: www.europarl.europa.eu.

16. C. Schmucker and K. Kober, "Offene strategische Autonomie", Deutsche Gesellschaft für Auswärtige Politik, December 10, 2021, available at: https://dgap.org/de/ (last accessed, September 17, 2023).

changes, insisting on more European "assertiveness" and "resilience".[17] Also, enforcement of rules and agreements became a new trade theme, with the EU even installing a new "Chief Trade Enforcer". These developments are echoed by Germany's first National Security Strategy presented in June 2023, which is focused around the three key concepts of "robustness", "resilience" and "sustainability", and in which the German government takes full stock of new geo-economic realities.

17. See "Trade Policy Review", European Commission, February 18, 2021, available at: https://ec.europa.eu/ (last accessed, September 17, 2023).

New Geo-Economic Realities

In times when the need for global public goods becomes more apparent – be it in relation to climate change, pandemics, or AI regulation – protectionism and anti-globalization public and political discourse are on the rise. In 2022, there were 3,000 new trade and investment restrictions, up from 1,000 in 2019. The EU recalibrated its trade strategy accordingly and lowered expectations for new trade liberalization, be it at the WTO, with the US, or with China. The EU's heightened sustainability agenda also meant that trading partners asked for higher EU concessions in FTA negotiations or refused them altogether.[18] An example highlighting the EU's confronting of criticism over what is decried as EU unilateralism is its level of ambition regarding sustainability, very well illustrated through the Carbon Border Adjustment Mechanism or the deforestation regulation, as documented by the difficult negotiations on the EU-Mercosur trade agreement.

Furthermore, the Covid-19 crisis exacerbated an increasing trend toward trade protectionism and state interventionism. It led to a scramble for critical goods and, an increase in prices, and highlighted dependence on external markets, the risk of supply-chain disruptions and the limits of a just-in-time economy. These trends were underway even before the coronavirus crisis as the tariffs race between China and the US as well as the technological decoupling of both economies edifyingly showed, but Covid-19 acted as a catalyst. The peak of the crisis, as far as free trade is concerned, was illustrated by export bans on food and essential health goods, and even toilet paper. This rattled the Single Market as well when member states, including Germany, introduced intra-EU trade restrictions.

18. "Projet d'accord de libre-échange Europe-Mercosur : les négociations virent à l'aigre", *Le Monde*, September 15, 2023, available at: www.lemonde.fr.

A NEW GEOECONOMIC REALITY: EU TRADE DEFENSE MECHANISMS AND TRADE AND INVESTMENT RESTRICTIONS		
Number of trade defense measures in place in the EU (2022)		177 (mostly targeting China, Russia, India, South Korea & US)
Number EU official trade barriers in third countries		455 in 65 countries (most of them in China, Russia and the US)
Number of new trade and investment restrictions (2022)		3,000

As a consequence, the WTO was challenged during the Covid-19 crisis. After the crisis peak, however, many trade restrictions were lifted. The Russian war in Ukraine was an even bigger external shock leading to a major rethink in Brussels. To the surprise of many, the EU moved swiftly to severely restrict trade and investment, with (so far) 11 sanctions packages targeting its key energy supplier Russia – all supported by Germany, which was heavily dependent in this respect. In 2020, Germany imported 50% of its gas, 34% of its oil and 45% of its coal from Russia, but completely phased out these supplies within less than a year after the start of the war. While such decoupling was politically completely unthinkable before the war, other EU member states vetoed measures – on the nuclear or diamond trade, for example – that would have affected their economies similarly. The Russian share in EU energy imports decreased from 27% in the first quarter of 2021 to 4.4% in the second quarter of 2023.[19] Before the war, Russia used to supply more than the US, Norway, and the UK combined. The value of EU exports to Russia fell by 61% between February 2022 and June 2023, while imports from Russia fell by 84% in this period.[20] Few believed that decoupling with Russia would be feasible, but it happened. At the same time, two-thirds of the world population live in countries that have not joined the sanctions regime against Russia.

