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Conference Summary

Economic statecraft in an age of geopolitical rivalry

2nd Ditchley Deutschland Annual Conference at Schlosshotel Kronberg

4-5 April 2024

EXECUTIVE SUMMARY

Ditchley Deutschland's second Annual Conference examined the role of economic statecraft in an age of geopolitical rivalry.

- **Developing a coherent strategy of economic statecraft means integrating with other areas of policy.** There was a consensus that Western governments need to set economic statecraft in a broader strategy. This could include a number of components: the prevention of extreme economic dependencies on hostile or unreliable countries; the diversification of supply chains; a quick implementation and rigorous enforcement of economic statecraft instruments; a multilateral approach and coordination with international allies; active maintenance of domestic political support; compensation for those groups that are disadvantaged by the application of economic statecraft tools; and the integration of economic and military statecraft.

- **Improving the Western sanctions regime against Russia.** Most participants agreed that the West's current economic sanctions were not working well. Some attendees concluded that the sanctions regime was beyond repair and that it was time to find an off-ramp. Others suggested specific improvements: sharpening the oil price cap and strengthening its enforcement, as well as refining export controls on dual-use goods, among other things.

- **Avoiding a double squeeze**. In the coming years, Europe may face financial pressures from two sides: on the one hand, Washington may weaken its security umbrella, which would result in substantial defence costs for the Europeans. On the other hand, the US may put pressure on Europe to decouple from China in the course of a major US-Chinese conflict, which would have severe consequences for Europe's economy. To avoid this double squeeze, Europeans might want to offer US support on China but in return expect continued US engagement and support on European security vis-à-vis Russia.

- **Alignment between US and European statecraft towards China.** Whilst recognising that the US and Europe do not have completely aligned interests on China, the US and its allies should seek to align policy in key areas, including export controls on dual-use goods in specific sectors; inbound investment screening; joint standards for the deployment of AI in everyday use;

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diversification of supply chains away from China; efforts to exploit relevant raw materials at home; outreach to alternative providers of important raw materials in South America, Africa and Southeast Asia; and offering the Global Majority[1] alternatives to Chinese provision of 5G infrastructure and other technologies.

- **Communicating Europe's interests to the US.** These interests include ongoing US military protection under the NATO treaty; reliable US deliveries of LNG to help Europe avoid Russian gas; a new transatlantic tech alliance based on increased European access to the American AI ecosystem; a revision of US protectionist policies, such as the Inflation Reduction Act (IRA); closer mutual consultation in relation to future industrial policy initiatives and export controls.

- **Enhancing cooperation among the US allies.** Especially in light of a prospective second Trump presidency, the participants felt that the US' allies – Canada, Europe, Japan and others – would need to enhance cooperation among themselves. For example, the UK and the EU should work together and think strategically about how to integrate their economies in a mutually beneficial fashion. The Canada-EU free trade agreement needs to be ratified and other trade arrangements among the allies ought to be launched. Finally, the allies could join forces in developing a joint strategy to dissuade the US from economic initiatives that would harm allies' economic interests.

- **Coordinating on development aid and climate finance.** At a time when development aid budgets are being cut, it is important for Washington and its partners to limit the impact on the Global Majority. There was a consensus in the group that Western countries are currently spreading their resources too broadly. They are giving to too many countries for too many purposes. Some participants suggested that the West should use these funds in a more targeted and deliberate fashion to advance its foreign policy goals. For example, Europeans ought to focus on neighbouring countries and emerging economies that could be useful economic partners in the future. Other attendees, however, strongly disagreed, arguing that if we wish to win over the Global Majority, we should not tie the development aid to foreign policy considerations. They also felt that better trade conditions would be much more powerful than development aid.

FULL REPORT

Introduction

This conference addressed the following questions:

1) How can Europeans and their allies develop a coherent strategy of economic statecraft?
2) How effective have Western economic sanctions against Russia been and how could they be improved?
3) How should Canada, Europe and Japan respond to the Chinese-American strategic rivalry?
4) How much scope is there for a joint transatlantic approach to economic statecraft?
5) How do we best employ finance as a tool of economic statecraft?

The conference brought together 31 representatives from government, politics, business, academia, think tanks and the media from across Canada, Germany, Japan, the Netherlands, Poland and the

[1] We use the term "Global Majority" as a substitute for the widely criticised notion of "Global South".

United Kingdom. The discussion built on some of the findings from the Ditchley Conference on "Partnering with the Indo-Pacific" on 16-18 November 2023.

How to develop a coherent strategy of economic statecraft?

