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'The Geoeconomic Turn of the European Single Market'

The EU's Geoeconomic Turn: From Policy Laggard to Institutional Innovator

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Abstract

Heightened geopolitical tensions and the growing securitization of economic exchange over the past decade have prompted many countries to adopt new geoeconomic tools. Long resistant to this geoeconomic turn, the European Union (EU) has created since 2017 a panoply of innovative policy tools that blend trade and investment with essential security concerns. This paper asks why and how the EU has been able to operate the doctrinal and policy changes necessary to be an effective economic player on the geopolitical stage. After introducing a typology of the defensive and offensive geoeconomic tools deployed by advanced industrial economies, we present the novel geoeconomic toolkit quickly assembled by the EU, which we explain by the confluence of external factors that triggered European leaders' beliefs that change was necessary and of internal factors that made such change institutionally and politically possible, a trend reinforced by the pandemic and the Russian invasion of Ukraine.

Introduction

Upon taking office as president of the European Commission in December 2019, Ursula von der Leyen vowed to lead a "geopolitical" Commission (2019). Amidst the brewing rivalry between the United States (U.S.) and China, so the rationale went, the European Union (EU) had to become more proactive in using economic tools for geopolitical purposes (referred to here as "geoeconomics"), instead of naively preaching free flows of trade and investment while its partners had seemingly abandoned multilateralism and openness. The creation of these geoeconomic tools became the cornerstone of the EU's new doctrine of "open strategic autonomy", referring to the capacity for the EU to defend its interests and values and manage interdependence in a more confrontational world (Borrell, 2020).

Neither its history, nor its unique institutional structure suggested that the EU would be well positioned for this geoeconomic turn. As a multilateral institution revolving around a single market characterized by freedom of movement, the EU was less equipped institutionally and politically than other advanced economies to adjust to the new world of deglobalization, fragmentation, and economic statecraft (Meunier and Nicolaidis, 2019). However, in the face of a shifting global context where interventionism and unilateralism became increasingly commonplace from 2017 and where the conceptual line between national security and economic policy blurred substantially, the EU adapted remarkably quickly and created a series of novel, innovative tools that have enabled it to play the geoeconomic game.

Placing the EU's geoeconomic turn in the global context, this paper asks why and how the EU has been able to operate the doctrinal and policy changes necessary to be an effective player on the geopolitical stage.

The paper starts by situating the shift in EU economic strategy in a broader global milieu by presenting a typology of the defensive and offensive geoeconomic tools deployed by advanced industrial economies (such as Australia, Canada, Japan, South Korea, and the U.S.) over the past decade. Next, we show that even though the EU lagged in taking the geoeconomic turn compared to its partners, it quickly assembled a defensive and offensive geoeconomic toolkit starting in 2017. Using process-tracing based on primary and secondary sources, Section Three explains what made this swift geoeconomic turnaround possible by focusing on the confluence of external factors that triggered European leaders' beliefs that change was necessary (the rise of unilateralism and authoritarianism in China, and the protectionist and unilateral turn of the U.S. under the Trump administration) and internal factors that made such change institutionally and politically possible (competence transfer over investment policy, Brexit, political successes of populist parties), a trend only reinforced by the pandemic and the Russian invasion of Ukraine. We conclude by considering how the EU's geoeconomic turn creates both opportunities for deeper cooperation among allies and risks for further fragmentation of economic networks into regional blocs.

A Shifting Global Context from Liberal Economics to Geoeconomics

The EU has long remained a holdout for liberal economic institutionalism, even as the global context was shifting to more interventionist and unilateral ways. Because of the centrality of the single market to the process of European construction, of the institutional division of competences that empowers the union in the areas of trade and competition, and of the traditionally pro-free market ideological bent of DG Trade, the EU clang on to carrying the torch of neoliberal globalization while other major countries around them developed more geopolitical attitudes towards managing their economic relationships.

By contrast, the EU's major economic partners, most notably the U.S., were quicker to embrace geostrategic thinking and the reentry of hard geopolitics into the economic realm. Here, we follow others in this issue who use the term "geopoliticization" to denote a rhetorical and ideational shift away from principles of liberal institutionalism – mainly, the project of removing "at the border" and "behind the border" barriers to the flow of goods, services, and finance through legally binding multilateral and bilateral instruments – toward one that places greater import on identifying and mitigating the security vulnerabilities that accrue from open, globally integrated markets (Meunier and Nicolaïdis, 2019).

Defining Geopoliticization and Geoeconomic Tools

Geopoliticization need not be incompatible with generally open markets and is not synonymous with protectionism or even economic nationalism. What differentiates geopolitical attitudes from liberal institutionalism is a matter of emphasis. Policy guided by liberal institutionalism sees economic interdependence as generating economic welfare as well as positive security externalities through the pacifying effects of commerce. Policy guided by a geopolitical lens, in contrast, sees interdependence primarily as a source of vulnerability that can be exploited and weaponized by strategic competitors.

Geoeconomic tools are the principal levers through which states engage in geopoliticization. Some of these instruments are defensive, designed to prevent others from leveraging economic dependencies against them – such as investment screening, supply chain diversification policies, and trade remedies. Use of these tools reflect 'reluctant geopoliticisation' because they seek to defend economies against other countries' instruments that exploit economic openness (Manuscript 1, this issue). Other geoeconomic tools are offensive, designed to develop and maintain key chokepoints in trade, finance, technology, and infrastructure - such as supporting national champions to build key infrastructure abroad, controlling critical technology through export controls, and using industrial policy to undercut competitors and dominate key global markets. These tools may well reflect 'deep geopoliticisation' because their use reflects a willingness to reject accepted norms and ideas central to liberal economic thought and practice and to instead embrace more mercantalist views of how national economies do and should be organized (Manuscript 1, this issue). The geoeconomic tools states develop to pursue defensive or offensive policy objectives could be inducements, or "carrots," as well as sanctions or, "sticks." For instance, industrial policy is an inducement instrument because it operates through rewarding desired behavior. However, industrial policy could be used defensively to prevent a country from becoming too reliant on one other actor or it could be used offensively to establish a dominant position in a critical supply chain, thereby creating economic leverage for it to exploit. Thus, whether an instrument is offensive or defensive in nature is not always clear to observers, and instruments can be used for mixed purposes. Table 1 provides a typology of these geoeconomic tools.