The elephant in the room is the outlook for the great-power rivalry between the US and China, which might lead to a similar level of trade restrictions between the EU's top two trading partners. While "*Wandel durch Handel*" (change through trade) – the expectation of liberalizing economies and societies going hand in hand – was mainstream thinking when China entered the WTO in 2001, it now seems a model from a distant past. US National Security Advisor Jake Sullivan's Brookings speech in 2023 called for a "new Washington consensus" shifting towards a more

19. "EU International Trade in Goods - Latest Developments", Eurostat, August 2023, available at: https://ec.europa.eu/ (last accessed, September 17, 2023).
20. "EU Trade with Russia - Latest Developments", Eurostat, August 2023, available at: https://ec.europa.eu/ (last accessed, September 17, 2023).

state interventionist and less free trade approach.[21] US Trade Representative Katherine Tai similarly advocated trade ties to advance greater national and economic security.[22] Other US-officials go so far as to say: "We don't see tariffs as being at the core of trade policy. We don't see trade policy as being at the core of international economic policy".[23] For many trading partners, this translates to « buy American, invest American, employ American workers », but also to a world of more politicized trade relations. The US increasingly sees all policy choices through the lens of strategic competition with China. In fact, the increasingly important geoeconomic school of thought sees economy as an arena of competition between states, as opposed to market-driven activity. Trade thus becomes a potential source of vulnerability, while mitigating risk through a state-led economic statecraft becomes a new priority.[24] Power and security replace trade and rules. The jury is still out on how permeable the new power blocks will be and for which types of economic interaction.

Decision-makers therefore prepare for a world of geoeconomic fragmentation, putting an end to an efficiency-driven globalization that helped raise millions out of poverty (although the distribution of the benefits of globalization in many countries has been insufficient), and allowed for rapid technological advances to be shared around the globe. However, this is not a smooth process of slowly untangling trade ties; it is much messier, like trying to disentangle cooked spaghetti. According to the WEF Global Risks Report 2023 "Economic warfare is becoming the norm".[25] The writing is on the wall: The WTO's 2023 World Trade Report shows that since the Russian war in Ukraine, trade between geopolitical allies grew 4-6% more than among geopolitical adversaries, indicating an ongoing fragmentation process towards like-minded trade and investment blocks.[26] On the one hand, the US has pushed back hard against allies joining China-led initiatives like the Belt and Road Initiative and is setting up partnerships to limit China's access to cutting-edge technologies (as the agreement in January 2023 between the US, Netherlands and Japan, restricting exports of highly competitive semiconductor technology to China, illustrates). On the other hand, China for many years has been following a long-term "Dual Circulation" strategy combined with "Made in

21. J. Sullivan, "Remarks on Renewing American Economic Leadership", White House, April 27, 2023, available at: www.whitehouse.gov (last accessed, September 17, 2023).
22. K. Tai, "Remarks on Supply Chain Resilience", Office of the United States Trade Representative, June 15, 2023, available at: https://ustr.gov/ (last accessed, September 17, 2023).
23. G. Bade, "'Bidenomics' is Going Global. The World is Skeptical", *Politico*, September 08, 2023, available at: www.politico.com (last accessed, September 17, 2023).
24. See D. Flatley, "Former Biden Adviser Explains Economic Statecraft", *Bloomberg*, September 04, 2023, available at: www.bloomberg.com (last accessed, September 17, 2023).
25. "WEF Global Risks Report 2023", World Economic Forum, January 11, 2023, p. 7, available at: www.weforum.org (last accessed, September 17, 2023).
26. "World Trade Report 2023", World Trade Organization, September 12, 2023, p. 32, available at: www.wto.org (last accessed, September 17, 2023).

China 2025" to shield an inner economic circle from foreign influence and shocks. It is also trying to position a BRICS+ alliance as an anti-G7 club. Thus *status quo* powers are increasingly confronted with countries challenging the existing multilateral rules-based system. This is highly relevant regarding the trend of securitization of resources, e.g. through export restrictions and local content requirements. Many resource-rich countries have become more self-confident, and demand higher concessions than previously for access to their goods.