Interdependence as a precondition of successful economic statecraft

Free trade and the resulting economic interdependence used to be seen as overwhelmingly beneficial to the global economy. A growing chorus of voices is now calling for a substantial reduction of interdependence between the "West" on the one hand and China on the other. But tools of economic statecraft can only work if target countries like China are dependent on economic relations with the West. Once this dependence is eliminated, tools such as sanctions or export controls lose their bite.[2] Russia is arguably a warning example, with Russia now unconstrained by sanctions.

Four categories of economic statecraft

The conference separated economic statecraft into four categories:

1) **Domestic policy:** instruments of economic statecraft that are designed primarily to pursue economic and political goals inside one's own country, such as the tariffs that the Trump administration imposed on trade partners.
2) **Foreign policy**: tools and measures whose main goal is to influence other countries, such as Western sanctions against Russia.
3) **Symbolic:** measures that are taken to express disapproval but which do not have any substantive impact on a target country. Sanctions on individuals tend to fall into this category. They often do not have any effect but their implementation can cause a substantial amount of administrative work for banks and other companies.
4) **Prepare and prevent:** tools and measures that help us to prepare for and, if possible, prevent worst-case scenarios. An example would be economic measures to deter China from attacking Taiwan.

These four ideal-typical categories may blur and overlap in practice. The Biden administration's industrial policy, for example, represents an attempt to both reindustrialise Middle America and weaken Chinese competition in core technology areas.

Developing a coherent strategy of economic statecraft

The conference agreed that Western governments tend to employ economic statecraft tools ad-hoc. There is frequently a lack of clarity about the precise aims of these instruments and insufficient analysis of their consequences over time. As a result, the use of economic statecraft often ends up having merely symbolic impact. At worst, it can harm the originators of the measures more than the target.

There was a consensus that economic statecraft needs to be set more holistically in broader policy. Such a strategy needs to take into account not only economic, trade and business expertise but also be synchronised with political and military statecraft: economic statecraft is part of a national security strategy and economic strategy simultaneously. A number of precepts for successful strategy were emphasised:

[2] See also Henry Farrell and Abraham L. Newman, "Weaponized interdependence: How global economic networks shape state coercion", *International Security*, vol. 44, no. 1 (Summer 2019), 43.

- **Prevention:** Western governments should make sure that their economies do not become overly dependent on resources and technologies from countries that are strategic competitors.

- **Diversification:** In cases where economies have already become overly dependent on resources and technologies in problematic countries, governments need to encourage diversification to more reliable partners. This is why it will be necessary for Europe to achieve improved trade relationships with Australia, Canada and Mercosur, among others.

- **Protection:** Governments should protect their countries against economic security risks by deploying the entire spectrum of economic statecraft instruments. This ranges from sanctions, inbound and outbound investment screening, export controls and asset freezes to trade defence.

- **Targeted instruments:** Economic statecraft tools like sanctions, investment screenings or export controls require a precise focus. Governments need to define exactly which goods or sectors they wish to target.

- **Implementation at speed:** speedy implementation of economic statecraft instruments is a particular challenge in the EU, where individual member states often fail to reach agreement in a timely fashion. For example, German companies may not get a licence to export certain goods, but Hungarian companies do.

- **Enforcement:** Economic statecraft instruments need to be rigorously enforced to be effective. This also involves identifying loopholes and developing counter-evasion measures.

- **Multilateral and coordinated action:** The implementation and enforcement of a country's economic statecraft instruments is more effective when this is carried out in cooperation with other countries. The application of economic statecraft tools may have detrimental and unintended consequences on partners. To avoid such unintended consequences, governments should consult and coordinate with their allies early on as they design economic statecraft tools.

- **Communicating and maintaining domestic political support:** To be successful, economic statecraft requires the support of electorates. Leaders should explain the reasoning behind the use of these instruments. They also need to justify the resulting material sacrifices for certain sectors of the economy and society in the interest of a country's overall economic security. At the same time, politicians should refrain from overselling economic statecraft tools. The population may then get disappointed if these instruments turn out to be less effective than expected.

- **Compensation:** In light of the costs of economic statecraft to parts of the local economy and society, governments should launch appropriate compensation schemes.

- **Integrating economic and military statecraft:** Economic statecraft is no substitute for hard power. It only works if it is employed in conjunction with military statecraft, especially the will and ability to use military force. China and the United States have developed the full range of power dimensions – economic, technological and military. Allies of the US need to make a stronger effort to follow suit. Economic statecraft cannot substitute for insufficient spending on defence and insufficient defence capability.