Table 1: Typology of Geoeconomic Instruments

	Offensive	Defensive
Inducement	Industrial policy to achieve global market dominance in chokepoint items. Subsidized infrastructure projects abroad to control chokepoints like ports, electricity, and IT networks.	Industrial policy for supply chain diversification
Sanction	Export controls, including over persons & knowledge, to maintain global market dominance in chokepoint technology Outbound investment screening Extraterritorial application of otherwise defensive tools	Inward investment screening Trade remedies against foreign subsidized items Anti-coercion instruments Narrow export controls to prevent critical technology leakage.

A Growing Geoeconomic Turn?

Outside the EU, major OECD economies were quicker to embrace geopolitical strategies toward managing economic integration and to create new geoeconomic tools. This section provides an overview of geoeconomic policy developments in Australia, Canada, Japan, South Korea, and the US from 2010 onward. The geopolitical turn is reflected in policy, practice, and rhetoric, because some aspects of geopoliticization are more clearly viewed through the articulation of rhetoric and strategic posture rather than concrete policy changes or alterations of economic flows, which take longer to adjust. These countries entered the 2010s with greater access to existing institutional resources to address geoeconomic considerations than did the EU. As unitary states, they also faced less complicated domestic political environments within which to enact changes, either due to bipartisan agreement (US, Australia, Canada) or state-society relations that facilitated faster change without long public consultation processes (Japan, South Korea). Moreover, these countries all face more direct security challenges from China than EU member states who are more geographically removed from East Asia. Despite these unifying features, the country experiences outlined here display important differences in their approaches to geoeconomics. These differences relate to their varying structural constraints and growth models as well as their responses to the geoeconomic actions of each other. Table 2 below illustrates our typology of geoeconomic tools by using examples of legislation and regulations from these five countries.

Defensive Sanctions

The most prominent examples of the emerging geoeconomic turn fall into the defensive sanctions category. These are instruments that seek to delineate small areas of the domestic economy that have substantial security implications and then prevent foreign actors from gaining access to these areas. Officials often characterize these tools as "small yard, high wall" approaches. Inward investment screening and traditional export controls focused on non-proliferation of military technologies are best characterized as defensive sanctions because their purpose is to protect the home country from foreign interference in a narrow range of activities and the method by which they do so is by denying ownership or export of sensitive assets. Additionally, mechanisms designed to thwart others' more aggressive use of economic leverage, such as anti-coercion instruments and trade remedies against foreign subsidized critical items in order to maintain indigenous capacity, are also inwardly focused and defensive in nature.

All of the countries we reviewed have strengthened their investment screening mechanisms in recent years.[1] Australia's Foreign Investment Review Board (FIRB), established in 1975, has been amended ten times since 2010, lowering thresholds, establishing filing fees and fines, increasing timelines for review, adding greenfield investment to review, and even eliminating a monetary or beneficial share threshold for review during the pandemic. Australia also established separate mechanisms for reviewing telecommunications and critical infrastructure projects in 2017 and 2018. Canada has screened inward investment for national security reasons since 2003, though the Investment Review Division has been able to review investment for economic benefit reasons for longer. It has updated its related law multiple times since 2015, most recently creating a voluntary filing process for non-control investments in 2022. Japan has screened inward investment since 1950 but amended its legislation four times since 2014, tightening its review process and more closely aligned its regulatory understanding of national security threats to critical technologies, especially technologies developed with governmental support. During Covid, Japan reduced the threshold for review to acquisitions as small as one percent for publicly traded companies. South Korea has similarly amended its

[1] All data on investment screening come from Bauerle Danzman and Meunier, 2021.

investment screening authority numerous times over the last decade, strengthening its mandate and focusing on key critical assets and technology. Finally, the U.S., considered a leader in efforts to strengthen investment screening authorities, updated the laws governing the Committee on Foreign Investment in the United States (CFIUS) in 2018 in response to, in its opinion, aggressive Chinese economic policy. The new regulations place greater emphasis on emerging technology, sensitive data, and the cumulative effect of foreign purchases on market control and created mandatory filing requirements for transactions involving certain critical technologies and foreign government-controlled buyers. The legislation also allowed for information sharing about cases to trusted partners and funded outreach efforts to encourage allies to adopt or strengthen their own investment security regime.[2]

The U.S., Japan, and South Korea have also strengthened their export control authorities in recent years. These changes reflect increasing concerns about the transfer of sensitive knowledge, not just the export of critical goods. The U.S. Export Control Reform Act of 2018, passed concurrently with its investment screening law, shifted the country's export control system from one based on executive authority to one encoded in statute. It also introduced the concept of "emerging and foundational" technologies, which sexpands the set of technologies to control to include a much larger set of items on the frontier of innovation such as quantum computing. Other countries have been less enthusiastic about substantially expanding their export control lists, but have strengthened their ability to prevent technology transfer to entities that may subsequently provide this technology to the Chinese military or surveillance organizations. Japan implemented new regulations in 2022 that make it easier to restrict technology access to individuals in Japan who are controlled or influenced by foreign governments. South Korea also has a strong export control regime, following a series of reforms it undertook in 2007 and regularly updates its control lists to incorporate changes in multilateral control regimes (Ghiretti, 2023). In contrast, and likely because of their rather limited participation in the semiconductor supply chain, Australia and Canada have relatively weaker export control policies (Ghiretti, 2023).