Since Germany's economy is internationally highly interconnected with an important industrial sector and scarce domestic resources, these trends amount to a perfect storm. Increasing fragmentation of the global trade landscape involving its key partners, mercantilist policies and economic nationalism gaining traction, and a lingering energy crisis push many companies to offshore. A recent German Chamber of Commerce and Industry (DIHK) survey found that 32% of German industry companies plan to relocate abroad.[27] Companies have to price geopolitical uncertainty into their calculations and like Germany and the EU, increasingly face requests to "take a side". The German government, while not monolithic in its positioning, is clearly following this trend. Foreign Minister Annalena Baerbock thus declared that trade policies are also security policies.[28] While German Chancellor Olaf Scholz coined the term "Zeitenwende" (turning point) to signal a major shift in German policies following the Russian war in Ukraine, it is yet to be seen to what degree this will translate into a reshaping of the German business model. Current discussions at EU level are key to this.

27. U. Beland and Dr. S. Bolay, "IHK-Energiewende-Barometer", German Chamber of Commerce and Industry, August 29, 2023, p. 5, available at: www.dihk.de (last accessed, September 17, 2023).
28. A. Baerbock, "Rede zur Eröffnung des Wirtschaftstages der Konferenz der Leiterinnen und Leiter der deutschen Auslandsvertretungen", German Federal Foreign Office, September 05, 2023, available at: www.auswaertiges-amt.de (last accessed, September 17, 2023).

Defining European sovereignty and economic security

The EU is still far from having a powerful and coherent foreign policy (going further than the Strategic Compass), but this is now required more than ever, including for the survival of the European project. Will the EU remain a sovereign actor in a decoupling world? This is not only a question of foreign relations: Rapid technological advances enable not just third countries but also non-state actors, such as digital gatekeepers, to affect the very foundations of European societies if the EU is in no position to act. Paul-Henri Spaak, one of the European Union's founding fathers, rightly noted: "There are only two types of country in Europe: small countries and countries which are small, but don't yet know that they are."

The stakes could not be higher, since turning more "sovereign" is bound to clash with the multilateral rules-based system. Through its trade policy, the EU has always projected its own rules-based model – and for a good reason: If the EU were to openly disregard international law, such as the WTO rules, it would also undermine its own foundations, since all it is built on and can count on are rules.

Given this conundrum, how can European sovereignty be defined? While strategic autonomy was already mentioned in EU Council conclusions in 2013, it only became a main strategic approach during the Covid-19 pandemic in October 2020 after difficult negotiations, with the Council president calling it the "highest goal of our generation".[29] After the European Commission put forward its new trade strategy, the EU Council was not able to support the key OSA *leitmotiv* in the Council's conclusions. Member states were split between free traders and protectionists. OSA designates the ability to take autonomous decisions and to actively shape what happens outside the EU: to remain a rule-maker and not become a rule-taker; to be cooperative wherever possible but act autonomously where needed. The diversification and resilience of value chains become priorities, yet the EU still supports the multilateral trading system. The term OSA is sufficiently vague to allow everybody to interpret it in their own particular way. On March 11, 2022 at the Versailles summit, the EU heads of state

29. C. Schmucker and K. Kober, "Offene strategische Autonomie", Deutsche Gesellschaft für Auswärtige Politik, December 10, 2021, available at: www.dgap.org/de (last accessed, September 17, 2023).

agreed to strengthen European sovereignty.[30] On September 15, 2023, the Spanish EU presidency published a non-paper on an EU OSA strategy to advance EU consensus on a new balance between resilience and competitiveness.[31]

Closely linked to the question of European sovereignty is the concept of "economic security", which Japan has been championing for some time – even introducing a dedicated ministry. The EU and G7 have taken great interest: On May 20, 2023 at their Hiroshima summit, the G7 leaders agreed to coordinate their approach to economic resilience. In June 2023, the EU Commission put forward its first "European Economic Security Strategy", focusing on developing a joint European approach to identify, assess and manage risks to European economic security.[32] This includes supply chains, critical infrastructure, technology and economic coercion. As regards policy measures, the balanced approach foresees strengthening the competitiveness of the European economy, expanding defensive trade tools, and engaging closely with international partners. Interestingly, the public debate paints economic security mostly as a purely defensive concept, disregarding for example how trade can strengthen economic resilience during shocks such as natural disasters that destroy local production.

