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Making European Economic Security a Reality

POLICY PAPER - MARCH 2024

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Through our policy papers, we aim to provide practical recommendations to help senior politicians, public servants and industry leaders adapt and respond to today's challenges.

Author

François Godement

François Godement is Institut Montaigne's Special Advisor – Asia and America. He is also a Nonresident Senior Fellow of the Carnegie Endowment for International Peace in Washington, D.C., and an external consultant for the Policy Planning Staff of the French Ministry for Europe and Foreign Affairs. François Godement was previously the Director of ECFR's Asia & China Program, and a long-time professor at INALCO and Sciences Po. He created *Centre Asie* at IFRI (1985-2005) and Asia Centre in 2005. In 1995 he co-founded the European committee of the Council for Security Cooperation in the Asia-Pacific (CSCAP). He is a graduate of the *École normale supérieure de la rue d'Ulm* (Paris), where he majored in history, and was a postgraduate student at Harvard University.

His last published books are *Les mots de Xi Jinping*, Dalloz, 2021 and *La Chine à nos portes – une stratégie pour l'Europe* (with Abigaël Vasselier), Odile Jacob, 2018.

He recently authored the following Institut Montaigne's policy papers: *China's Disappointing Economic Figures and the Crisis of Confidence* (September 2023), *Cross-border Data Flows: the Choices for Europe* (April 2023, with Viviana Zhu), *China's Change of Economic Model: Not So Fast!* (June 2022), *Rebooting Europe's China Strategy* (May 2022), *Xi Jinping as an Ordoliberal: China's Margins for Growth in 2022* (February 2022) and *China's Economic Rebound: Views from Beijing* (June 2021).

Table of contents

Introduction

Security has entered Europe's trade, investment and innovation landscape. The shift can be dated to 2016 and the alert caused by targeted Chinese investment into niche industrial and promising tech firms – with the most notorious cases in Germany but spreading beyond.[1] The Covid pandemic, and concerns about the United States' extraterritorial legislation, also fueled this trend. Russia's invasion of Ukraine in 2022 was an even bigger jolt, with the continent belatedly realizing it had added a large energy dependence to Russia in addition to our dependence on Middle Eastern oil. Since then, the pace has accelerated. Europe has been enacting or debating a host of rules and financial measures designed to improve its economic security from a defensive standpoint, along with positive measures resurrecting industrial policies. The China-related risks, whether linked to a hot Taiwan crisis or to China's policies of self-sufficiency and economic coercion, represent a far greater prospective challenge to Europe's economic security.

Recent geopolitical shifts have entailed a redefinition and an extension of the notion itself. Economic security once meant guarding from the consequences of natural disasters, or ensuring that free trade allowed for exchange between nations. Its implications have multiplied. Economic security now covers a huge domain, from guaranteeing defense and national security on the one hand to ensuring competitiveness and eventually protecting sectors in distress. **Increasingly, new technologies are dual-use, especially in the digital sector, further blurring the border between national security and economic security.** The challenges to Europe's competitiveness are acute, especially to its continued leadership in industrial sectors where it previously retained an edge.

[1] *KUKA AG, "Kuka Signs Investor Agreement with Midea and Recommends Acceptance of the Offer," KUKA Press Information, June 28, 2016, https://www.kuka.com/-/media/kuka-corporate/documents/press/news/2016/06/press-release-kuka-signs-investor-agreement-with-midea-and-recommends-acceptance-of-the-offer.pdf.*

Defining the respective competences of the European Union (EU) and its Member States is not easy. Investment became a shared competence within the European Union under the Nice Treaty,[2] but national security remains a Member State prerogative. "Public order" and the concept of economic security have been ways to get around this structural limitation. This creates a paradox: **Member States agree to protection against national security risks, yet many of them do not want an overextension of the perimeter for economic security.** Meanwhile **the European Union has the legal competence for economic security,** for which it is difficult to obtain political approval from Member States, but it has **no authority on national security, in spite of near unanimity among Member States that this is a priority** for protection.

This policy paper starts from the current debates on de-risking, including the extent of risks to be covered, and the relationship between defensive options and so-called offensive and "positive" aspects – largely innovation and industrial policies. We argue that **the stand-off, wait-and-see attitude or reluctance of various Member States are hindering the progress of defensive policies, particularly in comparison with like-minded partners.** Industrial policies involving exemptions from state aid rules on subsidies gather more support, albeit on a case-by-case basis. But even more than defensive options, these choices bear huge costs that are decided on a non-market basis. Even more than defensive options that limit the access to the European market for sellers in non-compliance with EU norms and rules, this will create dilemmas and a necessity to choose between several simultaneous European goals: greening, defense, structural funds, revenue transfer.

[2] *"Treaty of Nice," EUR-LEX, March 10, 2001, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:12001C/TXT.*

For both defensive and offensive or positive policies, the European Union, while starting from the priority of ensuring our future geopolitical security, should remain as inclusive of outside partners (companies and states) as the pace of innovation or the scale of industrial policies require. To ensure its future security, it is also necessary to redefine policy structures and instruments in a coordinated way across the single market. Given the 27 Member States with various abilities and resources, the risks of research and development (R&D) or industrial project duplication, the need for continuous exchange of sensitive information across Europe, with our companies and with other nations, we plead for hubs of information and decision at the European level. **Political decisions must be shared with Member States, but economic sovereignty cannot be decreed. It must be made workable.**

Finally, the note suggests incremental steps rather than a choice between defensive and positive options. This course is also realistic to limit our excessive dependencies on unreliable but predominant suppliers.

Consolidating our defensive toolbox is the primary objective for the short term. It already requires budgets and skills, capacity-building inside European institutions and national capitals, cooperation with like-minded countries and with companies. Innovation and industrial policies are also needed. They require a longer term horizon and cannot substitute for defensive measures. The trust gained from defensive measures among Europeans and with like-minded partners will help the ambitious projects involved in our industry and innovation rebirth.

1 Protect, Promote, Partner

Any proposal to ensure economic security has to defend (or "protect") itself on two fronts: doing too little or doing too much. The jolts from very immediate threats have also induced responses with longer time horizons for the European Union. **Europe's calendar moves more slowly than that of our like-minded partners.** The United States has a federal structure and budget, as well as the minting privilege of a dollar acting as a global reserve currency. Japan, which had in previous decades moved away from a guided economy, still has the ingrained habit of its most powerful ministry, the Ministry of Economy, Trade and Industry (METI), obtaining direct cooperation from companies.

The European Union is the strongest remaining advocate of multilateral rules, with the belief that all challenges to these rules are to be put into perspective with the preeminent goal of maintaining a competitive free market. It acts more slowly, with a golden rule of proportionality in defensive actions and remnant fears of subsidy wars. This is not only a principle, it also suits an economic bloc that has almost always kept an external trade and current account surplus. Yet, while the claim of multilateralism is maintained, the addition of economic security measures constitutes a revolution for the bloc in effect, whose success previously rested on internal and external openness.

In parallel to the defensive or negative measures on the "protect" side, the European Union is creating an offensive (or positive) agenda on the "promote" side that can be summed up under the notions of industrial policy and control over supply chains. Such a development is this second revolution. Industrial policy, even focused on the EU Chips Act of 2022 and a few large projects undertaken in common such as the Important Projects of Common European Interest (IPCEI), needs supporting tools such as education for skilled human resources and the pooling of financial resources. These measures compete with other priorities in the

budgets of the European Union's and Member States, including past subsidy policies towards endangered sectors such as agriculture, structural funds for the "new" Eastern European Member States, the huge costs of energy transition, the need for defense budget increases, economic and military assistance to Ukraine that are also priorities.

Moreover, while some sectors of Europe's industry and service industry still retain a certain lead, civilian airplanes and chemical industries for example, Europe is outgunned by the United States in defense and the soft digital sector, and by China in hard digital industry and many emerging sectors at the core of the energy transition. **How much industrial policies are a component of economic security is debatable.** While ensuring supply chain security, whether for raw materials or critical inputs, is unquestionably part of the problem. Achieving or maintaining a competitive edge through innovation is a much wider market issue. Yet the fact that "others do it" is also an issue of economic security: a state like China has massive subsidy and innovation policies with a goal of achieving power, including over partner countries.

In fact, the notion of "comprehensive security" *(sogo anzen hosho)* was pioneered by Japan in the early 1980s.[3] Japan's hard power was heavily constrained by its post-war Constitution. An argument can be made that the European Union, with a limited transfer of competences in the domains of foreign policy and hard security, needs more than a conventional state to ensure its comprehensive power – whether technological, economic or regulatory.

This leads to the third element of the European Union's quest for economic security: the "partner" side. Its insistence on "open" strategic autonomy as a purveyor of economic security is not merely a value preference. It is a recognition that partnering through innovation flows, and retaining

[3] *Tsuneo Akaha, "Japan's Comprehensive Security Policy: A New East Asian Environment," Asian Survey, 31(4), April 1991, pp. 324-340, www.jstor.org/stable/2645387.*

interdependence with other producers, is the only way to improve productivity and open new sectors without the excessive costs of a self-reliant Malthusian approach. **The question, of course, is whether this openness through diversification can be maintained within a limited subset of the global economy.**

2 De-Risking: The State of Play

Europeans, and more recently the Biden administration, have rejected the notion of decoupling, which was a very tall order when it concerned China, the world's first trading nation. Instead, de-risking has risen to the fore, as a much more acceptable concept based on narrow criteria of national security and public order. Even there, in Europe as in the United States, the outward border of de-risking remains fuzzy: dual-use products, technological leadership, ethical and sustainable sourcing have entered the fray. **While the "small yard and high fence" definition by the Biden administration is privately shared by the European Commission,[4] China's Xi Jinping has reportedly challenged the EU president by saying that de-risking was decoupling in disguise, and a case of protectionism.** Meanwhile, many Europeans subscribe to the view that the Biden administration, which launched unilateral actions such as the Inflation Reduction Act (IRA) while remaining involved in consultations across the Atlantic but without a clear trade policy, actually practices "unilateral protectionism". A Republican administration would likely practice it less politely.

[4] *"Remarks by National Security Advisor Jake Sullivan on the Biden-Harris Administration's National Security Strategy," The White House, October 13, 2022, www.whitehouse.gov/briefing-room/speeches-remarks/2022/10/13/remarks-by-national-security-advisor-jake-sullivan-on-the-biden-harris-administrations-national-security-strategy.*

In reality, the limits of de-risking are very hard to define, raising issues for practical implementation. This is particularly evident for supply chain vulnerabilities. To use a non-European example, a company such as General Motors had 856 first-tier suppliers, themselves depending on 18,000 second-tier suppliers, who in turn have their own suppliers in third-tier.[5] Covid-19, and more recently Red Sea attacks, have shown immediate and unforeseen consequences for the supply chain: in the last instance hitting the Berlin gigafactory of Tesla, a company which usually happens to emphasize in-house manufacturing of components. Similarly, a 2020 Japanese study finds that 43% of Japanese companies consider that they cannot properly implement by themselves an evaluation of their supply chain's resilience according to Japanese officials interviewed in February 2024. **In Europe, an automobile industry executive estimates that tier-two and tier-three suppliers to manufacturers have no more than two weeks of visibility over their own sourcing.[6]**

Mapping critical dependencies can be done according to the face value of direct inputs. For raw materials, the Commission has done its own evaluation.[7] However, the dependencies extend to subcontractors for some parts. In this case, the external cross-border dependency rate is quite small for major industrialized countries, and not necessarily focused on distant providers – even if they are low-cost. But if one takes a deeper look, through an approach factoring the dependencies of direct first-tier providers to foreign suppliers, the ratio increases. For the United States, this hidden exposure is four times the face value in 8 of 17 major industrial sectors. And by 2018, China had become the first foreign supplier, directly or indirectly, to all sectors except pharmaceuticals in the American industry.

[5] *Richard Baldwin, Rebecca Freeman and Angelos Theodorakopoulos, "Hidden Exposure: Measuring US Supply Chain Reliance," National Bureau of Economic Research, October 2023, https://www.nber.org/papers/w31820.*

[6] *"SAI Weekly #07 – 24: My Musings," Sino Auto Insights, February 16, 2024, https://sinoautoinsights.benchurl.com/c/v?e=17A0FB4&c=F8133&t=0&l=B5A9D99C&email=2TJK-4dARh%2FJNUL2rdZZ%2FAyDTW6ndA2ngSU4MPoLShUU%3D.*

[7] *"Critical Raw Materials for Strategic Technologies and Sectors in the EU: A Foresight Study," European Commission, September 2, 2020, https://ec.europa.eu/docsroom/documents/42882.*

Is it possible that delocalization and global allocation of supply chains have gone further for the United States than for Europe? A recent study by the Kiel Institute for the World Economy indicates that the risks from decoupling for the German economy would be much more limited than usually estimated. In the most extreme case of a sudden and total decoupling, it would account for less than 5% of Gross National Expenditures (GNE).[8] The analysis rests on overall trade flows however, and the average rate of face value dependency on China as a supplier, whether for the United States or for Germany, does not differ much from those of the National Bureau of Economic Research study cited above: **these major industrial powers are more self-based than usually considered.** But the Kiel study does not factor the dependencies among suppliers (including those based in third countries), and makes some hypotheses on trade flexibility by recalling for instance how Japan quickly overcame China's punitive rare earths embargo in 2010. It ends in fact with a recommendation of careful step-by-step de-risking – leading perhaps later to a more thorough decoupling or preparing for one.

