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STRATEGIC SOVEREIGNTY: HOW EUROPE CAN REGAIN THE CAPACITY TO ACT

**Edited by Mark Leonard
and Jeremy Shapiro**

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Mark Leonard and Jeremy Shapiro

Empowering EU member states with strategic sovereignty

Summary

- European countries are increasingly vulnerable to external pressure that prevents them from exercising their sovereignty.
- This vulnerability threatens the European Union’s security, economic health, and diplomatic freedom of action, allowing other powers to impose their preferences on it.
- To prosper and maintain their independence in a world of geopolitical competition, Europeans must address the interlinked security and economic challenges other powerful states present – without withdrawing their support for a rules-based order and the transatlantic alliance.
- This will involve a creating a new idea of “strategic sovereignty”, as well as creating institutions and empowering individuals that see strategic sovereignty as part of their identity and in their bureaucratic interest.
- Most fundamentally, the EU needs to learn to think like a geopolitical power.

European governments’ ability to have a voice in the world is under threat. When President Donald Trump pulled the United States out of the Iran nuclear deal and threatened to punish European companies for following international law, he exposed European vulnerability. Although European governments continued to back the deal, European companies such as Total and Airbus pulled out of their Iranian investments, while Belgian-registered international payments firm SWIFT suspended Iran – effectively cutting the country off from the global banking system. Europe’s view did not matter.

But the fate of the Iran nuclear deal is just the tip of the iceberg of European vulnerability. European countries are increasingly aware of their vulnerability to external pressure – and struggle to exercise sovereignty. While European sovereignty seems an abstract notion, its absence could have enormous costs:

- What would happen if the Americans restricted EU trade and investment in Russia or China in the same way they have done with Iran? This would disrupt trade worth around €190 billion per year for Russia and around €1 billion per day for China.
- The cost of European cyber vulnerability was estimated at €400 billion in 2018. And this will only grow with the coming of 5G and the “Internet of Things”.

- According to PwC, artificial intelligence (AI) will contribute more than €13 trillion to the global economy by 2030. How much of this market can Europe capture if China and the US set its rules?
- Unless the European Union changes its rules, powers such as the US, Russia, and China could block the union from using its resources to stabilise an African country through the United Nations, send an OSCE monitoring mission to eastern Europe, or bail out a third country through the International Monetary Fund (IMF).
- Europe also struggles to guarantee its security. What could the EU do if Russia decided to treat Poland or Latvia in the way it has treated Ukraine, using a combination of cyber attacks, disinformation, and direct action to destabilise an EU state and perhaps overthrow its government?

As the world descends into geopolitical competition, other powers increasingly challenge European countries' ability to defend their interests and values. Russia is willing to weaponise energy supplies, cyber capabilities, and disinformation; China invests strategically and uses state capitalism to skew the market; Turkey instrumentalises migration; Saudi Arabia leverages its energy resources. And the Trump administration is willing to exploit European dependence on the transatlantic security alliance and the dollar to achieve short-term policy goals. What unites these disparate powers is their unwillingness to separate the functioning of the global economy from political and security competition.

The EU has the market power, defence spending, and diplomatic heft to end this vulnerability and restore sovereignty to its member states. But, unless it acts soon, Europe may become not a player in the new world order but the chessboard on which great powers compete for power and glory.

This report seeks to lay out a picture of Europe's vulnerabilities – and a strategy for turning the EU into a player that can act on the world stage. Based on more detailed papers in this series – which look at the specific policy issues of international economic policy, sanctions, AI, defence, hybrid threats, and multilateral institutions – it demonstrates how the EU is becoming, or may soon become, less independent in all these domains. In these six areas, the papers make 56 specific policy recommendations for improving Europe's capacity to act. This paper looks at those problems more holistically and proposes a new concept of "strategic sovereignty" that can help guide the EU through the new era of geopolitical competition. It then proposes some overarching institutional changes at the European and national levels that can both create an overall sense of the need to protect European sovereignty and help implement the more specific recommendations from other papers in this series.

The new sovereignty challenge

For most of the last seven decades, the key problems facing the EU's citizens and member states have come from within the European space. By increasing interdependence and ripping down physical and regulatory borders, European leaders hoped to create both

peace and prosperity. The biggest challenge of European sovereignty was in taming it to serve this larger goal.

But, although there will continue to be internal challenges, the most significant problem in the next few decades will be the opposite: many of the biggest dangers to Europeans come from outside the European space. And, as Europe becomes increasingly “provincialised”, European states will increasingly want to regain sovereignty rather than tame it on the world stage.

A core part of the European narrative is that, in a world of superpowers, collective action can allow Europe to be a player in geopolitics. But, today, it is unclear whether the EU has the collective ability to protect European sovereignty, enhance the independence of its member states, and defend their interests and values. Europeans have traditionally struggled to influence the world when they lacked a collective strategy, were disunited, or were unwilling to put real resources into European foreign policy. This was what held Europe back on the Balkans, on Iraq, and on Russia.

But the experience with the Iran nuclear deal was different. Europeans had a long-term strategy that they had sold to the Chinese, the Russians, and, eventually, even the Americans. They remained united behind the nuclear deal and were willing to put resources into upholding it. The failure to protect the deal was a real wake-up call – and showed that there had been a structural shift in the world order.

Since the end of the cold war, Europeans have based their idea of a world they wanted to live in on three crucial pillars:

- A multilateral, rules-based order that insulates economic relations and global problems from geopolitical competition.
- A security alliance based on shared interests and values, with the US as the foundation of global order.
- Free and fair global trade that benefits everybody and that allows state policy to focus on consumer protection rather than the interests of producers.

These core assumptions are increasingly in question. The multilateral order is under assault from multiple sources as the world descends into geopolitical competition. Russia and China have long pushed back against the idea of pooling sovereignty and interfering in the internal affairs of countries. And the Trump administration is now actively undermining many core international arrangements, from the World Trade Organisation (WTO) and the Paris climate deal to the Intermediate-range Nuclear Forces Treaty and the UNESCO.

Meanwhile, Europe’s alliance with the US is becoming more instrumental and transactional every day. The transatlantic alliance remains a key pillar of European security and prosperity – breaking it up is not just unthinkable; it is unwise. But opposition to multilateral institutions from the Trump administration, increasing transatlantic divergence on policy issues, and greater American willingness to leverage

the alliance to restrict European sovereignty have led many Europeans to wonder how they can pursue their own goals when the US opposes them.

Finally, the idea that globalisation benefits everyone no longer has much currency anywhere, including within Europe itself. And many in the West have particularly acute concerns about the pressure that China's model of state capitalism puts on the global system through its closed markets, subsidised production, and forced transfer of intellectual property.

On a host of issues, from Iran policy to defence and technology standards, it appears that the EU has never been as sovereign as it thought. In retrospect, even the EU's geo-economic power now appears to have resulted from a relative lack of geopolitical interference and competition. A time of fiercer geopolitical competition and an America more focused on its narrow interests have exposed the EU's lack of independence in new ways. It is also clear that the EU's highly fragmented internal power structures mean that it lacks the capacity to stand up to more centralised powers, such as Russia and China.

Europe's vulnerabilities and opportunities

Europeans need to rethink many of their assumptions about the world order and the best way of defending their interests, values, and the rules-based system that has been the foundation of European foreign policy in the last few decades.

Europeans are increasingly aware of their vulnerabilities in a series of different sectors. Secondary sanctions, asymmetric hybrid warfare, foreign investments in strategically important European economic sectors, exploitation of energy dependence, and political interference in the public debate are just a few of the means that undermine Europe's strategic decision-making and hamper its freedom of action.

With increasing awareness of vulnerabilities has come a debate about strategic autonomy and sovereignty. Given that these terms have some baggage, it is worth defining them in this context. The goal should not be protectionism, aspiring to abandon the transatlantic relationship, nor ending interdependence. But it is important for Europeans to be clear about their own interests and values, how best to defend them, and the areas in which their dependence on others could lead to a loss of sovereignty.

It is just as important for Europeans to work out how they can stand up for their interests in the context of increasingly transactional relationships with their partners, including by taking countermeasures against acts of aggression. At the foundation of this effort will be a sufficient degree of unity among Europeans, which will prevent third powers from imposing their preferences on Europe.

In the last few months, a team of a dozen ECFR researchers have conducted a detailed study of some of the different dimensions of the challenge to Europe's strategic sovereignty – looking at both functional areas and cross-cutting structural problems. The first dimension is the fragmentation of decision-making. The second is a lack of capacity in different areas. And the third is the lack of a habit of bargaining in the global system. ECFR has analysed these vulnerabilities in three main baskets: economics and finance;

security and defence; and politics and diplomacy. The table below summarises some of the biggest challenges – and some of the major policy responses to these challenges.



Strategic sovereignty: Key recommendations

| | Europe's vulnerabilities | Policy agenda |
|-------------------------------|--|---|
| Economics and finance | US dollar and financial market dominance | <ul style="list-style-type: none"> – Create deep and integrated capital markets and a euro-area safe asset – Establish euro swap lines to central banks |
| | Secondary sanctions | <ul style="list-style-type: none"> – Create a compensation fund – Broaden INSTEX to all EU members, consult on parallel financial channels – Adopt asymmetric counter-measures with formal legal processes – Establish a European Sanctions Enforcement Office, investigate blocking regulation violations |
| | Lack of investment transparency | <ul style="list-style-type: none"> – Establish a process for national security screening of foreign investments – Empower European Commission to recommend prohibiting investments on security grounds |
| | Competition policy | <ul style="list-style-type: none"> – Expand state aid control beyond European companies, taking into account the strategic importance of sector and national security |
| | Artificial intelligence | <ul style="list-style-type: none"> – Develop shared, cleaned-up European data bases for research – Increase investment and beef up VentureEU – Leverage regulatory power to promote ethical AI, establish an EU seal – Train 1 percent of policymakers and the public |
| Security and defence | Russian threats in eastern Europe | <ul style="list-style-type: none"> – Establish a Fort Charlemagne in Poland |
| | Uncertain US security guarantee | <ul style="list-style-type: none"> – Create a European Level of Ambition within NATO – Establish a division of labour with the US: take over in Kosovo, step up in Africa |
| | Hybrid threats | <ul style="list-style-type: none"> – Transform ENISA into a cyber security institution – Establish standards for information platforms and cyber hygiene – Build domestic resilience to info war – Establish a European investigative service on foreign interference |
| Politics and diplomacy | A fraying multilateral order | <ul style="list-style-type: none"> – Strengthen the E3 and EU8 as diplomatic formats – Expand the WTO and IMF reform agendas – Establish a new EU-UN plan on migration, with elements of the Global Compact – Adopt QMV for human rights positions in the UN – Allow external role for ESM, EIB, and EBRD for independent action – Agree emergency rules for arbitration if WTO Appellate Body is blocked |
| | Instability on Europe's troubled periphery | <ul style="list-style-type: none"> – Establish a European Reconstruction Authority – Build robust framework for planning, funding, and running European-African mission |
| | New challenges to multilateralism | <ul style="list-style-type: none"> – Develop and harmonise national AI strategies – Invest in norm-setting panels like IPAI |

Economics and finance

The EU has long taken it for granted that the global system will provide a functional framework for international economic relations, regarding this as separate to the spheres of geopolitics and security. But, today, increased geopolitical competition, particularly that between China and the US, means that other powers no longer see these spheres as separate (if they ever did). The US is now willing to make full use of the global importance of its currency and its economy to enforce secondary sanctions against Iran, to secure immigration deals with Mexico, and to challenge the Nord Stream 2 natural gas pipeline.