It is not the first time the EU has analyzed the vulnerabilities of its value chains. In May 2021, the European Commission published the "Staff Working Document on Strategic Dependencies and Capacities", which focused on the areas of security, health, green and digital transformation for existing dependencies, and found that 6% of EU imports (137 products), mainly from China, were affected; 0.6% of these imports (34 products) were deemed extremely vulnerable, including raw materials, semiconductors and batteries. In February 2022 a more detailed investigation followed, including on solar panels and IT software. The main focus is clear: China controls 70% of global rare-earth production and 90% of its processing, and 98% of the EU's rare-earth imports come from China.

For a long time, Germany has rejected European sovereignty as a protectionist and anti-Atlanticist concept. However, that debate has shifted. After the 2016 US presidential elections, German Chancellor Angela Merkel stressed that Europe needed to take its destiny into its own hands. The 2021 coalition agreement of the German government commits Germany to increase Europe's "strategic sovereignty". Also, Economic Affairs Minister Robert Habeck, in particular, has been pushing for the European economic security strategy to include instruments such as outbound investment

30. See "Versailles Declaration", European Council, March 11, 2022, available at: www.consilium.europa.eu (last accessed, September 17, 2023).

31. See "Resilient EU 2030", Spain's National Office of Foresight and Strategy, September 15, 2023, available at: https://futuros.gob.es/ (last accessed, September 17, 2023).

32. See "Joint Communication on a European Economic Security Strategy", European Commission, June 20, 2023, available at: https://eur-lex.europa.eu/ (last accessed, September 17, 2023).

screening. There is also increasing Franco-German convergence on adapting EU competition law, for instance when it comes to European champions (awareness on this issue notably grew after the European Commission prohibited Siemens' proposed acquisition of Alstom in 2019, under the EU Merger Regulation, which was criticized with regard to EU's capacity to face foreign competitors of a critical mass). As a whole, Germany does not support decoupling from non-ally third countries. Chancellor Scholz thus explicitly stated that the G7 climate club should be open to non-democracies. Germany also insists on respecting international trade rules when drawing up new EU trade policies, and is the third biggest contributor to the WTO budget after the US and China. Germany also supports the use of the *Passerelle* clause to move to qualified majority voting in EU foreign policy, for example on sanctions, so as to render the EU more agile.

Reducing vulnerabilities – how to de-risk

In 2023, the global decoupling debate took a curious turn when the new term “de-risking” was championed by a number of actors. This proved so successful that not only the EU and the G7 but even the G20 agreed to “de-risk” trade and set up a G20 Generic Framework for Mapping Global Value Chains to help members identify risks and build resilience.[33] “What gets measured gets managed”, as Peter Drucker would say. A host of countries started to closely monitor international trade flows, as did many companies – some of their own accord, others because new due-diligence regulations forced them to do so. Thus, the just-in-time business model moves towards a just-in-case approach, with companies increasingly opting for a “China for China” strategy, i.e. localizing production for that market to reduce trade risks.

In theory, a fitting de-risking strategy would be to strengthen the WTO system so that its rules and commitments were up to date with the economic and political realities, and were also appropriately enforced. A total of 24 countries are currently negotiating their WTO accession, which would help diversify and secure global trade ties. Since all of the current 164 WTO members need unanimity to agree to changes such as the crucial dispute settlement reform, to again make WTO rules enforceable, as well as updating the rulebook regarding digital trade, subsidies, food security and sustainability, this avenue is not realistic. However, even in its eroded status, keeping the multilateral rules-based system alive and thereby the only transparent setting for global trade policy deliberation is of great importance.