In Europe, discussions about economic statecraft have taken place primarily among foreign and security policy experts, rather than among economic, trade and business specialists. As a result, economic statecraft tools have often been designed in a way that does not take into account economic expertise and the perspectives of business. Moreover, security policy experts and economists often do not speak the same language. Whereas the former tend to think in terms of threat assessments, the latter typically employ cost-benefit analyses to assess trade-offs. To achieve coherence in economic statecraft, the strengths of each of these distinct approaches will need to be combined. Economic understanding needs to be mainstreamed into the national security apparatus, and geopolitical expertise needs to be fed into the corporate world. This involves explaining both the national security risks and the complexity of the supply chains to each other.[3]

Assessing the impact of the West's economic sanctions against Russia

On 23 February 2024, the EU adopted its 13th package of sanctions against Russia. The US and other allies instituted additional sanctions, such as export controls on dual-use technology and other high-tech products. The participants debated how effective these sanctions have been. A large group – perhaps the majority in the room – was sceptical about their overall effect. Those attendees with a background in finance and economics were particularly doubtful. The main criticisms can be summarised as follows:

- **Western sanctions against Russia have not achieved their main goals.** After Russia's invasion of Ukraine, the West had to respond and it had to do so quickly. It resorted to sanctions because there had to be a signal that Russia's attack was unacceptable. However, after thirteen sanctions packages, it has become apparent that these instruments are not working well. Sanctions have not prompted Russia's oligarchs to turn against Putin; they have not led to a popular uprising against the Russian regime; they have not disrupted the Russian economy; and they have not had any substantive impact on the Kremlin's conduct of the war. Some participants went so far as to argue that sanctions have not had any impact on Putin's decision-making.

- **Sanctions against large countries rarely have an effect.** The architects of the Western sanctions against Russia essentially replicated the sanctions practices employed against countries like Iran and Sudan in the past. Russia, however, is a militarily powerful target with a substantial current account surplus and the ability to sell its energy. It continues to trade actively with the non-West, and its economy is too large to be significantly affected by sanctions.

- **Some Western sanctions have turned out to be beneficial to Russia.** The West imposed export restrictions on various consumer goods in order to try and create dissatisfaction among the Russian population with its leadership. This has not had the hoped-for effect. We underestimated Russia's ability to become a siege economy. Some of the sanctions even turned out to be to Russia's benefit. For instance, McDonalds gave up its Russian branches for free – only to see them incorporated into a Russian oligarch's business empire.

- **The sanctions regime has had a strong negative impact on European populations.** Europe has seen a rise in energy prices and a cost-of-living crisis. Some attendees expressed doubts whether voters will be willing to pay this heavy price much longer. Throughout the continent, incumbent governments are facing frustrated electorates. While Western democracies are sensitive to economic difficulties, history suggests that Russian rulers are in a position to force

[3] See Jami Miscik, Peter Orszag and Theodore Bunzel, "Geopolitics in the C-suite: More than ever, US foreign policy depends on corporations – and vice versa", *Foreign Affairs* (11 March 2024).

their population to "eat dirt". However, a couple of participants insisted that spending 40 percent of its state budget on the military was not sustainable for the Kremlin in the long-term. The regime could maintain its war economy only for so long.

- **The sanctions have had a detrimental effect on the European economy.** The sanctions have resulted in higher inflation. Elevated energy prices have led to a departure of energy-intensive industries. North American LNG supplies are expensive and it is uncertain how reliable their deliveries will be in the future. If we maintain the current sanctions regime, we are risking a deindustrialisation of Europe, one participant claimed. Another attendee responded that high energy prices are not the foremost challenge for European companies. There are a number of measures that could be taken to alleviate the situation. For instance, France should stop obstructing the delivery of Spanish energy to Germany. Moreover, carrying out an energy transformation does not necessarily mean deindustrialisation.

In short, many participants felt that the long-term costs and the short-term benefits of the Western sanctions regime against Russia are not proportionate. Some went so far as to argue that the sanctions have done more harm to Europe than to Russia and that we need to identify an off-ramp from our current approach to sanctions. Sanctions were not an end in themselves and should be ceased if self-harming. Other participants argued that simply abolishing sanctions without any Russian concessions was not an option and that the lifting of sanctions should be a lever in ceasefire negotiations.

Balancing to a certain extent the criticisms of sanctions, some participants argued that certain sanctions have yielded successes, albeit of a limited nature:

- **Export restrictions on Western technology** were seen as effective in the initial phase of the war in Ukraine. During the first six to twelve months of the conflict, the Russian forces lost access to technology that could have made a difference on the battlefield. For example, Russia was not able to build certain trucks because it lacked injection pumps by Bosch.[4] Subsequently, however, Moscow adapted. It managed to procure dual-use technology from China and other countries. It also succeeded in circumventing some of the Western sanctions by importing goods from third countries. Finally, Russia also improved its own domestic production of certain goods and technologies.

- **The oil price cap** introduced in September 2022 by the G7 finance ministers had a material effect for about six months in 2023 but Russia had since found ways to circumvent it and better enforcement was needed.