Finally, all of the countries we reviewed implemented bans on Chinese telecommunication services and infrastructure provider Huawei, usually by prohibiting them from receiving government contracts. The PRC has assisted Huawei's bid to become the largest provider of wireless telecommunication infrastructure by underbidding competitors. While Huawei insists it is not owned or directed by the PRC, a series of incidents at the African Union headquarters in 2018 and 2020 indicate that Huawei equipment was used to spy on the Union and send data back to China (Satter, 2020). Subsequently, Australia and Japan issued bans in 2018, the U.S. moved to exclude the companies' equipment from its networks in a series of policies implemented in 2019 and 2020, South Korea issued a ban in 2021, and Canada in 2022.

[2] The U.K.'s passage of the National Investment Security Review Act in 2021 is an example of legislation that was encouraged, at least in part, by the U.K.'s desire to remain on the U.S. "excepted countries" list (Politi and Pickard, 2023, Interview #5).

Offensive Sanctions

Not all of these economies' geoeconomic policies have remained defensive in nature. The U.S., in particular, has often employed offensive tools, such as the extraterritorial application of its export control rules - called the foreign direct product rule - to force companies in other countries to follow U.S. export control laws, both by imposing unilateral controls first, while engaging in diplomatic efforts to cajole key partners into complementary controls. In response, the U.S. has recently shown more appetite for The U.S. has used this tool both for list-based export controls on companies such as Huawei and on end-user export controls for advanced semiconductor items and tools in China. This strategy illustrates how geoeconomic tools can often mix offensive and defensive strategies as well as tactics of inducements and sanctions.

Japan has also used its export control regime more assertively in recent years, sometimes for clearly offensive rather than defensive purposes. In 2019, and in retaliation for a court ruling related to Japanese business' conduct during WWII, Japan removed South Korea from its export control whitelist for semiconductor manufacturing chemicals. This had the effect of requiring businesses seeking to export to South Korea to apply for product licenses, creating costs and delays to shipments.

Offensive and Defensive Inducements

Compared to the adoption of geoeconomic sanctions, countries' embrace of inducements has been more recent, and reflects growing institutionalization of policy organs devoted to developing and implementing coordinated economic security strategies. Many advanced economies have created new bodies to compile data on and coordinate action related to geoeconomic issues such as supply chain resilience. Japan created a National Security Council in 2013 and added an economic directorate to the body in 2019 to focus on technology, investment, and telecommunications (Shigeta, 2019). Australia, Canada, South Korea, and the U.S. have all developed new working groups and committees to address economic security issues stemming from supply chain security concerns, often with international collaboration (Canada-U.S. Supply Chain Working Group, 2021).

This increased focus on supply chain security and resilience, especially in the wake of Covid-19, has catalyzed an increased willingness on the part of governments to develop industrial policy in the name of economic security. Canada has developed an industrial policy around critical minerals (Canada, 2022). Japan's 2022 Economic Security Promotion Act focuses on advanced critical technologies and related materials (GreenbergTraurig, 2022). In 2022, Australia created a support program for semiconductor chip foundries (Capri and Clark, 2022). South Korea provides financial assistance to companies to facilitate stockpiling and diversification for items for which Korea is overly dependent on foreign suppliers.[3] The U.S. passed two important pieces of industrial policy legislation in 2022 - the CHIPS and Science Act and the Inflation Reduction Act. Both use a combination of direct subsidies and tax incentives to encourage domestic semiconductor fabrication

[3] Defined as over 50 percent foreign dependence. The list of items is over 4000. See Ghiretti (2023).

and battery production. The local content provisions embedded in these laws have helped strengthen a domestic coalition between security hawks and organized labor, but have also bolstered charges that the U.S.'s geoeconomic turn is really protectionism in disguise and has further indicated that the WTO trade rules are increasingly irrelevant to U.S. policymakers. Whether such industrial policies are defensive or offensive ultimately depends on whether governments use subsidies merely to encourage supply chain diversification - especially to friendly nations - or instead use subsidies to cultivate their own positions as technology chokepoints. In practice, policies may be mixes of offense and defense.

Finally, some countries are using the development assistance programs to support offensive economic security objectives, particularly to block China from controlling critical infrastructure in developing countries. The U.S., Japan, and Australia have developed cooperative relationships between their overseas development finance organizations to finance critical infrastructure in the Indo-Pacific (U.S.-Japan-Australia, 2022).

Table 2: Examples of Geoeconomic Instruments in non-European countries

	Offensive	Defensive
Inducement	Some elements of U.S. IRA and Chips and Science Act (2022) Overseas development banks' investments in strategic infrastructure	U.S. IRA (2022) U.S. Chips and Science Act (2022) Japan's Economic Security Promotion Act (2022)
Sanction	Japanese semiconductor materials export controls on South Korea (2019) U.S. 7 Oct 2022 export controls on semiconductor items U.S. use of foreign direct product rule	Inbound investment screening: Australia (10 times since 2010); Japan (four times since 2014); U.S. (FINSA in 2007 and FIRRMA in 2018) Huawei procurement bans: Australia (2018); Canada (2022); Japan (2018); South Korea (2021); the U.S. (2019-2020); Export control reforms: Japan (2022); U.S. (2018)

The EU Strikes Back: A Swift Geoeconomic Turn with Innovative Tools

Compared to its partners, the EU was late in taking its geoeconomic turn. While other countries gradually embraced geoeconomic instruments throughout the 2010 decade, the EU lagged behind. This is not to say that the EU was not using trade for non-trade purposes. To the contrary, the EU had long leveraged its position in the global economy, using access to the single market as a carrot to induce conditional change among its trading partners, notably with respect to human rights, rule of law, and the environment (Meunier and Nicolaidis, 2006). But this use of trade as a coercive instrument was done for political, not geopolitical, purposes.