There are policies designed to secure value chains by cutting out unreliable first-tier suppliers. The consequences of these policies are often counterintuitive. According to a study by the Bank of International Settlements, **supply chains have actually lengthened. Increasingly, they involve second-tier suppliers based in third countries:** "firms from other jurisdictions have interposed themselves in the supply chains from China to the United States."[9] This is an effect that closely resembles some of the effects of international sanctions, where prohibited trade takes new routes through intermediaries. **The only region that seems to have decreased the length and complexity of its supply chains is the Asia-Pacific,** suggesting a closer degree of production integration with China.

[8] *Moritz Schularick, "What If? The Effects of a Hard Decoupling From China on the German Economy," Kiel Institute for the World Economy, January 1, 2024, www.ifw-kiel.de/publications/what-if-the-effects-of-a-hard-decoupling-from-china-on-the-german-economy-32324.*

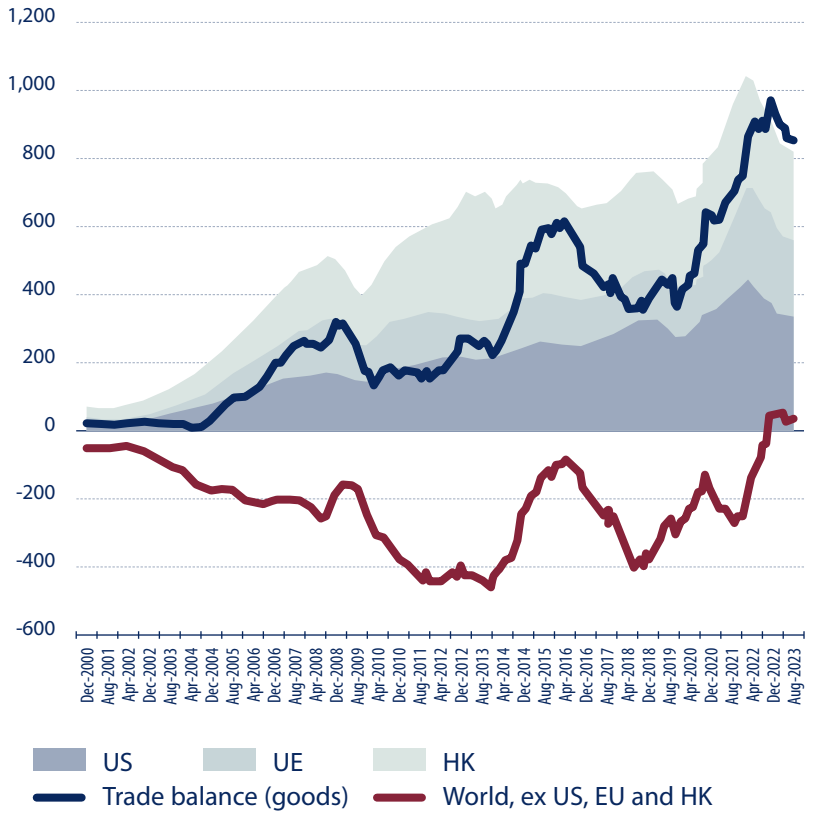
[9] *Han Qiu, "Mapping the Realignment of Global Value Chains," Bank of International Settlements Bulletin, No. 78, October 3, 2023, www.bis.org/publ/bisbull78.htm.*

Of course, China itself has also been pushing the most consistent systemic decoupling policies to weed out supply dependencies. China's absorption of foreign technology, including through import substitution and Foreign Direct Investments (FDI), came at the cost of high dependencies: China's manufacturing industries depended on other domestic and foreign suppliers for 50% of its output in 2005.[10] Its direct dependency on foreign suppliers was 7% in 2005 – higher in Japan and the United States but lower than in Germany. It has since gone down, reaching 4% in 2018. Whatever the industry, the dependency is more diversified in the Chinese case, with South Korea ranking first when one includes indirect dependencies. Consistently, industry policies are launched to close the gap and substitute domestic and nationally-owned suppliers in order to ensure economic security. **China has therefore turned the tables and is now creating more dependency in its partners' supply chains than it has towards them. This is particularly the case in sectors dealing with energy transition.**

[10] *Pan Yue and Simon J.Evenett, "Moving Up the Value Chain: Upgrading China's Manufacturing Sector," International Institute for Sustainable Development, July 25, 2010, https://www.iisd.org/system/files/publications/sts_3_moving_up_the_value_chain.pdf.*

Decomposition of China's Trade Balance in Goods

(in USD billion)



Source: X account of Brad_Setser.

The flip side is that China's gross domestic product (GDP) is more reliant on its exports and on trade partners, especially the European Union and the United States, accepting large and growing trade deficits.[11]

As other growth engines in the Chinese economy falter, this turns into a key economic and political vulnerability. China compensates this dependency by being much more willing and able to impose import restrictions, whether formally or informally, than Europe's free and open market. In other words, **lacking a strong and unitary European capacity to respond, China's command economy and authoritarian society might allow it to keep an edge in tit-for-tat games of trade war.** China-related incentives have been a catalyst, if not the exclusive incentive, for a rethink of the European Union's posture, and a shift towards ensuring its economic security.

3 The EU's Pathway to Economic Security: An Analysis Over Time

The EU's approach evolved over time from a case-by-case approach of single issues, fueled by dissatisfaction over trade asymmetries with China, to an increasingly systematic pursuit of economic security. There were failures at the beginning, and often long phases of internal debate. Implementation has also been slow, generally slower than in peer economic powers such as the United States and Japan. Yet, through two successive Commissions (the Juncker and Von der Leyen teams), the direction has not changed, and the tempo has even accelerated. We are now approaching the second generation of instruments, created only a few years ago such as inward investment screening,[12] dual-use regulations, already revised once in 2021,[13] and the General Data Protection Regulation (GDPR),[14] part of which also constitutes a building block of digital security.

[11] *Sylvie Bermann and Elvire Fabry, "EU and China between De-Risking and Cooperation: Scenarios by 2035," Institut Jacques Delors, November 2023, https://institutdelors.eu/en/publications/eu-and-china-between-de-risking-and-cooperation-scenarios-by-2035/.*

In 2013, the first attempt at deciding on inward investment screening actually failed. **It was the 2015-2016 debate on China's market economy status that led to changes.** Anti-dumping rules were modified and, while still not country-specific, provided for additional safeguards: treating all state enterprises in a command economy as one enterprise, allowing companies to register their complaints confidentially instead of publicly, speeding up decisions. But, unlike the United States, the European Union stuck to the rule of proportionality of sanctions to damage.

Pushed by a non-paper originating from France, Germany and Italy,[15] inward investment screening passed in 2019. Its implementation since 2020 has been the subject of three successive and increasingly detailed reports by the Commission. The third report, from October 2023, groups the implementation of inward investment screening with that of the dual-use export controls regulation (in discussion since 2014, in force since 2021).[16] This simultaneous evaluation demonstrates the increasing wish of the Commission to synchronize developments on various fronts. It is also much more detailed than its predecessors. What the 2023 report does not describe though is the origin of foreign investments which have been the object of Commission opinions.

[12] *"Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 Establishing a Framework for the Screening of Foreign Direct Investments into the Union," EUR-Lex, March 21, 2019, https://eur-lex.europa.eu/eli/reg/2019/452/oj.*

[13] *"Dual-Use Export Controls", EUR-Lex, August 21, 2021, https://eur-lex.europa.eu/EN/legal-content/summary/dual-use-export-controls.html.*

[14] *"Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the Protection of Natural Persons with Regard to the Processing of Personal Data and on the Free Movement of Such Data, and Repealing Directive 95/46/EC (General Data Protection Regulation) (Text with EEA relevance)," EUR-Lex, May 4, 2016, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32016R0679.*

[15] *"Proposals for Ensuring an Improved Level Playing Field in Trade and Investment", Bmwk – Bundesministerium Für Wirtschaft Und Klimaschutz, February 21, 2017, https://www.bmwk.de/Redaktion/DE/Downloads/E/eckpunktepapier-proposals-for-ensuring-an-improved-level-playing-field-in-trade-and-investment.html.*

[16] *"EU Foreign Investment Screening and Export Controls Help Underpin European Security," European Commission Press Corner, October 19, 2023, https://ec.europa.eu/commission/presscorner/detail/en/ip_23_5125.*

Key findings of the European Commission Third Annual Report on FDI Screening (2023)

In the sectors screened: IT, manufacturing and retail dominate FDI into Europe.
On the countries screened: The United States is the largest screened-investor by very far while China is the investor with the most participation by state entities. China's investments are increasingly turning to greenfield investment over acquisitions.
On the cases screened quantitatively: Among the 21 Member States with a screening regulation in place, 55% of the 1,444 cases submitted for authorization were screened. Of these 1,444 cases, 1% were denied, 4% were withdrawn, 9% were authorized with some restrictions.
On the most and least pro-active Member States in screening: Six countries submitted 90% of the 422 cases transmitted to the Commission in 2022, with values ranging from "less than one euro" to 25 billion. The European Union opened an unstated number of *ex officio* inquiries over cases from Member States devoid of a screening regulation. Of these cases, the Commission issued an opinion in 3% (or roughly 13 to 15 cases), a very small number.
On the dual-use export controls applications: China dominated by far the number of applications, which in total concerned 45.5 billion euros, or 2.1% of the European exports. 568 denials were issued, representing 0.6% of total applications, or 0.01% of European exports *(Figures only available for 2021)*.

Other regulations put in place during this recent European regulatory push also remain in a very early implementation stage, if not preparatory:

The **Anti-Coercion Instrument** (ACI),[17] adopted in October 2023 to act as a deterrent against economic coercion, would follow the following time frame if used. The Commission normally has four months to complete an examination of any third-country measure, the Council eight to ten weeks to act on a Commission proposal for an affirmative determination, and the Commission would then consider response measures within six months. The first review of the regulation is due by December 2028, or three years after the first implementing act, if taking place earlier.

A **provisional Critical Raw Materials Act** (CRM) was agreed on by the Commission and the Council in November 2023, which is also linked to greening and the energy transition.[18] This act follows a review of sourcing for 83 materials: of these, 34 are deemed critical raw materials, and 17 have been designated as strategic. Ambitious objectives have been set for 2030: at least 10% extracted in the European Union, 40% processed, 25% recycled, and no more than a 65% dependency on a single external source. The goal also implies strategic stocks, working with third countries, and a review of the list every three years.

[17] *"Regulation (EU) 2023/2675 of the European Parliament and of the Council of 22 November 2023 on the Protection of the Union and Its Member States From Economic Coercion by Third Countries – 2023/2675," EUR-Lex, December 7, 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L_202302675.*

[18] *"Proposal for a Regulation of the European Parliament and of the Council Establishing a Framework for Ensuring a Secure and Sustainable Supply of Critical Raw Materials and Amending Regulations (EU) 168/2013, (EU) 2018/858, 2018/1724 and (EU) 2019/1020," EUR-Lex, March 16, 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52023PC0160.*

The **Digital Services Act** (DSA)[19] and **Digital Markets Act** (DMA),[20] which aim to create a safer digital space, were recently enacted. The former became effective on January 1st, 2024, with Member States required to appoint Digital Services Coordinators by February 17. On that same day, all platforms, including those with less than 45 million active users, were expected to comply with DSA rules. These platforms will be under the watch of national regulators where they have their European headquarters, but only half of those regulators were in place as of mid-February 2024.[21] For the DMA, gatekeepers, platforms with a systemic role in the internal market, they have until March 2024 to ensure that they follow all DMA rules.