Meanwhile, China is, [according to the European Commission](#), behaving as “an economic competitor in the pursuit of technological leadership, and a systemic rival promoting alternative models of governance”. The US and China have fundamentally different relationships with Europe, but they share an unwillingness to separate economics from geopolitics.

Although it perceives this new linkage across policy areas as deeply destabilising, the EU has the capacity to tackle these issues effectively. The EU should adopt an economic sovereignty agenda with four key goals: boosting Europe’s research, scientific and technology base; protecting assets critical to national security from foreign interference; enforcing a level playing field in both domestic and international competition; and strengthening European monetary and financial autonomy. Accomplishing these goals will require reforms to EU competition policy and its systems for controlling state aid, as well as a more coordinated approach to monitoring foreign investments, a conscious effort to increase the role of the euro as an international currency, and a new approach to both multilateral economic institutions and to European development banks.

A particularly important area is secondary sanctions. The Trump administration’s withdrawal from the Iran nuclear deal and imposition of secondary sanctions have harmed European countries’ interests in nuclear non-proliferation and laid bare their limited ability to implement an independent strategy on Iran.

European vulnerability to Washington’s secondary sanctions results mostly from economic interdependence with the US. Europe could respond by reducing such interdependence – but this would not be in its broader interests, either economically or politically. A more attractive option is to minimise Washington’s opportunities to use US-EU interdependence in ways that restrict European freedom of action. This would mean enforcing European sanctions more stringently; developing more effective mechanisms for minimising the impact of secondary sanctions through the creation of alternative financial channels and blocking regulations; strengthening the international role of the euro; adopting asymmetric countermeasures to provide a credible retaliatory capacity; and leading a global dialogue on the use (and abuse) of sanctions.

In the longer term, AI seems set to revolutionise technology, society, and the way militaries fight. But, given the power and influence new technology can have, it is striking that – unlike China, Russia, and the US – the EU and most European countries do not appear to consider AI to be of geopolitical importance. By contrast, other states appear to be adopting techno-

nationalist agendas, including through increased protectionist state action to support national champions, secure talent, and provide access to the large pools of data that fuel AI.

There is no easy way to make Europe stronger and more independent in AI, but four broad measures would help. Firstly, the EU should improve data collection and sharing on the European level, in a manner consistent with privacy concerns. Secondly, it should increase European research and development investment in AI, which lags China and the US, to help create the ecosystem and the supply chains that can support an effective AI industry within Europe. Thirdly, the EU should establish a regulatory process for AI, with the aim of creating an ethical and legal framework for the technology based on European values. Finally, the union should adequately train both its population and its policymakers in AI, as the technology is likely to permeate many areas of policy soon.

Security and defence

With a revanchist Russia now flexing its muscles on Europe's eastern border, persistent instability to Europe's south, and discontented rumblings from the US president about NATO and Europe, it is no wonder that Europeans are seeking to increase their defence capabilities and strategic autonomy. The trouble with this effort is not that it is infeasible. Europe has both the financial and technological resources to achieve the aim. The problem is the scale of Europeans' defence deficiencies: achieving genuine defence autonomy would be the work of decades rather than years.

This will require a political narrative that both motivates Europeans and avoids antagonising Americans (the US reaction to revived talk of a "European army" and the European Defence Fund highlighted the dangers here). Any effort to achieve European strategic sovereignty must, first and foremost, avoid creating a rupture in the transatlantic security alliance. At the same time, the narrative must focus European defence efforts on fixing the key vulnerabilities that would arise from a weakening or withdrawal of the US security guarantee – while avoiding accusations that Europeans are wasting resources by duplicating US capabilities and undermining NATO.

Achieving that delicate balance will require the EU and its member states to undertake two broad initiatives to reform European defence. The first is to strengthen the European pillar of NATO, creating a European level of ambition with NATO to create the capacity to conduct one major operation and three smaller joint operations without US assistance. The second is to establish a division of labour with the US that can relieve the latter of some of its operational burden in areas where American involvement is not essential or likely, such as Kosovo and Africa.

Beyond the conventional challenges, Europe also faces an amorphous set of threats below the level of war, broadly labelled "hybrid threats", which seek to exploit existing societal divisions to sow instability or simply confusion and thereby limit Europe's ability to mount an effective response to foreign challenges.

Dealing with hybrid threats requires a broad approach: on the political front, to make people aware of the threat without causing an overreaction; on the digital home front,

to establish standards for information platforms and build the capacity to respond to cyber threats, and to educate the public and the government in proper cyber hygiene; on the intelligence front, to establish an independent European investigative service and general prosecutor that can tackle the sensitive issue of foreign interference in domestic affairs; and, on the diplomacy front, to work with allies and international organisations such as NATO to mitigate these threats.

Confronting both traditional and hybrid threats will also require Europeans to embrace new technologies in the defence realm. In particular, the EU and its member states should embrace AI, seeking to adopt it in their military systems. This will create ethical challenges, but AI has many military applications even beyond hotly debated autonomous lethal systems.

Politics and diplomacy

A well-functioning multilateral system is widely acknowledged as a fundamental interest of EU member states. Europe currently confronts at least three strategic challengers in the multilateral domain: the US, China, and Russia.

Nonetheless, the current turmoil in the multilateral system provides a strategic opening for the EU. Many non-European states are simultaneously: unnerved by the US attack on international institutions; worried about China's emerging ambitions to rival or surpass the US in this sphere; and disgusted by Russia's behaviour in Ukraine and Syria. Against this backdrop, the EU's broad, if imperfect, commitment to international cooperation makes it an appealing alternative pole in multilateral affairs.

EU member states have already shown some interest in exploiting this opportunity through a flurry of initiatives to reinforce their presence at the UN Security Council; an effort to strengthen the E3 (comprising France, Germany, and the United Kingdom) as a diplomatic format; and a push to adopt European qualified majority voting on human rights, to establish a common position in multilateral forums. But the EU also needs to consider establishing an EU8 group of incoming and existing European members of the UN Security Council, while making a strong push to restore a common European position on migration within multilateral institutions. As a major economic power, the EU also has the weight to act as a leader in supporting existing trade and financial institutions, such as the WTO and the IMF; and to help craft rules for emerging industries such as cyber technology and AI.

This diverse array of vulnerabilities and solutions initially seems to be something of a grab bag. Individually, they each present important and complex policy challenges. But, collectively, they suggest that the EU and its member states should create either a mindset or a policy mechanism devoted to protecting their overall ability to act independently of other great powers. This report suggests that, rather than looking at these problems on their own, Europeans need to approach them more holistically, proposing a new concept of strategic sovereignty – and a governance system for dealing with it.

Developing a doctrine of strategic sovereignty

The Iran nuclear deal and other recent issues have certainly spurred European thinking on such issues. This has led to important debates about “strategic autonomy” and “European sovereignty”. Both these linked concepts are useful, pointing to EU member states’ desire to defend the security of their citizens. Unfortunately, they both have a lot of undesirable semantic baggage.

“Strategic autonomy” suggests that Europeans want to act alone in the world and implies a desire to free Europe from the interdependent world it has co-created in the last few decades. A forthcoming ECFR mapping exercise on perceptions of strategic autonomy in the EU member states shows that many EU capitals conceive of this concept as being anti-American.

“European sovereignty” is also a problematic term. The notion of sovereignty is traditionally associated with a nation-state, while the goal of European sovereignty has often been interpreted as implying that sovereignty should be taken from national capitals and recreated in Brussels. Some analysts also see it as a product of earlier thinking about sovereignty, in which the EU’s biggest challenge consisted of taming the destructive national sovereignty of its member states.

A better organising principle for the EU in the next few decades is the goal of building strategic sovereignty. Both parts of this term are carefully chosen.

The purpose of talking about “sovereignty” is to create circumstances in which – if Europeans have a clear and shared sense of what they want to do in the world – they are able to achieve it. The term “strategic” refers to setting rules at a global level rather than getting into the weeds of national life.

In this sense, sovereignty is not to be taken from EU member states but recovered from other great powers, such as China, Russia, and the US. Above all, it does not mean trying to end interdependence. On most issue areas, complete European autonomy is not possible or even desirable. Rather, strategic sovereignty should allow Europeans to decide their policies for themselves and bargain effectively within an interdependent system. By remaining able to make common decisions and credibly counter threats and hostile actions, the EU can both deliver for its citizens and demonstrate its worth.

This means fundamentally rethinking the purpose of European integration. In an earlier era, the main tools of EU policymaking served quite different purposes than they do today. Defence and security policy was about demilitarising Europe rather than building capabilities and a capacity for action. Competition policy was about eliminating state aid and unfair competition within the EU rather than defending European consumers and companies from the predatory behaviour of actors outside Europe’s borders. Equally, European technology and research policies were about redistributing resources within the EU rather than matching the best in a global technology race.

Today, the power of European integration needs to focus on enhancing the capacity of EU member states to compete effectively in a world of harsh geopolitical competition.

This is quite difficult within the fragmented European governance system for foreign policy. In geopolitics and security, particularly relations with the US and other big powers, member states have largely guarded their capacity to exercise their own foreign policy. The result is that most geo-economic issues are accorded to Brussels, but most geopolitical issues remain national prerogatives.

Given that it can only work when external economic relations are protected from geopolitical interference, such a fragmented system is no longer fit for purpose. As the papers in this series demonstrate in a range of important issues, the EU's fragmented foreign policy governance is no longer able to effectively support European interests and values.

To address the problem, the EU needs to pursue a new concept of strategic sovereignty. As with other areas of EU competence, the intent is not to transfer power or sovereignty to Brussels. Member states will always be the source of European sovereignty and the EU will necessarily have a mixed governance system in which competences are shared and divided in a variety of ways. But strategic sovereignty is not simply a call for greater unity of action and a stronger sense of shared purpose. Rather, the intent is to create a mixed governance system for foreign policy that better integrates and leverage all forms of European influence, thereby enhancing member states' independence from outside powers. In this sense, European strategic sovereignty is crucial to, in Alan Milward's famous phrase, rescuing national sovereignty.

For this broader purpose, Europe needs an operational concept and a political process on the European level that allows it to implement some of the recommendations above.

A strategy for building strategic sovereignty

European policymakers can consider these disparate issues areas separately and, to a degree, can even individually manage them without paying attention to the overall problem of strategic sovereignty. At the same time, each of the challenges reflects a common problem in the EU's approach to foreign policy.

Because it does not consistently assign responsibility for maintaining strategic sovereignty to any one place, the EU's fragmented governance system for foreign policy consistently fails to protect European independence. The EU can potentially respond to, say, the crisis of secondary sanctions on Iran but it cannot anticipate the problem and gather a set of tools and assets – at the EU or national level – to protect itself or prepare countermeasures for the next problem. Its response is, therefore, necessarily piecemeal and often ineffective.