Several factors contributed to the EU being slower than its partners to take the geoeconomic turn in the current decade. For one, EU trade policy has long been characterized by a pro-free trade, liberal ideology, especially emanating from the powerful Directorate General for Trade (DG Trade) at the European Commission (Siles-Brugge, 2014; see also Manuscript 10 in this Issue). Second, for reasons having to do with the EU's idiosyncratic nature as a federation of nation states and the division of competences between the national and supranational levels, there was no logical place in the EU's institutional apparatus to oversee the nexus between economic objectives and national security. Third, by 2015 the EU had decided to recenter its trade policy around traditional economic objectives, with its "Trade for All" Strategy focusing on the redistribution of the benefits and costs of globalization, instead of on the use of trade for non-trade purposes (Young, 2019). Fourth, remaining "open for business" while other countries were slowly closing down for geopolitical imperatives was interpreted by several Member States as comparative advantage, especially in the area of investment screening (Meunier, 2014) and relations with China, with which the EU engaged as partner, competitor and rival, against U.S. insistence to treat China in a more cautious, even hostile way.

By 2017, however, the EU undertook a policy turn, followed a few years later by a doctrinal turn, first with the 2019 release of its China strategy and by the 2021 publication of its trade policy review "An Open, Sustainable, and Assertive Trade Policy"(European Commission, 2019, 2021). Both the EU and its largest member states began to worry that the organizing principles of the international economy had changed and that they needed new tools to defend their interests in an increasingly geopolitically competitive environment.

Once the EU made the assessment that it had been holding onto these liberal ideals a bit too long in the face of these global shifts and that this "naivety" had indeed been costly, it unleashed with great rapidity a series of unilateral policy tools to accompany its new doctrine of "open strategic autonomy" (Manuscript 3 in this Issue). The broader objective of EU trade and investment policy has not changed: it is still to preserve and grow an open, multilateral, sustainable economy, which is essential for prosperity, democracy, and peace. But the methods to achieve this objective have been radically updated, especially with the creation of innovative policy tools, which include autonomous tools designed to restore and ensure an economic level playing field, tools to ensure sustainability and environmental security, strategic tools to respond to the new linkages between economy and national security, and tools to preserve European sovereignty. We survey these instruments briefly by using our typology of geoeconomic tools, as illustrated in Table 3.

Defensive Sanctions

Because of the Member State competence over national security, the EU has lagged behind its partners in adopting defensive sanctions that are designed to prevent foreign actors from gaining access to economic areas with the potential to jeopardize national security. However, as the linkage between economy and national security became ever closer, the EU was able to jump into the fray.

The first new instrument of strategic autonomy proposed and passed by the EU in the "post-naive era" was the foreign investment screening framework, adopted in 2019 and in effect since 2020 (Regulation (EU) 2019/452). Launched in September 2017, the policy process that led to the drafting and passing of the first ever pan-European investment screening capabilities was surprisingly swift, despite initial opposition or indifference from the vast majority of Member States (Chan and Meunier, 2022; Vlasiuk Nibe, Meunier and Roederer-Rynning, 2022). For the first time this regulation creates procedures for foreign investment in the Single Market to be reviewed by entities other than the host country and for Member States to recognise that some investments may be politically problematic. However, the ultimate decision to accept or reject an investment lies with the host country. The main feature of the EU ISM is a cooperation mechanism between the Member States and the Commission to exchange information and raise concerns about specific transactions that "may threaten security or public order," mostly concerning investments in critical technologies and infrastructure. Still, two years in, this new instrument has had a real impact in at least two ways. First, the number of national ISMs in Europe has drastically increased: while only 11 Member States had investment screening measures in 2017, by 2023 all but one Member State (Bulgaria) have an ISM in place or in development. Second, the EU received 414 FDI notifications from its member states in 2021, with investors coming mostly from the US, the UK, China, Canada and the UAE in a variety of sectors dominated by manufacturing, ICT and financial services (European Commission, 2022).

The EU has also reinforced its ability to respond to new security risks and emerging technologies through its new Export Control Regulation, adopted in 2021, designed to tighten controls on trade in dual-use items – civilian goods and technologies with possible military or security use (Regulation (EU) 2021/821).

Another novel defensive geoeconomic instrument is the Foreign Subsidies Regulation (FSR) passed in 2022. Designed to level the economic playing field, this new instrument fills a regulatory gap that has existed for decades in the EU when it comes to subsidies for companies active in the Single Market (Basedow, Meunier, and Roederer-Rynning, 2022). The EU has long ensured a level playing field internally by severely limiting state aid given by its Member States and externally by using countervailing duties to nullify cost advantages of imports benefiting from foreign subsidies. However, until 2022, the EU could not address market distortions caused by foreign subsidies, which puts European companies at a competitive disadvantage at home and in world markets when foreign companies participate in mergers and acquisitions and bid in public procurements thanks to state subsidies that are not allowed to EU companies. After decades of not addressing this issue, the Commission issued a legislative proposal in May 2021, which enables companies operating in the EU "to compete on the basis of merit" regardless of their nationality by allowing the EU to monitor FDI transactions, to investigate potentially distortive subsidies and, if necessary, to adopt remedial measures (European Commission 2021b). A political consensus was reached on the proposal in June 2022, which was adopted in November 2022 and will be implemented in 2023.

Another novel geoeconomic tool of a defensive sanctions nature is the Carbon Border Adjustment Mechanism (CBAM), adopted also in 2022. Created to deal with issues of sustainability at the nexus between economic security and environmental security, the CBAM imposes tariffs on carbon-intensive products and processes (Manuscript 11 in this issue).

Finally, the EU has designed a novel geoeconomic tool to defend European sovereignty, the Anti-Coercion Instrument (ACI), which is intended to deal with bullying by third countries The most controversial of all these new "assertive" geoeconomic tools to address pressing concerns about the increasingly porous border between the economy, security, and foreign policy, the ACI was still being debated as of writing but expected to be adopted in 2023 (Manuscript 9, this issue). Proposed by the Commission in December 2021, the ACI will provide a tool with which to retaliate against countries that take economic action against a Member State's legitimate sovereign choices for political reasons, including by imposing tariffs and quotas, restricting access to EU capital markets and public procurement tenders, and blocking exports (European Commission, 2021b).