On the cybersecurity front, there exists a variety of legislative texts starting with the 2019 **EU Cybersecurity Act.**[22] On April 18, 2023, the Commission further proposed a targeted amendment to enable the future adoption of European certification schemes for "managed security services". Simultaneously, the Commission proposed the **EU Cyber Solidarity Act** to improve preparedness,

[19] *"Regulation (EU) 2022/2065 of the European Parliament and of the Council of 19 October 2022 on a Single Market for Digital Services and Amending Directive 2000/31/EC (Digital Services Act) (Text With EEA Relevance)," EUR-Lex, October 27, 2022, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32022R2065.*

[20] *"Regulation (EU) 2022/1925 of the European Parliament and of the Council of 14 September 2022 on Contestable and Fair Markets in the Digital Sector and Amending Directives (EU) 2019/1937 and (EU) 2020/1828 (Digital Markets Act) (Text With EEA Relevance)," EUR-Lex, October 12, 2022, https://eur-lex.europa.eu/legal-content/EN/TXT/?toc=OJ%3AL%3A2022%3A265%3ATOC&uri=uriserv%3AOJ.L_.2022.265.01.0001.01.ENG.*

[21] *"Digital Services Coordinators," European Commission, Last updated on February 16, 2024, https://digital-strategy.ec.europa.eu/en/policies/dsa-dscs.*

[22] *"Regulation (EU) 2019/881 of the European Parliament and of the Council of 17 April 2019 on ENISA (the European Union Agency for Cybersecurity) and on Information and Communications Technology Cybersecurity Certification and Repealing Regulation (EU) No 526/2013 (Cybersecurity Act) (Text With EEA Relevance)," EUR-Lex, June 7, 2019, https://eur-lex.europa.eu/eli/reg/2019/881/oj.*

detection and response to cybersecurity incidents.[23] As regards the so-called **EU Cyber Resilience Act,** a political agreement was reached within the Commission in December 2023 and a provisional one between the Parliament and the Council in March 2024.[24] Upon entry into force, manufacturers will have to apply all legal obligations within 36 months. This Cyber Resilience Act will complement the Directive on measures for a high common level of cybersecurity across the Union **(NIS2 Directive**) that entered into force in January 2023,[25] giving Member States 21 months to incorporate the provisions into their national law.

The **Public Procurement Directive** was last revised in 2014.[27] The fourth revision of the Action Plan on Public Procurement in 2020 included a series of new initiatives with a view to improving public procurement practices, properly using the public procurement framework in an emergency situation, ensuring a level playing

[23] *"Proposal for a Regulation of the European Parliament and of the Council Laying Down Measures to Strengthen Solidarity and Capacities in the Union to Detect, Prepare for and Respond to Cybersecurity Threats and Incidents," EUR-Lex, April 18, 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52023PC0209.*

[24] *"Proposal for a Regulation of the European Parliament and of the Council on Horizontal Cybersecurity Requirements for Products With Digital Elements and Amending Regulation (EU) 2019/1020," EUR-Lex, September 15, 2022, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52022PC0454.*

[25] *"Directive (EU) 2022/2555 of the European Parliament and of the Council of 14 December 2022 on Measures for a High Common Level of Cybersecurity Across the Union, Amending Regulation (EU) No 910/2014 and Directive (EU) 2018/1972, and Repealing Directive (EU) 2016/1148 (NIS 2 Directive) (Text With EEA Relevance)," EUR-Lex, December 27, 2022, https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A32022L2555.*

[26] *"Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on Public Procurement and Repealing Directive 2004/18/EC Text With EEA Relevance," EUR-Lex, March 28, 2014, https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32014L0024.*

[27] *"Action Plan on Public Procurement Annex," European Commission, January 11, 2021, https://ec.europa.eu/regional_policy/sources/policy/how/improving-investment/public-procurement/action-plan/public-procurement-action-plan-annex.pdf.*

field and using procurement as a strategic tool to pursue key policy objectives.[28] After much debate among Member States, a European International Procurement Instrument (IPI) was created in 2022, applying to partners who are not a party to the World Trade Organisation's General Procurement Agreement.

A **Corporate Sustainability Due Diligence Directive** (CSDDD) was put forward by the Commission in 2019, following the revelation of massive human rights violations in Xinjiang and advocacy by members of the European Parliament and NGOs.[29] The directive requires large companies to conduct due diligence on their supply chains, and those of their suppliers, in order to identify, end or mitigate adverse impacts on human rights and the environment. Though only applying to companies with a net turnover of above €300 million or above in the European Union, it still sets new EU-wide standards for human rights and the environment. However, and even as a provisional agreement was found between the Parliament and Council negotiators in December 2023, the directive is on hold. Member States representatives failed to agree on the directive's content on February 28, with 13 countries abstaining, including France, Germany and Italy.[30] *De facto*, there is a receding possibility of adopting the directive during the April plenary session, the last before the European elections.

[28] *"The EU's International Procurement Instrument – IPI," EUR-Lex, https://eur-lex.europa.eu/EN/legal-content/summary/the-eu-s-international-procurement-instrument-ipi.html.*

[29] *"Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and Amending Directive (EU) 2019/1937," EUR-Lex, February 23, 2022, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52022PC0071.*

[30] *"Press conference by Lara Wolters, rapporteur on corporate sustainability due diligence directive," Multimedia Centre of the European Parliament, February 28, 2024, https://multimedia.europarl.europa.eu/en/webstreaming/20240228-1600-SPECIAL-PRESSER.*

Thereafter, the onset of Russia's war on Ukraine, China's increasing pace at technology acquisition of sensitive technologies, as well as the challenge of the United States' own actions to create a "small yard with a high fence" around these technologies resulted in a second push by the Commission, **a push embodied by the June 2023 communication on economic security.[31] No doubt, the roots for this new stage are geopolitical,** just as the March 2019 designation of China as a "systemic rival" marked a sea change in Europe's overall perception.[32] Ursula von der Leyen's March 2023 speech on China policy provided the geopolitical background for new economic security steps.[33]

If the analysis is clearly geopolitical – with some accusing the Commission of being too aligned with the United States – the June 2023 outline for economic security in fact places the stakes at the intersection of geopolitics and geoeconomics. In that sense, some of the European Union's official commentary crossed the line into an expanded concept of economic security, introducing regulations designed to ensure European competitiveness, with implied key changes to a more guided and subsidy-based industrial policy. Indeed, **a global race is on to master in large volumes the industries of the future, from energy transition to digital innovation and biotechnologies.** It is worthy of note, however, that the definition given in June 2023 for economic security is narrower than that for economic resilience, and does not include climate change, pandemics and natural disasters for instance.[34]

[31] *"Joint Communication of the European Parliament, the European Council and the Council on 'European Economic Security Strategy'," EUR-Lex, June 20, 2023, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52023JC0020.*

[32] *"Commission Reviews Relations With China, Proposes 10 Actions," European Commission Press Release, March 12, 2019, https://ec.europa.eu/commission/presscorner/detail/en/IP_19_1605.*

[33] *"Speech by President Von Der Leyen on EU-China Relations to the Mercator Institute for China Studies and the European Policy Centre," European Commission Press Release, March 30, 2023, https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_23_2063.*

[34] *"Press Remarks by Executive Vice-Presidents Vestager and Dombrovskis and High Representative and Vice-President Borrell on Economic Security Strategy," European Commission Press Release, June 20, 2023, https://ec.europa.eu/commission/presscorner/detail/en/speech_23_3388.*

The "promote" side of economic security further pits advocates of a renewed public intervention into key economic sectors against those who argue that the market is still the best judge of what works – and what doesn't. **The massive turn of U.S. federal policy towards re-industrialization, reshoring and large-scale support to investors, well represented by the IRA and other incentives** (Infrastructure Investment and Jobs Act, CHIPS and Science Act, etc.) or reinforced institutional support (Supply Chain Disruptions Task Force, Council on Supply Chain Resilience, etc.) **is a call for Europe to turn away from some of its market-based competition policies.** So is China's success – whatever the costs – in key industries of the future, and particularly all sectoral components of the energy transition.

A temptation to compete with U.S. subsidies, and also "do as the Chinese do" is there, even if the European Union has neither the resources of giant U.S. companies and the debt capacity of a country that prints the world's currency, nor the extractive capacity of a Chinese Party-state, routinely dipping into individuals and companies savings that hover around or above 40% of China's GDP.[35]

This "promote" side further embodied by industrial policies intersects with economic security in two key aspects. One is the production capability for a given technology, beyond innovation itself. **The idea that scale matters is the heart of IRA and the U.S. Chips initiative, and it is also the core justification of Europe's IPCEIs** – so far launched on batteries, microelectronics, hydrogen, cloud and edge computing. The second aspect is where the integrity of the supply chain is concerned. This could involve looking at suppliers of parts and subcontractors, to the second or even third tiers. But the search for securing these is endless in an era of globalized production, where parts and components travel back and forth across borders.

[35] *Tianlei Huang and Nicholas R. Lardy, "Can China Revive Growth Through Private Consumption?," Peterson Institute for International Economics, January 10, 2023, https://www.piie.com/blogs/realtime-economics/can-china-revive-growth-through-private-consumption.*

4 Member States and Corporate Reluctances: Sticky Points for European Progress

There remain no-go areas, however, either because of institutional constraints, or because of political reluctance among Member States. While the Commission can be said to have gained self-confidence in its policy direction because of a series of geopolitical shocks and a general awakening to danger, it has also come up against the reluctance of some large Member States to surrender their initiative and say over new common regulations. **This political reluctance comes from two sides: the so-called "frugal" Member States** – in effect, often those with a positive trade and current account balance – unwilling to entrust the European Union with more resources. **On the other hand, those with less favorable external accounts are often also saddled with higher levels of existing debts,** and therefore less funding capacity for new projects or less skin in the game. Only Hungary, Cyprus and Malta are cited off the record in Brussels as across-the-board opponents of new economic security initiatives.

The Commission, which will end its mandate after the June 2024 parliamentary elections, is therefore staking the ground for its successors – whoever they may be. The comments it has faced ever since it published its overall strategy in June 2023 are revealing of a political dilemma. The Commission has been tasked to push for projects some deem unnecessary, such as monitoring outbound investment, or forcing the hand of Member States – especially larger ones that want to remain in control of processes touching on security, whether hard or soft, and export controls. **It is sometimes an unlikely coalition, one grouping Northern European countries and companies very invested in China, and France, whose industry interests are not fully aligned because of smaller stakes in the Chinese economy but which places a high value on its capacity to decide.** The pushback against a Commission thought to make a power grab through these initiatives has thus been strong.

Often, the contradiction runs within one country. The Netherlands has concluded with the United States and Japan an agreement regarding advanced semiconductors exports to China, extending to equipment and in particular the most advanced Extreme Ultraviolet (EUV) lithography machines, on which ASML has a monopoly. The agreement has been deemed consistent with European rules and is sometimes cited as a model to break the impasse of such multilateral processes as Wassenaar. But because this has deep commercial implications, it is notable that in the months preceding actual enforcement on January 1st of this year, ASML sales to China, which were already 46% of its global sales, soared suddenly.[36] In early 2024, the company reported it was limiting its exports after consultation with the U.S. government though,[37] and a further restrictive order was signed by the Dutch government on certain lithography machines.

The ASML case illustrates a key dilemma facing both public action and companies: **companies are often reluctant to agree on self-limitations to their exports and outward investments** – although ASML did go along with restrictions on its most sensitive equipment. Concerns exist on potential lost profits and being outpaced by competitors not saddled with the same rules. This prisoner's dilemma is exactly the same as that faced by European producers in the energy transition. What's more, faced with potential retaliation and coercion by China, they may indeed refuse regulations and controls adopted in their own economic interest, because they feel the unintended consequences will be worse. **This is an economic hostage situation, evident for companies with extreme reliance on their exports, and even more on investments into the China market.**

[36] *Pan Che and Finbarr Bermingham, "China's Imports of Dutch Chip-making Equipment Surged Tenfold in November After Washington Tightened Restrictions," South China Morning Post, December 22, 2023, https://www.scmp.com/tech/article/3246046/chinas-imports-dutch-chip-making-equipment-surged-tenfold-november-after-washington-tightened.*

[37] *"Statement Regarding Partial Revocation Export License," ASML, January 1st, 2024, https://www.asml.com/en/news/press-releases/2023/statement-regarding-partial-revocation-export-license.*

The resistance from companies, and its impact on public statements, has been most obvious in Germany. Bundesverband der Deutschen Industrie (BDI), self-described as "the voice of German industry", has taken a largely negative stand towards the June 2023 communication. While accepting the national security imperative, it regrets that the strategy is too focused on defensive instruments, and considering the costs incurred are neither specified nor are alternative trade flows identified. In short, **German industry would like more emphasis on positive rather than defensive measures, and it fears a backslide of Europe in free trade agreements.** In Italy, while major state firms and the government back defensive measures, Confindustria, the Italian business union, is reluctant, as is BusinessEurope on many aspects.

This German disagreement may also run inside its federal government. While Chancellor Olaf Scholz has said that companies are best placed to know their own risks and "because [the State] don't tell them where to invest,"[38] the first comprehensive China Strategy commits the German government to dialogue with companies on their risks,[39] and Minister for Foreign Affairs Annalena Baerbock stated that "companies that make themselves dependent to a large extent on the Chinese market will in the future have to carry the financial risk more heavily themselves."[40]

France's reluctances are much harder to decrypt, because on some issues, such as electric vehicles (EV) and subsidies, there is a stand that extends the scope of economic security much further, towards safeguarding market positions. Meanwhile, there also appears to be a general reluctance to

[38] *Sabine Siebold, "Companies Rather Than Countries Must De-risk Relations With China, Scholz Says," Reuters, June 30, 2023, https://www.reuters.com/world/companies-rather-than-countries-must-de-risk-relations-with-china-scholz-2023-06-30/.*

[39] *"Strategy on China of the Government of the Federal Republic of Germany," The Federal Foreign Office, July 2023, https://www.auswaertiges-amt.de/blob/2608580/49d50fecc479304c3da2e-2079c55e106/china-strategie-en-data.pdf.*

[40] *Moulson Geir, "Germany Presents Long-awaited Strategy on China, Stresses Economic Security," Associated Press News, July 13, 2023, https://apnews.com/article/germany-china-government-strategy-relations-e5d34b9df4618a1ace3490dc07a5f961.*

cede powers of decision to the Commission, with an emphasis on Council mastery of the process. **While France promotes strategic autonomy and, as a corollary of European sovereignty, it is much less forthcoming on actual delegation of competences, beyond consultation.** This impacts the views on export controls and outward investment screening, while policies such as anti-dumping and subsidy investigations meet with no resistance.

