



# **An EU Trade Policy for Geopolitical Ends**

— clashing perspectives and policy recommendations

2021



# Preface

In recent years, geopolitical considerations have increasingly influenced trade policy. Tensions have been high, not just between great power rivals but even between traditional allies such as the US and the EU, in particular during President Trump's four years in the White House. Historically, economic integration with partners and allies was the answer to how trade policy should ideally be used for geopolitical purposes. In recent years, this historic lesson appears to have been forgotten and the current trend is to use security-related arguments to limit economic integration. In the EU debate, there are even calls for a trade policy for the purpose of "coercion" or "deterrence", terms traditionally confined to security policy.

As director-general for Sweden's government agency for international trade and trade policy, I view this development with increasing concern. The purpose of this report is therefore to analyse how EU trade policy, executed by the current "geopolitical" European Commission, could be applied more effectively for geopolitical ends. As the report shows, geopolitical tensions are indeed on the rise, but the answer to that challenge is not necessarily to limit economic exchange. It also shows how traditional security policy approaches cannot be transferred directly to trade policy. Instead, an EU trade policy for geopolitical purposes should build on our own successful historical experience, an experience that uses economic integration to project peace and stability in Europe and beyond.

I hope that this report will contribute to the debate on how trade and economic integration, besides improving economic well-being, can be employed to strengthen the EU geopolitically and to bolster European security.

Stockholm, August 2021



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## Summary

The EU's grand strategy of economic integration has produced an unprecedented period of peace and stability in Europe and beyond. This historic lesson still applies. Economic interdependence has a moderating influence on great power relations. At the same time, open trade stimulates EU productivity and economic competitiveness.

Historically, the EU has been one of the largest beneficiaries of the multilateral framework. As the European Commission's Trade Policy Review emphasised, rules-based multilateralism is in the EU's strategic interest and it remains the first-best option for the Union to deepen economic integration.

If the multilateral course is blocked, however, the most realistic alternative is alliance-building with partners that have similar trade policy objectives and perceive global challenges similarly. Rather than a hub-and-spoke structure, a larger cohesive area that links EU free trade agreements (FTAs) to each other could be envisioned. Strategically, the idea would be to create an extension of the leverage provided by the single market together with like-minded partners. While the EU is not in a position to shape geopolitics or globalisation on its own, a larger economic area of like-minded partners would have sufficient attraction to do that. Besides neighbouring countries, candidates for such a strategy are countries with which the EU has concluded or is about to conclude FTAs. Many of these countries are current members of the CPTPP. It therefore makes sense to approach these countries in efforts to expand trade integration among like-minded partners. In this context, the recently concluded but not yet ratified EU-MERCOSUR agreement is also important.

### Neighbours first

The EU's most important geopolitical interests remain in Europe and along its perimeters. The European Commission, therefore, correctly identifies "stability and prosperity in the EU's neighbouring countries" as a vital interest in the Trade Policy Review. In recent years, EU accession talks have slowed down. This is unfortunate because it could allow other great powers to expand their influence in the EU's immediate neighbourhood, particularly in the western Balkans. Renewed efforts to advance EU accession or close integration with neighbouring countries would, therefore, be desirable from a geopolitical perspective.

### The transatlantic relationship

The EU's single most important geopolitical relationship is with the US. Given the fact that the Commission describes the transatlantic relationship as "the linchpin of a new global alliance of like-minded partners", the EU should consider new ways to deepen transatlantic economic integration, including via an EU-US trade agreement.

### The relationship with Russia

Due to the lack of progress in implementing the Minsk agreements, trade policy options in the EU's relationship with Russia remain limited. If the Minsk agreements are implemented, the prospect of future economic integration between the EU and Russia should be kept open, however.

## **The relationship with China**

The EU's multifaceted strategy toward China emphasises challenges related to China's state-capitalist system as well as the benefits of economic interdependence from a security perspective. Maintaining interdependence, rather than seeking decoupling, is therefore a sensible strategy for the EU. The EU-China comprehensive agreement on investment also makes sense from a geopolitical perspective since it represents an effort to bolster economic interdependence and cooperate on selected issues of mutual interest.

## **Unilateralism as a last resort**

Unilateralism is an inferior alternative to options based on economic integration. Applying unilateral measures in a WTO consistent manner, while advancing EU geopolitical interests, is a difficult balancing act that is unlikely to yield significant positive effects. It also risks undermining rules-based multilateralism. Unilateral measures could, moreover, hurt the EU economically since they interfere with the process that allows the most productive EU firms to grow and structural adjustment to take place.

In line with this analysis, unilateral measures that discriminate between domestic and foreign commercial interests should not be imposed without an assessment of their effectiveness, overall welfare effects, the risk of countermeasures, administrative costs for firms (particularly SMEs) and the magnitude of the problem in question. Assessments of welfare effects should always be based on established methods used in economics. Unilateral action that restricts the right of EU firms to conduct business with non-EU countries must also adhere to general principles of EU law and EU commitments in international trade and investment agreements.

The EU should furthermore avoid giving special treatment to a wide and fluctuating range of goods, technologies and sectors designated as strategic or critical. Otherwise, the Union runs the risk of introducing distortions and reducing productivity in sectors that it wants to promote, for instance, for the purpose of the digital and climate neutral transition. It would also undermine transparency and, ultimately, good governance. Lists of strategic or critical goods and technologies should, therefore, be kept narrow, overlapping lists should be weeded out and each list should be determined by objective criteria. Subsidies associated with the designation of special status should be transparent to facilitate evaluation.

Finally, it is important to separate security objectives from competitiveness concerns. For the purpose of security or public order, there are sometimes legitimate reasons to discriminate against foreign interests. By contrast, industrial competitiveness is not a national security objective and is best promoted via non-discriminatory, open trade and investment policies.

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# 1. Background, purpose and scope

Geopolitical considerations have always influenced trade policy. The EU was created on the notion that coal and steel were of geopolitical importance. The GATT was a strategic US instrument in the emerging Cold War struggle with the Soviet Union. After the Cold War ended, great power relations became less antagonistic, but recently tensions have increased again. In particular, relations between the EU and the US on the one hand and China/Russia on the other, have deteriorated. Under former US President Trump, even the relationship between the US and the EU came under stress.

For the founders of the EU and the GATT, increased economic integration with partners and allies was the answer to how trade policy should be used for geopolitical purposes. In recent years, this notion has changed. The current trend is to limit economic integration and even disengage from allies. US withdrawal from the TTIP and TPP negotiations, US tariffs on steel and aluminium, more unilateral action by the US, China and the EU, EU difficulties to finalise trade agreements with strategic partners such as Canada and Brazil (MERCOSUR) and Britain's exit from the EU, are all examples of this. Our own previous analysis in areas such as IT security also indicate increased regulatory fragmentation based on geopolitical considerations.

As Sweden's government agency for trade and trade policy, the Board views this development with increasing concern. In our view, it could harm the EU's strategic interests in a "harmonious development of world trade" and "the abolition of restrictions on international trade" (article 206 of the TFEU). The purpose of this report is therefore to analyse how EU trade policy could be applied effectively for geopolitical ends. While discussions about domestic political support for alternate trade policy strategies are highly relevant, the report limits itself to the question of how EU trade policy could ideally be used for geopolitical purposes. Apart from climate change, which is a security threat with potential geopolitical implications, the report also does not discuss global sustainable development challenges more broadly.



The report is organised as follows. Section 2 outlines relevant international relations (IR) and trade theory, and section 3 discusses recent geopolitical developments. Using official EU documents, section 4 and 5 then present strategic aspects of EU trade and industrial policy and describe EU relations with other great powers. Section 6 identifies challenges for the EU in matching policy means and ends. Finally, the last section presents realistic solutions to the challenges and makes policy recommendations.

## Box 1

### Key concepts in the report

#### Geopolitics

Geopolitics is not defined in international relations theory, but it represents a state-centric perspective that belongs in the neo-realist or neoliberal tradition of international relations theory. It is closely related to security insofar as it deals with relative material power for the purpose of national or EU security. In this sense, geopolitical action is a means to achieve national or EU security. Economic factors, including trade, affect geopolitical considerations by shifting material power in one direction or another.

#### Security

While security is a contested concept, an often-cited definition is Buzan (1991). According to Buzan, security represents “the pursuit of freedom from threats... in the context of the international system, security is about the ability of states and societies to maintain their independent identity and their functional integrity”. For many years, the national security concept has been broadened to include defence against a wider set of security threats (Sweden’s national security strategy, 2017).