It is inherently difficult to measure the impact of sanctions, because we are partly trying to make sense of a counterfactual scenario: How would Putin's conduct of the war have unfolded if the West had not imposed any sanctions against Russia? A couple of participants argued that Russian military operations would have been more successful if the West had not imposed any sanctions.[5]

[4] See András Rácz, Ole Spillner and Guntram B. Wolff, "Why sanctions against Russia work", *Intereconomics*, vol. 58, no. 1 (2023), pp. 52-55.

[5] See also Christian von Soest, *Sanktionen: Mächtige Waffe oder hilfloses Manöver?* (Frankfurt a.M.: Frankfurter Allgemeine Buch, 2023), chapter 13.

How to improve the sanctions regime against Russia

Sanctions are an ongoing cat-and-mouse game. If we want them to be effective, then as targets manage to evade and circumvent, we need to:

Specify the objectives of sanctions more precisely. We need to be clearer about what we wish to achieve.

Improve the oil price cap. Some participants argued that it is possible to sharpen the oil price cap and strengthen its enforcement, which would also benefit the Global Majority.[6]

Refining and enforcing export controls of dual-use goods could still have an impact on Russia's future military performance. The West would need to close loopholes and find ways to improve enforcement with regard to third states that still trade with Russia.

Even proponents of sanctions at the conference acknowledged that sanctions alone will not achieve a breakthrough in the war. They are merely one instrument in the economic statecraft toolbox that needs to be complemented with financial aid and military materiel for Ukraine. Some participants suggested that Russia's hard power had to be met with hard power. Difficult choices about supplying more advanced arms to Ukraine can no longer be put off, in their eyes, and need to be integrated with the use of economic statecraft tools.

How to respond to Chinese-American strategic rivalry?

The Biden administration is determined to maintain US economic, military and technological superiority over China. There is a bipartisan consensus in Washington that China's rise needs to be contained and slowed down. A potential second Trump presidency would not significantly change US policy towards the People's Republic. Although the Biden administration has described its export restrictions and other tools as a "surgical" approach focused on a "small yard", this yard has been getting larger.[7] Nonetheless US-Chinese trade has been increasing. American companies are trying to profit from their China business as much and as long as possible. At the same time, many companies have responded to political pressure from Washington by turning their ventures in China into Chinese entities for the Chinese market.

The conference participants agreed that the West does not understand well enough what is happening in China and how the Chinese leadership thinks. There is an argument that the Chinese economy has already entered long term decline given its aging population and the CCP's growing authoritarianism. Beijing started to pursue its own form of de-risking when it put forward its policy of dual circulation in May 2020: the idea was to improve the country's capacity for innovation, reduce dependence on Western technology, and stimulate domestic consumption. However, in the response to slowing growth, China has returned to an export-driven economic model. The country currently accounts for over 31 percent of global manufacturing but less than 13 percent of global consumption.[8] It risks swamping global markets with high-level manufacturing goods like solar panels and electric vehicles, even though the global economy will not be able to absorb them, and price reductions will result.

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[6] See Benjamin Hilgenstock, Elina Ribakova and Guntram B. Wolff, "Toughening financial sanctions on Russia: Enforcing energy sanctions and reducing shadow reserves effectively", *Intereconomics*, vol. 58, no. 3 (2023), pp. 201-8.

[7] Peter E. Harrell, "How to China-proof the global economy: America needs a more targeted strategy", *Foreign Affairs*, vol. 103, no. 1 (Jan./Feb. 2024).

[8] See Michael Pettis, *Can trade intervention lead to freer trade?* (Washington, D.C.: Carnegie Endowment for International Peace, 23 February 2024).

US allies depend on both China and the US, but to varying degrees

The US' allies depend strongly on both China and the US, albeit to varying degrees. China is Europe's most important trading partner and a key investment location, especially in the automobile sector. Europe is also reliant on China's raw materials, such as lithium. European companies are benefitting from China's low prices in the short-term while discounting the long-term costs that come with this dependence. Europe is strongly dependent on US military support and protection, trade with the United States and American deliveries of LNG.

These dependencies in tension would make it extremely difficult for Europe to choose sides economically between the United States and China. Some participants concluded that Europe must avoid such a choice at all cost. Others argued that the time had now come to make such hard choices. The Canadian government has already signalled that it will side with Washington, given its strong reliance on the US market and its vulnerability to Chinese dumping of industrial products. It is felt that to maintain viable industries, including a critical minerals sector, Ottawa has no choice but to align fully with the US. Meanwhile, Japan has chosen to regard China and the US as two independent important markets while diversifying its supply chains as much as possible.