Much of this French reluctance is linked to another issue: the creation by the Commission in June 2021 of a Trade and Technology Council (TTC) with the United States, an initiative supposed to serve as a debating and clearing house for many of these developments regarding economic security. Because, since 2019, the Commission has shifted to a general language on China that is closer to its American counterpart, there are suspicions, besides the French positions, and a broad refusal to "align" with the United States. French officials tend to talk about "vassalisation". There are indeed suspicions that some export restrictions originating in the United States may hit foreign companies (ASML for instance) while sparing American competitors. **But it is also a reality that as of now, neither France nor the European Union can come up with the risk assessments that would enable them to make their own decisions on export control and outward investment screening.** Refusing these two developments and failing to present coordinated, if not unitary policies in the global context will harm economic security as a whole. One has to proceed from the least worst options.

In fact, there has been no alignment because even with TTC-related meetings, preemptive consultation by the U.S. administration has been scarce on the most important decisions taken in the same area and relating to China. The situation is different from the close coordination of sanctions that happened after the Russian invasion of Ukraine in February 2022. Beyond the reservations expressed by Member States and corporations on EU-led initiatives, economic security remains a concern to be addressed collectively by Europeans.

All of these concerns justify a better devolution of competences inside the Commission, in some cases with shared work across several Directorate Generals (DG). This is in fact what the Commission has been doing. DG TRADE is in charge of the risk assessment on trade weaponization and trade dependencies. This includes an inter-service group and an informal group with Member States, reportedly drawing 25 of them in a recent meeting, according to figures shared in Brussels in December 2023. DG GROW (DG for Internal Market, Industry, Entrepreneurship and SME) is in charge of supply chain resilience and energy issues. DG CNECT (DG for Communications Networks, Content and Technology) deals with infrastructure security and technology leakages together with DG RTD (DG for Research and Innovation), while DG CNECT is more specifically in charge of investigating the four critical technology sectors designated in 2023, except biotechnologies which are with DG RTD.

It is up to Member States to increase the coordination among their own national administrations – where they exist – and to strengthen the cooperation of these with EU-level actors. Still, in the presentation of its economic security package in January 2024, the **Commission acknowledged that sensitive issues deserve consultation and coordination at a higher political level with Member States.**

5 The January 2024 Economic Security Package: Realist and Cautious Forward Steps

With these reservations and reluctance in mind, not to mention the coming European and American elections and the possible political shifts they could generate, what the Commission proposed in January 2024 has a realistic tone, contrasting with some overly broad goals that had been previously mentioned or hinted at.[41] Deadlines have been extended, as is

the case for the monitoring of developments in four critical technologies designated in September 2023 (semiconductors, Artificial Intelligence, quantum technologies, biotechnologies), whose deadline has here been pushed back twice. **Public consultation is repeatedly sought, with time and space for Member States to negotiate compromises among themselves.** The Commission thus released a package with the following elements:

- A legislative proposal for a revamping of the 2019 inbound investment screening regulation;
- A proposal to the Council to enhance research security;
- Three white papers on monitoring and assessing outbound investment risks, on reforming the 2021 dual-use export control regulation, and on supporting R&D in technologies with dual-use potential.

By and large, all these moves have to do with controlling technology transfers. They involve only limited sectors of trade and research flows though, confirming, at least for the time being, a very limited perimeter for "de-risking", as opposed to the broader perspective of technological and economic competition.

Some observers have described the announcements as a retreat from the ambitions of the June 2023 economic security strategy.[42] It is true that some of the goals outlined then are not included in the January package. **The goal of "working to ensure that we maintain and grow our technological edge," which extended economic security towards broad competition and technological superiority, is not mentioned.** The links to an industrial or offensive policy are not obvious, except in the proposal for support to R&D with dual-use potential.

[41] *"Communication From the Commission to the European Parliament and the Council – Advancing European economic security: an introduction to five new initiatives," European Commission, January 24, 2024, https://commission.europa.eu/system/files/2024-01/Communication%20on%20European%20economic%20security.pdf.*

[42] *Thomas Moller-Nielsen, "EU Reveals New Economic Security Plan to Resist 'Fierce' Chinese Tech Competition," Euractiv, January 25, 2024, https://www.euractiv.com/section/economy-jobs/news/eu-reveals-new-economic-security-plan-to-resist-fierce-chinese-tech-competition/.*

What we have presently is a list of separate proposals focusing on shielding technology and research from outright theft or indirect appropriation. Their focus is on reinforcing the national security of Member States through coordinated action, and on strengthening the hand of the European Union in the international economic security debates of a geopolitical nature. And at this stage, these are proposals to Member States with widely open public consultation.

5.1. THE PROPOSAL FOR REVAMPING THE INBOUND INVESTMENT SCREENING REGULATION

An exception is the revamped inward investment screening directive, which is final and now subject to approval by the European Parliament. **Interestingly, this regulation addresses the issue of capacity building, since it provides for an increase in the EU-level budget of 5 millions euros and 29 officials.** This remains of course a far cry from the means at the disposal of the U.S. federal administration or Japan's METI.

Key Features of the Proposal to Revamp the Inbound Investment Screening Regulation

- Obligation for the five Member States (Bulgaria, Croatia, Cyprus, Greece and Ireland) still not on board to adopt their own rules;
- Extension of the rule when the investing party within the European Union is actually controlled by a non-EU investor;
- Inclusion of subsidies by non-EU governments to companies making acquisitions, or involved in public procurement;
- Right for the Commission to launch market investigations on its own initiative;

- Inclusion of cases that may result in dual-use exports outside the European Union;
- Harmonization of investment regulations across the European Union – for example, setting identical thresholds for investigation;
- Mandatory national screening for specific technologies and sectors;
- Obligation for Member States to publish a yearly report.

As down to earth as they may seem, these improvements in investment screening are closing existing gaps, forcing Member States to create rules and to report on them. Reportedly, **among Member States that have adopted screening rules, some have as little as two officials for all issues regarding economic security.** An EU official is reportedly noting that "some Member States are looking for an excuse not to do anything. They think a passing reference to de-risking in the G7 communiqué was enough."[43] The mandatory focus for investigation is more precisely defined. Notably, the new regulation does not consider at all greenfield investments, which now represent the bulk of Chinese companies moving into Europe. Overall, the goal is to focus on a critical segment, perhaps 20% of FDI cases, while leaving the remaining 80% outside of the scope.

5.2. THE PROPOSAL TO ENHANCE RESEARCH SECURITY

A finalized proposal to the Council is also made on enhancing research security. Investigations have shown multiple cases of cooperation between European universities and Chinese entities directly linked to the People's Liberation Army. These involve joint research or placement of researchers

[43] *Noah Barkin, "Watching China in Europe," German Marshall Fund of the United States, July 4, 2023, https://www.gmfus.org/news/watching-china-europe-july-2023.*

from China. **The Horizon Europe program has generally been supportive or neutral towards these research agreements.**[44] The new proposal is for a Council recommendation to Member States, not a binding regulation. It targets critical technological transfers, infringements on research integrity and use of research to undermine fundamental values. On the measures side, this includes risk profiles, communication between government and research entities, including the circulation of classified information, setting up a one-stop shop Research Security Advisory Hub in each Member State linked to an EU-level Centre of Expertise. Relatedly, it is proposed that the Horizon program exclude high-tech cooperation with China and Belarus, a current proxy for Russia.

5.3. THE WHITE PAPERS ON SUPPORTING R&D IN TECHNOLOGIES WITH DUAL-USE POTENTIAL, ON DUAL-USE EXPORT CONTROL AND ON OUTBOUND INVESTMENT RISKS

The remaining research initiatives are only options. A white paper on promoting dual-use research proposes to do away with the rule restricting Horizon program funds to research targeted at civilian use. A further option would be to create a dedicated instrument from the Horizon and European Defence programs to fund dual-use programs, breaking silos and opening the way to more EU-backed research for dual-use applications.

The other two white papers are proposals to monitor outward investment and export controls. They are likely to be the most sensitive with some Member States. **On outward investments, the Commission notes a large knowledge gap, which in fact is also mentioned within American debates on the same issue:** "the United States' capacity to

[44] *"Research and Innovation – China," European Commission, https://research-and-innovation.ec.europa.eu/strategy/strategy-2020-2024/europe-world/international-cooperation/bilateral-cooperation-science-and-technology-agreements-non-eu-countries/china_en.*

understand the global economy has eroded."[45] It therefore proposes a 12-month period of monitoring involving Member States. The investigation could be broad in terms of numbers (any direct investment abroad), but is limited initially to the four critical technology sectors already designated. There is a suggestion to include human resource transfers as part of the inquiry, meaning research and business management. The ultimate deadline is to arrive at a decision by the summer of 2025.

Commission officials note that the United States, preparing a similar action, is also taking a lot of time and presumably facing internal debates.[46] In the United States as in Europe, **a key motivation is the observation that funding and technology transfers from companies have contributed to China's rise up the chain in key sectors.** For instance, between 2015 and 2021, American investors participated in 17% of all investment cases in Chinese AI companies for instance.[47]

The proposal on export control builds on the existing 2021 revision of the regulation for dual-use exports.[48] It notes that all three multilateral export control regimes (Wassenaar, the Missile Technology Control Regime and Nuclear Suppliers Group) are paralyzed by Russia's membership that prevents decisions since unanimity is required. Unilateral export controls are therefore on the rise. This is also the case among European Member States. Although there is an obligation of national control lists

[45] *Henry Farrell and Abraham Newman, "The New Economic Security State: How De-risking Will Remake Geopolitics," Foreign Affairs, October 19, 2023, https://www.foreignaffairs.com/united-states/economic-security-state-farrell-newman.*

[46] *Emily Kilcrease, "U.S. Economic Security Strategy, Authorities, and Bureaucratic Capacity," Center for a New American Security, January 18, 2024, https://www.cnas.org/publications/congressional-testimony/u-s-economic-security-strategy-authorities-and-bureaucratic-capacity.*

[47] *Emily S. Weinstein and Ngor Luong, "U.S. Outbound Investment into Chinese AI Companies," Center for Security and Emerging Technology, February 2023, https://cset.georgetown.edu/wp-content/uploads/CSET-U.S.-Outbound-Investment-into-Chinese-AI-Companies.pdf.*

[48] *"Dual-use Export Controls", EUR-Lex, August 21, 2021, https://eur-lex.europa.eu/EN/legal-content/summary/dual-use-export-controls.html#:~:text=Regulation%20(EU)%202021%2F821%20of%20the%20European%20Parliament%20and,1%E2%80%93461.*

for coordination, there is a risk of a "patchwork", creating both difficulties for exporters and the risk of shopping around for the least restrictive rules inside the European Union.

The export control proposal therefore has two key elements, one facing outward, the other inward. **Facing outward, the European Union would adopt new controls on export items that have been blocked by a veto in multilateral regimes. This realist approach amounts to what many would call a "multilateral minus one approach".** While this would go around the obstacle that Russia presents, it would also seek to preserve a large degree of multilateralism, and where the United States often moves unilaterally, with extraterritorial leverage. This novel approach is also favored by Japan. It is a particularly important political development.

Off the record, Commission officials also refer privately to the Netherlands as the most advanced in terms of awareness of technological security awareness and mitigation processes. The Dutch agreement with the United States and Japan on restrictions for chip machinery exports went beyond Wassenaar, and received a green light from the European Union. While all the changes proposed in the January 2024 economic security package remain country-agnostic, following past European doctrine, they emphasize country-risk assessments and therefore more directed, if not targeted, measures.

The other element is facing inward. The lack of unitary action also limits European influence in this area. In the words of Valdis Dombrovskis: "when we act alone, we are a playground, when we act together, we are a player."[49] A proposal is made to coordinate national lists, to create a forum for debate at the political level for these very sensitive export issues and also to improve early coordination at the technical level on national export restrictions. According to an EU official in late 2023, the objective

[49] *"Plenary Session – European Economic Security Strategy (debate)," Multimedia Centre of the European Parliament, December 12, 2023, https://multimedia.europarl.europa.eu/en/webstreaming/plenary-session_20231212-0900-PLENARY.*

"is not to take away national licenses, but to ensure every Member State is informed of European Union positions on where to draw the line." In other words, **it is about nudging rather than coercing.**

Coordination is indeed necessary, as least demanding Member States could pocket the benefit of exports denied by others. As of now, **it seems that a debate remains on whether mutual information and coordination through the European Union should also have binding consequences,** allowing for unitary export controls and perhaps preventing Member States from going it alone in one direction or another. From the 2019 regulation to the revamped directive now submitted to the European Parliament, the same debate existed for inward investment control, and coordination has moved ahead very cautiously. The Commission therefore suggests a shorter time span for the present debate, moving ahead the evaluation of the dual-use export regulation from 2026-2028 to 2025.