The EU needs to move to a governance system for foreign policy that can better protect European strategic sovereignty. The union should establish an operational concept and a political process on the European level that can allow it to implement some of these recommendations. The process will be quite complicated because it will involve a mixture of national and European action, and because it will cut across many areas of European and national governance.

In practical terms, building strategic sovereignty requires three things: a strategy process, a work plan for developing capabilities for independent action, and new mechanisms for achieving unity among Europeans.

1) A European Strategic Sovereignty Strategy

In the first instance, the EU needs a change of mindset to address threats to its strategic sovereignty. It needs to learn to think like a geopolitical power. The goal is to create a shared project for gaining strategic sovereignty, while learning lessons from the process used to create the EU's Global Strategy. This would result in a process to create an Agenda for Protecting EU Strategic Sovereignty, with a mandate for the new high representative for foreign affairs and security policy to assemble the plan, working with the College of Commissioners and contacts in member states, who would take the lead in different areas.

On one level, the process and the resulting change in mindset are more important than the content of the strategy. The resulting strategy will inevitably involve various compromises, so its exact content is impossible to prejudge. But one can set out a few clear goals by which to evaluate progress, as well as some structures that could helpfully result from a clear-eyed process. Principally, any such strategy will need to integrate geo-economic and strategic policymaking. Currently, European economic governance purposefully ignores geopolitical considerations. So, for example, EU state aid rules make it difficult to channel support to emerging strategic industries such as AI, thereby allowing other powers to gain an advantage in such areas.

Another important goal for the process is achieving EU unity. As Europe fragments into different tribes, it becomes ever easier for other powers to divide and rule it. Russia has long seen this opportunity. China has joined it in this, holding up EU statements on the South China Sea and other issues. And with Trump seeming to reach out to both eastern Europe and southern Europe as a way of bypassing the E3, even the US is a threat to EU unity.

What is the best way to deal with this? Is it to introduce qualified majority voting? Is it to make it costly for countries that break ranks on foreign policy? Is it to allow EU member states *carte blanche* in their domestic affairs in exchange for maintaining a united front on foreign policy? Is it to invest in dealing with all Europe's security concerns – in the south and to the east – so that member states feel they have something to lose?

Clearly, there will have to be compromises on all sides. The EU was built through deals, so the ultimate guarantee of strategic sovereignty will be the development of a concept broad enough for all member states to regard collective European action and solidarity as the first line of defence against their most pressing national concerns. That implies that the project has to reach deep into other policy areas, ranging from EU energy policy to telecommunications, from trade to cyber security, and from the Arctic to the Mediterranean.

2) A work plan for developing EU capabilities

The second step is for Europeans to agree on a work plan to build the capability for strategic sovereignty in various areas. As discussed above, the papers in this series lay

out 56 substantive ideas that represent a strong foundation for such an agenda. The EU member states should particularly consider the ideas below if they want to invest in economic, military, and political agency.

In the economic realm, the EU needs to create a Financial Sanctions Enforcement Office and to ensure that all member states are represented on the board of the Instrument in Support of Trade Exchanges. The EU should also adopt asymmetric countermeasures by setting out a formal legal process for enforcing the EU Blocking Regulation through investigations into companies that withdraw from a country in response to non-European sanctions. The EU could mobilise its competition policy instruments to expand state aid control beyond European companies, and bolster the euro's international role by fostering deep and integrated capital and banking markets, creating a euro area safe asset, and extending currency swap lines to partner central banks. The EU could improve its AI capacity by leveraging its significant regulatory power through shared, anonymised European databases for research, as well as an EU seal for ethical AI.

In defence and security, Europe needs to increase its readiness and force posture in eastern Europe to underscore its commitment to the region's security. A Fort Charlemagne in Poland would do just that. Such a facility would complement NATO efforts while also building up Europe's own defence capacity – especially if combined with a European level of ambition in NATO. The EU could also take over missions in Kosovo and Africa to improve burden-sharing within the transatlantic alliance. As it also needs an effective cyber security institution with centralised functions, Europe could transform the EU Agency for Network and Information Security to that end. An investigative service focusing on foreign interference would also be valuable.

In the political-diplomatic field, Europe should expand the WTO and IMF reform agendas. But it also needs to prepare to deal with blockages in international institutions. Europeans should agree on emergency rules with other multilateralists to engage in trade arbitration if the WTO's Appellate Body ceases to function. They should also prepare their own institutions to engage outside the EU if necessary: the European Stability Mechanism could bail out a country that non-European powers would allow to default on its debts, damaging European interests; and the European Investment Bank or the European Bank for Reconstruction and Development could prepare to sustain Europe's capacity to act in the development field. A European Reconstruction Authority could independently address instability on Europe's troubled periphery.

3) Mechanisms for breaking down policy silos in Brussels and building unity among member states

The overarching goal of this effort is to create new decision-making forums and organisations designed to protect strategic sovereignty at both the European and national levels. This is not merely about communication; it is about creating institutions and empowering individuals that see EU strategic sovereignty as part of their identity and in their bureaucratic interest.

One can imagine several such new forums or organisations that, in addition to their specific roles, could gradually help integrate Europe's fragmented foreign policy governance system. They are:

- **A Strategic Sovereignty Committee within the European Commission.** The Commission already includes a “priority area” focused on strengthening the EU as a global actor. This priority area brings together several relevant European commissioners (specialising in foreign and security policy, neighbourhood and enlargement, trade, international cooperation and development, civil protection and humanitarian aid) under the chairmanship of the high representative for foreign affairs and security policy. This effort would reconstitute the area in three ways. Firstly, it would introduce an economic security element to the process by including commissioners whose portfolios European leaders generally think of as separate to sovereignty, including competition policy; economic and financial affairs; and research, science, and technology innovation. Secondly, it would establish a standing staff for the committee that would handle cross-cutting issues and monitor compliance among directorates-general. Finally, the staff would seek to create an organic link with their counterparts in similar bodies in key member states, facilitating the coordination of economic sovereignty efforts across all levels of governance.
- **An EU Task Force on Strategic Industries and Technologies.** This would comprise officials from across relevant directorates and would include industry representatives and experts. The task force would seek to identify the strategically important industries of the future, while proposing limits on foreign investment and exceptions to state aid policies and competition policy as appropriate, for approval by the European Council.
- **A Financial Sanctions Enforcement Office within the European Commission.** This would be staffed by representatives seconded from the European External Action Service, the directorate-general of economic and financial affairs, and relevant member state representatives, who would closely coordinate with banks and other financial institutions to ensure that European sanctions regulations were strictly enforced. The body would also impose penalties on entities that violated sanctions and help protect European companies against secondary sanctions imposed by other states.
- **A determined EU effort, led by the high representative for foreign affairs and security policy, to move towards greater self-sufficiency in defence through the promotion and development of NATO's European pillar.** While Europe's industrial and technological capacities should be expanded through the Common Security and Defence Policy (CSDP), NATO may be – for now – the better bet for capability development. This implies a “division of operational labour” between NATO and Europeans working without the US, whether through the CSDP or through arrangements such as the European Intervention Initiative. Both approaches should be pursued as a

conscious strategic bargain between those Europeans who focus on Russia and those who look more to the south.

- **A renewed push by the European Commission for member states to agree on their positions in key multilateral debates, particularly those on human rights issues, through qualified majority voting.** To this end, the next high representative for foreign affairs and security policy should appoint informal “multilateral ambassadors” within EU missions to various multilateral institutions, aiming to begin intra-EU dialogues on key issues such as migration. The purpose of these dialogues would be to avoid splits between EU members within multilateral institutions.
- **An EU-level monitoring and best practice body for societal resilience.** National resilience will, of course, largely remain the responsibility of member states. But member states currently take a wide variety of approaches to this area and vary greatly in their ability to resist outside interference in their domestic affairs. An EU body could, therefore, document societal vulnerabilities to external interference across the EU and recommend standards and best practice responses to this.

These steps are all both politically difficult to implement and insufficient to the task by themselves. Together, they would have a significant impact on the issues in question. They would seek to institutionalise, within the EU and member states apparatuses, the idea that protecting strategic sovereignty is the job of European governments. They would also begin to create a core of officials and technocrats with the skills and incentives to deal with each issue. Given the complexity of these areas, an effective response will require cooperation and an initiative to share competences between Brussels and member states, as well as “mini-lateral” responses that involve subsets of member states.

The goal of the effort is to create a Europe that can prosper and that maintains its independence in a world of geopolitical competition. This requires Europeans to recognise that, even as they continue to support a rules-based multilateral order and the transatlantic alliance, they need to respond to the interlinked security and economic challenges that other powerful states present. The strategic sovereignty of Europe depends upon it.

*Mark Leonard, Jean Pisani-Ferry,
Elina Ribakova, Jeremy Shapiro,
and Guntram Wolff*



Redefining Europe's economic sovereignty

Summary

- Great powers, particularly China and the US, are increasingly using economic tools for geopolitical purposes, and have no qualms about doing so.
- The fragmented structure of the EU separates economic tools from geopolitical interests, thus putting its economic sovereignty at risk.
- Europeans can take steps now to enhance their economic power, without advocating increased protectionism or a retreat from globalisation.
- The incoming set of European leaders should develop an economic sovereignty strategy to boost Europe's research and scientific base, enforce a level playing field in competition, protect assets critical to national security from foreign interference, and strengthen European monetary and financial autonomy.
- The EU should also consider institutional innovations such as establishing an Economic Sovereignty Committee and a Committee on Foreign Investment in the European Union to create a culture of greater integration between economic and political policymaking.

Europeans like to believe the European Union has the collective economic size and capacity to determine its own economic destiny. But the behaviour of other global powers is increasingly calling this ability into question. China and the United States, especially, do not separate economic interests from geopolitical interests in the same way the EU does. They are increasingly using economic connections, from cyberspace to financial links, to gain geopolitical advantage or to serve geopolitical goals. Europe's economic sovereignty is at stake.

The problem for Europe is real but manageable. This Policy Contribution examines the specific problems that China and the US pose for European economic sovereignty, and considers how the EU and its member states can better protect European economic sovereignty in a range of areas, including state aid to domestic industries, competition policy, investment screening, export controls, the international role of the euro, the role of European development banks, the European payments infrastructure and the global governance system. In each area, we recommend ways to improve the EU's capacity to wield economic power, without advocating increased protectionism or a retreat from globalisation.

We make recommendations on how to adapt the EU and national policy systems to better integrate economic and geopolitical considerations. The next European Commission should develop an economic sovereignty strategy to boost Europe's research and scientific base, protect assets critical to national security from foreign interference, enforce a level playing field in domestic and international competition, and strengthen European monetary and financial autonomy.

To guide the implementation of this strategy, an economic sovereignty committee should be established that will seek to integrate economic and security considerations within the European Commission. But the answer to this problem does not lie only in Brussels. We recommend a flexible implementation strategy that connects with member-state policy debates and makes use of 'mini-lateral' groups of member states.

