G|M|F The German Marshall Fund of the United States

STRENGTHENING TRANSATLANTIC COOPERATION

Policy Brief

|*Europe Program*|

Leveraging Europe's International Economic Power

by Guillaume Xavier-Bender

In Brief: The European Union yields immense economic power globally. Yet it does not sufficiently leverage that power to achieve political goals. This is the result of institutional — if not constitutional — limitations and policy choices, and a lack of coordination between member states that often compete for individual interests abroad. As Europeans increasingly see the added value of the geopolitics of trade, and of economic diplomacy, the EU Global Strategy should give Europe's international economic relations their appropriate share of strategic relevance. European economic statecraft is and should be more than a tool for jobs and growth. The use of economic power to achieve global goals could mark a long-term shift in EU internal and external policymaking — in parallel or conjunction with member states' initiatives. Economic security should therefore be recognized as core to any future EU foreign and security policy strategy. This would require redefining the equilibrium between economic and political objectives in the definition of European foreign policy goals, as well as the institutions and mechanisms that would support it.

In an article written in 1978 to make the case for a U.S. economic diplomacy toward the USSR, Samuel Huntington argued that "harnessing economic power to foreign policy goals presents formidable obstacles: bureaucratic pluralism and inertia; congressional and interest group politics; the conflicting pulls of alliance diplomacy; and most important, in dramatic contrast to military power, a pervasive ideology that sanctifies the independence, rather than the subordination, of economic power to government."[1] Yet Huntington believed that overcoming these obstacles would be in the United States' best strategic interest. As he later phrased it, "if war is too important to be left to the generals, surely commerce is, in this context, too salient to be left to bankers and businessmen."[2]

There is a lot of resonance between Huntington's article and the current situation of the European Union. While the global context has obviously changed in the last 36 years, the rationale behind a full-fledged economic diplomacy apparatus remains valid. Indeed, harnessing economic power to foreign policy goals may present formidable obstacles, but it also provides an invaluable strategic hedge for the future. It is this foresight that allows the president

1 Huntington, Samuel P. et al. "Trade, Technology, and Leverage: Economic Diplomacy," *Foreign Policy* 32, 1978,

2 Ibid.

of the United States to write that "America's growing economic strength is the foundation of our national security and a critical source of our influence abroad";[3] the fact that this is the second sentence of the U.S. National Security Strategy of 2015 says enough on how strategic thinking on international economic relations differs on both sides of the Atlantic.

As the European Union seeks to redefine a common, comprehensive, and consistent global strategy, it should look at its international economic relations beyond recognizing trade as an engine for growth and jobs, beyond the realization that there are tensions between trade and non-trade objectives, and beyond gloomy assumptions that "the EU's declining economic dynamism, the high demands it makes of its trading partners, and what it is willing to offer may be hampering its leverage."[4] If the EU remains the world's wealthiest and most integrated economic block — as consistently advocated by the European Commission — and if Europe's capacity to project civilian power globally, including the tools of its economic and social prosperity, remains unmatched, then assumptions regarding a European decline are misplaced. In a holistic approach — or "multidimensional" according to Andrew Moravcsik — the EU is well positioned to exercise the appropriate leverage it needs to meet its foreign policy goals through the use of its economic power. [5] This would be in line with the growing necessity for the EU to think more strategically about the means and measures of its economic security.

Ever Stronger Link between Foreign and Economic Policy

In recent years, the linkages between economic and foreign policy have become more apparent, whether through increased awareness of the external dimension of the EU's internal policies, or of the internal dimension of the EU's external policies. In this interaction, long-standing dilemmas disrupt the EU's ability to project itself as a single foreign policy power. Should there be a coordinated approach to commercial and investment opportunities between member states, or should their "natural" competition to gain market shares persist? Should trade agreements be used to push European agendas on the protection of human rights? Should comprehensive trade agreements limit themselves to their normative power, or should they openly take into account their political dimension? Is the cost of EU sanctions on member states' economies worth the political gains? Should there be rules of primacy between politics and economics at the EU level?

> The EU is well positioned to exercise the appropriate leverage it needs to meet its foreign policy goals through the use of its economic power.