If one compares the defensive technology measures taken or envisaged by the European Union with a well-informed American analysis listing measures needed in the area of techno-economic statecraft, their overlap is large – if not 100% – with export controls, sanctions, supply chain *due diligence*, inbound and outbound investment screening, anti-dumping, research security, prosecution of intellectual property (IP) theft, tariffs on high-tech industries.[50] Again, this convergence of objectives between the European Union and the United States does not equal a comparable level of funding or institutional support. The October 2022 U.S. export denial measures for semiconductors ran over 400 pages.[51] And even so, the modalities for implementing the executive order are not yet completely clear.

[50] *Lindsay Gorman, "Lindsay Gorman Testifies Before the Senate Committee on Housing, Banking, and Urban Affairs," Alliance for Securing Democracy, January 18, 2024, https://securingdemocracy.gmfus.org/lindsay-gorman-testifies-before-the-senate-committee-on-housing-banking-and-urban-affairs/.*

[51] *"Public Information on Export Controls Imposed on Advanced Computing and Semiconductor Manufacturing Items to the People's Republic of China," Bureau of Industry and Commerce, October 7, 2022, https://www.bis.doc.gov/index.php/policy-guidance/advanced-computing-and-semiconductor-manufacturing-items-controls-to-prc.*

Thus, **the caution and lengthy timetable of the Commission in some cases reflects both the difficulty of collecting timely information on extremely complex issues, and acknowledgement that some Member States will seek to retain a large degree of control.** This is the reason why the Commission's package is almost entirely devoid of propositions on the institutional process of information sharing, with the exceptions noted above. In words attributed to Margrethe Vestager, "we could have a turf war, we could just suggest that competency moves and then we would have, I think, a very conflictual discussion about competencies."[52]

6 Moving Ahead: The Choices to Make, the Means to Select, the Partners to Find, the Capacity to Build

The European Union and Member States are faced with hard choices with deep consequences for the European economy. In almost all rules or proposals for defensive economic security, there have been few or no estimates of the costs involved. Relevant estimates are missing, whether for budgetary expenses for defensive actions at Member States or EU-levels, direct costs associated with securing technology, indirect ones resulting from lopsided competition with less demanding partners, or costs from countervailing actions by third parties that see European actions as disguised sanctions or instances of protectionism.

[52] *Finbarr Berminghamn, "EU Slows Down De-risking Plans for China in Face of Member State Resistance," South China Morning Post, January 24, 2024, https://www.scmp.com/news/china/diplomacy/article/3249663/eu-slows-down-de-risking-plans-china-face-member-state-resistance.*

6.1. HARD CHOICES: SEQUENCING AND PRIORITIZING AMONG DEFENSIVE AND OFFENSIVE POLICIES

As soon as one considers offensive or positive measures such as industrial policy, and to a lesser degree supply chain resilience, the costs are likely to match those required by the substitutions needed for energy transition and decarbonation. Conventional defense spending, the core component of national security, also needs vast budget increases. Factories have delocalized for a reason, and the process is still ongoing, for example, in chemical industries that are moving out of Europe (and often towards China). **Economic security and environmental policies, which require tariffs creating a level-playing field with producers who are under fewer constraints than their European competitors, are likely to create additional costs for European consumers.**

One should also point out the unintentional consequences that regulation (or over-regulation) may have. This is exemplified by the current debate on proofing the development of AI against misuse. The issue is so serious that as in the case of cybercrime and spying, the United States and China have created a channel to try and contain aggressive use against one another. Yet, in the broader economy and society, innovation requires experimentation and a degree of risk.

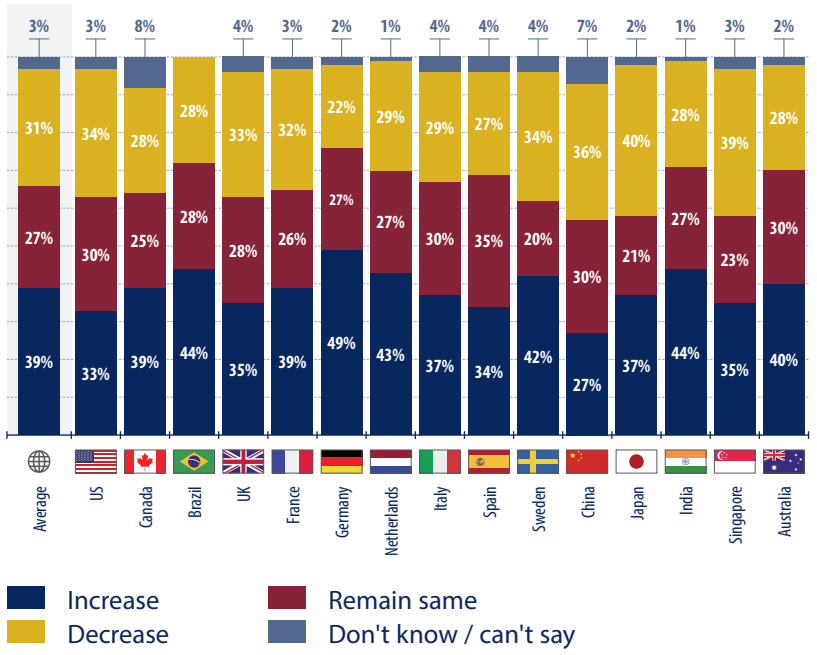
Whether the judges of those risks are the private innovators themselves or public regulators entrusted with the requisite information is an open question. This is likely to be an extension of debates surrounding the issue of digital privacy. For instance, for most individuals, the most sensitive aspect of data or AI security is their health data. However, the pooling and re-use of this data is sure to lead to great progress for prevention and treatment. Similarly, while competition laws and antitrust action are useful to allow new actors into any sector, and therefore to encourage innovation, the **financing required to scale up innovation can only come from very large actors:** in the United States, the top-tier of digital companies, and in China, public investment and subsidies. What about Europe?

Food security, a topic largely left untouched by EU debates and measures, whereas it is a priority of Chinese government policies, is also likely to come into the picture. How difficult these choices will be is demonstrated by the current farmers' revolt in several Member States. Free trade for European industrial and service exports often comes at the expense of more competition to European agriculture. **Environmental norms and food security (or "agricultural sovereignty") would require vastly more subsidies to the sector.** As agreed in December 2020, the Common Agricultural Policy already absorbs 31% of the EU budget starting from 2021,[53] and it is vital to farmers, including those in Central and Eastern Europe.

On top of this, there is a slow growth context and electorates. The latter react negatively to price or tax increases coming from the added costs of the energy transition, and tomorrow from policies ensuring economic security. Each of these choices creates political difficulties. Urgently, **voters need to see some payback from new policies, or at least that the costs do not fall only on European consumers or taxpayers but are also shared with other major economies.**

[53] *Vera Milicevic, "Financing of the CAP: Facts and Figures," European Parliament – Fact Sheets on the European Union, December 2023, https://www.europarl.europa.eu/factsheets/en/sheet/106/financing-of-the-cap.*

Percentage of executives stating how investments in supply-chain diversification will change in the next 12-18 months



Source: Advancing through Headwinds – Where Are Organizations Investing?," Capgemini Research Institute, January 2023 https://prod.ucwe.capgemini.com/wp-content/uploads/2023/01/Final-Web-Version-Report-Davos-2023.pdf.

Some economic security policies may be mutually reinforcing. Reshoring, if not "friend-shoring",[54] increases employment opportunities at home, and this may help to accept the added costs. A Carbon Border Adjustment Mechanism (CBAM), has been introduced provisionally for some sectors in October 2023, and a definitive regime should be created by 2026. The European Union aims to create a level playing field between domestic producers and importers, if not in third-party markets. This is ensuring competitiveness and economic security in the broader sense. To ensure innovation, Member States and companies will have to weigh the relative advantages of supporting strong local R&D and denying its benefits to strategic competitors, against the cost of being themselves cut off from some global sources of innovation.

Every rational observer agrees that designing rules at the level of the European single market is far more efficient than operating at the national level. **It is not evident though that even the European market provides enough scale, as the United States or Chinese markets do, for some categories of products.** The aerospace market is global as are the automotive, solar, wind industries, and much of the hardware and software digital market.

Scaling capabilities requires very large investments with long time horizons. China's centralized economy and the U.S. federal system have more direct leverage over their companies than the European Union. To patch these gaps, coalitions of some Member States and a rise of the EU's common resources are the next best solution. But a key requirement is to remain open to investors and contributors outside the European Union, in order to provide financial and technological resources and to retain reciprocal access to research.

6.2. WAYS AND MEANS: LOOKING FOR A REAL EUROPEAN FINANCING IMPULSE

Experts on economic security also agree that defensive measures alone cannot do the job to stay ahead in economic competition. Industrial policies and support for innovation are needed. **But the time horizon**

[54] *"Remarks by Secretary of the Treasury Janet L. Yellen on Way Forward for the Global Economy," U.S. Department of The Treasury, April 13, 2022, https://home.treasury.gov/news/press-releases/jy0714.*

stretches much further for major industrial policy initiatives, and their costs are likely to be higher. To use the example of critical materials, Europe currently has almost no mining resources for lithium (except Finland) or nickel (except in New Caledonia), and it has zero capacity for refining or extracting these metals. Regarding gigafactories for batteries, only one is currently operating out of nine projects, and four are Chinese companies-led initiatives.

Capital needs for the key projects that have already been adopted (batteries, semiconductors, hydrogen) are huge. For instance, the EU's Chips initiative is only funded from the EU budget to a limited extent. As is the case for IPCEI, it innovates by exempting Member States from many requirements for state aid, and it relies on inputs from private investors. In June 2023, the Commission estimated it had raised 22 billion euros for the European semiconductor supply chain, including 8.1 billion euros from state aid.[55]

Country commitments may seem important for projects ranging from clouds to wafer factories, but the **amounts pale when compared with the level of investment available to the world's top IT companies, none of which are Europe-based.** American technology companies are the five biggest R&D spenders in the country on the other hand. In yet another development, Open AI's Sam Altman, backed by Microsoft, is said to campaign with governments across the world, including in East Asia but especially in the Middle East, for trillions of dollars of investment towards capacity building for the chips needed by generative AI.[56]

[55] *"EU Chips Act Triggers Further €22 Billion Investment into European Semiconductor Value Chain | Statement by Commissioner Thierry Breton," European Commission, June 8, 2023, https://ec.europa.eu/commission/presscorner/detail/en/statement_23_3156.*

[56] *Madhumita Murgia and George Hammond, "OpenAI's Sam Altman in Talks with Middle East Backers Over Chip Venture," Financial Times, January 20, 2024, https://www.ft.com/content/1cdaadc3-b384-4f50-88ff-291c062c8376.*

And **governments move ahead too, in what is a race for subsidies or investments.** Indeed, the subsidy race for semiconductor capacity is in full swing, it is led by the United States with 52.7 billion dollars (51.6 billion euros at the August 2022 exchange rate) for the CHIPS Act,[57] and by China with its reported 143 billion dollars (134.4 billion euros at the December 2022 exchange rate) support for its semiconductor industry.[58]

But this race is not limited to the two economic superpowers. Besides the United States and China, Japan is also very active. It had chosen to rely mostly on private investments since the dismantling of its industrial policies in the early 1980s. Its restructured New Energy and Industrial Technology Development Organization (NEDO) is now able to fund an equivalent of 43 billion euros for innovation in 2022 according to NEDO officials. Semiconductor deals for approximately the same amount have been struck with large international partners: Rapidus project, TSMC, Western Digital, Micron, Samsung. Strikingly, when it comes to funding specific R&D for industry projects, **Japan adopts a very narrow gauge on dual-use technologies, through its first so-called K program list.** This list includes satellites for vessels and for optical communication, satellite infrared sensors, work on airflow for drones, jet engine materials, next-generation batteries, detection of unauthorized implants in hardware, inter-cloud communication and data protection.[59] The program is likely to expand, but it does illustrate a pinpoint approach, likely coordinated with private R&D needs.