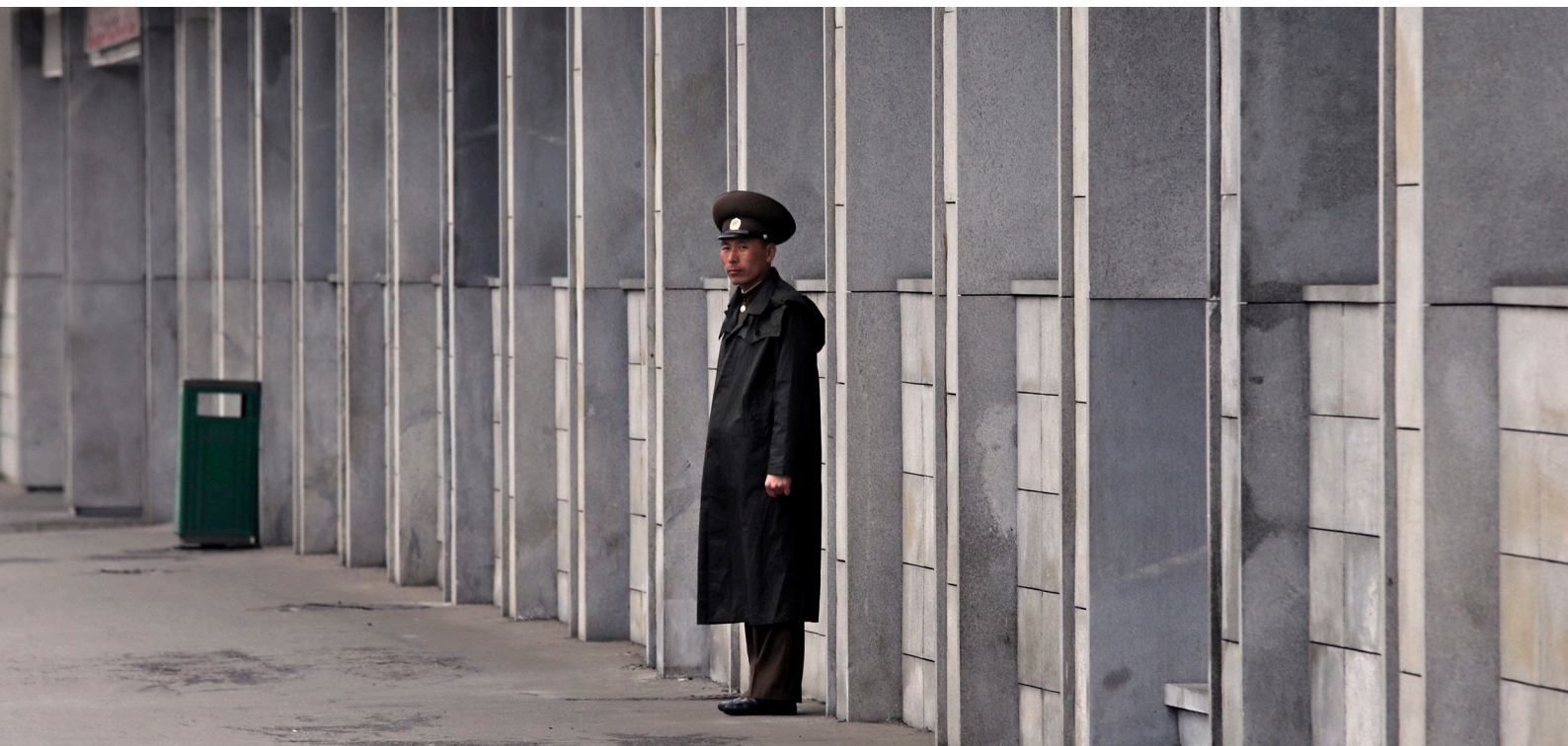
## 2. Trade and security policy: a clash of perspectives

On the surface, it is hard to find two policy fields in international relations where basic perspectives and concepts are further apart than trade and security policy. On the most fundamental level trade is defined as mutual economic exchange, whereas national security is about protection from threats. The clash of perspectives is also observable at the theoretical level. In international trade theory, cross-border specialisation creates ‘gains from trade’ for countries that take part in it. Non-discrimination and comparative advantage are basic legal and economic propositions. Security policy, on the other hand, deals with issues such as anarchy, threat assessment, sovereignty, balance of power, containment and security dilemmas. Military concepts such as deterrence, coercion and defence also figure prominently in security policy.

This dichotomy oversimplifies things, however. Within the IR field, there are several theoretical perspectives that are compatible with economic integration and cross border economic specialisation. Below, we summarise conclusions based on the perspective that explicitly connects trade and security policy – economic interdependence theory.

### 2.1 Economic interdependence theory

According to the economic interdependence paradigm, trade changes the cost-benefit calculus of great powers to pursue aggressive policies and even military conflict. Interdependence makes trade more profitable and territorial conquest may do more harm than good for states that wish to increase their wealth and power. The opportunity cost of aggression rises further in the presence of modern technology, making the trading option even more attractive. Economic interdependence thus mitigates incentives to pursue aggressive policies when other (structural or state-level) factors predisposition conflict. Arguments regarding the security benefits of economic interdependence can be traced back to Richard Cobden’s campaign against the British corn laws in the 1840s. The theory was updated by Angell (1933) for the interwar period, and by Keohane and Nye (1977) and Rosencrance (1986) for the Cold War era. After the Cold War ended, Copeland (1996) extended the theory to include *expectations* about the future level of interdependence.



According to Copeland, there will be an incentive for continued peace if the current level of economic interdependence is low, as long as there are expectations of increased trade and economic integration. Conversely, a high level of economic interdependence today might not prevent conflict if a government suspects that the country will face economic isolation in the future. More recently, Brooks (2007) examined the effect of globalisation of production on the security calculations of great powers. His conclusion was that the globalisation of production has a moderating influence on great power competition.

As Ikenberry (2020) observes, moreover, the primary value of economic interdependence from a security perspective has to do with its moderating influence on great power relations, irrespective of their domestic ideology. In Ikenberry's view, US President Woodrow Wilson's famous call to create a world "safe for democracy" can be understood as emphasising *safe* rather than *democracy*: "Rather than an idealist appeal, it is a call to reform...so as to allow Western liberal democracies to survive" (Ikenberry, 2020).

### Neorealist critique

Proponents of the (neo)realist school object that if states perceive a threat to their vital interests, they will take any necessary action without regard to the costs of breaking economic ties (Waltz, 1979). This will particularly be the case in the presence of a rising, revisionist great power that wants to upset the status quo. According to realists, economic interdependence not only fails to promote peace, but makes conflict more likely. The reason is that states will want to avoid dependence since critical imported goods could be cut off during a crisis. If states are or become dependent on others for vital supplies, they have an incentive to go to war to secure them. According to Mearsheimer (1992), for instance, dependent countries will want to "extend political control to the source of supply, giving rise to conflict with the source".

In relation to trade, Copeland (1996) furthermore links realist views on economic interdependence to mercantilist thinking dating as far back as the seventeenth century:

"Mercantilists saw states as locked in a competition for relative power and for the wealth that underpins that power. For mercantilists, imperial expansion the acquisition of colonies is driven by the state's need to secure greater control over sources of supply and markets for its goods, and to build relative power in the process."

Copeland (1996), p. 11

### Neoliberal critique

While neoliberal IR scholars typically recognise the moderating influence of economic interdependence on great power competition, some worry that it can be exploited under asymmetric interdependence. Farrell and Newman (2019) calls this 'weaponised interdependence'. As Bluth (2021) argues, however, it is difficult to weaponise interdependence when it is symmetric. Under symmetric interdependence, aggressive action by one major power is likely to be avoided or replicated by others.

## SUMMARY

Overall, IR theory supports the view that economic interdependence has a moderating influence on great power relations under most conditions in the current era. The two main cases that qualify this conclusion are when there are expectations of future decline in economic relations, or when interdependence is asymmetric. In the latter case, interdependence can be "weaponised" by the more powerful actor.

## 2.2 Relevant trade theory

### Under perfect competition

It is a surprisingly common perception that countries must “defend themselves” to remain competitive in the world economy. From a trade perspective, however, the law of comparative advantage tells us that irrespective of the absolute level of productivity, countries will always be net exporters in some sectors and net importers in others. A country’s comparative advantage is determined by patterns of relative productivity within the domestic economy, not by how hard or fair foreign competition is. As a country such as China grows economically, it will automatically take on a larger share of world trade, but it does not mean that there is a need to defend EU competitiveness via trade distortive measures. For instance, the main effect of Chinese subsidies that promote a certain industry (strategic or not) will be to subsidise domestic and foreign consumption of goods produced by that industry. Empirically, moreover, Felbermayr and Yotov (2021) recently showed that bilateral trade balances are indeed explained by underlying macroeconomic factors, rather than by uneven or unfair trade barriers.