These dilemmas are increasingly reflective of the state of the world, and of the changing external challenges facing the EU. For instance, the political dimension of the EU-Ukraine Association Agreement was clearly underestimated by Europeans, until its rejection by then Ukrainian President Viktor Yanukovych in November 2013. The EU failed to anticipate the political resonance of the Association Agreement with regards to its own external relations with Ukraine and Russia. Inversely, the entry into force of the EU-Ukraine Deep and Comprehensive Free Trade Agreement (DCFTA) in January 2016 raises new concerns vis-à-vis Russia's response, but its political — if not strategic — implications are clear.

3 White House, *National Security Strategy*, February 2015

4 European Commission, *The European Union in a changing global environment. A more connected, contested, and complex world*, June 2015

5 Moravcsik, Andrew, "Europe, the Second Superpower," *Current History*, March 2010

Another example can be found in the normative power of trade, and the use of trade and investment agreements to set global rules and standards. Through the successful conclusion of a Transatlantic Trade and Investment Partnership (TTIP), the EU and the United States would openly state their ambition to continue being rules-setters, as opposed to being rules-takers. Yet this relative hegemony through trade requires an examination from the eyes of third countries worried about the imposition of a transatlantic agenda. Approaching TTIP through the lens of geopolitics, and not just economics, is therefore essential. Any failure to do so will have direct repercussions on the EU's relations with other parts of the word, in particular Turkey, Russia, China, and partner countries in Africa.

> Approaching TTIP through the lens of geopolitics, and not just economics, is essential.

Finally, competition between member states is fierce when it comes to maximizing individual gains of the EU's external economic relations. There are indeed still far too many diverging interests at play. Whether it is through Greece's hesitations to impose sanctions on imports of Iranian oil, Germany's resistance to broader economic sanctions against Russia, France's "cultural exception" in the TTIP mandate, or the United Kingdom's unilateral decision to join the Asian Infrastructure Investment Bank, the rational is domestically driven.

All these examples are telling of the lack of conceptual and institutional preparedness of the EU when it comes to addressing the linkages between its external economic relations and its foreign policy goals.

Conceptual and Institutional Gaps in EU International Economic Policymaking

Despite existing inter-service coordination mechanisms; despite the clearer attribution of portfolios and roles between the high representative, other commissioners and various directorate generals; and despite the greater role given to EU delegations when it comes to projecting Europe's economic interests throughout the world, policy and decision-making too often remain in silos (vertical). As relatively successful sanction policies toward Iran and Russia have shown, a cross-sectoral (horizontal) approach to foreign policy is the best way for the EU and its member states to achieve strategic goals. Yet the European Commission is far from having fully implemented its new internal cluster-structure, originally intended to encourage such cross-sectoral coordination. While progress has been made at the level of the commissioners themselves, and their direct staff, much remains to be done at lower levels of operation.

The European Commission's objective to ensure more coherent policymaking for internal and external policies suffers from a lack of clear guidance on how to ensure that external economic relations bear a strategic significance for the EU.

On July 28, 2015, Federica Mogherini, high representative of the European Union for foreign affairs and vice-president of the European Commission, announced a revision of the organization of the European External Action Service (EEAS). The creation of a deputy secretary general for economic and global affairs was then made official.[6] With the revision of the EU's Global Strategy underway, and the announcement of a new EU Trade and Investment Strategy made in March 2015 by EU Commissioner for Trade Cecilia Malmström, such a horizontal role within the EEAS made sense.

Six months later, little progress has been made in how the EEAS can play a key role in defining and imple-

6 http://eeas.europa.eu/statements-eeas/2015/150728_04_en.htm

menting the EU's external economic policy. Whether it is the institution that lacks the strategic goals, or the strategic goals that lack the institutional support, many hope the EU's Global Strategy, to be announced in June 2016, will fix this catch-22. Yet nothing is more uncertain.

The high representative's June 2015 interim analysis of the EU's role in the world had indeed already failed to embrace the strategic relevance of the EU's economic power. As noted by Hans Kundnani, "the document hardly mentions the effects of changes in global trade and investment on EU member states and includes only a superficial discussion of the strategic consequences of the euro crisis."[7]

The Communication on *Trade for all: Towards a more responsible trade and investment policy* published in October 2015 does state that "an effective trade policy should, furthermore, dovetail with the EU's development and broader foreign policies, as well as the external objectives of EU internal policies, so that they mutually reinforce each other."[8] But it fails to distinguish strategic goals from policy objectives. It promises to "develop a more coordinated approach to economic diplomacy, ensuring that all EU diplomatic assets are deployed to support EU trade and investment interests." But it fails to explain how the EU could use the very different tools of traditional diplomacy, economic diplomacy, and commercial diplomacy.