In the absence of a WTO reform, the EU has updated its trade defense arsenal: The Enforcement Regulation and the Anti-Coercion Instrument now allow the EU to act more swiftly and on a broader set of trade disputes than was previously possible, including when a third country keeps blocking dispute mechanisms by “appealing into the void” or against mere threats of economic coercion. This is important as a deterrence tool, but also for the EU to gain respect as an actor that “follows through”, which in turn can be used in trade negotiations. Other trade tools recently established are the International Procurement Instrument and the Foreign Subsidy Instrument, which puts foreign subsidies in the Single Market under the

33. See “G20 Trade and Investment Ministerial Meeting Outcome Document”, G20, August 25, 2023, available at: www.g20.org (last accessed, September 17, 2023).

same scrutiny as those already bound by the EU state-aid regime. Upcoming plans for trade instruments include harmonizing European export controls and European investment screening mechanisms. In this regard, the EU-US Trade and Technology Council (TTC) proved to be of great importance for coordinating transatlantic sanctions policy regarding Russia in the wake of its invasion of Ukraine. Given Russia's participation in the Wassenaar Agreement coordinating global dual-use policies, the TTC is even more relevant with a view to future export control regimes. Furthermore, in the footsteps of the US, the EU is drawing up plans for a mechanism to screen European investments abroad (outbound investment screening) in areas such as quantum, advanced semiconductors, and artificial intelligence to address technology leakages detrimental to national security. One reason for the plethora of new trade instruments being put forward on the European level is that the unanimity principle in EU foreign policy makes the EU less agile, whereas for trade policy, according to Article 207 of the Treaty on the Functioning of the European Union, a qualified majority is sufficient (although in general member states seek unanimity).

Autonomy is no one-way street. The EU shares dependencies, while others share dependencies regarding the EU. Reducing trade dependencies also means less leverage over trading partners. Fostering strategic interdependence can be a solution. This is one of the key goals of the US-led Indo-Pacific Economic Framework for Prosperity, which foresees a Supply Chain Agreement with a Supply Chain council.[34] The EU is at the same time negotiating a Critical Minerals Agreement with the US that might inspire other raw-material agreements or clubs. It also has set forth a Critical Raw Material Act and a Chips Act and Net-Zero Industry Act (NZIA) that are aimed at increasing local production for strategic goods. The distinction between "Single Market" and trade issues is thus becoming increasingly blurred. One major building block of de-risking strategies is this more activist role of the state as regards competition and industrial policies to cut dependencies on foreign suppliers in strategic areas and to promote Europe's technological edge.[35] Just like the US Inflation Reduction Act, the EU Chips and NZIA Acts, aim at moving value chains away from China and at reducing the impact of political crises related to the region. As the Brazilian diplomat Henrique Moraes noted, these "policies suggest not a

34. See the "Indo-Pacific Economic Framework for Prosperity (IPEF) Supply Chain Agreement", U.S. Department of Commerce, September 17, 2023, available at: www.commerce.gov (last accessed, September 17, 2023).

35. The EU's SWD (2021) 351, Annual Single Market Report 2021 identifies the following 14 industrial ecosystems where the EU aims to play a leading role: 1. Aerospace & Defense, 2. Agri-food, 3. Construction, 4. Cultural and Creative Industries, 5. Digital, 6. Electronics, 7. Energy Intensive Industries, 8. Energy-Renewables, 9. Health, 10. Mobility-Transport-Automotive, 11. Proximity, Social Economy and Civil Security, 12. Retail, 13. Textiles, 14. Tourism. Further ecosystems may be identified and their delineation adapted based on stakeholder dialogues and changing realities.

world of autarky, but a state-induced redistribution of global economic activity" as opposed to market-led economic interdependence.[36] The EU economic security strategy foresees a list of technologies that are critical to economic security and might later on be in the scope of further trade instruments, such as outbound investment screening. Since 2020 many trade actors (EU, US, every BRICS member and others) have put forward lists of critical raw materials ranging from four to 49 items, mostly focusing on rare earths, lithium and graphite that are notably necessary in the frame of the EU's dual transition.[37]