Offensive Sanctions

Even though the EU has long been wary of jeopardizing the open, multilateral economic order, it is also creating new tools of offensive sanctions. The most prominent is the International Procurement Instrument (IPI), also adopted in 2022. Though negotiations on this instrument started a decade prior and seemed stalled for a long time, renewed momentum came in the wake of the geopolitical Commission's quest for strategic autonomy and new willingness to confront protectionist, illiberal moves by its partners with assertiveness and reciprocity. Once negotiations resumed, the European Parliament and the Council quickly agreed in 2022 to set up the IPI in order to pressure foreign countries to open their protected markets to EU operators (European Parliament, 2022). The IPI instructs the Commission to determine if third countries allow EU companies fair access to their public tenders and, if they don't, IPI measures such as a price penalty on the bid or even the exclusion of bids from particular countries are applied. Designed to restore a level playing field and introduce reciprocity in public procurement, the IPI will constrain and limit the conditions under which companies from non-EU countries that do not offer EU companies similar access can bid open procurement tenders in the EU.

Another potential geoconomic instrument of offensive sanctions could be if the EU decides to proceed with the creation of outbound investment screening. Following the lead of the U.S., where such a novel instrument is currently in the legislative process, the EU is starting internal and external consultations about the pros and cons of crafting this new instrument (Interview 2, Interview 4).

Offensive and Defensive Inducements

Finally, the EU has recently started to break with its neoliberal foundations of unfettered competition and openness and is now adopting elements of an interventionist industrial policy in pursuit of its geopolitical strategy of "open strategic autonomy". This includes the European Green Deal Industrial Plan proposed by the Commission in February 2023 as a complement to the EU Industrial Strategy launched in 2020 (updated in 2021) to help Europe's industry with the twin transitions towards climate neutrality and digital leadership -and as the EU's response to the U.S. IRA. It also includes the European Chips Act proposed by the Commission in 2022 in order to increase the EU's resilience to supply chain disruptions in semiconductors.

The CBAM could also be interpreted as being partly a defensive inducement because, so the EU's rationale goes, it incentivizes industry in third countries to decarbonize by preventing competitive advantage from companies in jurisdictions not pricing carbon.

Table 3: Mapping the New EU Geoeconomic Instruments

	Offensive	Defensive
Inducement		European Green Deal Industrial Plan (2023) European Chips Act (2022) Carbon Border Adjustment Mechanism (2022)

Sanction	International Procurement Instrument (2022) Outbound FDI screening (in consultations)	FDI Screening Regulation (2018) Export Control Regulation (2021) Foreign Subsidies Regulation (2022) Carbon Border Adjustment Mechanism (2022) Anti-Coercion Instrument (in draft)

The EU came late to the development of geoeconomic tools, but when it decided to abandon its "naivety" around 2017 and moved to become "assertive", it did so with a vengeance, churning out new instruments quickly one after the other. All these new instruments plus additional ones currently being developed will enable the EU to restore some evenness to the economic playing field, to respond swiftly to economic actions encroaching on national security by foreign actors and to achieve some degree of strategic autonomy. As seen on Table 3, the EU has clearly been most comfortable with defensive tools, especially defensive sanctions. In contrast to some other unitary actors, such as the US and Japan, the EU has been far less willing to develop offensive tools, and especially offensive inducements, consistent with its willingness to achieve "open" strategic autonomy. This embrace of defensive tools and continued wariness of offensive tools that strain commitments to economic liberalism suggest that the EU's approach to geoeconomic measures is one of 'reluctant geopoliticisation' rather than 'deep geopoliticisation' (Manuscript 1, this issue).

Explaining Why and How the EU Developed Geoeconomic Tools So Quickly

How has the EU been able to shift gears and create these many defensive and offensive geoeconomic tools so quickly, when it has neither the history nor the ideology supporting their use? This swiftness can be explained by the confluence of external factors that triggered European leaders' beliefs that change was necessary and internal factors that made such change institutionally and politically possible, a trend only reinforced by the pandemic and the Russian invasion of Ukraine (Gehrke 2022, Manuscript 8).

Growing concerns about China

The EU had been agnostic towards the rise of Chinese investments and other tools of Chinese economic interdependence for about a decade, from the mid-2000s until 2016. While Washington was expressing concern about the looming geopolitical rivalry with China, individual Member States, and the EU as a whole, were treating Chinese direct investment as an unexpected economic opportunity (Meunier, 2014). This was particularly true for those countries that had suffered most from the euro crisis and had to undergo massive privatization programs. The German economy under former Chancellor Angela Merkel forged increasingly strong ties between the German and Chinese automobile and technology sectors while Chinese investors scrambled to acquire *Mittelstand* technology firms. Smaller, export-oriented Member States were especially keen to protect the EU's commitment to open markets and endeavored to keep business and security concerns separate.

However, this position became less tenable over time as Chinese policy developments since 2012 substantially weakened traditional boundaries between economic competitiveness and essential security concerns by blurring the lines between private profit-seeking commerce and state-directed power-seeking exchange. Under Premier Xi's leadership, the People's Republic of China (PRC) implemented a series of policies that directly linked its economic strategy with broader foreign policy and security objectives. It rolled out a strengthened military-civil fusion strategy, which intensified efforts to obtain and ultimately indigenously develop advanced technology in the pursuit of military dominance. The PRC's 2015 release of its "Made in China 2025" industrial policy underscored the government's design to indigenize capabilities in technologies critical to military applications.