### Under imperfect competition

When the analysis is extended to markets characterised by imperfect competition, the possibility of profit shifting, location advantages and advantages due to increasing returns to scale enters the picture. Under such conditions, new arguments, both for and against trade-distorting measures, appear. Under certain theoretical assumptions, for instance, a tariff can then shift production and profits to domestic producers. Policy recommendations under such “strategic trade policy” are far from robust, however. Small changes in assumptions about competitive conditions, technological development and the prospect of reciprocal action by trading partners can turn a policy recommendation on its head. In most cases, the outcome will be worse if a policy intervention is met by similar measures by other countries. Hence, the most robust policy advice is to avoid trade-distorting measures altogether.

### Picking winners and rent seeking

Another problem – irrespective of assumptions regarding market conditions or the size of the economy – has to do with the information problem faced by governments that try to ‘pick winners’. Since policies to subsidise some firms have an opportunity cost in that it discriminates against other firms that compete in the same factor markets, the policy hurts the overall economic performance if the government ‘picks’ firms that turn out to be less productive. Empirically, a recent OECD study on financial subsidies showed that subsidies are negatively correlated with productivity in the firms that receive them (OECD, 2021a). In other words, the subsidies may have caused distortions in world markets, but it did not strengthen the economy of the subsidising country – in this case typically China. Finally, policies that subsidise or provide special treatment to certain goods, services, sectors and technologies encourage so called rent seeking, i.e. when firms focus increasingly on securing benefits from public bodies charged with implementing such policies.

### New trade theory

Finally, it is important to recall recent advances in international trade theory that emphasise new channels through which gains from trade are realised (Melitz, 2003). According to this line of research, states’ gains from economic integration are considerably higher than previously thought (Melitz and Trefler, 2012; Balistreri, et al., 2011). The additional gains have various sources, including improved firm- and sector-level productivity,

increased competition and improved incentives for product and process upgrading (Lapham, 2015). The processes that produce these gains are undermined when trade policy serves to shield some parts of the economy from foreign competition or to subsidise certain firms or sectors.

### **This time it's different?**

The arguments above are familiar to most policy makers. So why do we see a renewed debate on industrial policy and strategic trade policy? An important 'this-time-it's-different' argument in some policy circles has to do with digitalisation and new technologies. According to this argument, emerging digital technologies augment economies of scale and first-mover advantages. In order to ensure that domestic firms are not left behind in a race to scale up, new industrial policies are required. The sense that 'this time it's different' is currently strengthened by the fact that the development is perceived to benefit a systemic rival (China).

A closer look at this argument reveals that not so much is different after all. While it is true that a technological leap, such as the digital transition, can benefit countries with large domestic markets and that digital platforms can boost productivity, the policy advice that follows is not a modern version of the infant industry argument. On the contrary, in order to benefit from emerging technologies that are associated with high productivity when scaled up, it is important to reduce trade barriers, not the least in order to expand the market for domestic firms. If firms are protected from foreign competition or if a new industrial policy is designed to pick winners, technological development is delayed, and the structural adjustment which allows the most productive firms to grow and scale up never occurs.

### **SUMMARY**

Overall, there is no strong economic rationale for a strategic EU trade policy that seeks to bolster certain sectors or firms for the purpose of competitiveness. Digitalisation and changing geopolitical conditions have not altered the basic economic analysis. If anything, recent advances in trade theory strengthen the case for maintaining an open EU trade policy irrespective of what other large economies do.

### 3. Recent developments in geopolitics and trade

As mentioned in the introduction, geopolitical tensions have risen in recent years. Two main factors behind this development have to do with the combination of a rising China and quick technological development perceived to determine future economic strength. Other factors include the rise of nationalist sentiments in a range of countries and a changing perception of US power, as well as Russian aggression toward neighbouring European countries.

The return of geopolitical rivalry increasingly spills over into trade policy. Russia's aggression against Ukraine and illegal annexation of Crimea, as well as its interference in US elections, have resulted in economic sanctions against Russia by the EU and the US. Factors associated with China's state-capitalist model – including its push for technical superiority, plans to promote manufacturing (Made in China 2025), the belt and road initiative and wide-ranging surveillance programmes – have triggered security concerns with trade policy implications among western countries. The US has, for instance, imposed technology-related export restrictions on China, restrictions that have extraterritorial effects on third countries. China has imposed similar restrictions on US technology and seeks deeper economic integration in the Asia-Pacific region. Under President Trump, even the relationship between the US and the EU deteriorated sharply and the Biden administration still has not lifted extraterritorial sanctions against Iran or steel and aluminium tariffs motivated by national security.<sup>1</sup> Another important geopolitical shift that has occurred in Europe is the UK's disengagement from the EU via Brexit.

In a closely related development, mercantilism with its emphasis on zero-sum games and bilateral trade balances has made a comeback in trade policy. This was particularly evident during the previous US administration as President Trump repeatedly associated trade deficits with “losing”. While the EU still largely views trade in positive-sum terms, the perception that Europe needs to defend itself against imports is widespread, and some perceive that Europe must become more self-sufficient, particularly in technologies and sectors viewed as strategic (European Commission, 2020a). The EU has already announced plans to become self-sufficient in electric vehicle (EV) batteries by 2025 and to double its share of semiconductors from 10 to 20% by 2030. In a 2020 speech at the European Conference on Batteries, Maros Šefčovič, vice-president of the European Commission, argued that the EU should use its “trade and customs instruments to promote local sourcing, by moving away from the practice of customs duty suspensions”.<sup>2</sup> Finally, military terms such as “coercion”, “deterrence” and even “collective defence” are used increasingly in the EU trade policy debate (European Council on Foreign Relations, 2020). Overall, our assessment is, therefore, that trade policy sentiments in both the US and the EU have become more mercantilist in recent years.

In terms of sectors, technologies and products viewed as critical to great power competition, there have also been important recent developments. While sectors such as steel, aluminium and fossil fuels are still regarded as strategic, digital technology has increasingly taken centre stage in great power competition. Since digital technology permeates large parts of the modern economy, it is easy to make the argument that a lot of different sectors are of strategic importance. According to the OECD (2021b), some countries also argue that lists of essential goods need to be ‘fluid and dynamic’ in order to account for different scenarios.

1 While the Trump administration justified tariffs on steel and aluminium by national security exceptions under GATT article XXI, the EU argues that they are in fact safeguard measures, an assessment shared by the Board. In other words, the national security motivation can be regarded as a rationalisation rather than a genuine motive.

2 [https://ec.europa.eu/commission/presscorner/detail/en/SPEECH\\_20\\_2202](https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_20_2202)

## 4. Geopolitics in EU Trade Policy

### 4.1 The EU trade policy review

After Ursula Von der Leyen was elected Commission President in 2019, she famously declared that she would lead a “geopolitical commission”. In line with this, geopolitical trends are well-covered in the European Commission’s Communication on the future of trade policy (*Trade Policy Review – An Open, Sustainable and Assertive Trade Policy*) of 18 February 2021 (henceforth, the TPR Communication).

To address geopolitical challenges the TPR Communication emphasises “open strategic autonomy” as a key aspect of EU trade policy. As the meandering definition of open strategic autonomy suggests (see box 2, p. 13), the term is ambiguous. In our view, it therefore provides insufficient strategic guidance to address the challenges identified in the TPR Communication.

On the subject of geopolitics, the TPR Communication talks about “a new multipolar global order marked by growing tensions between major players” and argues that “the EU needs to equip itself with tools to operate in a more hostile international environment.” At the same time, it describes “openness and engagement as a strategic choice” for the EU and it calls effective, rules-based multilateralism “a key geopolitical EU interest”. Regarding the means through which EU geopolitical objectives can be achieved, the Communication makes the following assessment:

“In order to help fulfil its geopolitical ambitions globally, the EU will need to diversify its relations and build alliances with like-minded partners, including through its broad network of trade agreements. This network is essential with each and every current and future agreement forging our relationships with partners. The EU’s free trade agreements (FTAs) are platforms for enhanced cooperation pursuing our values and interests. They are the basis for engagement with important markets and countries around the world, particularly in the Asia-Pacific region, in Latin America and the Caribbean.”

While ambiguous terms such as “open strategic autonomy” muddles the Communication’s strategic orientation somewhat, the quoted section above provides a clear and coherent vision of the EU’s main strategic approach in the years ahead. As we shall argue, it is also the approach that is most realistic and best suited for the EU.