From a normative point of view, the US allies are not neutral. Canada, Europe and Japan are all part of the West and view the United States as their natural partner. The US regards its provision of security to Europe with regard to Russia as meriting economic support for US policies from Europe on China. Yet, many Europeans do not regard Beijing as threatening as Washington does.

The participants identified some areas where American allies could align with US economic policy towards China. They should:

Go along with US proposals regarding export controls on dual-use goods in specific sectors and inbound investment screening. It was pointed out though that these instruments are currently not as effective as they could be. Export controls and their implementation differ widely among EU member states and are therefore easily circumvented. At present, 22 EU member states employ often distinct foreign direct investment screening mechanisms. It was noteworthy though that the majority of transactions reported for screening were from the US, the UK and Switzerland. It was not clear whether this represented solely self-censorship – companies deciding not to pursue transactions with China that they knew would be likely rejected – or continuing security concerns post Snowden about the US and the UK.

Agree with the US on joint standards for the deployment of AI in everyday use. If the West does not come together to set those standards and export them to developing countries, China will set them.

Increase their economies' resilience against supply chain shocks from China. European governments would need to explain to the corporate sector that they would not provide compensation if its investments in China were affected by geopolitical tensions. They would also need to encourage companies to manage and diversify their supply chains in ways that enable them to survive after a potential cut-off from China. This will be an expensive and cumbersome process, which will require us to gain a better understanding of the complexity of our global supply chains in the first place.[9]

Make stronger efforts to exploit relevant raw materials at home. This would require more speed and flexibility when it comes to the provision of mining concessions. According to one participant,

[9] See Federico Steinberg and Guntram Wolff, "A European strategy of economic statecraft", *Internationale Politik Quarterly* (9 October 2023), n.p.

obtaining official approval for the opening of a mine in Canada takes about two to three years on average, while it can last more than fifteen years in Germany.

Make stronger efforts to reach out to alternative providers of important raw materials in South America, Africa and Southeast Asia. Indonesia would be a particularly valuable partner, given that it has rejected the idea of joining the BRICS group and is keen to become a member of the OECD. Western governments should also provide incentives and assurances to the private sector for investments in emerging economies, given that return/risk profiles are frequently unsatisfactory.

Strengthen their efforts to reach out to and invest in leading emerging economies like Brazil, South Africa or India. These countries face important decisions about whether to use Chinese companies to set up their 5G infrastructure. Western government need to think carefully what alternatives they can offer.

At the same time, a number of participants advised caution. Russia had managed to change its supply chains quickly, and the same would likely happen in the case of China. Another participant pointed out that “keeping face” was an important cultural norm in Confucian societies like China. Given that the imposition of sanctions can come across as humiliating to targets, the West would need to be very careful in its approach to and design of sanctions and other economic statecraft tools vis-à-vis Beijing. Yet another participant pointed out that Western governments today impose economic sanctions because they seek to avoid war. Historically, however, sanctions often contributed to the outbreak of wars. In the 1930s, for example, League of Nations sanctions accelerated Germany’s and Japan’s drive for autarky and expansion.

What could the US offer its allies in return for their alignment with its China policy?

A number of participants suggested that Europe’s current military and relative economic weakness meant that it was not in a position to make demands on the United States. They were particularly doubtful that a future Trump administration would be willing to offer any material return of allied support. Other attendees maintained that the allies should nevertheless formulate their interests openly:

- ongoing US military guarantees under the NATO treaty
- reliable US deliveries of LNG to replace Russian gas
- a new transatlantic technology alliance based on increased European access to the American AI ecosystem
- a revision of US protectionist policies, such as the IRA
- closer mutual consultation in relation to future industrial policy initiatives and export controls

The looming danger of a US-Chinese conflict over Taiwan or the South China Sea

US-Chinese tensions over Taiwan and Philippine territory in the South China Sea have risen in the past years. The participants agreed that a military clash in East Asia would have devastating consequences for the region and the rest of the world. The situation could even escalate into World War III. Yet, there was no consensus in the group on how Europe would respond in this situation. Some participants suggested that such a crisis would represent an element of external compulsion that might force the US and its allies closer together. Others felt that after the negative impact of Russia’s war on the European economy, decoupling from China was simply not an option, even if Beijing attacked Taiwan. European businesses would rebel if they lost access to the Chinese market.

The group agreed that Europe and its allies should work hard to try and help prevent a US-China clash in the first place. Some participants maintained that Europeans ought to play an active role in deterring China from upsetting the status quo in East Asia. They should convey to Beijing the profoundly detrimental global economic and political consequences for all sides if Beijing were to move against Taiwan. This would also require issuing European red lines on China's behaviour in the South China Sea.[10]

Transatlantic economic statecraft in an age of geopolitical rivalry?