The interim analysis, as well as the new trade and investment strategy, look more like lists of guidelines than instruments of strategic dimension. At best, they bring tactical insights and frameworks to existing policy choices. The mere existence of two distinct documents supposed to redefine the strategic goals of the EU's international economic relations creates confusion. It also has the potential to revive underlying tensions between the EEAS and the Directorate General for Trade when it comes to exercising leadership in defining and implementing EU economic goals abroad. Indeed, while increasingly rare, it can still be heard in Brussels that the EU's true external action service sits in Charlemagne (where the offices of DG Trade are).

The EU therefore finds itself in the right moment to commonly refine the economic linkages of its foreign policy, and to create the institutional mechanisms needed to support them. In the future, the EU might come to recognize more openly that its still growing economic strength is the foundation of its collective security and a critical source of its influence abroad. Economic statecraft and economic security should therefore be core to any EU global strategy.

Economic statecraft and economic security should be core to any EU global strategy.

Foreign Investments and Strategic Industries

Constitutionally, trade policy — at least trade in goods — has always been a core competence of the European Union. While the scope of the EU's competence evolved through treaty changes, it is the Treaty of Lisbon in 2010 that established an exclusive competence on foreign direct investments (FDI) as part of the common commercial policy.[9]

Nonetheless, trade agreements are still considered to be the sacrosanct tool for projecting influence and

7 Kundnani, Hans, "How Economic Dependence Could Undermine Europe's Foreign Policy Coherence," GMF Policy Brief, January 2016, http://www.gmfus.org/publications/how-economic-dependence-could-undermine-europes-foreign-policy-coherence

8 European Commission, *Communication on Trade for all: Towards a more responsible trade and investment policy*, October 2015

9 See De Gucht, Karel, "The Implications of the Lisbon Treaty for EU Trade Policy," European Commission, October 8, 2010, http://trade.ec.europa.eu/doclib/docs/2010/october/tradoc_146719.pdf

asserting "soft" power. This is likely to take its origins in both historical and constitutional constructs of the EU. Europe's capacity to project itself globally has greatly emanated through time from its commercial interactions with the rest of the world. Regardless of power dynamics and doctrines, a constant of European foreign policies has been the use of trade relations as an instrument to pursue both internal and external policy goals. More recent examples of that include the EU sanctions put in place against Iran to reach a deal on its nuclear program, and against Russia to encourage a peaceful solution to the Ukrainian crisis. Through such tactical logic, trade relations have become an extension of foreign policy. And as EU Commissioner for Trade Cecilia Malmström put it early January 2016, "Trade is a core part of how Europe connects with the world. It's part of Europe's history. It's part of our identity."[10] The time is right for Europeans to reevaluate how they perceive and absorb foreign economic power from abroad at home, in particular when it comes to the transformation of strategic industries in Europe.

> The time is right for Europeans to reevaluate how they perceive and absorb foreign economic power from abroad at home.

While trade is often considered to be the main driver of the EU's international economic relations, foreign investments are their engine. In 2012, the EU accounted for more than 40 percent of the outward stock and more than 30 percent of the inward stock of global FDI.[11] They also constitute a reliable tool at the disposal of the EU and its member states to project its influence abroad. Regardless of the direction of investments (inward or outward), the capacity of a county or region to attract or generate investment opportunities is indicative of its role in the global economy. Foreign investments are both a visible instrument of projection of the EU abroad (outward FDI), and they are an indicator of the EU's attractiveness for other global powers (inward FDI). In addition, foreign investments in the EU can provide valuable insights on the state of Europe's strategic industries — and the political will to conserve control over them. As increased linkages are being made between investment and security policies in member states, a coordinated approach at the EU level could be beneficial.

The EU should reaffirm the central role that FDIs play in its economy, and unbundle issues related to investment policy and investment protection. With increased pressure from abroad on strategic industries from the energy, transport, agricultural, and telecom sectors, a consistent debate about foreign investments is sorely needed at the EU level. The European Commission could, for instance, think creatively of how to review and investigate foreign investments that might result in foreign control over EU assets or infrastructures that raise community security concerns. While a structure similar to the Committee on Foreign Investments in the United States (CFIUS) might be too ambitious for a start, novel inter-service processes could be put in place to review and advise member states on a case-by-case basis. This will require time, and very likely cause controversy at the member states' level. The nature of these investments would indeed imply that national security concerns —which only member states themselves are competent to assess — could be addressed at the community level. Yet this should not restrain the EU from consolidating its role as a coordinating platform for the continent's international economic relations.