At the same time, trade agreements can be useful tools to "de-risk" by incentivizing trade diversification towards less risk-prone partners. This includes reducing tariff barriers for imports and exports; opening services and public procurement markets; protecting investment and intellectual property; agreeing on principles for trade defense instruments, subsidies, competition and digital policies, including data flows; setting up cooperation structures on technical standards, and ruling out import and export restrictions. The modernized EU-Chile agreement, for example, ensures the continued supply of lithium at a time when many countries want to restrict strategic exports. Through these provisions and dispute mechanisms, enforceable trade agreements provide the planning security that companies need to invest and reorient complex value chains. There are also more purpose-driven initiatives such as raw-material agreements (like the raw-material partnership Germany signed with Chile in January 2023[38]) and digital trade agreements. The Russian war in Ukraine has led to a remarkable revival of the EU's offensive trade agenda, as all EU institutions agreed on the need for close engagement with partners. Yet, the usual split between protectionist and free-trade member states continues, complicating the ratification of the important EU-Mercosur agreement. At the same time, given the bilateral sanctions imposed in 2020, there is currently no prospect of the Comprehensive Agreement on Investment between the EU and China being ratified. A range of Economic Partnership Agreements are currently not being pursued by African countries, and an EU-African Union trade agreement is still a long way off.

Of increasing importance are digital dependencies where a few gatekeeper companies possess very strategic monopolies. The rapid roll-out of powerful AI technologies is showcasing this. The EU thus needs an open source and open standards strategy (public money, public code) to ensure

36. H. Moraes, "Decoupling by Discrimination? Strategic Competition and the Limits of Trade Law", *Georgia Journal of International and Comparative Law*, Vol. 51, No. 3, June 2023, p. 674, available at: https://ssrn.com/abstract=4496332 (last accessed, September 17, 2023).

37. S. Evenett and J. Fritz, "The Scramble for Critical Raw Materials: Time to Take Stock?", Global Trade Alert, 2023, p. 12, available at: www.globaltradealert.org (last accessed, September 17, 2023).

38. "Schriftliche Fragen an die Bundesregierung", Bundesministerium für Wirtschaft und Klimaschutz, July 2023, available at: www.bmwk.de.

full interoperability and to render it more resilient against cyberattacks, economic coercion and decoupling. Safeguarding the open, decentralized, interoperable and global internet architecture, as opposed to the fragmented structures of "walled gardens" or a "splinternet"[39] of national internets, must be a key EU priority. Given the increasing relevance of space-based applications, such as geo-location services, strengthening European space capabilities and preventing further dependencies also is crucial.[40] As the French would say: *Il faut demander la lune!*

Reducing trade and customs bureaucracy can help increase SME trade exposure and diversification, in particular. This goes as well for continuously reviewing trade defense measures and the EU customs code according to changes in strategic EU dependencies. Given the increased scramble for resources and push for circular economies, reverse supply chains should become part of trade strategies. Changing linear to circular production models clashes, for example, with incoherent customs tariffication and waste-management regulations, making necessary a rethink of offensive and defensive EU trade interests in relation to virgin and recycled products. As regards export measures, a similar trend is foreseeable, where "reverse" certificates of origin (end-user certificates) are being mainstreamed, to prevent sanctions evasion.

A hasty and all-encompassing decoupling from China would harm strategic projects in Germany such as the green and the digital transition. This is why Germany's new national security and China strategies have been awaited eagerly by international trade partners to see how much of a shift away from China Germany will pursue. Both strategies aim at reducing strategic dependencies, name China as a competitor, partner and systemic rival, and have a strong European focus. Yet, no unexpected positions have ensued. Looking at the trade data, one finds that both the EU and Germany have relatively diversified trade relations, making a complete shift in the direction of the EU trade strategy unnecessary. The German government coalition, including the ministers of economic affairs and agriculture (members of the Green Party), is – after internal struggles – publicly supporting trade deals with Mercosur, India and Indonesia. However, this process did not go swiftly; to ratify the EU-Canada FTA, Germany unilaterally forced changes to the agreement a second time through a text on investment protection (the first time involved the then Social Democratic German economic affairs minister in 2016). These unilateral approaches create mistrust and endanger European unity – something that

39. The term "splinternet" refers to the "establishment of a multipolar Internet, fragmented into as many closed cyberspaces as there are competing blocks in the world". In: A. Mhalla, "Splinternet: How Geopolitics is Fracturing Cyberspace", *Polytechnique Insights*, January 17, 2023, available at: www.polytechnique-insights.com.