## Box 2

### Open strategic autonomy in the EU Trade Policy Review

"[O]pen strategic autonomy emphasises the EU's ability to make its own choices and shape the world around it through leadership and engagement, reflecting its strategic interests and values. It reflects the EU's fundamental belief that addressing today's challenges requires more rather than less global cooperation. It further signifies that the EU continues to reap the benefits of international opportunities, while assertively defending its interests, protecting the EU's economy from unfair trade practices and ensuring a level playing field. Finally, it implies supporting domestic policies to strengthen the EU's economy and to help position it as a global leader in pursuit of a reformed rules-based system of global trade governance. Open strategic autonomy is a policy choice, but also a mind-set for decision makers. It builds on the importance of openness, recalling the EU's commitment to open and fair trade with well-functioning, diversified and sustainable global value chains. It encompasses:

- resilience and competitiveness to strengthen the EU's economy;
- sustainability and fairness, reflecting the need for responsible and fair EU action;
- assertiveness and rules-based cooperation to showcase the EU's preference for international cooperation and dialogue, but also its readiness to combat unfair practices and use autonomous tools to pursue its interests where needed."

### Vital and non-vital interests in the Trade Policy Review

In a geopolitical context, countries typically distinguish between vital and non-vital interests. Such a determination should ideally form the basis for a discussion about EU trade policies for geopolitical purposes. While the TPR Communication does not use the term "vital interests", a careful reading of it suggests that overall EU economic performance, a climate neutral economy and the digital transition can be described as vital economic interests for the EU. Preventing climate change is the "defining objective of our time" and trade policy has "a vital role" to play in attaining EU objectives linked to the digital transition. The overall economic performance of the Union is not mentioned explicitly but is arguably implied. In addition, the TPR Communication states that

- "support for effective rules-based multilateralism is a key geopolitical EU interest",
- "Stability and prosperity in the EU's neighbouring countries and Africa are in the EU's political and economic interest"; and
- "the EU has a strategic interest to support enhanced integration in the world economy of vulnerable developing countries"

## 4.2 The new EU industrial strategy

According to the 2020 communication on a new industrial strategy (European Commission, 2020a), "new and ever-changing geopolitical realities are having a profound effect on Europe's industry". The Commission further argues that "Europe's strategic autonomy is about reducing dependence on others for things we need the most: critical materials and technologies, food, infrastructure, security and other strategic areas." At the same time, it makes the case that "Europe's response [to geopolitical headwinds] cannot be to erect more barriers, shield uncompetitive industries or mimic the protectionist or distortive policies of others. Being competitive requires competition – both at home and in the world."

In connection with the new industrial strategy, its 2021 update (European Commission, 2021a), and the Covid-19 recovery plan (European Commission 2020b), the Commission identifies a number of strategic sectors and dependencies as well as critical technologies and materials.

### **Sensitive industrial ecosystems and strategic dependencies**

In the 2020 Covid-19 recovery plan (The European Commission, 2020b), 14 so called ‘industrial ecosystems’ are listed.<sup>3</sup> Six of these (aerospace and defence, health, digital, renewable energy, energy intensive industries and electronics) are described as ‘sensitive’ in a staff working document (European Commission, 2021b) accompanying the 2021 update of the industrial strategy. It is unclear what makes an industrial ecosystem ‘sensitive’, but all six are described as ‘strategic’. According to the document, dependencies are strategic when they impact:

- a. the security or safety of Europeans or limit the possibility for the EU to exercise a foreign and security policy in line with its values and strategic interests,<sup>4</sup>
- b. the health of EU citizens,
- c. the EU’s access to inputs, technologies and services that are key for the climate neutral and digital transitions.

In EU regulation 2019/452 on the screening of FDI, the objective is strictly limited to security or public order. It is therefore notable that the new industrial strategy mixes security objectives with broader foreign policy interests and even economic objectives.

Ultimately, only 34 products representing 0.6 percent of extra EU-imports are characterised as particularly vulnerable given their indicated low potential for diversification or substitution. Twenty-two of these products are raw materials and intermediate goods, whereas 12 are final products such as turbo-propellers, parts of protective garments, radio-broadcast receivers and some medicines. In a recent evaluation of the updated industrial strategy, the Board concluded that the 12 final products identified do not appear to be of sufficient strategic importance for the EU or Sweden to warrant special attention beyond measures that are already in place.<sup>5</sup>

### **Strategic areas and industrial alliances**

The updated industrial strategy furthermore identifies six “strategic areas”, namely raw materials, active pharmaceutical ingredients, batteries, hydrogen, semiconductors and cloud and edge computing. To support these strategic areas, industrial alliances within sectors such as batteries, clean hydrogen and raw materials have been launched and two new alliances on semiconductor technologies and industrial data, edge and cloud are about to be launched. Another two industrial alliances on space launchers and zero emission aviation are being prepared.

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3 1. Aerospace & Defence, 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 and 14. Tourism.

4 Here, reference is made to EU regulation 2019/452 on the screening of FDI, which mentions a range of sectors, technologies and inputs that may be taken into account (article 4.1).

5 *Kommentarer på EU:s uppdaterade industristrategi* (COM(2021) 350 final), Dnr 2021/00862-3.

## Critical technologies and raw materials

Ursula von der Leyen has declared that the EU should achieve ‘sovereignty’ within critical technology areas. A range of such critical technologies are listed in a 2021 communication on synergies between civil, defence and space industries (European Commission (2021c, pp. 8-11).

A study by the European Commission’s Joint Research Centre (European Commission, 2020b) identifies a different set of critical technologies and raw materials. Among the technologies described as critical, the study lists EV batteries, fuel cells, wind energy, electric engines, solar panels, robotics, drones, 3D Printing and information and digital technology more broadly. Connected to these are a range of similarly critical raw materials.

Yet another illustrative list of ‘critical technologies’ is found in article 4.1 of regulation 2019/428 establishing a framework for the screening of FDI.

In addition, there are established procedures for identifying “critical raw materials”. The 2020 update of the critical raw materials list resulted in an extension of the list from 26 to 30 such raw materials.

To summarise, EU industrial policy is going through a period of quick transformation, not the least via a wide-ranging and fast-changing designation of sectors, technologies and raw materials described as strategic or critical. Their identification is furthermore based on a number of different factors, and their objectives range from security and public order to foreign policy, health as well as the digital and climate neutral transitions.

### Box 3

#### IT security regulation and trade

In a previous analysis (Kommerskollegium, 2019), we noted that IT-security regulations affect international trade and that there is an urgent need for national security and trade policy to communicate better. This is especially important in order to address increased regulatory fragmentation. To solve this problem, the report recommended more targeted and effective regulatory strategies. One of the recommendations was to analyse security threats more carefully in order to better support decisions on what kind of regulatory measures and requirements are relevant and justifiable to secure information. The analysis also argued for regulation in transparent, open fora with preference for international standards that avoid national or regional gold plating.

Another recommendation was to avoid regional regulatory frameworks that do not acknowledge crucial international dependencies (for member states individually and EU as a whole) since the competitiveness of EU firms often depends on interconnectivity. If such regional solutions are still pursued, however, a basic requirement should be that they are traceable, transparent and proven to be effective through a comprehensive regulatory impact assessment. Otherwise, there is a high risk of trade barriers, especially since the cybersecurity landscape is fragmented and difficult to monitor and enforce.

## 5. EU relations with other great powers

Before discussing challenges and potential solutions, it is important to take a closer look at the EU's current relations with other great powers, as expressed in official EU documents.

### 5.1 The United States

The December 2020 Joint Communication from the Commission and the High Representative for foreign affairs and security policy (“A new EU-US agenda for global change”) describes the EU's relationship with the US as follows:

“The relationship between the European Union and the United States is unique and built on shared history, shared values and shared interests...

In recent years, our relationship was tested by geopolitical power shifts, bilateral tensions and retreats to unilateral policies. With a change of administration in the US, a more assertive Europe and the need to design a post-corona world, we have a once-in-a-generation opportunity to design a new transatlantic agenda for global cooperation – based on our common values, interests and global influence. This should be the linchpin of a new global alliance of like-minded partners.”

On the issue of transatlantic cooperation, the TPR Communication refers to the December 2020 joint Communication and concludes that the EU will “give priority to strengthening its partnership with the US.”

### 5.2 China

The 2019 joint Communication between the Commission and the High Representative for foreign affairs and security policy (*EU-China: A Strategic Outlook*) to the European Parliament and the Council, describes the EU's relationship with China as follows:

“China is, simultaneously, in different policy areas, a cooperation partner with whom the EU has closely aligned objectives, a negotiating partner with whom the EU needs to find a balance of interests, an economic competitor in the pursuit of technological leadership, and a systemic rival promoting alternative models of governance.”