The creation of an EU Decentralized Agency tasked with the monitoring and review of foreign investments

10 Malmström, Cecilia, "Dealing with Challenges through Global Trade," *Karlsruhe*, January 11, 2016

11 Eurostat, "International trade, investment, and employment as indicators of economic globalization," November 2015, http://ec.europa.eu/eurostat/statistics-explained/index.php/International_trade,_investment_and_employment_as_indicators_of_economic_globalisation

in Europe could fill this institutional gap. In addition, setting up joint working groups on investments should be made more systematic. As illustrated by the EU-China joint working group created in September 2015 as part of China's intention to contribute to the Investment Plan for Europe, such initiatives provide greater ex-ante coordination and increased cooperation on all aspects of investments.

Finally, in order to fully recognize the growing convergence between the EU's international economic relations, and its foreign policy agenda, the commissioner for trade should also be vice-president of the European Commission. In the current design of the Commission's cluster system, and considering how strategic trade and investment policies have come to project EU power globally, rethinking this role in such way would give it greater institutional and political weight, both internally and externally.

A Nascent Rationale for the EU's Economic Security

The European Union is still too shy about defining its economic security as a core element of its overall security. In this context, economic security can be defined as the framework in which elements of prosperity contribute directly or indirectly to national security. By definition, economic security has an internal and external dimension. The internal dimension includes aspects related to employment and wages, access to healthcare, pension systems, housing, and national debt. The external dimension includes trade agreements, currency and foreign exchange, investments, access to natural resources, and connectivity (both physical and digital).

Traditionally, for the EU, economic opportunities should not dictate foreign policy goals. At the same time, foreign policy goals should not neglect economic opportunities. Yet in the context of the future of a global strategy, foreign policy objectives would benefit from using economic tools more systematically to advance their goals. If prosperity increasingly depends on the capacity for goods, services, people, capital, and data to cross borders, then peace and stability are intimately interlinked with it.

If prosperity increasingly depends on the capacity for goods, services, people, capital, and data to cross borders, then peace and stability are intimately interlinked with it.

There are indications that the EU's economic security is emerging as a rational for external relations. Malmström identified in early 2016 that "the first concern [being raised by many European people] is about economic security and opportunity." Yet more could be said and done in this regard to include economic security as a core element of community security, especially in the framework of the EU Global Strategy. In particular, the strategy should steer away from the temptation of solely addressing economic prosperity through the prism of trade, humanitarian assistance, and development cooperation. Indeed, labor and environmental standards, technological transformation, the role of the euro currency in international exchanges, Europe's global connectivity, and more broadly the EU's rules-based system are some of the key elements of Europe's capacity to project its economic power abroad. They should not be ignored in defining a global strategy for the EU.

While the creation of a deputy secretary general for economic and global affairs at the EEAS was a move in the right direction, the EU still lacks a robust institutional framework under which it can develop and implement a global strategy supported by greater economic security. For instance, there is no equivalent counterpart in the EU institutions to the U.S. deputy national security advisor for international economic affairs at the White House, or the undersecretary of state for economic growth, energy and environment, or even the recently created role of chief economist at the U.S. State Department. That is not to say that the European Commission and the EEAS should model their approach to economic security on that of the United States, but they could commonly identify gaps in their organizational structure and fill them.

If a new holistic approach to the EU's foreign and security strategy is adopted, one that takes into account economic relations and recognizes the role of economic security in Europe's overall security, then the rational for a new structure might become evident. But the policy should precede the structure. Indeed, this would require the EU to think differently about its foreign policy goals, going beyond its organic resistance to use economic power as a foreign policy tool. In this case, greater capacity and competence should be granted to the EEAS deputy secretary general for economic and global affairs in order for the EU to move beyond conceptual and institutional divergences on the pre-eminence of economic and political drivers in external relations.