Convergence and divergence

The participants identified instances of both convergence and divergence among the transatlantic allies. Under a Biden administration, the allies share the goals of further decarbonising the economy, maintaining a common security architecture on the basis of increasing European defence spending, and furthering cultural ties across the Atlantic, among others. With regards to divergences, the Biden administration's IRA continues to be a sore point for Europeans, while the Americans and Canadians complain about the EU's unilateral imposition of the Carbon Border Adjustment Mechanism (CBAM), which they view as a protectionist tariff.

Regular coordination at the G7 and the EU-US Trade and Technology Council (TTC)

The mutual disgruntlement about the IRA and CBAM, respectively, suggests that North Americans and Europeans should coordinate more closely with each other before they launch such unilateral measures. They ought to consider the effects of their planned policies on the allies and give them a chance to suggest improvements. The group discussed which forum would be most suitable for such transatlantic consultations. In the absence of a functioning WTO, several participants suggested that a small plurinational group, such as the G7 and the EU-US Trade and Technology Council (TTC), would be the most practical setting. These fora have the added benefit that they will facilitate stronger relations among medium-sized countries such as Germany, Japan and the UK. The US and its allies should use these platforms to hold regular meetings about a few selected key sectors including semiconductors and critical minerals, among others. A couple of participants posited that it was necessary to modernise these formats to include a better understanding of China through the big economies that work with it. They recommended the D-10 Strategy Forum – a group of ten leading democracies including the G7 and Australia, India and South Korea – as the most suitable platform.

How would a second Biden and Trump administration differ from each other?

The group agreed that another Trump presidency would bring more hostility and unpredictability for Europeans and other allies. There would be less transatlantic cooperation. Countries like Germany might be back on President Donald Trump's enemy list, and President Trump would likely impose tariffs on China. If the US allies did not follow President Trump's approach, they would likely be targeted by secondary or primary sanctions. Some participants wondered whether President Trump might be more inclined to try and reach a "deal" with China over Taiwan, rather than supporting the island for democracy's sake.[11]

A second Biden administration, on the other hand, was expected to be more open to using existing transatlantic formats. It would be more inclined to take multilateral approaches to developing

[10] See Charlie Vest and Agatha Kratz, *Sanctioning China in a Taiwan crisis: Scenarios and risks* (Washington, D.C.: Atlantic Council, June 2023); Logan Wright, Agatha Kratz, Charlie Vest and Matt Mingey, *Retaliation and resilience: China's economic statecraft in a Taiwan crisis* (Washington, D.C.: Atlantic Council, April 2024).

[11] See Arancha González Laya, Camille Grand, Katarzyna Pisarska, Nathalie Tocci and Guntram Wolff, "Trump-proofing Europe: How the continent can prepare for American abandonment", *Foreign Affairs* (2 February 2024).

sanctions and export controls. At the same time, however, participants assumed that it would maintain its industrial policy approach and its so-called foreign policy for the middle class. Some attendees suggested that the occupant of the White House would matter less than the future composition of the Senate and the House of Representatives.

How much scope is there for a joint transatlantic approach?

Europeans tend to react to the agenda set by the United States. In preparation for the next US administration, they should define their own priorities. There was agreement among the participants that the transatlantic relationship was becoming more transactional, even under President Biden. Consequently, European policymakers ought to think carefully what they could offer the US and for what they would ask in return.

- **Defence spending:** There was a consensus that Europe would need to invest more in its security to share some of the burden with the US. Poland is leading the way by spending almost 4 percent of GDP on defence in 2023. The other EU members should aim for a minimum of 2 percent. If Germany, Italy, Spain and the Netherlands follow suit, Europe may become a serious defence player, provided that its defence procurement mechanisms are improved. These investments in the military will also result in longer-term economic opportunities as innovation in defence products will spill over into the civilian sector. In return for increased European defence spending, Washington should keep substantial US troops stationed in Europe.

- **Industrial policy:** Ideally, the world would be free of subsidies, because they are not a viable economic strategy in the long-term. Some participants felt that the US IRA seems to confirm this because its impact has apparently been limited. They also expressed concern that this form of industrial policy had contributed to a substantial rise in US national debt, whose debt-to-GDP ratio currently stands at 123 percent. In their eyes, Europe should not compete with the US on subsidies. Others pointed out that the IRA has prompted numerous leading companies to leave Europe and Asia for the US. In their view, the IRA has been politically successful: it killed two birds with one stone by offering both an economic and an environmental justification. They suggested that European governments should make efforts to make their economies more attractive to US business and investment. Countries like Canada have few choices about how to respond to the IRA. The EU as a trading bloc, however, has more clout. Future EU-US negotiations should try and achieve the inclusion of European companies in US industrial policy initiatives.