The 2021 TPR communication refers to the 2019 joint communication and adds the following:

“the rapid rise of China, demonstrating global ambitions and pursuing a distinct state capitalist model, has fundamentally changed the global economic and political order. This poses increasing challenges for the established global economic governance system and affects a level playing field for European companies competing globally and at home”

Regarding policy, it then goes on to make the following assessment:

“The EU’s [China] policy is based on a combination of active engagement, both at bilateral and multilateral level, and of parallel development and implementation of autonomous instruments necessary to protect the EU’s essential interests and values – in full compliance with its international commitments. Building a fairer and rules-based economic relationship with China is a priority. Ensuring that China takes up greater obligations in international trade, and dealing in parallel, with the negative spillovers caused by its state-capitalist economic system will be central to the EU’s efforts to rebalance the bilateral trade relationship. The recent political conclusion of the negotiations on a Comprehensive Agreement on Investment is part of these efforts.”

Overall, the 2021 TPR communication carries the same message as the 2019 joint communication on China, but the TPR has a more urgent tone.

### 5.3 Russia

EU policies toward Russia are based on the five guiding principles that were established after the 2015 illegal annexation of Crimea and Sevastopol.<sup>6</sup> The five principles are:

1. Full implementation of the Minsk agreements;
2. Closer ties with Russia’s neighbours;
3. Strengthening EU resilience to Russian threats;
4. Selective engagement with Russia on certain issues such as counter-terrorism; and
5. Support for people-to-people contacts.

Within this framework, the room for EU engagement with Russia on trade policy is very limited. In connection with the 23 March 2021 Foreign Affairs Council, EU High Representative Josep Borrell made the following statement regarding the state of EU-Russia relations:

“It is clear that Russia has taken a confrontational stance towards the European Union. The authorities’ violations of human rights and international law both on Russian territory...as well as beyond its borders, are increasing. The Russian authorities have shown unwillingness to engage on addressing these issues. Russia is drifting towards an authoritarian state and away from Europe and Europe must draw the consequences of that.”

Given Russia’s geostrategic importance, it is notable that the TPR communication does not mention Russia, possibly reflecting the limited policy space. Unlike for the US and China, there are also no recent strategic EU communications on Russia.

### 5.4 Other regional powers

In a discussion about trade and geopolitics, there are also regional powers such as Japan, India, Brazil, Indonesia, Turkey, the UK, Canada, Australia, Korea and Vietnam that are relevant from an EU perspective. In terms of global influence, intentions and capacity, however, the US, Russia and China stand out.

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<sup>6</sup> See, for example, conclusions from the Foreign Affairs Council, 14 March 2016: <https://www.consilium.europa.eu/en/meetings/fac/2016/03/14/>

## 6. The challenge – matching means and ends

In order to draw conclusions and make recommendations, it is important to discuss challenges that the EU faces in developing a trade policy for geopolitical purposes.

### Treating all tools as if they were a hammer...

While geopolitical action can take a lot of different forms, the hybrid nature of EU governance (with powers at EU or member state level depending on the issue) means that the Union has fewer instruments at its disposal than other great powers. Most notably, foreign and security policy decisions still require consensus and the EU has limited military capabilities. In a historical perspective, the hybrid structure of EU governance is not unique<sup>7</sup> and it need not be a problem in practice. It can also be compensated via close coordination of foreign and security policy. In connection with trade policy, however, there is one additional problem related to this. The limited number of available instruments for deterrence or coercion does not necessarily mean that it is desirable or effective to use trade or investment policy for those purposes. The risk that the EU faces here is a version of the so-called law of the instrument<sup>8</sup> – that we use all available policy tools as *if* they were a hammer.

### Deterring ourselves

As mentioned in the introduction, the essence of trade – mutual exchange – does not necessarily mix well with security-related concepts. Consequently, it is not suitable to copy military terms such as “deterrence” or “coercion” and paste them onto trade policy. Beyond the risk of using a trade policy screwdriver as if it were a hammer, there are several reasons for this. To begin with, a trade policy that restricts the commercial transactions of EU firms hurts EU firms first. By contrast, military force for the purpose of coercion or deterrence hurts the adversary first when used (even when destruction is ultimately mutually assured). Since trading EU firms are importers to at least the same degree that they are exporters – the most productive EU firms are typically both – measures that are discriminatory or more trade restrictive than necessary, act as a deterrent to our own economic success.<sup>9</sup>

### The autonomy trap

Another challenge in matching trade policy means with geopolitical ends has to do with the so called ‘autonomy trap’ (Youngs, 2021). As Youngs explains, the EU’s autonomy from others will simultaneously give other economies more autonomy from the EU.

“Other powers will have less need to cooperate with the union in their own political-strategic actions. In this way, the EU’s quest for strategic autonomy could risk undercutting, not driving, the projection of geopolitical power.”

The ‘autonomy trap’ thus suggests a paradox: a geopolitical strategy that emphasises autonomy from others is difficult to square with policies that require engagement with partners to achieve common objectives. Youngs further warns that the EU risks adopting a perspective that the UK has been criticised for in the Brexit debate. Autonomy and/or sovereignty buy neither the EU nor the UK effective leverage to get things done on the world stage.

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7 A range of European great powers from the 16th to the 19th century were hybrid forms of government with shared or devolved powers in foreign and security policy.

8 According to the original law of the instrument “it is tempting to treat everything as a nail if the only tool you have is a hammer”. It was first attributed to philosophy professor Abraham Maslow.

9 For recent evidence of EU gains from imports, see DG Trade (2020).

Finally, there is a risk that the autonomy trap becomes a vicious circle. Because of an increasing sense of vulnerability, the EU seeks more autonomy from others. This reduces EU leverage over others, further weakening the EU geopolitical position. This, in turn, leads to calls for more autonomy and so on.

### **Unilateralism: tit-for-tat or unblocking our harbours?**

The TPR Communication argues that a growing problem in international trade is the increasing resort to unilateralism. The question then becomes: How should the EU best address this? Again, drawing analogies from the security sphere can be misleading. While tit-for-tat is generally a reasonable strategy for repeated games in security policy, the same is not necessarily true in trade policy. As mentioned above, the economic benefits from trade derive as much from imports as from exports. In most cases, therefore, the same strategy (maintaining open trade channels) is superior for the EU irrespective of what our trade partners do. This becomes even clearer when the trade-is-like-security analogy is turned on its head: during war or imminent conflict, countries often block the harbour of its enemy, but no country would dream of imposing a blockade on itself. In trade, the open harbour approach is, therefore, better than a tit-for-tat approach in most conceivable cases.

### **The securitisation of trade policy**

Another potential challenge in squaring security policy with trade policy is a phenomenon that international relations scholars refer to as “securitisation” (Buzan et al., 1998). During such a process, more and more societal challenges are framed as a security threat in order to pave the way for extraordinary policy measures. This is particularly relevant when states wish to insure against an increasing number of threats under a range of future scenarios. As our analysis of trade and IT security (see box 3) shows, this risk is particularly relevant in the context of IT security regulation.

The risk of securitisation increases during a technological leap forward that shapes large parts of the economy – in other words during current circumstances. Related to this observation, there is also a risk that measures that have a different motivation are *justified* on national security grounds in order to comply with national security exceptions under WTO law.

### **It's the evidence, stupid...**

Obviously, the EU should not use trade policy for the purpose of defence, coercion or deterrence unless the intended measures are likely to be effective. Before introducing potential trade distorting measures, evidence regarding the existence, nature and magnitude of the problem in question should, therefore, be collected. In a quickly evolving technological environment, it is particularly important to base policy on solid empirical evidence, not on worst-case scenarios regarding how certain technologies *could* potentially disrupt markets and change power relations.

Measures that restrict the transactions of some EU firms – effectively compromising their rights – should furthermore be based on evidence regarding the extent to which they help or hurt the EU economy as a whole. Within the EU, such considerations have historically been accommodated through a Union interest test in trade defence investigations. The problem with the Union interest test is that the current method to account for wider interests does not include a standard general equilibrium analysis (i.e. overall EU welfare effects) and only includes a limited set of stakeholders.

Finally, it is important to develop a solid understanding of the conditions under which trade restrictions help the EU reach its aims and when they are more likely to escalate a conflict. Such evidence could be based on the experience of the effects of current and past countermeasures adopted by the EU and other WTO members.

## 7. The solution – alliances with like-minded partners

The EU's historic lesson on how to build security and advance geopolitical interests through trade is abundantly clear. On the [70th anniversary of the Schuman declaration](#), the European Council described the strategic vision of the EU founding fathers as follows:

“Their vision was that European countries would pool strategic resources together in order to make war between historic rivals, like France and Germany, not merely unthinkable, but materially impossible.”