The Risks of Non-Strategizing and of Over-Strategizing

Is the EU over- or under-strategizing its international economic policy? At the moment, it is mostly faced with the risks of non-strategy. First, the logic of trade policy primacy could undermine the EU's foreign policy objective, with a risk that commercial interests define Europe's security policy.[12] Second, assimilating policy objectives to strategic goals may limit European ambitions in the long term as immediate policy gains may overshadow broader political visions. Third, should it fail to appropriately leverage its economic power through a coherent foreign policy agenda, as well as the capacity of trade and investment relations to set global norms, the EU might increasingly be perceived as a "sweet power," a region able to obtain preferred outcomes through attraction, coercion, or payment, but unable to do so for lack of unified political ambition.

> Is the EU over- or under-strategizing its international economic policy? At the moment, it is mostly faced with the risks of non-strategy.

At the same time, over-strategizing is risky for the EU as well — although it holds fewer long term consequences than the absence of strategizing. Indeed, the proliferation of strategic reviews since January 2015 throughout the spectrum of EU policymaking might seem worrisome to stakeholders looking for concrete actions going forward. Fortunately — but at the same time, sadly — these initiatives have mostly turned out to produce policy recommendations rather than strategic vision. Part of the problem might indeed lie in the EU's use of the term "strategy" or "strategic." The choice of words matters greatly, and the current trend in the EU wrongly conflates strategy and goals. Roughly defined, a strategy is the path chosen to achieve a decided goal. It is not the goal itself. Nor is it a policy objective.

In the end, the EU seems to be narrowing toward a more obvious geopolitical approach to economic relations. The evolution of its interactions with Russia and China indicate a greater impetus given to economic tools to pursue political objectives. The now recognized geostrategic dimensions of both the Transatlantic Trade and Investment Partnership (TTIP) with

12 See Erixon, Fredrik, *How Trade and Security Became Europe's Unhappy Couple*, Carnegie Europe, March 24, 2015, http://carnegieeurope.eu/publications/?fa=59475

the United States and the EU-Japan Free Trade Agreement negotiations also support the idea that strategic partnerships transcend economic and political silos. In this spirit, and in light of the strategic goals it will have set itself in June 2016, the EU should also take stock and review its relations with strategic partners (China, Russia, Japan, South Korea, South Africa, Brazil, the United States, India, Canada, and Mexico).

The EU should therefore bring back under one roof any strategic discussion that might affect its international economic relations. It makes little sense nowadays to draw a trade and investment strategy separate from a global strategy. The European Union is an economic project at the service of a political ambition. More specifically, its founding members were "resolved to ensure economic and social progress of their countries by common action to eliminate the barriers which divide Europe."[13] As such, it is the embodiment of linkages between economic and security policy. Yet as the EU now strives to eliminate the barriers that divide the world, it lacks the resolve for the same common action that made its existence sustainable.

13 Treaty of Rome, Preamble, March 25, 1957

The views expressed in GMF publications and commentary are the views of the author alone.

About the Author

Guillaume Xavier-Bender is a transatlantic fellow in the Brussels office of The German Marshall Fund of the United States.

About the Europe Program

The Europe Program at GMF enhances understanding of the challenges facing the European Union and the potential implications for the transatlantic relationship. It contributes to the European and transatlantic policy debate through policy-oriented research, analysis, and convening to help improve the political, economic, financial, and social stability of the EU and its member states. The Europe Program focuses on the following key areas: integration and disintegration in the EU; Germany's role in Europe and the world; challenges in the EU's neighborhood; reconnecting Southern European member states; migration; the rise of populism; and EU energy security.

About GMF

The German Marshall Fund of the United States (GMF) strengthens transatlantic cooperation on regional, national, and global challenges and opportunities in the spirit of the Marshall Plan. GMF contributes research and analysis and convenes leaders on transatlantic issues relevant to policymakers. GMF offers rising leaders opportunities to develop their skills and networks through transatlantic exchange, and supports civil society in the Balkans and Black Sea regions by fostering democratic initiatives, rule of law, and regional cooperation. Founded in 1972 as a non-partisan, non-profit organization through a gift from Germany as a permanent memorial to Marshall Plan assistance, GMF maintains a strong presence on both sides of the Atlantic. In addition to its headquarters in Washington, DC, GMF has offices in Berlin, Paris, Brussels, Belgrade, Ankara, Bucharest, and Warsaw. GMF also has smaller representations in Bratislava, Turin, and Stockholm.

1744 R Street NW
Washington, DC 20009
T 1 202 683 2650 | F 1 202 265 1662 | E info@gmfus.org