One example of this shifting position is the way in which EU and Member States's attitudes toward China's Belt and Road Initiative (BRI) and the related "16/7+1" initiative changed over time. When the BRI was first announced, several Member States - especially in CEE and Southern Europe - joined the initiative. While many Member States initially had high hopes that BRI-connected investments could finance much needed infrastructure, despite concerns over the opacity of Chinese lending and procurement, this view has largely soured over time. In 2015, the Commission signed a memorandum of understanding with the PRC to further EU-China cooperation on infrastructure through the EU-China Connectivity Platform (European Commission, 2015). By 2018, 27 EU ambassadors to the PRC signed a report stating that the BRI 'runs counter to the EU agenda for liberalizing trade and pushes the balance of power in favour of subsidized Chinese companies (Prasad, 2018)." Since then, Lithuania, Estonia, and Latvia have all left the 16/7+1 group and the Czech Republic is considering doing so as well (Gosling, 2022).

Concurrently, the creation of investment screening at the EU level and in many Member States that did not previously have ISMs stems directly from fears raised by increased levels of FDI from China in strategic sectors and in non-strategic sectors with a technological edge (Chan and Meunier, 2022; Bauerle Danzman and Meunier, 2021). As the Commission states in its year one ISM report, "The past years have seen a clear change in investor profiles and investment patterns, i.e. increasingly non-

OECD investors, occasionally with government backing or direction, whose motivation for a particular investment might not always be exclusively commercial" (European Commission 2021c).

Similarly, the foreign subsidies regulation was designed primarily with China in mind. The regulatory gap putting EU companies, which are prohibited from receiving state aid, at a disadvantage compared to foreign companies receiving state subsidies in European and world markets has existed for decades. The rise of Chinese companies as foreign investors and competitors in procurement markets gave the issue of distortive foreign subsidies a sense of urgency. The issue was first raised as an urgent problem in 2019 when the EU released its strategy on China, identifying it as an "economic competitor" and a "systemic rival." While previously issues of foreign subsidies had been seen as an economic issue, PRC support for critical infrastructure suppliers and construction companies generated substantial concern that Chinese participation in EU infrastructure, aided by heavy PRC subsidies that allowed Chinese firms to outbid European counterparts, could generate public order and security risks.

The International Procurement Instrument was also designed with China primarily in the EU's sights. The timing of the agreement on this new instrument is telling. While the Commission proposed the IPI a decade ago, it was stuck in the EU decision-making process until 2019. Talks were revived after the Commission stressed the challenge posed by China, which does not allow Member States and the European Parliament reciprocal access to its own public tenders.

As for the anti-coercion instrument, it was interestingly not designed specifically with China in mind (see below), but the dispute between China and Lithuania, which exploded a few weeks before the EU unveiled its proposed regulation, provided a textbook illustration of why it was needed (Manuscript 9, this issue). After Lithuania exited the 17+1 forum and allowed Taiwan to open an office in Vilnius in 2021, China retaliated harshly with a variety of coercive economic measures in an attempt to force a change in Lithuania's position, including by blocking all trade with Lithuania and all trade in products containing components made in Lithuania. The EU launched a case against China at the WTO, but it is also speeding up negotiations on the anti-coercion instrument that would enable it to react faster in the future.

Underappreciated response to US growing use of their own economic statecraft

The shift in EU trade policy towards assertiveness was also prompted by the unilateral, protectionist turn in US trade policy under the Trump administration, which did not hesitate to weaponize trade instruments and weaken rules-based multilateralism as part of its 'America first' vision. Strains in the transatlantic relationship predated Trump. Under Obama, the U.S. became increasingly dissatisfied with the WTO trading system, as described in greater detail in Section 1. Along with criticizing WTO appellate decisions related to state-connected subsidies and the ability of the PRC to flout trade rules while awaiting dispute settlement judgements, the Obama administration continued negotiating trade and investment agreements outside the multilateral system, including with the EU through the (later abandoned) Transatlantic Trade and Investment Partnership (TTIP).

The Trump administration's unilateral turn greatly magnified these challenges to the liberal international economic order. Trump's mercantilist rhetoric and suspicions about multilateralism turned into policies, including withdrawing the US from the TPP, starting "trade wars" with China and the EU, and directly attacking the WTO system, notably by incapacitating the Appellate Body. The Administration's decision to withdraw from the JCPOA, despite evidence that Iran was complying with the terms of the agreement, and reimposing secondary sanctions on EU firms engaged in business with Iran furthered fears that the U.S. was an unreliable partner in the economic realm and emboldened to use the centrality of the dollar for geoeconomic leverage. After the U.S. used a national security rationale to justify the imposition of tariffs on EU steel and aluminum, it became clear to the Commission and the Member States that the EU needed to "Trump-proof" its economic relations (Interview 3, Interview 4). The COVID pandemic further accelerated the EU's drive to create a multiplicity of new assertive trade and investment instruments in a world where U.S. support and cooperation could no longer be taken for granted. Indeed, even though the EU's foreign subsidies proposal was already in the works, it was the rumored acquisition of a German vaccine company with funds from the U.S. government that put the issue in the news in 2020 (Reuters, 2020).

Commission development of, and Member State support for, other geoeconomic tools was also, at least in part, a reaction to EU concerns over U.S. behavior (Interview 3, Interview 4). The decision to create the Anti-Coercion Instrument was in direct response to concerns about Trump. Section 232 tariffs and the U.S.'s increased application of extraterritorial export controls through its use of the foreign direct product rule, which prevents exports without a license of items that are produced anywhere in the world so long as they contain a certain percentage of U.S.-owned technology, convinced the Commission and Member States that they needed a way to check the growing propensity of the U.S. to leverage its market and technological power for expanding concepts of national security (see Manuscript 9, this issue). While the transatlantic relationship improved with the 2020 election, the concern did not fully dissipate. Indeed, the Biden administration has also shown itself to be willing to enact a series of economic security policies that could have substantial negative effects on the EU. For instance, the U.S. imposed an expansive set of unilateral export controls on the Chinese high-end semiconductor industry on October 7, 2022, with little warning. These controls affect European semiconductor firms, and the U.S. subsequently applied substantial pressure on the Dutch to impose similar controls to prevent its tooling company ASML from selling high end equipment to China. The Biden administration's massive industrial policy legislation, the Inflation Reduction Act (IRA), created an uproar in Europe as well as East Asia because it applies a strict local content requirement to subsidies for electric vehicles.