In recent history, the EU's vision of strategically motivated economic integration has been applied not only internally but also in relation to neighbours through accession and close economic partnerships. This grand strategy has produced an unprecedented period of peace and stability in Europe and it has strengthened the EU and its member states geopolitically compared to a counterfactual ‘non-Europe’. Globally, the same strategy is reflected in the EU's strong commitment to multilateral cooperation.

While the view that economic integration promotes democracy has not been borne out by evidence during the past decade, the theoretical discussion in section 2 suggests that economic interdependence is still a relevant geopolitical strategy to keep the EU safe. Irrespective of whether the past ten years represent a temporary or long-term setback in democratic enlargement, the basic EU lesson therefore still applies.

The EU's historical grand strategy is also supported by the treaties. In fact, it is reflected in the very first sentence of the general provisions of EU external action as laid out in article 21 of the Treaty on European Union:

“The Union's action on the international scene shall be guided by the principles which have inspired its own creation, development and enlargement, and which it seeks to advance in the wider world”.

According to article 206 of the Treaty on the Functioning of the Union, the EU shall furthermore:

“contribute...to the harmonious development of world trade, the progressive abolition of restrictions on international trade and on foreign direct investment, and the lowering of customs and other barriers”.

A third cornerstone – besides historic lessons and treaty prerogatives – of an EU trade policy for geopolitical purposes is trade theory (see section 2.2). Economic benefits associated with trade cannot be realised unless we allow specialisation, mutual exchange and structural adjustment to take place. While mercantilist ideas might be of historic interest, they are not relevant for today's EU economy. The discussion of the costs and benefits of a ‘strategic trade policy’, moreover, suggests that the economic rationale of such a policy remains elusive. Finally, 21st century trade theory emphasises new channels through which productivity can be enhanced via trade.

Productivity growth in Europe currently lags that of other great powers (see for instance Draghi, 2016, pp. 12-13 in the European Commission [2019], and Lamprecht, 2021).<sup>10</sup> On top of that, the EU just lost almost 20 percent of its economy via Brexit. From a geopolitical perspective, one might therefore argue that it is a more pressing question how trade

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<sup>10</sup> For analyses of factors that hold Europe back economically, see discussions in Bluth (2021) and The Economist (2021).

can leverage the EU economy than how the EU economy can be leveraged for foreign policy purposes.

Productivity is also the key to achieving vital EU interests. *The digital transition* represents a vital interest in itself and is integral to the so-called fourth industrial revolution. Improvements in productivity are also necessary to achieve *the climate neutral transition* since this transition requires replacing old technology and infrastructure with low-carbon alternatives. It also requires scaling up production that uses digital inputs intensely. It is difficult to see how this can be achieved without the help of trade and economic specialization.

With this in mind, it is important to identify the channels through which trade strengthens the EU economy, particularly by improving productivity. Among other things, trade strengthens the EU economy by:

- giving EU firms access to productivity-enhancing technology, knowledge, competence, capital, services and low-cost inputs,
- allowing the most productive firms to grow and employ more people and capital,
- increasing real wages through lower prices and better paying jobs,
- allowing a more efficient resource allocation (via specialisation),

Nurturing these benefits should be the main objective of an EU trade policy for geostrategic purposes. The way that trade policy can support this objective is through increased economic integration with other countries. If the EU becomes the hub of global trade, Europe's geopolitical position will be stronger. If EU trade policies push economic dynamism to other parts of the world, it will hurt productivity and the EU will be weaker geopolitically.



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## 7.1 Rule-based multinationalism

In line with the assessment above, the Board supports the Commission's emphasis on effective, rules-based multilateralism ("a key geopolitical EU interest") as the main way to deepen economic integration with other countries. Historically, the EU has been one of the largest beneficiaries of the multilateral framework, and several vital EU interests, particularly digitalisation and climate neutrality, are best addressed in a multilateral context. Consequently, that should always be the first EU option. We also support the Commission's judgment that enhanced integration of vulnerable developing countries in the world economy is a "strategic interest".

Due to growing tensions between great powers (among other things), however, it is unlikely that multilateralism will take us all the way toward realising vital EU interests. Even when there are converging interests between, say, the EU, the US, China and Russia, there is always a risk that other countries block progress at the WTO. Consequently, the EU must have other options.

## 7.2 Alliance-building with like-minded partners

The most realistic alternative to multilateralism is alliance-building with like-minded countries that have similar trade policy objectives and perceive global challenges similarly. In other words, the policy option that best complements multilateralism is the path suggested by the Commission in the TRP communication: "In order to help fulfil its geopoliti-

cal ambitions globally, the EU will need to diversify its relations and build alliances with like-minded partners”. While the TPR communication does not name this strategy, “diversification and alliance-building” might apply. The problem is that the communication remains relatively empty on concrete policy content to realize diversification and alliance-building. Therefore, it needs to be filled with more concrete content. Below, we list some ideas on how this could be done.

### **Going from hub-and-spoke FTAs to larger areas of open trade between the EU and its like-minded partners**

So far, EU trade agreements have mainly been concluded in the form of bilateral agreements. For the future, linking these agreements to each other would be an attractive option. Rather than the current hub-and-spoke structure of EU FTAs, a larger cohesive area between the EU and like-minded partners could be envisioned. The Pan-Euro-Med arrangement on rules of origin is a potential model here. If harmonisation is not feasible, however, another option would be to use mutual recognition of origin between free trade areas with overlapping EU FTAs. Yet another option would be extended cumulation.

Similarly, a coherent adequacy arrangement for data flows between the EU and like-minded countries is in the EU’s vital interest. Harmonising standards in other areas regarded as critical for strategic technologies and modern industrial ecosystems could also form the basis for deeper integration under such a strategy.

Besides neighbouring countries (the EES, accession countries, the Euromed, the Eastern Partnership, the UK and Switzerland), the obvious like-minded candidates for such a strategy are countries with which the EU has concluded or is about to conclude FTAs, including Japan, Canada, Mexico, Vietnam, Australia, New Zealand, Korea, Indonesia, Brazil, Argentina, Uruguay and Paraguay. Many of these countries are current members of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). It therefore makes sense to approach these countries first in an effort to create a larger, cohesive free trade area among like-minded partners. Similarly, the recently concluded but not yet ratified EU-MERCOSUR agreement is important from a geopolitical perspective. If there is credible commitment to liberalise substantially all the trade (as the WTO requirement for bilateral/regional preferences reads) from India and the remaining ASEAN countries, the EU should also seek to include them in the alliance-building strategy.

On a strategic level, the idea would be to create an extension of the leverage provided by the single market together with like-minded partners. While the EU is not in a position to shape geopolitics or globalisation on its own, a larger economic area of like-minded partners would have sufficient attraction to do that. For such a strategy to be successful, the EU should approach it in a cooperative fashion. The EU’s own regulatory solutions are of high standard, but as long as regulatory objectives are reasonably aligned between the EU and our partners, we should seek mutually satisfying solutions. As the EU is about to design new unilateral trade-related legislation across a range of issues, it is important to leave sufficient room for compromises with like-minded partners. In this context, it is also important to keep in mind that the EU is of important strategic value for others, especially by having a harmonised market with a successful model for technical harmonisation, and high ambitions with respect to the environment, sustainability, consumer safety and new technologies. These are all important factors in facilitating economic cooperation in a range of areas with other countries. Finally, it is worth noting that close EU partners and original CPTPP members, such as Canada, New Zealand and Chile continue to take new trade policy initiatives that the EU might benefit from engaging with. One example is the modular approach to digital trade regulation envisioned in the Digital Economy Partner-

ship Agreement between New Zealand, Singapore and Chile.<sup>11</sup> Another example is the Global Trade and Gender Arrangement between Canada, Chile and New Zealand.<sup>12</sup>

As shown in *Improving economic resilience through trade – Should we rely on our own supply?* (Kommerskollegium, 2020), the alliance-building strategy also makes sense from a resilience perspective since it would help diversify EU trade and reduce reliance on specific countries and geographic regions.

## Neighbours first

From a geopolitical as well as a trade perspective, our neighbours affect us the most. In 2019, EU exports to neighbouring countries (UK, EFTA, Euromed, Eastern partnership) outweighed exports to China by a factor of four. While the US might ‘pivot to Asia’, the EU’s most important geopolitical opportunities and challenges remain in Europe and along its perimeters. In the TPR communication, the Commission therefore correctly identifies “stability and prosperity in the EU’s neighbouring countries” as a vital interest. Again, however, the communication is low on operative content, at least compared to the unilateral agenda. In recent years, EU accession talks have slowed down because domestic sensitivities have been allowed to override strategic priorities. This is unfortunate, because it could allow other great powers to expand their influence in the EU’s immediate neighbourhood, particularly in the western Balkans. Renewed efforts to advance EU accession or close integration with neighbouring countries would therefore be desirable from a geopolitical perspective.