I. The problem

The European Union was born during the cold war. It developed during the *détente*, and enlarged after the demise of the Soviet Union. It is now part of a world that is increasingly shaped by the strategic rivalry between the United States and China. Throughout this six-decade history, the EU never took part in the competition between great powers. Even though several of its member states have deployed some military forces abroad, the EU has considered itself a soldier of peace.

But whereas the EU does not send armies all around the world, its leaders like to believe the EU has the collective economic size and capacity to determine its own economic destiny, to set its own rules for economic life, to negotiate on an equal footing with partner economies, to tame would-be monopolies and even to set economic standards and regulations for the rest of the world.

Sovereignty, for the EU as a whole, is first and foremost *economic* sovereignty. The collective capacity of EU countries working together to preserve their economic independence underpins the argument that the European integration process provides value to Europe's citizens. That argument is bolstered by the EU's ability to participate in defining the rules of the game for the global economy – what Chancellor Merkel calls *Handlungsfähigkeit* and the French call *Europe puissance*.

But perhaps the EU has been lucky so far. Perhaps the EU's apparent economic independence in the global context was always the result of a lack of geopolitical interference. Perhaps it could only flourish under the benevolent aegis of a real superpower. Perhaps, in other words, it only existed because no serious power was willing to challenge it and because the US was willing to protect it.

Through the first decades of its history and up until very recently, the EU has taken for granted that the global system provides a functional framework for international economic relations, which could be regarded as separate from the spheres of geopolitics and security. For sure, the economic rules were determined by power relations in the wake of the second world war. But in the years that followed, even the US by and large followed them. The economic and geopolitical spheres often bled into each other, particularly

during the cold war. But the US regarded economic integration among ‘Western’ countries as conducive to the strength of the free world, and it stood by this principle even after the Soviet Union ceased to exist and was no longer a security challenge.

In this context, the EU was able to conduct an international economic policy that was reasonably insulated from geopolitical concerns. Its construction – with most international economic powers given to EU-level bodies and most security and foreign policy instruments left at the member-state level – reflected this assumption.

This separation between the economic and the geopolitical spheres was always fragile. It now looks outdated. The US and China have fundamentally different relationships with Europe, but have in common that they do not separate economics from geopolitics.¹ The competition between them has become simultaneously an economic competition and a security competition.

National security issues are gaining prominence everywhere, as is the almost-forgotten relationship between economics and national security. Economic connections, from cyberspace to financial links, are becoming the primary areas of great-power competition and are increasingly at risk of being weaponised.² Powerful countries often no longer abide by the primacy of economics.

In this new world there are more and more cases in which the US and China follow neither the letter nor the spirit of the rules in their relationships with the EU and its member states. As far as the US is concerned, its decision to make full use of the centrality of its currency and its financial system to enforce secondary sanctions against Iran was a major shock to the European partners and the 2015 nuclear agreement with Iran (whose own behaviour had remained fully compliant with principles negotiated between the US, Iran and other parties in the agreement). The US decision to abandon core principles of the global multilateral trading system and to withdraw from the Paris Agreement were further shocks for the EU and the world. Regarding China, it was a shock to the EU to realise that China is behaving as “*an economic competitor in the pursuit of technological leadership, and a systemic rival promoting alternative models of governance*”.³

For the EU, this new linkage across policy areas is deeply destabilising. Its own rules, and the organisation of its governance, were designed under the assumption that external economic relationships would be preserved from the interference of geopolitics. But now the EU’s main ally openly leverages its economic centrality to enforce its security preferences, while its main trade supplier departs from the internationally-accepted doctrine that investment decisions should be exclusively guided by economic criteria.

¹ There are of course many other threats or potential threats to European economic sovereignty. Russia is one, but its economic leverage is limited by its economic incapacity. Even its ability to wield the energy weapon is in decline, thanks to increasing energy diversification, EU efforts to liberalise the European gas market and the related programme to build interconnectors to link European gas markets. Non-state actors might also constitute a threat to economic sovereignty by damaging critical infrastructure or influencing election outcomes, with potentially significant economic consequences.

² Henry Farrell and Abraham Newman, ‘Weaponized Interdependence’, *International Security*, forthcoming; Mark Leonard (ed), *Connectivity wars: Why migration, finance and trade are the geo-economic battlegrounds of the future*, European Council on Foreign Relations, 2016.

³ European Commission/High Representative, ‘EU-China – A strategic outlook: European Commission and HR/VP contribution to the European Council’, JOIN(2019) 5 final, 2019.

In this new context, the EU must redefine its concept of economic sovereignty and the instruments it intends to use to defend and promote it. This is not an easy challenge, but the problem is manageable. There are strategic opportunities for measures the EU can take at national and EU levels to enhance its economic sovereignty without resorting to US-style protectionism and decoupling.

II. The great power threat to European economic sovereignty

There are many threats to European economic sovereignty, ranging from structural demographic and technological trends to lone-wolf hackers in their parents' basement revealing state secrets. But two great powers – China and the United States – represent specific and particularly difficult problems for the European Union because of their unique capacities and approaches to the international economic order. The two countries present distinct challenges, but overlap in one important respect: both increasingly link their international economic policies to their geopolitical goals and seek to use economic tools to secure geopolitical advantage.

A. China

China is governed by the Chinese Communist Party (CCP). It does not treat the economic realm as separate from the political and geopolitical realms. It simultaneously seeks economic growth, technological development and geopolitical influence. For this reason, the acquisition of a European company by a Chinese company might be motivated by long-term national or even CCP priorities rather than private profit-making objectives. Similarly, trade and investment relationships with third countries might be motivated by China's search for influence and its desire to secure commodity supplies, rather than by the intrinsic economic value of any particular project.⁴

The EU has three main concerns when it comes to China: China's influence over individual EU countries, the blurring of economic interests and security/military goals, and China's divergence from multilateral standards.

Influence over individual countries

On the first, the influence that China can acquire over individual EU countries through its foreign investment might become an obstacle to effective foreign policymaking in the EU. For example, China might seek to use economic tools to mute European opposition to its policies (for example in the South China Sea) and its domestic human rights record.

Chinese economic influence in Europe has already meant that, for example, Hungary, Greece and Slovenia have blocked or diluted resolutions relating to international

⁴ Wu described well the challenge for Europe: "When embarking on the process of reintegrating China, China's major partners may not have anticipated the extent to which the Chinese Party-state would reshape its economic structure along its own unique path. Over the past decade, we have witnessed the rise of 'China, Inc.', a form of economic exceptionalism with intertwined linkages between the state, the Party, and public and private enterprises." Mark Wu, 'The "China, Inc." Challenge to Global Trade Governance', *Harvard International Law Journal* 57(2): 261-324, 2016.

arbitration over the South China Sea and on human rights.⁵ Similarly, in March 2018, the EU members of the United Nations Human Rights Council all had to abstain on a Chinese resolution that re-defined the defence of human rights in terms of state-to-state cooperation according to “*mutual interests*”.⁶ That vote hardly accorded with EU values or interests, but Chinese pressure on certain vulnerable EU members meant abstention was the only way to avoid an internal EU division.

The 16+1 initiative has also undermined EU unity by creating direct bilateral links between some central and eastern European countries and China. Italy’s signing on 23 March 2019 of a Belt and Road Initiative cooperation agreement is set to further create tensions in the EU on the right approach to China.

These problems mostly stem from the EU’s unique internal organisation, particularly the requirement for unanimity on foreign policy decisions. Other powers, including the US and Russia, have long used bilateral relations to undermine EU unity on EU foreign policy.

Blurring of economic interests and strategic objectives

Second, China has an ambitious strategy to gain economic leadership. From a historical standpoint, this is a normal goal for a rising nation, but it nevertheless poses challenges for the EU.

Winning the global competition over emerging technologies such as artificial intelligence, big data and biotech are stated national security and economic imperatives for China. Many emerging technologies have dual uses and the old paradigm that technologies designed for military use will trickle down into civilian applications often works the other way in China. Chinese plans for industrial and technological development are also based on the premise that civilian companies help with military development and applications. Its resolute industrial policies and subsidies to key sectors (solar, batteries, autonomous driving and 5G are prominent examples) represent a clear strategy to gain competitive advantage in key sectors that China sees as critical for future geopolitical and economic advantage.

Of course, technological competition as a part of geopolitical struggle is nothing new. During the cold war, military-technological competition with the USSR provoked great fear in the West. But the current situation is vastly different. China and the West are deeply in each other’s business to an extent far beyond anything seen during the cold war. The huge degree of interconnection means there are many more channels through which each sides can hurt the other.

China has some structural advantages in that competition. Important parts of the digital infrastructure are controlled by large multinational corporations, which are subject to pressure and control from their home countries. The Chinese National Intelligence Law enables the government to force private companies to collaborate with Chinese intelligence services.

⁵ Robin Emmott, ‘EU’s statement on South China Sea reflects divisions’, *Reuters*, 15 July 2016; Robin Emmott and Angeliki Koutantou, ‘Greece blocks EU statement on China human rights at UN’, *Reuters*, 18 June 2017.

⁶ Ted Piccone, *China’s long game on human rights at the United Nations*, Foreign Policy at Brookings, The Brookings Institution, 2018.

Restrictions on foreign investment between the EU and China are asymmetric in favour of Chinese companies entering the EU market. In China, there are all kinds of problems for European investors, including the near impossibility of securing arbitration, difficulties in moving capital back from China and challenges to intellectual property rights. China also leverages market access to force companies to transfer technology, a practice incompatible with the spirit of World Trade Organisation rules. Finally, China heavily subsidises its own national champions and favours their access to credit, distorting the level playing field. This asymmetry means China can gain influence over technology from the European economy, but this does not work the other way around. Chinese state-owned enterprises, with their enormous financial muscle, are well equipped to use western openness to gain leadership in key sectors of the global economy. There is also a problem with transparency in that it is not always clear which Chinese funds are used to raise ownership stakes.⁷

EU countries have adopted measures on making Chinese investment in the EU subject to screening. The EU-China summit declaration of 9 April 2019 explicitly recognises the importance of “*following international standards in intellectual property protection and enforcement*”. It will be important to monitor progress in these areas.

Challenges to multilateralism

Third, China is increasingly present on third markets and does not necessarily follow the EU’s approach or existing multilateral principles. It is legitimate and normal for China to increase its global footprint. It is also understandable that China does not simply accept multilateral standards that were largely shaped by the US and the EU in the post-war period. Nevertheless, the fact that China has now the economic and political muscle to do so requires strategic thinking in the EU.

One topic is China’s Belt and Road Initiative (BRI), which aims to leverage Chinese trade flows to build infrastructure and create a broad network of partner countries. The BRI is explicitly not created as a multilateral framework of trade, investment and financial relations but is centred on China, which creates frictions with the existing multilateral system. Chinese BRI investment can be hugely beneficial for the recipients, offering opportunities for trade and investment for companies around the world: an airport or port, once built, facilitates trade and creates jobs.⁸ But the BRI deserves some criticism for its lack of transparency and for its sometimes-onerous conditionality.