In which areas is there room for greater cooperation among the US allies?

Especially in light of a prospective second Trump presidency, the participants felt that the US' allies would need to enhance cooperation amongst themselves. The goal should be to transform the current transatlantic hub-and-spokes model – Washington as the hub liaising individually with each of its allies – into a federated model – in which the allies maintain strong ties both with Washington and among themselves. If the continental Europeans develop a team approach with Canada, Japan and the UK, they may collectively be able to have more influence.

The group suggested that the following areas have potential for greater coordination:

- **Promoting trade and economic integration among the US allies.** The UK and the EU should work together and think strategically about how to integrate their economies in a mutually beneficial fashion. The Canada-EU free trade agreement could serve as a role model for additional trade agreements among the allies. Given that traditional free trade agreements have become unpopular, we ought to exploit the new legal fuzziness that the global trading system offers.[12]

- **Developing a joint strategy to influence the US.** The US political system is not a monolith. It is a complex and open network including executive, legislative and judicial branches at the federal and state levels. Canada has done an excellent job understanding the complexity of this system. For example, before the passing of the IRA, the Canadian government successfully lobbied dozens of select senators and state governors relevant for Canadian business in order to achieve exemptions for Canada. The Europeans, on the other hand, had failed to do their homework and the IRA took them by surprise. They should learn from the way Ottawa has succeeded in influencing the US legislative process.

Finance as an instrument of economic statecraft

Financial sanctions against Russia

The group focused on two distinct financial sanctions:

- **Anti-money laundering measures against Russia.** Putin's regime has used its current account surplus to conduct money laundering in London, Vienna, Zurich and other Western cities. These activities have ranged from investments in hotel chains in Austria to Gulf clubs in the UK. They involved major transactions that took place because the rules were too lax. Some participants argued that new European money laundering laws have helped to restrict these illicit Russian activities. Others countered that the money laundering laws were still not effective enough in catching people outside of the West. They only work in countries like Germany and the UK and even there their performance is often suboptimal.

- **SWIFT ban.** The group discussed the SWIFT ban against a number of Russian banks by the EU and other western countries. In February 2022, French Finance Minister Bruno Le Maire described a SWIFT ban as a "financial nuclear weapon". He and other policymakers naively assumed that this threat would impress Russia. When the ban was instituted on 1 March 2022, however, the effect was underwhelming.

There was concern that western financial sanctions are pushing Russia into China's arms. This is likely to encourage Beijing to promote its alternative Cross-border Interbank Payment System (CIPS).[13]

Some attendees complained that there was a fundamental disconnect between Treasury experts and foreign policy makers. The latter often do not understand finance, which can lead to unintended negative consequences. For example, the West's growing reliance on financial sanctions is having knock-on effects on the status of Frankfurt and London as key global centres of finance. Investors have increasingly moved their funds to Dubai, India and Singapore in the past few years.

A couple of participants suggested that the West should focus on strengthening its own system rather than weakening others. For instance, Canada boasts five large pension funds that invest actively at great success. Germany, on the other hand, does not allow its three trillion Euro pension funds to invest in its own economy. Another example relates to the City of London – a special asset that provides the UK with outsize influence. Its foundation on the rule of law makes it reliable in the eyes of the world. The City could be further strengthened if we abolish tax havens like the Cayman

[12] See Federico Steinberg and Guntram Wolff, "Dealing with Europe's economic (in-)security", *Global Policy*, vol. 15, no. 1 (February 2024), pp. 183-92.
[13] Yongyuan Zoe Liu and Mihaela Papa, "The Anti-Dollar Axis: Russia and China's Plans to Evade U.S. Economic Power", *Foreign Affairs* (7 March 2022).

Islands. Regulators would also need to take a flexible approach regarding the City: in some cases, they would need to allow London to become more like a tax haven. In other cases, the City needs to be regulated more strongly along Tokyo's lines. It will be necessary to strike the right balance between rules and openness.

Should the West confiscate Russia's assets?

There are currently ca. $300 billion of Russian assets in Western repositories. Around $6 billion of them are allegedly based in the United States, and ca. $190 billion are located at Euroclear in Belgium. There was a heated debate about the question of whether the West should confiscate these Russian assets in order to support Ukraine.

The US government may sequester the $6 billion of Russian assets located in the US, setting an example. A number of participants cautioned against such a move. They argued that expropriation would violate the law of private property. A confiscation of Russian assets could have wide-ranging consequences: two thirds of the world might lose trust and withdraw their funds from Europe. The stability of the Euro and its value as a reserve currency could be affected. One participant also pointed out that the West should retain Russia's assets as a bargaining chip in future negotiations.