[57] *"Fact Sheet: CHIPS and Science Act Will Lower Costs, Create Jobs, Strengthen Supply Chains, and Counter China," The White House, August 9, 2022, https://www.whitehouse.gov/briefing-room/statements-releases/2022/08/09/fact-sheet-chips-and-science-act-will-lower-costs-create-jobs-strengthen-supply-chains-and-counter-china/.*

[58] *Julien Zhu, "Exclusive: China Readying $143 billion Package for its Chip Firms in Face of U.S. Curbs," Reuters, December 13, 2022, https://www.reuters.com/technology/china-plans-over-143-bln-push-boost-domestic-chips-compete-with-us-sources-2022-12-13/.*

[59] *"The Cabinet Office's K Program Adds 23 Various and Advanced Projects in Its '2nd Vision' Based on Reports From JST/CRDS," Science Japan, September 12, 2023, https://sj.jst.go.jp/news/202309/n0912-01k.html.*

Europeans have also been surprised by South Korea's ability to quickly expand defense industry capacities, becoming a key supplier in Eastern Europe alongside the United States. The country has now announced plans for the world's largest chip-making hub by 2047 with 470 billion dollars (433.3 billion euros at the January 2024 exchange rate) to be invested, or 20 billion dollars (18.4 billion euros) each year.[60]

This is not to deny that all of the above European projects are a necessity for economic security. But defensive options can be first created, and cooperation – in and out of the European Union – will remain unavoidable in most cases, whether for sourcing, R&D or finance. The conclusion from these head-spinning figures from one sector alone is that **positive economic security plans relying on innovation and scaling are unlikely to be possible through Europe's sole financial means, whether these are private or public.**

Allowing broad exemption from state aid rules will not solve this. Instead, the exemptions and subsidies should first target specific technology gaps, while keeping the door wide open to qualified outside investors. This openness is a key aspect of "open strategic autonomy", a concept sometimes decried as an oxymoron but in fact essential. You cannot run a global race on a regional basis, much less on a national basis, while **the winners will be those who include as many significant partners as possible.**

6.3. POOLING INSTITUTIONAL AND HUMAN RESOURCES

Even for purely defensive measures, the human resources and budget needs at the EU-level and for Member States – although not as large – are significant, including in terms of the technical, financial and language

[60] *Sohee Kim, "South Korea Lays Out $470 Billion Plan to Build Chipmaking Hub," Bloomberg, January 15, 2024, https://www.bloomberg.com/news/articles/2024-01-15/south-korea-lays-out-470-billion-plan-to-build-chipmaking-hub.*

skills needed. As a way of comparison, the U.S. Department of Commerce has 42,000 full-time employees,[61] against 32,000 for the entire European Commission, and 705 employees for DG TRADE.[62] The Bureau of Industry and Security (BIS), a key actor of U.S. economic security, has a planned budget of 222 million dollars (204.7 million euros at the January 2024 exchange rate) for 2024, considered vastly insufficient by many observers in view of its expanding tasks.[63] On the CHIPS Act alone, the BIS has created 100 new positions, staffed largely from private industry, over this initiative. The BIS, of course, can count on inter-agency cooperation and intelligence resources that are not necessarily available to the European Union as such, or even to its larger Member States.

Still, U.S. analysts note a lack of knowledge regarding outbound investments, and a capacity gap to evaluate the impact of export restrictions or sanctions, including their possible unintended effects. In several interviews at the European Parliament, MEPs with very varying views on the issue of economic security concurred on the lack of human resources for the Commission, and the DG TRADE especially. It also appears that because of the sensitivity of issues involving possible new competences for the Commission and the so-called "power grab", it has avoided mentioning any resource needs in the proposals put to Member States and the public this January. **Asking for resources would imply that the decisions behind the proposal are already made.** This understandable shyness will lead to further delays in implementing any of the new proposals made by the Commission.

[61] *"The Department of Commerce Budget in Brief – Fiscal Year 2023," Department of Commerce, April 2022, https://www.commerce.gov/sites/default/files/2022-03/Commerce-FY2023-BIB-Introduction.pdf.*

[62] *"2023 – Human Resources Key Figures," European Commission, April 2023, https://commission.europa.eu/document/download/04118600-5b22-4b63-83e4-bdf74a6be3fe_en?filename=HR-Key-Figures-2023-fr_en.pdf.*

[63] *Emily Kilcrease, "U.S. Economic Security Strategy, Authorities, and Bureaucratic Capacity," Center for a New American Security, January 18, 2024, https://www.cnas.org/publications/congressional-testimony/u-s-economic-security-strategy-authorities-and-bureaucratic-capacity.*

6.4. THE TRANSATLANTIC PARTNER: THE MOST OBVIOUS PARTNER?

What is undeniable is that any detailed inquiry into technological security, and the implementation of economic security rules can only be achieved with a massive coordination and pooling of information and resources among private companies, Member States and the European Union. **There is a need for constant exchanges of information and mutual assistance in implementation with the United States and at least some influential and like-minded countries.** Japan, but also Korea, Australia come to mind, while Central Asia, Turkey, Southeast Asia and Singapore in particular remain big question marks. In the case of sanctions against Russia, there has been massive third-way trade evasion from the sanctions.

In the words of one European analyst: "if we think of the Champions League of economic security, we think of the United States, China, Japan. If you think of the Europa League, you think of Korea, Taiwan and, at best, the European Union as a collective."[64] Trust is indispensable and must be created alongside more competitive aspects such as trade competition or arms procurement. Knowledgeable Americans understand that a policy to prevent technology theft and key transfers in critical sectors, or to ensure continuity of supply, can only be collaborative. **Europeans must also understand Americans, and to some extent, Japanese lead on these topics.**

Cooperation at several levels with the United States is worth a more substantial look. It is the global leader in policies that hover between hard security goals, by preventing the leakage of technologies (defense components namely), and slowing down innovation by strategic competitors in sectors that are foundational to new and future weapon systems.

[64] *Conference held by the European Policy Centre (EPC) on "European Competitiveness and Economic Security: Towards a New Strategic Agenda," European Policy Center, January 10, 2024, https://www.epc.eu/en/past-events/European-competitiveness-and-economic-security~56cac0.*

This second objective already stretches the limit, since **it is often civilian R&D that leads to new defense developments.** This trend is recognized by the European Union's scheme for updated dual-use controls and for research security.

The United States' economic security policies expand into a third area which starts at economic competitiveness and moves on to production capabilities at scale. At this point, **American economic security intersects with trade protection and mercantilism, and clashes not only with the European Union, Japan and others' adhesion to free trade and global rules, but perhaps more importantly with Europe's own capacity to compete on market scale and with subsidies.** This tension was already evident in the transatlantic debate on custom increases for steel and aluminum in the name of "national security". To this day, this EU-U.S. irritant has not been resolved under the Biden administration, in spite of initial goodwill declarations,[65] and talks have faltered as the 2024 American presidential election approaches.[66]

It is important to note that Europeans have reasons to fear that the center of decisions for economic security is mostly in the United States, with pressure to "align" and forced implementation through extraterritorial means. Yet, this only compounds European problems that already existed. European Member States have diverging interests and tend to play bilateral games with strong partners such as China. As is well illustrated by sovereignist stands, the open opposition to transatlantic coordination policies often coincides with reluctance towards stronger EU-level binding action.

[65] *"Remarks by President Biden and European Commission President Ursula Von Der Leyen on U.S.-EU Agreement on Steel and Aluminum Trade," The White House, October 31, 2021, https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/10/31/remarks-by-president-biden-and-european-commission-president-ursula-von-der-leyen-on-u-s-eu-agreement-on-steel-and-aluminum-trade/.*

[66] *Andrew Duehren and Kim Mackrael, "'What the Hell?' Europe Chafes at America's Protectionist Tilt," The Wall Street Journal, January 29, 2024, https://www.wsj.com/politics/policy/us-europe-trade-relations-849fe23a.*

Because of the complexity of the European Union's functioning and its 27 Member States, there is little chance for a European lead in policies where hard security, or difficult implementation in interdependent supply chains and integrated production, are called for. **The celebrated "Brussels effect" is a model when rules and their implementation mostly depend on intra-European factors** – or when the soft power of the European market pulls in external actors. **It works far less for policies relying on forceful implementation outside the European Union,** policies that usually require negotiation with and endorsement from third parties.

A good example of the limit to European policies implying implementation out of Europe is our failure to address the need for extraterritorial implementation, including to ensure sanction capacities for its decisions.[67] Despite the realization that extraterritoriality can act as a tool to secure political power and influence, and while the European Union's competitiveness and resilience are under threat, the **European debate on extraterritoriality is virtually non-existent.** The term itself was entirely absent from the June 2023 strategy.

The European tunnel vision is limited to fear of economic coercion (or retaliation) by other large countries. This fear actually weakens the European resolve to strengthen its economic security on the legal front. Instead, **Europe clings to the multilateral framework, hoping it can contain these new coercive actions. On the defensive side of economic security, there are developments which have extraterritorial implications though.** For example, France's "blocking statute"(*loi de blocage* in French), introduced in 1968 and updated in 2022,[68] forbids French companies abroad from answering requests for sensitive information outside of agreed international judiciary or administrative channels,[69]

[67] *Georgina Wright, Louise Chetcuti and Cecilia Vidotto Labastie, "Extraterritoriality: A Blind Spot in the EU's Economic Security Strategy," Institut Montaigne, January 2024, https://www.institutmontaigne.org/ressources/pdfs/publications/extraterritoriality-blind-spot-eus-economic-security-strategy.pdf.*

and requires companies to inform French authorities of these requests. Overall, France's Ministry of the economy investigated about 1,000 security cases in 2023, usually on the occasion of mergers and acquisitions, with half of the cases involving strategic know-how. Of these, 60 involved the potential use of the blocking statute on legal grounds.

Legislation or sanctions without teeth outside the European Union often limit their efficiency to intra-EU use, unless European players are a major global factor. In many leading industries and innovation sectors directly concerned by economic security, particularly for technological developments, European companies are no longer the key players. **Market exclusion of non-European companies remains a possibility, but this has unintended costs for European producers and consumers.**

Less often documented is the fear in the United States that the measures designed to promote economic security are ineffective without the cooperation of like-minded parties, and cannot be promoted through extraterritorial means or unilateral enforcement alone. In recent testimony to the Senate Banking Committee,[70] an array of expert witnesses pointedly mention the need for cooperation, "including the need to limit extraterritorial application of U.S. authorities" in order to enable meaningful conversations with allies.[71]

[68] *"Law no. 68-678 of July 26, 1968 Relating to the Communication of Economic, Commercial, Industrial, Financial or Technical Documents and Information to Foreign Natural or Legal Persons [Loi n° 68-678 du 26 juillet 1968 relative à la communication de documents et renseignements d'ordre économique, commercial, industriel, financier ou technique à des personnes physiques ou morales étrangères]," Légifrance, https://www.legifrance.gouv.fr/loda/id/JORFTEXT000000501326.*

[69] *"The 'Blocking' Law: Reform and Publication of a guide [La loi 'de blocage' : Réforme et publication d'un guide]," Direction Générale des Entreprises, February 2, 2023, https://www.entreprises.gouv.fr/fr/securite-economique/la-loi-de-blocage-reforme-et-publication-d-guide.*

[70] *Lindsay Gorman, "Lindsay Gorman Testifies Before the Senate Committee on Housing, Banking, and Urban Affairs," Alliance for Securing Democracy, January 18, 2024, https://securingdemocracy.gmfus.org/lindsay-gorman-testifies-before-the-senate-committee-on-housing-banking-and-urban-affairs/.*

[71] *Emily Kilcrease, "U.S. Economic Security Strategy, Authorities, And Bureaucratic Capacity," Center for a New American Security, January 18, 2024, https://www.banking.senate.gov/imo/media/doc/kilcrease_testimony_1-18-24.pdf.*

An Unthinkable Scenario: Consequences of a Major Trade Conflict with the United States

To raise just one issue which we know to be very controversial, how central to economic security are green technologies really? What are the risks of depending on Chinese low-cost, comparatively high-tech suppliers of solar, wind, and EVs, compared to the costs of matching these with our own subsidies? **So far, European automobile manufacturers have made that choice, basing production lines in China and in the case of Tesla exporting to Europe.** Recently, France's Stellantis, now the world's third automobile producer, has concluded an alliance with a small Chinese EV producer to the same end.[72] Its competitor Renault has declared itself in favor of cooperation with Chinese car companies.[73]

At this time, it is hard to weigh the potential for such a trade policy shift, due to the persistent Chinese policies putting security ahead of economic growth, while pushing exports with every means available. But this eventuality needs to be raised because another development could possibly unfold: the end of transatlantic bargaining to find an acceptable outcome to the IRA issue and other trade disputes. **The United States under a new presidential leadership could go for a purely mercantilist policy. While that policy would likely target China, it would be much easier to implement against the European Union.**

[72] *"Stellantis to Become a Strategic Shareholder of Leapmotor with €1.5 Billion Investment and Bolster Leapmotor's Global Electric Vehicle Business," Stellantis, October 26, 2023, https://www.stellantis.com/en/news/press-releases/2023/october/stellantis-to-become-a-strategic-shareholder-of-leapmotor-with-1-5-billion-investment-and-bolster-leapmotor-s-global-electric-vehicle-business.*

[73] *Valérie Collet and Cécile Crouzel, "Luca de Meo, CEO of Renault: 'We Need to Forge Agreements with Chinese Players' [Luca de Meo, Directeur Général de Renault : 'Il faut nouer des accords avec les acteurs chinois']," Le Figaro, February 14, 2024, https://www.lefigaro.fr/societes/luca-de-meo-directeur-general-de-renault-il-faut-nouer-des-accords-avec-les-acteurs-chinois-20240214.*

One could consider that if Chinese taxpayers – mostly against their will – subsidize global green trade on a scale that democracies cannot match, there are economic benefits to our societies, as there were in delocalizing industrial production in the 1980s. Given the growing issues inside China's domestic economy, China's growth depends on access to export markets. The European Green Deal, with its emphasis on renewable energy, especially wind and solar, will require massive amounts of rare earth inputs. **We can lower our 90% dependence on China, but we cannot eliminate it – unless of course, we push back the target dates for greening.** At the European level, a strong hand, with carrots and sticks, in negotiating this continued access to China's green technologies and goods might be a more rational economic choice.