China’s financial claims over overindebted countries could also be turned into control of strategic infrastructure and political influence. This has led the US and the EU to express concern that China does not follow the principles of the Paris Club, which aims to provide multilateral solutions to problems of overindebtedness. The IMF also emphasised that the BRI should “*only go where it is needed and where it is sustainable*”.⁹ Beijing has made some efforts to alleviate these concerns. For the EU, it

⁷ One example seems to have been Geely’s February 2018 increase in its ownership stake in Daimler. Another example is the 2015 Chinese acquisition of Swedish company Silex Microsystems, which helped the Chinese transfer a key technology to China. On Silex, see Emily Feng, ‘How China acquired mastery of vital microchip technology’, *Financial Times*, 29 January 2019.

⁸ Uri Dadush and Guntram Wolff, ‘The European Union’s response to the trade crisis’, *Policy Contribution* 5/2019, Bruegel, 2019.

⁹ Christine Lagarde, ‘BRI 2.0: Stronger Frameworks in the New Phase of Belt and Road’, remarks at the Belt and

is important to clearly establish the facts and not fall into the trap of just repeating US official statements.

As part of the BRI, China has raised its profile in the Middle East through humanitarian aid and infrastructure projects, including a July 2018 pledge of \$20 billion for reconstruction in war-torn countries in the region, such as Syria.¹⁰ This support will be welcome because the support for the region from the west is unlikely to be sufficient. However, China's intervention could also frustrate European efforts to use reconstruction aid to induce greater cooperation from Syrian president Bashar al-Assad on issues such as refugee returns and protection of human rights.

China has also become an important economic partner and investor in African countries. This investment, if well executed, might boost much-needed growth, to the benefit of Africa and also the EU, which could find new trading opportunities. But it also means Europe faces more competition in advancing its policies on Africa. The lack of transparency over Chinese funding could also make it more difficult for Western multilateral development banks to lend in the region and carry out any subsequent debt restructuring.

In short, China is a major rising power with increasingly global interests that might collide with European interests. The EU has awakened to the challenge but it has not yet defined its response. It needs to shape a strategy for its foreign policy, its technology and investment policy and its policy on China in third markets and multilateral institutions.

B. The United States

The United States has been Europe's most important ally since the second world war. Naturally, the problems that it poses for European economic sovereignty are of a very different nature than those posed by China. The ongoing alliance with the United States reflects Europe's democratic values and history. However, the presidency of Donald Trump has created serious doubts in the EU about the reliability of that alliance.

A strategic shift

The United States has always had interests and priorities that differ from Europe's. But the primacy of the Atlantic alliance and the strong belief that US national security and long-term prosperity would be best served by the strengthening of a global rules-based economic system meant that infringements of the global rules were the exception rather than the rule. In the words of political scientist John Ikenberry, "*the United States sought to take advantage of the post-war juncture to lock in a set of institutions that would serve its interests well into the future and in return, offered – in most instances quite reluctantly – to restrain and commit itself by operating within an array of post-war economic, political and security institutions.*"¹¹

Road Forum, Beijing, 26 April 2019, available at <https://www.imf.org/en/News/Articles/2019/04/25/spo42619-stronger-frameworks-in-the-new-phase-of-belt-and-road>.

¹⁰ Laura Zhou, 'China pledges US\$23 billion in loans and aid to Arab states as it boosts ties in Middle East', *South China Morning Post*, 10 July 2018.

¹¹ John Ikenberry, *After Victory: Institutions, Strategic Restraint, and the Rebuilding of Order after Major Wars*, Princeton University Press, 2000.

Under Trump, however, US policy has placed much less value on the transatlantic alliance and has demonstrated on issues as varied as Iran and trade that it is willing to leverage its economic position to secure policy outcomes, even if that implies undermining the global rules-based system and EU security.

More broadly, the Trump administration has actively reduced the support it gives to the multilateral order and has sometimes used its advantageous position to extract immediate economic gains from the system. It is also using its unique position within the global economic order to secure its geopolitical goals, for example in the context of Iran. The dollar, the US's financial system and its current role as a hub for the global digital architecture provide the US with an unrivalled ability to use the global system to serve its own security goals. To what extent future US administrations will continue with that policy is an open question, but it is clear that the damage the Trump administration has inflicted on the multilateral trading system is already real and likely to be difficult to reverse fully.

The enduring monetary asymmetry of the global economic system

Concerns about US abuse of its special role in the international monetary system are not new. In the post-war period, the built-in asymmetry of the Bretton Woods system implied a special role for the US dollar. Countries that pegged their exchange rates to the dollar were dependent for build-up of foreign exchange reserves on US monetary policy and on the availability of US dollar liquidity. Providing the dollars for these foreign exchange reserves required the US to run a current account deficit, but these deficits undermined trust in the US currency (this is the so-called Triffin dilemma). The issuer of the anchor currency enjoyed 'exorbitant privilege' but it also performed an exorbitant duty.

The end of the fixed exchange-rate regime in the early 1970s and the gradual move to generalised floating rates initially seemed set to reduce, and possibly end, this asymmetry. Although the dollar remained the dominant international currency, a floating exchange rate system looked fundamentally symmetric. Each participating economy could conduct its own monetary policy and freely enter into trade and financial transactions with the rest of the world. By the late 1990s, financial opening was assumed to be universally beneficial, international macroeconomic and monetary coordination were widely considered unnecessary and the issuance of an international currency was regarded as yielding only minor benefits.

The experience of the 2008 global financial crisis forcefully challenged this view and provided a stark reminder of the dependence of international trade and finance on the US dollar. Even though the financial troubles originated in the United States, the resulting global liquidity crisis made a massive injection of US dollars into the global financial system an urgent necessity. The US decision to extend dollar swap lines to selected central banks was thus instrumental in containing the effects of the crisis. But this was not done through

multilateral institutions, rather on a discretionary basis taking into account the economic, financial and geopolitical interests of the United States.

Ironically, this meant that a financial crisis that originated in America strengthened the value of the US currency and enhanced US influence over the economic policies of other economies. This situation has not fundamentally changed: the current dollar funding requirements of international banks mean that swap lines from the US Federal Reserve remain a critical backstop for the stability of many national financial systems.¹

Subsequent research has shown how the US dollar has maintained and has even expanded its exorbitant privilege in the post-Bretton Woods world. Essentially, increasing international financial integration and global growth have increased the system's reliance on the US dollar, the US financial system and thus US monetary policy. The US remains more than ever at the centre of the global financial system. Policy initiatives from the Federal Reserve and the federal government reverberate throughout the world economy.²

For example, because so many international trade transactions are invoiced in dollars, as the share of trade in a given country's economy increases, its citizens require more dollar-denominated assets, and thus the local banking sector becomes more dollarised and the central bank requires more dollar reserves (Gopinath and Stein, 2018).³ This in turn increases the incentive to invoice cross-border trade in dollars and creates a feedback effect.

Similarly, as global growth and investment have boomed, [the supply of safe assets](#), or assets that are expected to preserve their value even during adverse events, has not kept pace with demand until the US massively increased its deficits and bond prices corrected downwards.⁴ The United States dominates the supply of safe assets, particularly in the form of US treasury bonds and notes because it remains one of the most dynamic economies in the world and one of the oldest democracies with a strong adherence to the rule of law and a long history of political stability.

The monetary and financial centrality of the United States is only one facet of the often underestimated asymmetry of the global web of economic and technical interdependence. Whereas globalisation was assumed to result in an unequivocal equalisation of economic power, network relationships increase the power of those states that enjoy control of key nodes of the network.⁵ In such a setting, sovereignty is unequally distributed.

¹ Saleem Bahaj and Ricardo Reis, 'Central bank swap lines', mimeo, 2018, available at personal.lse.ac.uk/reis/papers/99-cbswaps.pdf.

² Hélène Rey, 'Dilemma not trilemma: The global financial cycle and monetary policy independence', Proceedings of the Federal Reserve Bank of Kansas City Symposium: 285-333, 2013.

³ Gita Gopinath and Jeremy Stein, 'Banking, Trade, and the making of a Dominant Currency', NBER Working Paper No. 24485, National Bureau of Economic Research, 2018.

⁴ Ricardo Caballero, Emmanuel Farhi and Pierre-Olivier Gourinchas, 'An Equilibrium Model of "Global Imbalances" and Low Interest Rates', *American Economic Review* 98(1): 358-93, 2008.

⁵ Henry Farrell and Abraham Newman, 'Weaponized Interdependence', *International Security*, forthcoming; Mark Leonard (ed), *Connectivity wars: Why migration, finance and trade are the geo-economic battlegrounds of the future*, European Council on Foreign Relations, 2016.

The effectiveness of US secondary sanctions

The central position of the United States in the international financial system has sovereignty consequences for other countries. These consequences often stem from increasing US willingness to use financial sanctions, including secondary sanctions, to support various US geopolitical goals, for example when it comes to isolating Iran or threatening to sanction German companies over the Nord stream 2 gas pipeline project.¹²

When the Trump administration decided in spring 2018 to withdraw from the Iranian nuclear deal and to return to a policy of economic isolation towards Iran, the European parties to that deal (the United Kingdom, France, and Germany) objected and decided that it was in their interests to continue with the deal. But the essence of that deal is that, in exchange for ending its nuclear programme, Iran gets to return to global markets as a more or less normal nation. The US government sought not only to cut off Iran from US markets but also to ensure that other countries did not do business with Iran, whether or not they shared US goals. To do this, the US used so-called secondary sanctions that threatened to cut off foreign firms that traded with Iran from the US market, the US financial system and the use of the dollar. The US has supplemented this pressure by threatening to prevent the directors of companies that violate US sanctions from entering the territory of the United States.¹³

In principle, a 1996 EU regulation (Regulation (EC) No 2271/96) protects European companies from US enforcement of secondary sanctions. The EU attempted to leverage this to negotiate an EU exception from US secondary sanctions. But in the context of globalisation, the even more central position of the US financial system now means that such regulations no longer have the same deterrent value. European banks and companies do not believe in the EU's ability to protect them and place too much value on their access to the United States to even take the risk. They have pre-emptively complied with US sanctions, even as their governments have urged them not to.

In January 2019, France, Germany and the UK announced the creation of a special purpose vehicle called INSTEX that, by netting out exports and imports, would help substitute gross cross-border payments with gross intra-Iran transactions, in theory reducing the need for EU-Iranian trade to access the global payments system. This vehicle is unlikely to lead to a significant resumption of transactions with Iran, because any company doing business with the United States can be sanctioned directly. For now, at least, INSTEX is limited to humanitarian goods that are not under US sanctions.

More generally, the provision of payments to Iran has not been stopped by technical problems but by political pressure, as shown by the 2018 Bundesbank decision to

¹² Hallie Detrick, 'US Threatens to Sanction German Firms Constructing Russian Gas Pipeline', *Fortune*, 14 January 2019, available at <http://fortune.com/2019/01/14/nord-stream-2-sanctions/>; Daryna Krasnolutska, 'US Reiterates Threat of Nord Stream 2 Gas Pipe Sanctions', *Bloomberg*, 21 May 2019, available at <https://www.bloomberg.com/news/articles/2019-05-21/u-s-reiterates-threat-of-nord-stream-2-gas-pipeline-sanctions>.