## Strengthening the transatlantic partnership

The EU’s most important geopolitical relationship is with the US. Whereas the EU frames its relationship with China in more adversarial terms, the EU-US relationship is described as the “linchpin of a new global alliance of like-minded partners”. Given this characterisation and the fact that the TPR Communication gives “priority to strengthening its partnership with the US”, it is natural to consider new ways to deepen transatlantic economic integration.

The suspension of tariffs in the Boeing-Airbus dispute is a promising start to the EU-US trade relations under President Biden. In response to the EU’s decision to freeze counter-measures in the steel and aluminium dispute, the US should remove its Trump era measures on steel and aluminium as soon as possible, and they should not be replaced by other formal or informal trade-distortive measures. Recent analysis shows that they have not helped the domestic US steel industry and that current measures have had a negative impact on US employment (Cox and Russ, 2020). They also clearly have a negative impact on transatlantic relations.

As a second step, the EU should work to remove other major obstacles to transatlantic trade, primarily the absence of an adequacy framework for data flows. Related to this, it is our assessment that the EU-US economic relationship often lacks the necessary trust to advance critical regulatory issues of mutual interest. Finally, an EU-US trade agreement would be in the EU’s geopolitical interest. It would serve to strengthen Europe’s economy and give substance to the characterisation of the transatlantic relationship as “the linchpin of a new global alliance of like-minded partners”.

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11 See <https://www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-in-force/digital-economy-partnership-agreement-depa/depa-modules/>

12 See [https://www.international.gc.ca/trade-commerce/inclusive\\_trade-commerce\\_inclusif/itag-gaci/2020-08-04-joint-communique-commun.aspx?lang=eng](https://www.international.gc.ca/trade-commerce/inclusive_trade-commerce_inclusif/itag-gaci/2020-08-04-joint-communique-commun.aspx?lang=eng)

## 7.3 The relationship with Russia

From a geopolitical perspective, Russia is currently a more important challenge for the EU than China. (From a trade policy perspective, China is more important.) Russia threatens the territorial integrity, stability, prosperity and democratic development of neighbouring countries in Europe, whereas challenges posed by China are more multifaceted and geographically distant.

In relation to the discussion of the security benefits of economic interdependence, it is notable that the EU and Russia have a relatively low level of economic integration from the outset and that economic dependence cannot be described as symmetric. The EU is the larger economy and wants to reduce dependence further on products (fossil fuels) from which Russia receives a lot of its export earnings. All else equal, this could increase Russia's sense of vulnerability in the future. Overall, it appears unlikely that economic interdependence alone could provide a sufficiently strong counterbalance to factors that predisposition conflict in the event of a spiralling security dilemma between the EU and Russia.

Given the lack of progress in implementing the Minsk agreements, trade policy options in the EU's relationship with Russia remain limited. The prospect of future economic integration between the EU and Russia, provided the Minsk agreements are implemented, should be kept open, however. As the theoretical discussion in section 2 showed, expectations of future economic integration can strengthen the moderating influence of economic interdependence.

## 7.4 The relationship with China

The multifaceted EU strategy toward China emphasises challenges related to China's state-capitalist system as well as the benefits of economic interdependence from a security perspective. While global trade integration did not have the positive effects on China's domestic political development that many hoped, economic interdependence still has value from a security perspective. Maintaining interdependence, rather than seeking decoupling, is therefore a reasonable strategy for the EU. This conclusion also applies more generally. While targeted sanctions represent a legitimate EU foreign policy tool, EU firms should be able to continue to trade in civilian goods and services with authoritarian states. Special rules, of course, apply in all EU member states for defence-related goods and services, such as defence ordnance and dual-use equipment.

Our assessment is, furthermore, that the risk that China could successfully 'weaponise' economic interdependence in relation to the EU is low, in particular if the EU seeks partnerships with the US and other like-minded countries. As Bluth argues, "Interdependencies are vulnerabilities but since they work two-directionally, they are also an assurance of non-aggression, as long as they are more or less symmetric. Symmetric interdependencies are in fact the best guarantee of geoeconomic stability". From this perspective, the EU-China comprehensive agreement on investment makes sense for the EU since it represents an effort to bolster economic interdependence and cooperate on selected issues of mutual interest.

## 7.5 Unilateral action as a last resort

Unilateralism is rarely an effective alternative to any of the options discussed above. Besides the challenges discussed in section 6 (the risk of treating all tools as if they were a hammer, hurting our own economy, the autonomy trap and securitisation) it is a very difficult balancing act to apply unilateral measures in a WTO consistent manner, while at the

same time advancing EU geopolitical interests in relation to other countries. And if the EU abandons the spirit of WTO law, we undermine the very rules-based multilateralism that we say is in our geopolitical interest. Unilateral measures that ‘pick winners’ are also likely to hurt the EU economically since they interfere with the process that allows the most productive firms to grow and structural adjustment to take place.

Despite this, the current EU legislative agenda includes a host of unilateral initiatives that threaten to discriminate between domestic and foreign commercial interests. There are initiatives to increase self-sufficiency in certain sectors and technologies, discussions on whether to relax EU state aid rules, investment screening for the purpose of security or public order, an international procurement instrument, legislation to neutralise distortions caused by foreign subsidies, a carbon border adjustment mechanism and legislation to counter coercion by other countries. While these and any future initiatives should be evaluated on their own merit, the lack of balance in relation to initiatives under an alliance-building agenda, is striking.

With the above considerations in mind, the EU should develop stricter requirements for unilateral trade policy measures. In particular, unilateral measures that discriminate between domestic and foreign commercial interests should not be imposed without an assessment of:

- the magnitude of the economic distortion that the measures are intended to correct,
- their effectiveness in achieving stated objectives,
- their wider welfare effects (including on productivity, competition, EU consumer welfare, downstream and upstream EU industries),
- administrative costs for firms, particularly SMEs,
- whether the measure is likely to produce countermeasures by other countries.

Assessments of the wider welfare effects should always be based on established methods used in economics. The EU should also not develop unilateral instruments to shield the Union from relatively small economic distortions. Under those circumstances, potential benefits are unlikely to match economic and geopolitical costs.

Assessments of the kind listed above were largely absent in the impact assessment of the proposed legislation on foreign subsidies distorting the internal market (European Commission, 2021d) and during the consultation phase of the new anti-coercion instrument. While it is encouraging that the proposed legislation on foreign subsidies includes a balancing test that takes into account potential positive impacts of foreign subsidies, such a test does not represent a comprehensive cost-benefit analysis along the lines proposed above.

Any unilateral action that restricts the rights of EU firms to conduct business with non-EU firms must, of course, also conform with existing legal requirements, such as general principles of EU and international law, including requirements that they be precise, transparent and limited in purpose and scope, proportional to their purpose, and that they allow for legal recourse. They must also respect the Charter of Fundamental Rights (including the freedom to conduct business in Article 16) as well as EU commitments in international trade agreements.

### **Keep lists of strategic or critical goods, technologies and sectors transparent and narrow**

It is important to avoid a situation where the EU gives a wide and fluctuating range of goods, technologies and sectors special treatment because they are all designated as strategic or critical. Such a trend would run the risk of introducing economic distortions and

reducing productivity in sectors that the EU wants to promote, for instance, for the purpose of the digital and climate neutral transitions. It also prevents transparency, competitive neutrality and, ultimately, good governance. Lists of strategic or critical goods and technologies should, therefore, be kept narrow, overlapping lists should be weeded out, and each list should be determined by objective criteria. It is important that any subsidies for such goods, technologies and sectors be transparent to facilitate evaluation and accountability.

### **Separating security objectives from competitiveness concerns**

As we saw in section 4.2, some current EU initiatives are for the purpose of security or public order while others are for the purpose of economic competitiveness, a “level playing field” or the promotion of the digital and climate neutral transitions. During a period when a lot of unilateral instruments are introduced at the same time as EU industrial policy undergoes quick transformation, it is critical that each initiative have a clear and transparent purpose and that action be undertaken for that purpose only. For security or public order, there are legitimate objectives that need to be addressed even if measures for this purpose also need to be transparent, limited and targeted. Industrial competitiveness, on the other hand, including issues related to resilience and the twin transitions, is not a national security objective and it is best promoted via non-discriminatory, open trade and investment policies.

For standards and IT security, we refer to our previous conclusions (see box 3, p. 15).