40. See "Joint Communication to the European Parliament and the Council, European Union Space Strategy for Security and Defense", European Commission, March 10, 2023, available at: https://ec.europa.eu/ (last accessed, September 17, 2023).

neither Germany nor the EU can afford. Most recently, the French government succeeded in pushing the European Commission to start an *ex officio* anti-subsidy investigation into imports of e-vehicles from China; this was vehemently rejected by German car companies with a strong footprint in China. While the German government and companies are wary of increasing trade conflicts with China, the German Economic Affairs Minister supported that move. This shows that the road to a much-needed unified European voice and strategy in trade policy is still a long way.

Policy recommendations

The growing geopolitical shifts deeply affect Europe. Not only its trade relations but also the position of its economy and its regulatory autonomy are at stake. The new European Parliament and European Commission must put this at the center of their agendas. Breaking down silo thinking between "trade" and "single market" domains within the European institutions is of importance. Nevertheless, a proper trade commissioner is needed to adequately enforce one of the European Commission's most important exclusive competences. The EU should apply to other trade negotiations the lessons it learned from its strongly cohesive approach towards the Brexit negotiations. This includes a highly inclusive and transparent approach to all relevant decisions so as to maximize its internal and external political legitimacy.

Open and rules-based trade is still a core European interest and should be at the center of a new EU trade strategy, steering away from managed trade and protectionism that is bound to hurt economies. According to the Peterson Institute, Buy America amounts to the equivalent of a 26% tariff, costing US taxpayers more than 100 billion USD per year.[41] As Bill Clinton once noted, "Globalization is not something we can hold off or turn off". Trying to shape things at both the multilateral and the plurilateral level does not mean either being "naïve" nor preventing Europe from keeping track of strategic dependencies and setting up mitigating measures. The US is currently recognizing how difficult it has become to shape trade policies in Asia after having left the Trans-Pacific Partnership and when offering no market access in return for concessions by trading partners.

The EU should thus double down on its WTO engagement. Talk about the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) or an "economic NATO" taking the place of the WTO is preposterous. There is no plan B for the WTO. Likewise, discussions about the EU joining the CPTPP or Regional Comprehensive Economic Partnership are pure phantom debates. The EU will not reduce its role to a rule-taker. Even if swift resolutions to the Appellate Body crisis or new market access are not realistic, the WTO serves as a useful forum to make global trade policy more transparent, to reduce or prevent new trade barriers, and for further deliberation that can turn into template-building. Given the high importance of "trade and" topics and the need for global

41. G. C. Hufbauer, M. Hogan and Y. Wang, "For Inflation Relief, the United States Should Look to Trade Liberalization", Peterson Institute for International Economics, March 2022, p. 4, available at: www.piie.com (last accessed, September 17, 2023).

commons, the EU should bring its sustainability topics regarding climate, labor and human rights much more vocally to the table within the WTO to help find more efficient global solutions, but also to reduce the perception of it wanting to impose its views upon others or move towards "green protectionism".

This also goes for bilateral trade relations. While countries like New Zealand might want to include far-reaching trade sanctions in its FTAs (which can also be used against the EU), for most other countries this is a red line. It is more promising to advance an EU competitiveness agenda to make the Single Market so successful and attractive that additional incentives in trade agreements linked to higher sustainability criteria are used by trading partners. Such policies could, for example, allow for increased market access for eggs whose production methods reduce the dangers of antibacterial resistance through reduced antibiotics use (as is the case in the EU-Mercosur agreement). Using this approach, the EU should complete its outstanding trade deals in the Indo-Pacific and Latin America to provide for additional trade safeguards in case of further WTO erosion. Further down the road, instead of all-encompassing mega-deals, more purpose-driven digital, supply-chain and raw-material agreements are the way forward. Having key trading partners engage with the EU on the global standards of the future through a TTC is a strategic asset, and the process in itself is arguably more valuable than its potential outcomes. The Global Gateway initiative also has the potential to reconnect with many trade partners that feel neglected by the EU.