¹³ Jonathan Swan, 'The White House's next Iran fight', *Axios*, 13 August 2018, available at <https://www.axios.com/trump-administration-iran-sanctions-swift-financial-messaging-8fae6cd6-11c9-42a8-9d5b-6d3140a7ae83.html>.

suspend its rules on the free convertibility of an Iranian deposit in a bank subsidiary located in Germany into cash.¹⁴ No evidence of possible terrorism or money-laundering concerns was reported to back up this decision.

The challenge the EU faces in preserving its economic sovereignty is compounded by its security dependence on the US. Despite efforts to at least pursue an independent defence capacity, EU strategic autonomy remains “*limited to the lower end of operational spectrum [and] the prospects for significant change are slim over the coming decade based on current government plans*”.¹⁵ Barrie *et al* found that without the US, Europe would need to invest around \$100bn to establish sufficient capacity for a maritime confrontation and \$300bn or more to fill the gaps in defending territory against a state-level attack.

These numbers, while high, could without doubt be funded by the rich European countries if there was political will. However, even if military capacity was available, the issue is also of how much solidarity EU countries would be ready to provide. The question is of particular relevance for the central and eastern European EU members. Accordingly, many of the more security-conscious European states reject any sort of distancing from US policy on security issues. Moreover, even with political will, such investments would take ten to twenty years.

C. Europe's response

Europe's response to this new situation has been piecemeal. It has shown a readiness to address the new challenges in fields including trade, foreign direct investment, finance and currency internationalisation. But what it needs is a more encompassing strategy for the new context in which partners and competitors are prepared to let economic relationships serve broader geostrategic goals.

Such a strategy should be based on, first, a definition of what the EU considers the key tenets of economic sovereignty; second, on a clarification of the EU's goals and strategy for achieving them; and third, on a review and reform of the EU toolkit so it has the right instruments.

The starting point should be a confirmation that it is in the EU's interest to remain highly open and intertwined with international partners. In the US, there is a growing debate about decoupling from China. It is likely that tariffs already imposed by the US will substantially reduce bilateral trade between China and the US. It is also likely that the various US measures to prevent technology transfers will further contribute to decoupling from China. US actions and announcements also create uncertainties for European companies. This is already raising concerns in a number of sectors, from automobile to information technology.

¹⁴ Mark Schieritz, 'Kein Cash für die Mullahs', Zeit Online, 8 August 2018, available at <https://www.zeit.de/2018/33/iran-geldauszahlung-deutsche-konten-us-sanktionen-atomdeal/komplettansicht%20>.

¹⁵ Douglas Barrie, Ben Barry, Henry Boyd, Marie-Louise Chagnaud, Nick Childs, Bastian Giegerich, Christian Mölling, Torben Schütz, *Protecting Europe: meeting the EU's military level of ambition in the context of Brexit*, International Institute for Strategic Studies, 2018.

A decoupling strategy cannot be in the EU's interest. First, the EU is much more open to foreign trade than the US (or even China). Its prosperity critically depends on global economic exchange. Second, China is set to become an increasingly relevant trading partner for the EU and it is therefore in the EU's interest to engage with China. Third, while the US is in direct geopolitical confrontation with China, the EU is not. The US would like the EU to fully be on its side in this confrontation. However, that would mean the EU to subordinating itself to US interests.

The central challenge for the EU is therefore to uphold its economic sovereignty while staying highly intertwined with both the US and China.

III. A multifaceted challenge

The multifaceted challenge the EU is confronted with calls for a redefinition of the EU's strategic aims, a systematic review of the instruments at its disposal and the development of a new doctrine for international relations in a more transactional, more confrontational international context.

The EU should not try to emulate the US and China. It will never wield discretionary power in the ways that they do. Its economic system is based on explicit, stable principles, and it will remain so. State intervention is and will continue to be bound by the rule of law. These characteristics are not weaknesses. They are strengths. But in a world of mutual dependence, economic sovereignty hinges on the ability to project economic power in response to economic aggression, and on the robustness and diversification of the domestic economic system in order to minimise damage. This is where the EU has to engage in significant retooling.

Three essential aspects of the issue are technology, finance and the EU's participation in global governance.

A. Technology

There is no such thing as technological independence in an open, interconnected economy. But an economy of 450 million inhabitants (excluding the UK) with a GDP of €14,000 billion can aim to master key generic technologies and infrastructures. The EU's aim should be to become a player in all fields that are vital for the resilience of the economic system and/or that contribute to shaping the future in a critical way. This concept of technology sovereignty inspired major past EU initiatives in fields including energy, aviation, aerospace or geopositioning. It applies equally to today's infrastructures – digital networks and cloud computing – and to new fields such as genomics and artificial intelligence.

Technology is central in five debates that pervade strategic discussions:

1. *Innovation and education base*: Does the EU still possess a sufficiently wide world-class education and research base to be able not only to compete but also to understand key technological developments?

2. *Security of supply of key inputs:* Does the European Union have enough self-standing technology companies that can ensure secure supply of critical pieces if needed?
3. *Critical digital infrastructure:* The debate here focuses on the vulnerabilities of digital networks and the security implications of potential control of their key components by foreign powers.¹⁶ A related issue is whether cloud computing should be located within the EU as it represents a critical infrastructure.¹⁷
4. *Capacity of European firms to compete in the face of Chinese state subsidies, weaker merger control, lack of market access and forced technology transfers.* The EU's liberal and social market economy is now in direct competition with a very different Chinese political-economic model, which has a less clear separation between the state and business.¹⁸
5. *Appropriation of rents in a data-driven economy.* In a winner-takes-all network industry, US firms have secured dominant positions, but Chinese rivals are catching up fast. US and Chinese firms have advantages in network industries that could result in entrenched monopolies – with long-lasting consequences for Europe's ability to compete in cutting-edge technologies.

Although Europe has designed responses to several of these challenges, so far it has not had a broad discussion on the overall issue of technological sovereignty and it has not defined its strategic aims in this respect. The EU and its member states possess a battery of proactive instruments to strengthen the framework conditions for European companies to prosper. Arguably, these proactive tools are under-utilised.

Proactive instruments that aim to support Europe's technological capacity to lead do not raise issues of principle. Industrial policy is traditionally more controversial but we agree that the EU needs to become better in supporting the basis of entrepreneurial success in Europe. In relation to more reactive or even protective instruments, a careful balance needs to be achieved. The EU should remain an economy that is open to foreign investment and competition. Economic research is unambiguous: FDI and competition create jobs and increase growth. However, some essential interests deserve protection because Europe's autonomy and sovereignty would be severely impacted if dominated by foreign powers.

It is not the purpose of this paper to discuss in detail which initiatives the EU should take to catch up in education and research, improve infrastructure, make better use of the scale of the internal market, reform tax systems or even engage in specific industrial policy endeavours. We only want to emphasise that such actions are integral, and often critical, to any economic sovereignty initiative. In what follows we focus on three specific

¹⁶ Vodafone, for example, has decided to exclude Huawei from participation in core telecom infrastructure (see Nic Fildes, 'Vodafone suspends installation of Huawei kit in European core networks', *Financial Times*, 25 January 2019, available at <https://www.ft.com/content/8d55f756-2078-11e9-b2f7-97e4dbd3580d>).

¹⁷ The European Commission has a dedicated Cloud Computing Strategy.

¹⁸ This concern was expressed in a January 2019 policy paper from the Federation of German industries, which prompted a somewhat dirigiste policy reaction, as highlighted in a German government industrial strategy paper: BDI (2019) 'Partner and systemic competitor – How do we deal with China's state-controlled economy', BDI Policy Paper China, January, Federation of German Industries; BMWi, Nationale Industriestrategie 2030, Bundesministerium für Wirtschaft und Energie, 2019.

topics that are prominent in the discussion with China: state aid control, merger control and investment and export control.

State aid control

Companies receiving generous state support or tax privileges distort markets. Effective control of state aid to foreign companies, on European markets and extraterritorially, is important to ensure a level playing field. To this end, competition law should be applied in a non-discriminatory way, regardless of the origin of the firm; the criteria for pursuing cases should be where markets are distorted by state aid or leniency towards excessive market power.

In theory, the avenue to pursue is to build on the World Trade Organisation agreement on subsidies and countervailing measures, which provides a platform for an international collaboration and could help the EU to react in the case of subsidies that distort international trade.¹⁹ However, the current framework suffers from three main problems.²⁰ First, the notification of subsidies is not fully transparent and its efficacy is limited. One important reason is the difficulty in dealing with state-owned enterprises. Second, remedial action is slow and complex. Third, EU state-aid rules apply to both goods and services, while the WTO rules apply only to goods. In EU economies – which are increasingly driven by services, by networks and data – focusing only on subsidies in the goods sector is insufficient.

As well as working towards more effective WTO instruments, the EU thus needs to ensure a level playing field in the EU economy. The European Commission vigilantly monitors direct or indirect subsidies provided by EU member states to national companies. The same vigilance should apply to state aid provided by foreign governments. The main venue for tackling distortions arising from state subsidies remains the WTO, but this should be no excuse for failing to exercise vigilance. In the event WTO-based measures are not enough to ensure a level playing field, the EU should consider reviewing its competition policy instruments and their possible application to state aid emanating from foreign governments.

Merger control

Increasing returns, network effects and innovation rents contribute to the emergence of winner-takes-all markets. Competition policy in such markets affects technological leadership and has implications for sovereignty. But it is a delicate question whether, as argued by the German industry association, merger control should be relaxed to allow for the market-driven creation of European champions, or whether the Council of the EU should be given a final political veto on competition policy decisions, as argued by the German and French economy ministers.²¹

¹⁹ Petros Mavroidis and Andre Sapir, 'China and the WTO, towards a better fit', *Working Paper 2019/06*, Bruegel, 2019.

²⁰ Georgios Petropoulos and Guntram Wolff, 'What can the EU do to keep its firms globally relevant?' *Bruegel Blog*, 15 February 2019.

²¹ BDI (2019) 'Partner and systemic competitor – How do we deal with China's state-controlled economy', *BDI Policy Paper China*, January, Federation of German Industries.

We agree with the aim of strengthening the competitiveness of European companies and of assessing potentially dominant positions by looking beyond the confines of the EU market, but we doubt that a strategy of relaxation of competition principles is appropriate. Strong competition on the domestic market is often conducive to success on global markets. We also consider it unlikely that less competition domestically will make EU companies more able to enter foreign markets, including the Chinese market.

The core of the issue is the balance between producers' and consumers' interests. We agree that competition policy should review how to take into account the contestable character of domestic market shares (that is, the threat of entry and its consequences for the pricing behaviour of incumbent producers) and that a forward-looking definition of the pertinent market is important. But we disagree with the view that competition rules should be amended to give more weight to producers' interests. The very purpose of competition policy is to protect consumers from abuse by the producers of market power, and this principle should be upheld – even more so in a context of increasing concentration and market power at worldwide level.

We also reject the idea of politicising competition policy decisions. Competition policy decisions have a judicial character and they should be taken by independent authorities.