Would further deindustrialization be the unavoidable consequence of this choice? All advanced economies have gone down this path, regardless of political promises to the contrary. **A small but significant industry uptick is taking place in the United States, but with huge subsidies, a large unified market and disregard for multilateral trade rules.** In the much-debated automobile sector, both the United States and the United Kingdom were able to retain industry share in the 1980s because they nudged – many would say forced – Japan to localize plants on their turf.

Up to now the "Chinese factory" for the world has been very reluctant to delocalize, given the advantages of producing at home. But faced with the political unacceptability of complete sector domination, and the need for continued overseas markets, Chinese leaders might begin to relent. According to the latest news, an official directive is already suggesting to Chinese EV producers the need for more international cooperation "according to national conditions" towards a "supply chain system that is jointly built and shared by all parties."[74]

In the case of Chinese EVs, the sophisticated argument today is that chips embedded in these "computers on wheels" create a China-risk exposure.[75] But this is literally true of the entire Internet of Things (IoT). Given the difficulties in implementing a risk mitigation policy for 5G alone,[76] and this, in spite of an excellent assessment by the Commission, **how likely is it that we will shut ourselves off from the entire made in China semiconductor sector?** The same issue could equally apply to chip design from other sources, for which security is often just as opaque.

We raise this debate in part because it might become real, and because it is an example of hard choices that may come our way. **Currently, the main counterargument against taking advantage of Chinese home subsidies, at scale production and dumping is political: there is a known risk of coercion by China once it dominates supply or an industrial sector.** The European Union has never achieved a grand free trade bargain with China, and has found that promises were not kept and verification was nonexistent in many cases.

As of now, pooling economic security with the United States and other like-minded allies, even when interests diverge and need to be negotiated, is by far our best option. But **it is important**

[74] *"Opinions of the Ministry of Commerce and Nine Other Units on Supporting the Healthy Development of Trade and Cooperation in New Energy Vehicles [商务部等9单位关于支持新能源汽车贸易合作健康发展的意见]," Ministry of Commerce of the People's Republic of China, February 7, 2024, http://www.mofcom.gov.cn/zfxxgk/article/gkml/202402/20240203472074.shtml.*

[75] *Janka Oertel, "Security Recall: The Risk of Chinese Electric Vehicles in Europe," European Council on Foreign Relations, January 25, 2024, https://ecfr.eu/article/security-recall-the-risk-of-chinese-electric-vehicles-in-europe/.*

[76] *Mathieu Duchâtel and François Godement, "Europeans Struggle to Mitigate 5G Risks," Institut Montaigne, January 30, 2020, https://www.institutmontaigne.org/en/expressions/europeans-struggle-mitigate-5g-risks.*

to think of a situation where the United States would simultaneously withdraw its support for Ukraine and adopt pure mercantilist industrial and trade policies, based on its own large market and production base. In a situation where Europe's economic choices would be even more limited, while including a rising and costly defense priority, the least damaging option might suddenly look different. This is the scenario of a complete fragmentation for the global economy.

6.5. THE JAPANESE CONNECTION

Partnering with Japan,[77] not particularly emphasized in European Union or Member States public communications, is in fact easier because Japan's economic security is Janus-faced like the European Union. While it has to meet risks of technology leakage, input denials and attempts at coercion from strategic competitors, and above all from China, it must at least in some cases prevent unilateral processes from the United States that would predominantly place the cost of new measures on Japanese companies. **As the third exporting nation with a limited market, it simply cannot adopt a self-reliant and closed market perspective.**

In fact, Japan's whole industrial story over the last fifty years has been one of moving from an all-round industry supplying all needs and almost entirely based in Japan itself, with the sourcing of primary materials as the main dependency, to a much more complex internationalized production system. It remains that Japan's former tradition of a guided industrial policy, once embodied by the Ministry of International Trade and Industry (MITI), the precursor of METI, has left an imprint in the key area of public-private cooperation to ensure economic security.

[77] *Mathieu Duchâtel, "Economic Security: The Missing Link in EU-Japan Cooperation," Institut Montaigne, April 2023, https://www.institutmontaigne.org/ressources/pdfs/publications/Institut_Montaigne_policy_paper_economic_security_the_missing_link_in_eu_japan_cooperation.pdf.*

Japan, an "early bird" of economic security legislation,[78] is therefore ahead of Europe, and arguably of the United States, on several fronts. **It has an integrated economic strategy with a whole-of-government approach:** a cabinet-level appointee and a new directorate within METI, a Council for the Promotion of Economic Security that includes representatives from the private sector. **It seeks to break down traditional silos, and to create links to industry decarbonation policies.** Japan's Economic Security Protection Act (ESPA), adopted in May 2022, targets both 11 critical supplies, the security of infrastructures, critical technologies and a move to a secret patent system in some cases. It is also ahead in terms of human security for research, with processes in place for all centers of research, and extensive filtering of students and researchers from "problematic" countries.

These developments are facilitated by a turn of public opinion: 92% of Japanese polled in October 2023 have a negative opinion of China.[79] **Academic resistance to control of individuals is accordingly low.** And the former tradition of industry cooperation with the government is resuscitated, with what appears to be trust from key companies in transferring key technological information to authorities. **Cooperation on security goals is also incentivized by subsidies.** These last features will be harder to replicate in the European Union, yet they are key to a comprehensive approach of economic security.

The ESPA and the National Security Strategy, adopted in December 2022,[80] present strong similarities with Europe's defensive agenda.

[78] *Ulrich Jochheim, "Japan's Economic Security Legislation," European Parliamentary Research Service, July 2023, https://www.europarl.europa.eu/RegData/etudes/ATAG/2023/751417/EPRS_ATA(2023)751417_EN.pdf.*

[79] *Isabel Reynolds, "Japan Public Opinion Turns Most Negative on China in Nine Years," Bloomberg, October 11, 2023, https://www.bloomberg.com/news/articles/2023-10-11/japan-public-opinion-turns-most-negative-on-china-in-nine-years.*

[80] *"National Security Strategy of Japan," Ministry of Foreign Affairs of Japan, December 2022, https://www.cas.go.jp/jp/siryou/221216anzenhoshou/nss-e.pdf.*

Inside the G7, with the United States and the European Union, Japan supports cooperation against economic coercion, although it is not presently considering its own legislation. **The European Union has recognized the overall convergence of views and Japan's command of key technological information and potential leverage in international negotiations.** It has signed a first cooperation agreement on ensuring the security of undersea communication cables.[81] It has just concluded a first meeting for an EU-Japan working group on supply chains and economic security.[82] Japan has at least as much, and possibly more, joint consultation mechanisms with the United States, its security guarantor. But if U.S. trade policy was to undergo significant changes for the worse EU-Japan understanding would be important to mitigate the impact of these changes.

6.6. PARTNERING WITH THE PRIVATE SECTOR

This is a priority to ensure economic security. Information on technological developments, on threats and coercion, on supply chain vulnerabilities, necessitates the cooperation of the private sector. It requires going beyond agreement on purposes, to supplying the necessary intelligence, which is often proprietary and is jealously guarded against competitors, whether foreign or domestic rivals. **The European Union comes from far behind on that front, because it always held a doctrine of market neutrality and therefore separation of public decisions from private interests.** Yet, DG GROW's newly created Industrial Forum does not fit the bill because it is a top-level talk shop with a very broad mandate.

[81] *"EU and Japan Boost Strategic Cooperation on Digital and on Critical Raw Materials Supply Chains," European Commission, July 13, 2023, https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3831.*

[82] *"EU and Japan Hold First Working Group to Discuss Economic Security and Supply Chains," European Commission Press Release, January 30, 2024, https://policy.trade.ec.europa.eu/news/eu-and-japan-hold-first-working-group-discuss-economic-security-and-supply-chains-2024-01-30_en.*

The expanding public consultation mechanism – heavily emphasized in the January 2024 package – does not bridge that gap precisely because it is a process of open contributions from companies, NGOs, and citizens. This is not the confidentiality that companies require to share their information with a trusted public agent. There have been precedents in EU rules. For instance, company complaints regarding cases of dumping can now be made to the Commission without any public disclosure. But the issue of proprietary information and trade secrets requires more secure mechanisms. As is the case with clouds over issues of national security, **technical expertise and consultation of actors must be organized to guarantee safekeeping.** Several directorates of DG TRADE, which has always been entrusted with sensitive trade negotiations and is now vested with defensive functions, have put safeguards in place.

Introducing those safeguards is much less evident where coordination processes involve any or all of the 27 Member States and their administrations. As is the case with intelligence coming from external partners of the European Union, it is highly unlikely that such set-ups, as satisfying as they are to Member States wishing to keep a hand on the steering wheel, will be trusted. And as implementation will move forward from risk analysis to preemptive measures, this contradiction – and another hard choice – will emerge. A few of the larger Member States might think that they have the right security mechanisms at their disposal. But since it is the weakest link in the chain that creates security breaches, this does not suffice in a Europe-wide context.

7 Choosing a Realistic Course of Action

We are not the sole societies in the world that reach these conclusions on economic security dilemmas. But others often have natural or artificial advantages over us. The United States is more than self-sufficient for its energy needs, and benefits from its global currency. China not only (over)uses its immense coal base, but decades of forced savings and a reinforced top-down command economy allow it to take long-term perspectives in sectors where it wants to dominate global competition. Japan and South Korea, although still drawing from top-down traditions in innovation and industrial policy, have problems of scale and resources that place them closer to Europe.

Security and economic policies can no longer be delinked. Not only have the risks multiplied, but both the United States and China have interlinked defensive and offensive policies. **Implementing economic security is also a number game. Budgets and skilled human resources are needed,** and it is remarkable that information on these is almost totally absent from European Union or national presentations.

7.1. ON INSTITUTIONAL REFORMS

At what level should action occur? Pooling information and case analysis at the EU-level creates easier and faster mechanisms for decisions. The European Union is not a federation. And in practice it requires cooperation from Member States and several levels of public administration to collect information. **Where progress can be made is on norms and criteria:** defining risks (as was done for 5G technologies), adopting common criteria for statistical information and categories. However, this is likely to remain, at best, a shared competence. And the Commission has been right to draw out in the open a political consultation mechanism with Member States for thorny export control cases.

In one form or another, there is **a need for an institutional set-up that allows the sharing of confidential information and prepares joint assessments ready for decisions,** at whatever level these decisions must be made. Public administrations often have a tradition of informal communication with companies, as was especially the case for Japan. But today, it is often technological and trade secrets that need to be shared. Japan is currently preparing a formal legislation on a security clearance system, designed to ensure trusted exchanges between companies and the government.[83]

Some broader ideas float in Europe. They include creating **a Commissioner for economic security.**[84] But given the competition for new Commissioners (including for defense, as hinted by the Commission president),[85] this is unlikely to happen. So one might think instead of **a formalized cooperation structure among the relevant Directorate Generals.** Certain European Union officials have in mind the American and Japanese top-level centralized structures: the Bureau of Industry and Security and the National Security Council in the United States, METI's new directorate for economic security and the Council for Promotion of Economic Security in Japan. A one-stop shop for European institutions might be created but this will not solve by itself the issue of coordination with Member States.[86] Another proposal is for **a European Economic Security Committee** with the relevant Commissioners, along with a limited number of delegates appointed by Member States.[87] Still another proposal is for a specialized **Technology risk assessment Committee.**

[83] *Koya Jibiki, "Japan to Craft New Clearance to Safeguard Economic Security," Asia Nikkei, February 3, 2024, https://asia.nikkei.com/Politics/Japan-to-craft-new-clearance-to-safeguard-economic-security.*

[84] *Tobias Gehrke, "A Maker, Not a Taker: Why Europe Needs an Economic Security Mechanism", European Council on Foreign Relations, November 9, 2023, https://ecfr.eu/article/a-maker-not-a-taker-why-europe-needs-an-economic-security-mechanism/.*

[85] *Antoaneta Roussi, Joshua Posaner and Jan Cienski, "Von Der Leyen Plans New Defense Commissioner Post," Politico, February 17, 2024, https://www.politico.eu/article/von-der-leyen-plans-new-defense-commissioner-post/.*

[86] *Federico Steinberg and Guntram B. Wolff, "Dealing With Europe's Economic (In-)Security," Global Policy, November 13, 2023, https://onlinelibrary.wiley.com/doi/10.1111/1758-5899.13303.*

This leads to the question of how much staff such structures might have at their disposal, what would be their powers to obtain cooperation and with what confidentiality. Whatever the structure, it should have **a centralized component, with analysts working on risks, policy-makers preparing for political decisions, information flows from Directorate Generals, Member States and from intelligence sources,** perhaps leaving aside military intelligence per se.