On the other hand, a number of participants supported the idea of confiscating Russia's assets: they claimed that in the case of a major war of aggression with hundreds of thousands of casualties, is it legitimate to sequester assets. The West would need to explain its rationale and assure the Global Majority that such a move against Moscow was exceptional. Given that the Biden administration is facing increasing domestic political opposition to US funding for Ukraine, seizing the Russian assets was the next logical step. One participant referred to a recent paper by Michael Dooley, David Folkerts-Landau and Peter Garber which concluded that rather than weakening the US dollar, the confiscation of Russian assets would actually further strengthen it.[14]

Introducing outbound investment screenings in Europe?

In August 2023, the Biden administration issued an executive order to regulate certain types of US outbound investment in specific sectors, such as AI and semiconductors, in "countries of concern", especially China.[15] American companies have already reacted. For example, the US venture capital giant Sequoia has split off its Chinese and Indian/Southeast Asian businesses into two independent firms to better navigate these investment screenings.

Washington is keen for Europe and the EU to adopt similar outbound investment screening mechanisms. At present, there is no clear consensus inside the EU about the introduction of these tools. Germany has been sceptical about the idea of restricting the export of capital for political reasons.

One participant pointed out that if we really wanted to limit China's technological advances, it would be more useful to introduce targeted instruments limiting knowledge transfer to China. In the 2010s, Japan lost one third of its chip experts to China, Taiwan and South Korea. To avoid such a brain drain towards China in the future, we would need to impose controls over expert migration. In Germany, this would mean restricting the move of highly skilled labour, such as Zeiss optic specialists, to China.

[14] See Michael P. Dooley, David Folkerts-Landau and Peter M. Garber, "US sanctions reinforce the dollar's dominance", Working Paper no. 29943 (Washington, D.C.: National Bureau of Economic Research, 2022), p. 8.
[15] See Gisela Grieger, "US approach to outbound investment screening", European Parliamentary Research Service (September 2023).

Employing positive incentives vis-à-vis the Global Majority

Finally, the economic statecraft toolkit includes not only negative measures like financial sanctions but also positive incentives such as foreign aid, loans or preferential tariffs. China, for instance, has extended loans and investment across Africa, Asia and South America through its Belt and Road Initiative. If the US and its allies wish to succeed in diversifying their supply chains away from China, they would need to get countries from the Global Majority on their side. How could they provide an alternative at scale to nonaligned countries?[16]

One participant noted that the collective West has provided more in total development aid than China's Belt and Road Initiative. In fact, Beijing has not made any serious investments in the Belt and Road Initiative in the past two years. The initiative was allegedly "dead" and it has become apparent that many Chinese projects associated with it were "sugar-high" projects. They seemed highly promising initially but turned out not to make any economic sense in the long run. Many of them are turning into white elephants and stranded assets.

The troubles of the Belt and Road Initiative should not make the US and its allies complacent, however. Some participants argued that development aid and climate finance would need to be an important part of the economic statecraft toolkit. At a time when development aid budgets are being cut across the West, it would be even more important to coordinate a targeted approach among Washington and its partners.

However, such coordination is hampered by different national approaches to the provision of development aid. For example, the UK incorporated its Department for International Development (DFID) into the Foreign Office in June 2020 in order to integrate British diplomacy and development policy. In Germany, on the other hand, the government seeks to maintain a clear distinction between foreign policy and development aid. The German development aid community has been very reluctant to tie the provision of aid to foreign policy considerations. However, this can lead to suboptimal results. For example, a German development project on energy efficiency in Brazil used German funds to buy Chinese electrified buses, which were cheaper than their German counterparts.

There was a consensus in the group that Western countries are currently spreading their resources too broadly. They are giving to too many countries for too many purposes. Some participants suggested that Germany and its allies should use these funds in a more targeted and deliberate fashion to advance their foreign policy goals. After all, desk officers in charge of development aid tend to have better access to local policymakers than ambassadors in many developing countries. Germany and its European partners ought to focus on neighbouring countries and emerging economies that could be useful economic partners in the future. They should also use the aid to encourage the integration of economies. Other participants, however, strongly disagreed: if we wish to win over the Global Majority, we should not tie the development aid to foreign policy considerations. They also felt that better trade conditions for the Global Majority would be much more powerful than development aid.

This Note reflects the writer's personal impressions of the conference. No participant is in any way committed to its content or expression.

[16] Nicole Goldin and Mrugank Bhusari, "Positive economic statecraft: Wielding hard outcomes with soft money", in Kimberly Donovan et al., *Transatlantic economic statecraft: Different approaches, shared risks* (Washington, D.C.: Atlantic Council and Atlantik-Brücke, 2023), p. 19.

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