In the realm of investment screening, even though the U.S. has been the top origin of investor transactions reviewed by the new EU ISM, the EU regulation was not developed out of concerns about U.S. investment but instead out of a shared concern with the U.S. about the potential negative consequences of investment from third countries like China and Russia. American officials have worked quite closely to help EU member states develop their ISMs, share best practices and encouraged the EU and its members to go even further in tightening review (Interview #5). The US-EU Trade and Technology Council (TTC) is a prime example of transatlantic geoeconomic diplomacy, as is the budgetary provision in FIRRMA to support U.S. outreach to allies and partners to develop new and strengthen existing national security review bodies.

Internal EU politics: competence transfer, Brexit, and populist politics

If these external factors, coupled with technological change that has rendered many goods and services potential security threats, triggered European policymakers' doctrinal change, it is a series of internal factors that made the policy change possible.[4]

First, several of the new assertive instruments outlined above could not have existed in previous decades simply because the EU was not in charge of foreign investment issues. This changed with the 2009 Lisbon Treaty, which formally transferred FDI competence to the EU level by including "foreign direct investment" in Article 207 dealing with common commercial policy. However, since the competence transfer had not been debated beforehand and since the legal wording was so vague, an inter-institutional fight over the exact nature of the competence transfer erupted in the years following the implementation of the Treaty (Basedow, 2017; Meunier, 2017). The issue was finally settled in 2019 after a series of European Court of Justice cases. This competence transfer explains the timing of the new European investment screening mechanism.

Second, Brexit played a role in the paradigm shift in EU trade policy. The 2016 Brexit vote, which put economic nationalism at the center of the debate, led the EU to refocus its commercial policy on more purely economic objectives – namely jobs and growth – instead of normative power and guardianship of multilateralism (Young, 2019). To achieve these economic objectives in order to respond to popular discontent with the distributional impacts of globalization, the Commission became more assertive in trying to establish a level playing field on the global stage.

Brexit also transformed the ideological balance of power among the Member States. They had long been split in two factions: liberal free-traders opposed to policies introducing market distortions (anchored by the UK, Denmark, Sweden and the Netherlands) and the more Colbertist countries believing that some dose of reciprocity, dirigisme and even protectionism is sometimes necessary (anchored by France and some southern States). The UK's departure from the EU tilted this balance of power and gave greater voice to the critics of free trade . This rebalancing coincided with an ideological shift in German industry, which was traditionally opposed to defensive and aggressive measures, as a result of the perception of unfair competition and pressure from Chinese manufacturers (BDI, 2019a, 2019b).

[4] For more on the internal factors at play, see Manuscript 3.

Third, subsequent national elections in many Member States brought to power more populist and interventionist governments, softening the ideological free trade orthodoxy and further reinforcing the Colbertist/industrial policy faction. Moreover, for the EU to maintain its traditional open, liberal stance in the face of external threats would not be a politically palatable and democratic way of protecting its citizens in this growing populist moment.

Covid, Ukraine and the Politics of Crisis

Russia's aggression in Ukraine and the Covid-19 pandemic both contributed to increased concerns with the EU about economic vulnerabilities as well as opportunities to quickly push through institutional changes. Crises can speed up policy processes by reducing the capacity or willingness of interest groups to lobby against policies seen as necessary to address emergencies. They also generate uncertainties over the distributive effects of potential policy responses that cannot be resolved a priori because time pressures generate political demands for rapid action (Lipsey 2020, 2). As uncertainty, fear, and urgency take root, leaders and those who have well positioned themselves prior to crisis as trusted aides and policy thinkers gain greater latitude to offer their preferred policy solutions.

While COVID did not initiate the EU's interest in geoeconomic tools such as investment screening and mechanisms to reduce dependence on global supply chains, it does seem to have accelerated it. Before, EU members such as Ireland seemed disinterested in implementing ISMs, and some considered the EU FDI regulation toothless (Jacobs, 2019). But in March 2020, in response to the pandemic, the European Commission warned member states without ISMs "to set up a full-fledged screening mechanism and in the meantime to use all other available options to address cases where the acquisition or control of a particular business, infrastructure or technology would create a risk to security or public order in the EU, including a risk to critical health infrastructures and supply of critical inputs" (European Commission, 2020). Ireland then set in motion the process of developing its own ISM. Other Member States explicitly mentioned the pandemic in investment screening legislation and regulation. France and Germany expanded investment screening to biotechnology in early 2020 and lowered review thresholds. Italy and Spain began screening intra-EU investments. Poland and Slovenia introduced new investment screening mechanisms on a "temporary basis" as an extraordinary economic measure in the face of Covid-19.

More broadly, Covid changed the tone of the economic policy discussion and opened possibilities for policies that were previously unthinkable. Lockdowns and supply chain disruptions left the EU and Member States flatfooted and vulnerable to the complex trade dependencies that the crisis revealed. It became increasingly fashionable to talk about the "weaponization" of interdependence while the economic and security benefits of interdependence were largely discounted (Farrell and Newman 2019). Member States now reasoned that unchecked economic integration had made supply chains too fragmented and vulnerable. In France, for example, shortages of Chinese-made masks and pharmaceutical testing reagents catalyzed a renewed emphasis on "economic patriotism", including investment screening (Belouezzane and Zappi, 2021). Intra-EU state aid rules were relaxed to help governments address economic fallout. Subsequent proposals to rebuild and strengthen European supply chains through industrial policy at home and through protecting the single market from being overrun with unfairly subsidized foreign items became easier to justify.