Equally important is the creation of **a structure and process drawing in the cooperation of private companies.** At the political level, umbrella organizations for industry sectors should be integrated into regular consultation. But sensitive information is at the company level. Companies balance risks and rewards, and it is therefore necessary to incentivize them in the process of cooperation, instead of merely promulgating rules. There will remain tensions in some cases. **Short-term business interests do not necessarily align with long-term public needs.** Yet companies are often the first victims of infringements on economic security, and should increasingly understand the long-term risks of ceding technological lead or creating unreasonable supply dependencies.

7.2. ON DEFENSIVE POLICIES

Where to draw the line on economic security? As we have seen, it is a very loose concept, particularly so for a European entity that has no delegated competence for national security. Defense innovation and industries rely on many inputs, from fuel and critical materials to civilian innovation. For example, each F-35 jet fighter is said to require

[87] *Ole Spillner and Guntram Wolf, "China 'De-risking' – A Long Way from Political Statements to Corporate Action," German Council on Foreign Relations, June 2023, https://dgap.org/system/files/article_pdfs/dgap-policy%20brief-2023-15-en-AG%20Zeitenwende-GW.pdf.*

417 kilograms of rare earth elements.[88] At the other end of the concept, economic security reaches into competitive territory, whether it is about innovation and industrial policies or even broader notions of self-sufficiency and market leadership.

On this outward-facing front for economic security, what emerges repeatedly is that the means must dictate the ends. **It is pointless to encompass too much if the resources available for investigation or control are not available** – this is repeated time and again in debates about economic security across the Atlantic. In this sense, the European political quarrel about the respective competences of the Commission and Member States is counterproductive, since it leads the Commission to make proposals for investigations and regulation without making simultaneous requests for budgets and human resources.

Of course, the disagreements over the overall European budget play a role, and some Member States may be tempted to approve proposals for which the means are not available. But the main efforts are over skilled human resources (which need time to develop), over breaking down the silos inside the Commission, and agreement from Member States about shared information and common norms. **A defensive economic security costs money, but not of the same order as a positive industrial policy,** which requires moon shots for innovation, and economies of scale to achieve competitive production.

We therefore think that **defensive policies, such as outlined above, with as much cooperation as possible with partners outside the European Union, is a priority which is achievable as industrial policies take more time to materialize.** It is unrealistic to turn down or delay the defensive options while emphasizing industrial policies and economic sovereignty. The latter cannot succeed without the former, which may also be achieved earlier in time and at a lower cost. Except on the political front, where fear of surrendering competences to the European Commission or submitting to American priorities seems to remain a key consideration.

We also need to consider the sustainability option. Right now, the paramount criterion is cost. **Europe's greening ambitions, its need for catch-up innovations where some competitors are already at scale, hit the obstacle of costs.** This "China price", perhaps assisted by massive subsidies, perhaps helped by the scale of the Chinese market itself and its long-term planning, is a huge disincentive. CBAM is hopefully showing a way out, by adding a decarbonation requirement to the production costs of our trade partners. Japan, a leader on many fronts of sustainable development, is promoting sustainability criteria, from decarbonation to labor and other ethical concerns. This changes the rules of trade within a framework that it hopes to be WTO-compatible. It is something that the European Union has tried to embody in its new generation of free trade agreements. This might somewhat level the playing field with low-cost producers, while preserving the goal of serving global markets.

Sustainability criteria could particularly apply to demand side subsidies. The new French policy reserving EV purchase subsidies to producers meeting sustainability criteria very much echoes this idea.[89] Recycling obligations could also be integrated, where collection is easier in large and mature markets. Still, this is not a miracle solution. It will be challenged at WTO, even if the policies are not targeted against a particular state. **Countries with consistent industrial policies such as China could easily segment their production, with specific production networks meeting these criteria, while production for domestic sales or to third countries would not be concerned.** And above all, the added costs to our producers as well as to competitors will necessarily be passed on to consumers.

[88] *Doug Irving, "The Time to Prevent Shortfalls in Critical Materials Is Now," The RAND Blog, March 20, 2023, https://www.rand.org/pubs/articles/2023/the-time-to-prevent-shortfalls-in-critical-materials.html.*

[89] *"Conversion Bonus, Ecological Bonus: All the Subsidies Available for the Purchase of Clean Vehicles [Prime à la conversion, bonus écologique : toutes les aides en faveur de l'acquisition de véhicules propres]," Ministry of Ecological Transition, February 29, 2024, https://www.ecologie.gouv.fr/prime-conversion-bonus-ecologique-toutes-aides-en-faveur-lacquisition-vehicules-propres.*

7.3. ON OFFENSIVE POLICIES

As we move towards positive aspects of economic security, the problems change scale, and hit well-known obstacles. **Picking winners has always been a very difficult exercise.** The current U.S. process is complex, involves several stages, from research targets to the first stages of development, involving a mix of public and private funds in the research stage and more open competition for development. Even so, it has its gaps. For instance, the solar panel industry in the United States is increasingly dominated by Chinese investors.[90]

In fact, the United States' industrial policy was always inclusive, because American innovation relies on foreign talent and investment – 300 years later, **the United States is still a developmental state. Not so the European Union, with its limited common budget, the costs of a welfare state with an aging population, and other goals such as the green and energy transitions. China mobilizes and apportions savings basically as it wishes,** whatever the current level of public and domestic debt. Like a 360° garden sprinkler, it wastes funds, including with an extraordinary level of duplication and overproduction, but specific projects still get through whatever the cost. As long as this state of affairs endures, Europe cannot match either the United States or China – although it is making progress in raising venture capital and in a few specific projects.

Any policy towards positive economic security – whether it is about diversification of sources for materials, energy or suppliers – **has to balance the risks that could be avoided with the costs involved with these policies.** And any industrial policy involving innovative production at scale requires financing, which in many cases is also needed for other goals. Regardless if these are socially desirable goals in public budget, defense, greening, or more profitable private investments, these goals

[90] *Phred Dvorak, "America Wanted a Homegrown Solar Industry. China is Building a Lot," The Wall Street Journal, February 6, 2024, https://www.wsj.com/business/america-wanted-a-homegrown-solar-industry-china-is-building-a-lot-of-it-a782f959.*

will be in political competition. The real costs of sustainable agricultural policies, and of emission and greening requirements are now coming into full view.

Certainly, the State is back in economic development, after decades of retrenchment in favor of market-driven trends. But did the State ever shrink in Europe – and singularly in France, a world-class champion of public expenditures? We are currently obsessed with the apparent success of China's industrial policies, which also rely on flooding the world with exports. But **would we be ready to retrench other areas of public spending to match China's directed economy?**

Prioritizing economic security involves hard choices. Because the European Union (and politics) often rests on the power of speech, new priorities keep appearing, while deprioritizing is seldom a topic for public communication. Yet, **just as we have seen a general recoiling from a strategy of decoupling, some derisking must be questioned, and also be weighed against other priorities.** Greening is often said to coincide with economic security, but this is not at all evident except in some wonderful examples where green innovation ensures less dependence on questionable sources of energy or raw materials. The technologies for greening at scale overwhelmingly depend on China today.

Economic security will also compete with the costs of a heightened European defense capacity. It is true that defense and weapons increasingly rely on new technologies developed by the civilian sector. Developments in IT, quantum and artificial intelligence ensure future competitiveness, including for defense. But **the invasion of Ukraine painfully demonstrates that production at scale of conventional weapons, including tanks, munitions, already developed missiles and drones, is a priority in time.** Finally, in European societies whose politics often rest on welfare state support, revenue transfer and subsidies, policies for innovation are harder to finance than in societies where public expenditures as a share of the gross domestic product are currently more limited.

7.4. A GEOPOLITICAL SECURITY COMPASS FOR REALISTIC AMBITIONS

Painful choices lie ahead, whether we acknowledge them or not. Within the ambit of economic security, overstretch can prove to be the enemy of efficiency. Prioritizing and sequencing are necessary.

Our best option is to **cooperate as much as possible on risk investigations and defensive measures with like-minded partners, and to diversify at the lowest possible cost.** This implies much openness, and eventually technology and industry transfers to other regions – low cost producers inside the European Union or in its neighborhood, emerging economies, developing countries singled out for one particular resource. Given Europe's demography, **it also involves immigration of top-notch and skilled workers.**

Fine lines must be drawn. They must also include the risk that rules, norms and restrictions applied to Europe alone will leave third markets open to our competitors – unless we are able to project these rules beyond a Europe that is now less than 15% of the global economy.[91] This would **imply creating our own extraterritorial leverage. Absent this, we may achieve some successes, but these will be hard-won and case-by-case battles of persuasion.** Nobody, except candidates to European Union accession, goes the full European way. This pleads for a limited implementation of positive economic security policies. Carrots, and therefore resources, must be considered before sticks.

Diversification from any monopoly of resource and production, starting with the case of our systemic rivals, is a good idea. But neither Europe, nor anyone else, has the full means for this. Much as the international sanctions game begins to fail when it encompasses too large or too many targets at the same time, we must experiment and never forget the virtue of openness. **Financing, including for less developed partners who hold important natural resources without the means to process them, must be considered.** The World Bank and Japan's RISE (Resilient and Inclusive Supply-chain Enhancement) initiative,[92] joined by Italy, the Republic of Korea, Canada, and the United Kingdom, is a good example.

Like energy, commodities will not always remain commodities since they can be turned into weapons. While most companies worry about the impact of potential U.S. technology sanctions in the short term, they should also consider a reverse weaponization: the denial of energy, critical materials or components. **The one clear choice we should use as a compass is that of geopolitical security.** Failing to ensure this would mean that freedom of future choices would disappear. This freedom has always been a prerequisite for individuals in the democratic framework. But it is also true of societies and nations. After peace, this has become a major justification for building the European Union at scale.

News of the death of globalization, or of a complete decoupling from the world's second economy that is China, are greatly exaggerated, barring a hot war. **If countering the China risk is a priority, while continuing to multiply other goals,** however worthy each of them may be, **we face the risk of isolating ourselves from global exchanges.** This isolation generally leads to an economic impasse. What we need is to gain, or regain, the leverage in our external economic and technological relations, to prioritize the areas where economic security can be implemented, and to deprioritize other policies where they will impede or delay it.

[91] *"National Accounts and GDP," Eurostat Statistics Explained, June 2023, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=National_accounts_and_GDP#:~:text=In%202022%2C%20GDP%20in%20the,equals%20one%20euro%20(%E2%82%AC).*

[92] *"World Bank and Japan to Boost Mineral Investments and Jobs in Clean Energy," The World Bank, October 11, 2023, https://www.worldbank.org/en/news/press-release/2023/10/11/world-bank-and-japan-to-boost-mineral-investments-and-jobs.*

The Commission's homework is a modest first and second step. The way forward is not to counter it with overambitious goals lacking the means for implementation, but to build it piece by piece. This after all has always been the European way, with one important caveat: time is shorter than it was in the 1950s.

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Institut Montaigne
59 rue La Boétie, 75008 Paris
Tél. +33 (0)1 53 89 05 60
institutmontaigne.org/en

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Now is the time, when one considers Europe's need for economic security. Russia's war on Ukraine, China's increasing acquisition of sensitive technologies, its coercive use of economic leverage are all threats to Europe's security. Civil-military fusion, and critical technologies link economic security and defense concerns. Europe also faces the challenge of large US investment capacities and extraterritorial legislation – as well as their Chinese equivalent.

The Commission therefore created defensive rules, and launched a strategy in June 2023. Its January 2024 proposals mostly address the defensive side, with measures to "protect" while maintaining openness to like-minded countries on the "partner" side. The offensive and "promotion" side is less directly involved here.

Identifying supply chains or critical technology risks requires information not easily obtained. Companies beware of defensive measures that could hinder their outward exports and investments, and are reluctant to sharing sensitive information. Member States whose companies may suffer a backlash from defensive measures are also cautious. Some "frugal" states, including Germany, are reticent at EU budget expansion. Others, such as France, are unwilling to give more decision-making power to European institutions.

Building on interviews with policymakers, this policy paper from François Godement deciphers European debates on de-risking, while laying down a realistic course for coordinated action between the EU and Member States. It suggests incremental steps rather than a choice between defensive and offensive measures. In the short term, consolidating the EU's defensive toolbox requires Member States to put much more in common. The offensive side, involving innovation and industrial policies, requires a longer time frame and vast resources. A debate looms ahead with other competing goals: greening transition, defense, structural funds, welfare. In any case, cooperation inside the EU and with outside partners is unavoidable to diversify and innovate.

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