However, we agree that there might be instances when clearly-defined security interests could justify relaxation of a merger decision. For example, in certain key network infrastructures, there might not be much competition among European producers, but disallowing a merger would mean that a foreign company will dominate that infrastructure, with negative implications for security. In our view, there should therefore be security control mechanisms in merger control. The dilemma facing the EU, and as seen in the debate over a European equivalent to the US Committee on Foreign Investment (CFIUS), is that EU countries define what national security is – and the mechanism allows them to block a merger from a third country. But who could define that for intra-EU mergers?

Our proposal would be to empower the EU's High Representative to invoke a security clause, which would then lead to a Commission college decision on whether to overrule the proposal from the Competition Commissioner. The activation of the clause would have to be based on a clearly defined and limited set of criteria directly relating to security concerns. This solution would not require a treaty change and would avoid the politicisation of competition policy decisions. It would, admittedly, require a strengthening of the High Representative and the European External Action Service. But we regard such potential developments as positive.

Investment and export control

The US and the EU are strengthening their investment screening and export control instruments (see Box 2). However, their approaches and even their aims differ significantly. The US explicitly intends to make use of these instruments to preserve technological leadership, restrict access to critical technologies and serve unspecified foreign policy goals. It grants wide discretion to the executive to determine what their

scope will be. By contrast, the EU initiatives are motivated by much more specific aims, of which technological lead is not part. At the EU level, the scope for discretionary decisions is also much more limited.

As far as foreign investment is concerned, the EU and its member states are bound by the provision of the Treaty that prohibits restrictions on the free movement of capital (Art. 63 TFEU). Unlike in the US, limitations on FDI, including from third-country companies, cannot be justified by such broad aims as the preservation of technological leadership. And while a clause of Article 64 TFEU provides an escape from the prohibition of restrictions on capital flows from or to third countries, it requires unanimous agreement of the EU member states. The potential for blocking foreign investments remains therefore much more circumscribed than in the US case.

Several EU countries have introduced, or are considering introducing national security exceptions to standard investment rules. In the UK, the government announced in 2018 that foreign-initiated mergers and investments that might raise national security concerns will be subject to national security assessments. In the event an assessment concludes that there is a risk to national security, the government will impose remedies or block an investment altogether. Similar provisions have been introduced in Germany.

On 14 February 2019, the European Parliament adopted an EU framework for screening foreign direct investment. The regulation introduces a mechanism for cooperation and information-sharing among member states but stops short of giving veto powers to the Commission. The objective of the framework is greater coordination of national security-related screening of foreign investment. It will help increase awareness as well as increase peer pressure across the EU. But it does not establish an independent EU authority for investment screening.

Foreign investment can be banned if infrastructure is used in a way that threatens national security. The list of EU-wide interests over which the Commission has the right to issue an opinion is much narrower than US export regulation and CFIUS.

On export control, the EU's regime is limited to dual-use exports (exports of items that can be used for both civilian and military purposes) with a clear focus on peace and security and non-proliferation of weapons of mass destruction. A draft regulation proposed in 2016 by the European Commission and under consideration at time of writing, would broaden the definition to include cyber surveillance technology, clarify intangible technology transfer and technical assistance and add a requirement for authorisation of export items not explicitly listed. However, the focus remains on security and human rights aspects rather than on safeguarding technological superiority, as it is in the US.

In our view, the EU is right not to emulate the US in its approach to investment and export control. But the European CFIUS framework is unsatisfactory because it keeps the definition of security concerns at the national level – while an integrated single market requires more than coordination to effectively protect security interests across the EU. The EU should develop a common approach and common procedures for the screening of foreign investments and it should empower the Commission with the right

to recommend on security grounds the prohibition of a foreign investment. The final say should belong to the Council deciding by qualified majority.

Furthermore, not all decisions are of a black and white nature. For this reason, the EU should also develop instruments, such as a dedicated investment fund. This would make it possible to offer member states alternatives when foreign investments are deemed undesirable.

The revised US approach to export control and foreign direct investment screening

The US in late 2018 updated its [legislation on export control and investment screening](#) to address its concerns on China, in particular concerns on technology diffusion. The Export Control Reform Act of 2018 (ECRA) and the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) were officially signed into law on 13 August 2018. These laws aim at enhancing export and investment control respectively and address the concern that US *critical technology* is released to “*end uses, end users and destinations of concern*”.

Implications of ECRA and FIRRMA

The US Department of Commerce’s Bureau of Industry and Services has the authority to impose restrictions on exports that “*provide the United States with at least a significant military or intelligence advantage, or for any foreign policy reason*”. This broad statement gives the executive extensive discretionary powers to limit or ban exports. The legislation expands the jurisdictional reach of export controls and tightens restrictions. For example, it establishes an interagency review process in order to identify *emerging and foundational technologies* currently not covered by export controls. Furthermore, the process to obtain export licenses for critical technologies will be more restrictive.

The objective of FIRRMA is to overhaul legislation in relation to an existing inter-agency committee, the Committee on Foreign Investment in the United States (CFIUS). CFIUS is authorised to review certain foreign investments and determine their impact on national security. The new law widens the range of transactions to include non-controlling investments in US firms that are engaged in critical technology or other sensitive sectors. The law also establishes the Critical Technology Pilot Program (CTPP), which focuses on the implementation of the FIRRMA related to businesses that “*produce, design, test, manufacture, fabricate, or develop one or more critical technologies*”. The text highlights that a delay in the CTPP “*would create an unacceptable risk of erosion of US technological superiority*”.

Critical technologies

The rule establishing the [CTPP lists](#) critical technologies including defence articles, chemical, biological, nuclear and missile technology, and emerging and foundational technologies defined in section 1758 of ECRA. A review process that defines these technologies is at time of writing underway, but according to the legislative text, representative technology categories include: biotechnology, artificial intelligence, position, navigation and timing (PNT) technology, microprocessor technology, advanced computing technology, data analytics technology, quantum information and sensing, logistics technology, additive manufacturing, robotics, brain-computer interfaces, hypersonics, advanced materials, advanced surveillance technologies (*Federal Register*, Vol. 83, No. 223 p. 58202).

B. Finance

The EU has long regarded global finance as a domain in which the US-led multilateral order reigned supreme. Reflections on the reform of the international monetary system notwithstanding, the working assumption has been that the US dollar would remain the reference global currency for trade and investment purposes and the global financial architecture would remain centred on the Bretton Woods institutions. As far as payment infrastructure was concerned, the issue was simply not on the radar screen.

These assumptions – which were already somewhat shattered by the global financial crisis and the euro-area crisis – have been challenged by the US decision to leverage its central role in the global monetary and financial system to impose its own international policy preferences. At the same time, China’s assertiveness and its declared intention to promote the international role of its currency and to develop its own financing instruments indicate looming tectonic changes in the global monetary architecture. An already heterogeneous global monetary and financial system is now confronted with a real risk of fragmentation, if not ultimately break-up. In this context the EU is confronted with a series of strategic choices.

Global currencies

With a share of about 22 percent, still close to the 1999 level (but significantly below the level reached in the early 2000s), the euro is the second international currency after the US dollar and significantly ahead of other currencies³. As far as central bank reserves are concerned, the euro’s share in 2017 was 20 percent compared to 63 percent for the US dollar, 5 percent for sterling and the Japanese yen, and 1 percent for the Chinese renminbi. Clearly, the euro is an important international currency with a strong regional reach and a strong role in the invoicing of euro-area trade flows, but is very far from challenging the dominance of the US dollar.

Pisani-Ferry and Posen mentioned five factors that then accounted for the limited international reach of the euro: a limited economic base, financial fragmentation, uncertain governance, non-economic limitations (by which they essentially meant the lack of an European security policy) and a discouraging stance towards its *de-jure* adoption by third countries.²² In the meantime, the euro crisis has shattered confidence in the solidity of the European currency, though progress has been made on governance. The other observations made by Pisani-Ferry and Posen remain valid.²³

The EU’s official doctrine has long been that it neither encourages nor discourages an international role for the euro. However, the European Commission adopted a more positive tone and outlined proposals that would contribute to increasing the use of the euro by non-residents,²⁴ including the promotion of its use for international

²² Jean Pisani-Ferry and Adam Posen, ‘The euro at ten: Successful, but regional’, in J. Pisani-Ferry and A. Posen (eds) *The euro at ten: The next global currency?* Bruegel and Peterson Institute for International Economics, 2009.

²³ Jean Pisani-Ferry and Adam Posen, ‘The euro at ten: Successful, but regional’, in J. Pisani-Ferry and A. Posen (eds) *The euro at ten: The next global currency?* Bruegel and Peterson Institute for International Economics, 2009.

²⁴ European Commission, ‘Towards a stronger international role of the euro’, COM(2018) 796 final, 5 December 2018.

agreements and transactions in the energy and food sectors, and for invoicing for sales of aircraft.²⁵

Piecemeal initiatives are unlikely to bring about significant change. Three reforms could however significantly affect the international role of the euro:

1. *The creation of deep and integrated European capital and banking markets:* Numerous obstacles such as differences in regulation or supervision obstruct the cross-border integration of financial activities. There is still much too much ring-fencing in the euro area for pan-national banks to emerge. As a result, financial markets remain relatively fragmented and are insufficiently deep and liquid for foreign investors to invest in.
2. *The creation of a euro-area safe asset:* As emphasised by Coeuré, euro-denominated safe assets amount to a small fraction of dollar-denominated safe assets.²⁶ There is little doubt that the creation of a non-national benchmark safe asset would greatly increase the attractiveness of the euro for international investors, but there is also little doubt that even if such an asset would not involve debt mutualisation, its creation would require significant political obstacles to be overcome.²⁷
3. *Swap lines to central banks* of countries where the euro is widely used by the private sector. Swap lines are essential to ensure that banks operating in a foreign currency can retain access to liquidity even at times of market stress, which is why during the global financial crisis the Federal Reserve extended liquidity lines to a web of central banks in advanced countries.²⁸ However, the provision of such swap lines can involve fiscal risk. For this reason, the European Central Bank in 2008–09 did not directly provide euros to then non-member countries. Overcoming this limitation would therefore require political support and would boost the euro as a truly international currency.

Global financial architecture

The global financial architecture was initially conceived as a single system structured around two sister institutions: the International Monetary Fund and the World Bank. Regional development banks also provided support, but within the framework dominated by the Bretton Woods institutions.

In recent times the system has evolved in at least two significant ways:

²⁵ European Central Bank board member Benoît Coeuré has also highlighted the potential gains for monetary policy from a greater international role for the euro: Benoît Coeuré, 'The euro's global role in a changing world: a monetary policy perspective', speech to the Council on Foreign Relations, New York City, 15 February 2019.

²⁶ Benoît Coeuré, 'The euro's global role in a changing world: a monetary policy perspective', speech to the Council on Foreign Relations, New York City, 15 February 2019.

²⁷ Zettelmeyer and Leandro argued that the most promising option might be so-called E-bonds issued by a public entity against a diversified portfolio of loans to euro-area sovereigns: Alvaro Leandro and Jeromin Zettelmeyer (2018) 'Safety Without Tranches: Creating a "real" safe asset for the euro area', *CEPR Policy Insight* No. 93, Centre for European Policy Studies.