In an increasingly "decoupling" and "friendshoring" world, neighborhood countries become more important. It is thus curious how little trade discussions focus on these countries. Strengthening institutional ties with the UK, Switzerland and the European Economic Area to further regulatory convergence is key. The same goes for EU enlargement, which is seeing a revival since the Russian invasion of Ukraine and yet has been absent from most trade discussions. It will also have special relevance for the EU's economic security as regards its trade dependencies and its global position. Given the lack of consensus among EU member states and difficult domestic debates within certain member states, quick accessions are not foreseeable. Also, the EU-Turkey customs union is riddled with many problems. New approaches to more closely link these countries to the Single Market during the accession process should thus be envisaged. This would increase the EU's heft globally.

Also, the Market Access Strategy should be reinforced. WTO structures and bilateral agreements that provide for channels to address upcoming trade barriers are useful since they are more successful than breaking down existing ones. This will be an increasingly important part of trade policy: preventing trade conditions from worsening instead of actively improving them. Similar to the "Cost of Non-Europe" report, a "Cost of Non-Trade" report should be put forward and widely discussed in the EU and with its trading partners.[42] The EU is very proud of the "Brussels effect", i.e. European standards turning into global standards. Key to this is that it not be overly politicized and that there is close stakeholder involvement. Becoming more attractive to partners also means thinking about trading partners when doing "EU internal" regulation.

Germany's role as an honest broker to overcome trade policy blockades is crucial. The EU needs to deliver. The EU agreement with Central America of 2012 is still awaiting ratification by Belgium, that with the Caribbean of 2008 for ratification by Hungary. In a highly volatile global landscape, this is not viable. The German Bundestag is discussing setting up a committee on trade policy that could help increase German ownership of strategic trade policy decisions in Europe, and could serve as a model for other EU member states. In this way, EU trade policy decisions could get buy-in early on in the policy-making process, making ratification a matter of formality and preventing hostage-taking, as is currently happening as regards the Ukraine grain trade and ratification of the Post-Cotonou Agreement. Such treaty changes should become part of the big treaty reform package that is being discussed for the upcoming EU enlargement. Equally important is the reform of qualified majority voting for EU common foreign and security policy, which is increasingly intertwined with trade policy. Speaking with one voice – as sought by Paul-Henri Spaak – allows the EU to remain a credible actor. The Spanish Prime Minister Pedro Sanchez got it right: "The international order is changing [...] the European Union must change with it."[43]

42. See M. Thierry, V. Vincent and Z. Soledad, "The Cost of Non-Europe, Revisited", *Working Paper*, No. 673, Banque de France, September 04, 2018, available at: https://publications.banque-france.fr/ (last accessed, September 17, 2023).

43. P. Sánchez, "Promoting Open Strategic Autonomy will be One of the Priorities of the Spanish Presidency of the European Union", La Moncloa, February 06, 2023, available at: www.lamoncloa.gob.es (last accessed, September 17, 2023).

Annexes

Annex 1

Top 10 EU FDI stock 2021

Outbound FDI	Inbound FDI
USA: 27%	USA: 33%
UK: 22%	UK: 19%
Offshore financial centers: 7%	Offshore financial centers: 17%
Switzerland	Switzerland
Canada	Canada
Singapore	Japan
Brazil	Singapore
Russia	Russia
China	Hong Kong
Mexico	United Arab Emirates

Annex 2

Top 10 German FDI stock 2021

Outbound FDI	Inbound FDI
USA: 24%	Netherlands: 19%
Netherlands: 9%	Luxembourg: 18%
Luxembourg: 8%	USA: 9%
UK	UK
China	Switzerland
France	France
Switzerland	Austria
Italy	Ireland
Austria	Italy
Spain	Japan

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