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## Sammanfattning på svenska

EU:s historiska strategi att främja fred och säkerhet via ekonomisk integration fungerar och bör inte överges när vi går in i en ny era som präglas av geopolitiska spänningar och växande protektionism. Handelsutbyte med andra länder stärker EU ekonomiskt bl.a. genom att EU-företag får tillgång till produktivitetshöjande teknologi, kunskap, kompetens, kapital och insatsvaror, samt genom att de mest produktiva EU-företagen ges möjlighet att växa och blir större. En mer attraktiv ekonomi stärker i sin tur EU geopolitiskt, något som i slutändan även kan bidra till att värna säkerheten för EU och dess medlemsstater. Vidare visar forskning att handel och ekonomisk integration har en stabiliserande säkerhetspolitisk effekt, även i relation till auktoritära länder.

### Övergripande strategisk inriktning

Ett fungerande multilateralt samarbete bör fortsatt vara huvudstrategin i EU:s handelspolitik. Om denna väg blockeras bör EU söka fördjupad integration med länder som är likasinnade i handelspolitiken och synen på globala utmaningar. Förutom EU:s nära grannländer gäller det framför allt en rad länder som EU redan har eller håller på att teckna frihandelsavtal med, däribland Kanada, Japan, Mexiko, Vietnam, Australien, Nya Zeeland, Korea, Indonesien och Brasilien. En ambition bör vara att binda ihop existerande avtal bättre så att det skapas mer sammanhållna frihandelsområden som EU är en central del av. På sikt bör även USA vara en del av den visionen.

### Prioritera närområdet

EU:s viktigaste säkerhetspolitiska intressen finns i Europa och längs dess gränser. Under de senaste åren har dock EU:s utvidgningsförhandlingar bromsat in. Detta är olyckligt eftersom det möjliggör för andra stormakter att utöka sitt inflytande i EU:s närområde, särskilt på västra Balkan. Förnyade ansträngningar för EU-utvidgning eller nära integration med grannländer vore därför önskvärda ur ett geopolitiskt perspektiv.

### Relationen med USA

EU:s enskilt viktigaste geopolitiska relation är med USA. Med tanke på att EU-kommissionen beskriver det transatlantiska förhållandet som "en del av en ny global allians av likasinnade partner", bör EU överväga nya sätt att fördjupa den transatlantiska ekonomiska integrationen, t.ex. via ett handelsavtal mellan EU och USA.

### Relationen till Kina

När det gäller relationen till länder som Kina bör det ömsesidiga ekonomiska beroendet och fungerande handelspolitiska relationer upprätthållas, utan att det nödvändigtvis innebär samma ambition när det gäller fördjupad ekonomisk integration som med likasinnade länder. Ekonomisk "frikoppling" från Kina är inte önskvärd vare sig ur ett handelspolitiskt eller ett säkerhetspolitiskt perspektiv. Investeringsavtalet mellan EU och Kina är också meningsfullt ur ett geopolitiskt perspektiv eftersom det representerar ett försök att vidmakthålla det ekonomiska ömsesidiga beroendet och samarbeta i utvalda frågor av ömsesidigt intresse.

## Relationen till Ryssland

Med tanke på Rysslands illegala ockupation av Krimhalvön och Sevastopol samt bristen på framsteg i genomförandet av Minskavtalen, är EU:s handelspolitiska alternativ i relation till Ryssland mycket begränsade. Om Minskavtalen genomförs bör dock EU hålla öppet för framtida ekonomisk integration mellan EU och Ryssland.

## Ensidiga åtgärder enbart som en sista utväg...

Att tillämpa ensidiga handelspolitiska åtgärder på ett WTO-förenligt sätt, samtidigt som EU:s geopolitiska intressen främjas, är en svår balansgång som sannolikt inte kommer att ge några betydande positiva effekter. Det riskerar också att undergräva den regelbaserade multilateralism som ligger i EU:s intresse enligt den nyligen publicerade handelspolitiska översynen. Unilaterala åtgärder kan vidare skada EU ekonomiskt eftersom de bromsar upp den process som leder till att de mest produktiva EU-företagen växer och blir starka globalt. Även andra utmaningar som diskuteras i rapporten ger stöd åt slutsatsen att unilateralism är ett sämre strategiskt alternativ. Till dessa utmaningar hör risken för att:

- säkerhetspolitiska synsätt kopieras till handelspolitiken utan hänsyn till om det är effektivt eller lämpligt,
- EU går i den så kallade "autonomifällan", dvs. att strävan efter oberoende från andra blir till en ond cirkel som till slut gör det svårt att lösa problem med andra parter,
- vi främst straffar oss själva när vi begränsar handeln med EU, samt
- handelspolitiken genomgår en "säkerhetisering", dvs. att utmaningar slentrianmässigt beskrivs som säkerhetshot för att motivera extraordinära åtgärder.

## ...och med ett antal villkor

Mot denna bakgrund bör EU inte införa unilaterala åtgärder som diskriminerar utländska kommersiella intressen med mindre än att det görs en bedömning av:

- åtgärdernas effektivitet,
- deras övergripande välfärdseffekter,
- risken för motåtgärder,
- administrativa kostnader för företag (särskilt små och medelstora företag), samt
- omfattningen av det problem som åtgärderna syftar till att lösa.

Bedömningar av välfärdseffekter bör alltid baseras på etablerade nationalekonomiska metoder. Unilaterala åtgärder som begränsar europeiska företags rätt att bedriva affärer med länder utanför EU måste också respektera EU-rättens allmänna principer, samt EU:s åtaganden i internationella handels- och investeringsavtal.

EU bör vidare undvika att subventionera eller särbehandla långa och ständigt skiftande listor av varor, tjänster, teknik eller sektorer som betecknas som strategiska eller kritiska. Annars riskerar Unionen att bidra till snedvridning och minskad produktivitet inom sektorer som vi vill främja, t.ex. vad gäller digitalisering och klimatomställning. Subventioner till och särbehandling av utvalda sektorer leder till sk rent seeking och i slutändan undergräver det transparens och god samhällsstyrning. Det är exempel på precis den typ av diskretionära handelspolitiska åtgärder som Kommerskollegium tidigare har konstaterat är olämpliga vid en prioritering mellan olika typer av åtgärder som snedvrider handeln. Listor över strategiska eller kritiska varor och tekniker bör därför vara begränsade, överlappande listor bör rensas bort och varje lista bör bestämmas utifrån objektiva kriterier. Sub-

ventioner som är förknippade med en särskild status bör vara transparenta för att underlätta utvärdering i efterhand.

Slutligen är det viktigt att tydligt skilja mellan åtgärder som har säkerhetspolitiska syften och åtgärder som motiveras av hänsyn till näringslivets konkurrenskraft. Genuina säkerhetshot legitimerar ibland diskriminering av utländska intressen. Näringslivets konkurrenskraft är däremot inte ett säkerhetspolitiskt syfte och det främjas bäst genom en icke-diskriminerande handels- och investeringspolitik.

### **Sammanfattning av sammanfattningen**

Under flera år har det pågått en glidning i EU-debatten mot uppfattningen att vår säkerhet är beroende av en handelspolitik som i större utsträckning begränsar handel och ekonomisk integration. Vår rapport visar att de geopolitiska spänningarna mycket riktigt ökar, men att svaret på den utmaningen inte är att dra upp vindbryggan och sträva efter att begränsa det ekonomiska utbytet med andra länder. Den visar också på hur traditionella säkerhetspolitiska synsätt inte kan överföras rakt av till handelspolitiken. Om EU ska använda handelspolitiken för geopolitiska syften måste det ske på ett smart sätt som fortsätter att bygga på den framgångsrika historiska erfarenheten av ekonomisk integration.

**The National Board of Trade Sweden** is the government agency for international trade, the EU internal market and trade policy. Our mission is to facilitate free and open trade with transparent rules as well as free movement in the EU internal market.

Our goal is a well-functioning internal market, an external EU trade policy based on free trade and an open and strong multilateral trading system.

We provide the Swedish Government with analysis, reports and policy recommendations. We also participate in international meetings and negotiations.

The National Board of Trade, via SOLVIT, helps businesses and citizens encountering obstacles to free movement. We also host several networks with business organisations and authorities which aims to facilitate trade.

As an expert agency in trade policy issues, we also provide assistance to developing countries through trade-related development cooperation. One example is Open Trade Gate Sweden, a one-stop information centre assisting exporters from developing countries in their trade with Sweden and the EU.

Our analysis and reports aim to increase the knowledge on the importance of trade for the international economy and for the global sustainable development. Publications issued by the National Board of Trade only reflects the views of the Board.

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