Similarly, Russia's initial illegal annexation of Crimea and invasion of the Donbas in 2014 and its full-fledged invasion of Ukraine in 2022 were crises that facilitated greater willingness to strengthen geoeconomic tools. Polish members of the European Parliament pushed the issue of investment screening in the wake of the invasion of Crimea because of their concerns about Russian aggression. Their advocacy helped to push the investment screening regulation onto the agenda and aided in fast tracking its approval (Interview 1). The 2014 invasion contributed to mounting concerns over dependence on Russian energy sources, given its willingness to use that leverage for policy concessions. Denmark, the Baltic States, and Poland all came out strongly against the NordStream2 project on national security grounds. And, the 2022 invasion caused Germany to fully reverse course on its reliance on Russian gas (Manuscript 7, this issue). The EU's Investment Screening Regulation includes critical infrastructure as important sectors to protect, and all Member States with ISMs review energy infrastructure. The EU also rapidly developed emergency programs to hasten the transition to renewable energy, using a security framework to justify action (e.g. European Commission, 2022). The unprecedented imposition and coordination of economic sanctions and export controls in response to Russia's invasion has helped strengthen coordination channels within the Union and has also generated calls within the bloc to develop more institutionalized pathways for the EU to centralize enforcement of export controls (Brzozowski, 2023). This proposal is especially telling because the EU has typically had limited competence over export controls since they are implemented for national security purposes.

Conclusion: Toward What Global Order?

This paper has analyzed how the EU's longstanding commitment to an open liberal international order has been challenged by the growing use of geoeconomic tools by its major partners. Once the EU assessed that this commitment had become too costly, both economically and geopolitically, it unleashed in rapid succession a panoply of unilateral geoeconomic instruments, including tools for screening investment, ensuring reciprocity in public procurement, mitigating the impact of foreign subsidies, and countering economic coercion by third countries. We explained how the EU was able to adapt so quickly through the confluence of external and internal factors, including the growing geopoliticization of Chinese economic relations but also the U.S.'s embrace of economic statecraft.

As one of the world's three largest economic powers, and a champion of multilateralism (at least in rhetoric, if not always in action), the EU's turn towards geoeconomics will have major implications on the global order, creating both opportunities for deeper cooperation among allies and risks for further fragmentation of economic networks into regional blocs. Previously, order was achieved through multilateral rules enforced through shared norms and binding commitments. The guiding principle of this equilibrium was most-favored nation status, not tit-for-tat reciprocity. Now, global order seems to be shifting to a system where the main actors view economic integration more suspiciously and are more inclined to employ increasingly assertive policy tools to retaliate against the unilateral actions of others.

The tools of geoeconomics are inherently discriminatory and challenge the previously dominant liberal order, even though not all geoeconomic instruments are developed with coercive intent. The demand for geoeconomics is self-reinforcing domestically and internationally. For example, industrial policy justified on national security grounds naturally leads to increased interest in investment screening: once a government invests taxpayer money in a project (i.e. industrial policy), it must have to protect the fruit of its national investment into R&D from going abroad. Additionally, aggressive use of extraterritorial measures for offensive purposes, such as the U.S.'s reliance on the foreign direct product rule to enforce export controls, can induce other countries to develop geoeconomic tools to protect themselves against coercion. These dynamics lead to a proliferation of tools that create regime complexity, increase trade and investment frictions, and can undermine diplomatic, trade, and security relationships.

Whether these new geoeconomic instruments are coherent with an open economy is questionable. Is it even possible for the EU to maintain its previous open economic stance while its partners and competitors move to manage and protect their own economies and encourage the EU to do the same? We suggest a research agenda for scholars of the single market and global governance focusing on three emerging areas.

First, to what extent and in what ways can actors develop shared definitions over national security and public order or a mechanism through which to enforce this standard? Can existing multilateral institutions, such as the WTO or the Wassenaar Arrangement, through which most dual-use items are multilaterally controlled, be modified to handle the securitization of trade, technology, and investment, or will effective governance devolve to like-minded clubs (Pinchis-Paulsen 2022)? What will be the development and security implications of these shifts in managing international relations?

Second, how will governments ensure that greater state control over internal markets is used only for security purposes and not in ways that encourage corruption and democratic backsliding? This is a particularly important question as governments shift from defensive sanctions to offensive inducements - the power to pick market winners can be weaponized internally to retain political power.

Third, how can governments build and retain trust in each other as economic exchange and technology development is increasingly seen through zero-sum frames? What will a more robust export control environment and inward facing industrial policies mean for the pace of innovation around key issues to humanity such as climate change adaptation? And how will these higher fences affect patterns of inequality within and across countries, alliances, and globally? These are all pressing questions that scholars will have to make sense of in the years to come.

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Interview #2: October 18, 2022, semi-structured in-person interview, European Commission official, Brussels, Belgium

Interview #3: December 22, 2022, semi-structured virtual interview, European Commission official, Brussels, Belgium

Interview #4: February 28, 2023, semi-structured virtual interview, European Commission official, Brussels, Belgium

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One anonymised reference to be added after peer review

Anonymised references to other manuscripts in this special issue

Manuscript 1 - 'The Geo-Economic Turn of the European Single Market'

Manuscript 3 – 'The ideational power of strategic autonomy in EU security and external economic policies'

Manuscript 7 – 'EU Geoeconomic Power in the clean energy transition'

Manuscript 8 – 'The geoeconomics of the Single Market for financial services'

Manuscript 9 – 'Commercializing security policy? The making of the EU anti-coercion instrument'

Manuscript 10 – 'Framing and Issue Linkage: The Geopoliticisation of Trade and the Single European Market'

Manuscript 11 – 'The EU Carbon Border Adjustment Mechanism's Geo-Economic Dimension'