²⁸ These swap lines were in principle reciprocal, but they were *de-facto* asymmetric because the US never drew on them.

1. A web of financial safety nets has supplanted the single net once provided by the IMF. Now, credit lines potentially available from bilateral swap lines, most significantly the Federal Reserve, and regional financing arrangements such as the European Stability Mechanism and the Asian Chiang Mai Initiative each account for amounts broadly equal to the IMF's total resources;
2. A series of new development finance institutions has been created, the most notable of which are the Shanghai-based New Development Bank (2014) and the Beijing-based Asian Infrastructure Investment Bank (2015). Furthermore, China launched in 2013 the Belt and Road Initiative, through which provides investment credit to a wide range of countries.

These changes have been significant enough to raise concerns about the fragmentation of the global financial architecture and to prompt calls for *“bold and defined steps to ensure that today’s institutions – global, regional and bilateral – work together as a system”*.²⁹

An unravelling of the post-second world war financial order is indeed possible. Growing tensions between the US and China could, for example, lead the US to assert dominance over the Bretton Woods system (where it holds a blocking minority) and lead China to secede from it and build a separate system of bilateral, regional and multilateral financing arrangements. Short of outright fragmentation, adversarial behaviour within the multilateral institutions is also a distinct possibility.

To cope with these challenges, the EU is equipped with two significant financial instruments: the European Investment Bank (EIB), with goals of fostering infrastructure development, innovation, investment in smaller companies and the transition to a low-carbon economy in the EU, and the recently-created European Stability Mechanism, which has the core mission of providing financial assistance to euro-area countries that risk losing market access. Both institutions are focused on the EU: 90 percent of EIB lending goes to EU countries, and the ESM's scope is limited to the euro area. The EU also contributes, alongside the IMF, to financial assistance to non-euro area members (balance-of-payment assistance) and to partner countries (macro-financial assistance).

Europe is also home to several financing institutions, the most significant of which is the London-based European Bank for Reconstruction and Development. The EBRD was established in 1991 to support the private sector in central and eastern Europe and the former Soviet Union during the transition to a market economy. It has a diversified shareholder base, with the EU-27 and its member states accounting for 54.3 percent of total capital, and the UK for another 8.5 percent. The United States is also a founding member and holds a 10 percent capital share. China joined EBRD in 2016, holding 0.096 percent capital share. The bank has gradually broadened its scope to intervene in the Maghreb, Egypt, the Middle East and Mongolia.

The EU so far has not taken a strategic approach to the reshaping of the global financial architecture. The period when the US and the European countries dominated decision-

²⁹ G20 Eminent Persons' Group on Global Governance, *Making the Global Financial System Work for All (Tharman Report)*, 2018, available at <https://www.globalfinancialgovernance.org/assets/pdf/G20EPG-Full%20Report.pdf>.

making at the IMF is coming to an end. Moreover, US-EU agreement can no longer be taken for granted. Europe should think strategically and prepare options for responding to a transforming international system. Specifically:

1. *The EU should prepare for the possibility of a politically- or geopolitically-motivated stalemate over the provision of IMF assistance to a neighbouring country.* Currently the EU is not equipped to provide such assistance outside the context of an IMF programme. A way to make this possible could be to amend the treaty establishing the European Stability Mechanism so that the ESM could provide conditional assistance to third countries. A possible, though financially less-potent alternative, could be to reform the balance-of-payments instruments for third countries funded by the EU budget to make this provision independent of the IMF;
2. *The EU should define its strategy towards the role of European development banks in third countries, and the division of tasks between them.* The EIB and the EBRD have different mandates but also different shareholders, with the EIB being 100 percent controlled by the EU whereas the EBRD is a Europe-based international institution with a predominantly EU shareholder base (including after Brexit). There are two clear ways forward: to give the EIB, which has so far been mostly focused on investment within the EU, a greater international role; or to broaden the geographical scope of EBRD operations to turn it into a sort of a European counterpart to the Asian Infrastructure Investment Bank. The first option would have the advantage that the EU would retain total control, and the downside that the EIB has limited experience of investment in third countries. The second option would build on the EBRD's international experience and on its wider shareholder base. Relying on such a strategy would have the advantage of leveraging the EU's involvement in it.

Payment infrastructure

The willingness of the US to exercise political power over the international payment system makes European firms vulnerable to unilateral pressure. The depth of the EU's and US's economic and financial interdependence would make it extremely difficult to ensure autonomy through the building of parallel systems, as pursued by Russia. The creation of a special vehicle for Iran should therefore be regarded as a political signal rather than an actual channel for significant transactions. In our view, there is a need to strengthen Europe's political power and make it more able to withstand pressure, if necessary through the adoption of appropriate and proportionate economic retaliatory measures.

At the core of the global payment infrastructure is a financial messaging service, SWIFT, which is used for almost all cross-border payments. Such a global public good can only function well if all major players support its activities. By its very nature, it is highly interconnected, and is therefore also subject to political pressures from governments. Disconnecting a country's banks from the SWIFT financial messaging systems isolates that country almost completely from the global financial system, curtailing its ability to conduct business even with countries that have not sanctioned it.

In November 2018, as a result of US pressure, SWIFT, registered and governed under Belgian law, disconnected Iranian banks, saying the step, “*while regrettable, [had] been taken in the interest of the stability and integrity of the wider global financial system.*” The US can monitor SWIFT data thanks to a deal with the EU on the US Terrorist Finance Tracking Programme and, in case of non-compliance with the US sanctions, the US Treasury could have sanctioned SWIFT, its executives or its board members.

China and Russia had already noticed the vulnerability that participation in such an interconnected payment system presents. They started collaborating on a payments system in 2014/2015³⁰. They have now fully functional domestic payments (and some domestic cards) and intend to connect them; other countries have expressed an interest in joining.

The option of separating out its financial (and, as a consequence, economic) system from that of the US is not one the European Union can pursue or wishes to pursue. The only way for it to oppose unilateral US secondary sanctions with which it disagrees is to rely on retaliation. The size of the European economy and the European market would be large enough for the threat of retaliatory measures to weigh significantly on US unilateralism.

C. Global governance

The EU plays a key role in multilateral organisations including the IMF, G20 and WTO. It regards these as fundamental pillars of the rules-based global system. Over last decade, voices of discontent with globalisation and its governance have become more forceful. However, increased interdependence and the emergence of true global public goods call for more cooperation on a global scale. In more and more areas, however, the best options on offer are non-binding coordination procedures and soft pledge-and-review mechanisms

The challenges for the EU are, first, how to make effective use of its voice in existing international organisations, and second and more importantly, how to promote effective collective action on a global scale.

IMF

The EU’s voting share at the IMF (EU 29.61 percent; of which UK: 4.03 percent) exceeds by far that of the largest single shareholder – the US 16.5 percent – and is well above the veto threshold. China, by contrast, only has 6.1 percent of the voting rights. For important decisions, 60 percent of the members that hold at least 85 percent of the vote is required, meaning that both the US and the EU hold veto power, whereas China, India, Brazil, Russia and South Africa jointly fail to reach the veto threshold.³¹ This representation has given the EU significant influence, though the EU is generally assessed as less influential than the US.

³⁰ Karen Yeung, ‘China and Russia look to ditch dollar with new payments system in move to avoid sanctions’, *South China Morning Post*, 22 November 2018, available at <https://www.scmp.com/economy/china-economy/article/2174453/china-and-russia-look-ditch-dollar-new-payments-system-move>.

³¹ The Executive Board is composed of 24 directors. Countries with the largest voting shares – United States, Japan, Germany, France, the UK, Russia, China and Saudi Arabia are represented individually. The remaining Executive Directors represent constituencies, or groups of countries, with European countries spread across seven multi-country constituencies.

The EU's mixed-representation model appears to give it significant weight in multilateral forums, with the added complexity that not all EU member countries are members of these clubs. The EU28 has 25 percent of the G20 seats (not counting guest countries), because individual country membership is complemented by the EU as a member (though the EU cannot hold the presidency). The EU has been similarly influential at the Financial Stability Board and the Bank for International Settlements.

Whether a single EU or euro-area seat would strengthen EU's influence at the IMF has long been discussed. In any case, the roots of external weakness are found in internal division: the coexistence of opposite views and philosophies within the EU is not conducive to unified external positions. In other words, the problem is more of substantive positions than of institutional representation. Furthermore, there is currently no appetite among EU countries to delegate external representation to the EU level.

The EU however faces a stark choice. In the context of heightened US-China tension, persistent underrepresentation of China and other emerging countries in the multilateral institutions mirrored by persistent European overrepresentation against the background of its diminishing economic weight, might strengthen the emerging world's defiance against what is often perceived as Western-dominated institutions serving as guardians of a Western-biased global order.

The trade-off for Europe is clear: fight to preserve the power it enjoys within the Bretton Woods system at the risk of precipitating the fragmentation of global governance, or accept a diminished role, as a condition for more involvement in, and ownership of the global institutions by China and other rising powers. The right path is not obvious but the perennial and regularly postponed debate on the consolidation of EU or euro-area chairs in the Bretton Woods system should not be postponed much longer.

WTO

The WTO is at risk of disintegration with its dispute resolution framework already near collapse. The US has criticised the WTO for being unable to uphold rules and for regulatory overreach, but it is also openly defiant of multilateral rules that constrain its freedom of manoeuvre. China has not transformed into a market economy, which everyone hoped would be the result of its membership of the WTO. State capitalism, property rights and developing country classification need to be addressed.

A fundamental goal of international rules on trade is to prevent a large economy from unfairly using its size as an advantage. The US's invoking of a national security clause to impose tariffs is particularly worrying, as it did, for example, in 2018 for steel and aluminium tariffs, and is threatening to do for cars. It leaves it up to the EU to find partners to uphold the basic principles of free and fair competition in trade. The EU has the market size and institutional capacity to do so, while the open US-China trade war gives other countries reasons to reach out to the EU.

Unlike the US, China considers itself a champion of trade multilateralism and the WTO. The EU and China have actually declared their intention to collaborate on reforming it. However, China's support to multilateral trade principles lacks depth. While it might

abide by the rules of the WTO, it does not abide by their spirit. This is why EU agrees with the US that WTO reform is necessary to better uphold the WTO principles and to address the risk that trade rules fail to take into account the specificities of the Chinese economic model and therefore fail to tackle unfair competition from Chinese producers.

The EU's aim should be to preserve the multilateral trading system as a core infrastructure of globalisation. The EU as an open economy with a large internal market can best leverage its influence over the global rules through a multilateral system. The same applies in a series of other fields, from greenhouse gas emissions mitigation to banking regulation.

But if this approach fails to gain enough traction, as is likely to be the case, alternatives need to be developed. Even post-Trump, the world is unlikely to return to the post-war multilateral architecture. Global governance is bound to be more patchy, more fragmented and more often based on weak mechanisms. As a strong proponent of a rules-based system, the EU should equip itself for this new configuration. Dadush and Wolff proposed concrete action for an EU trade strategy in the case the WTO ceases to function.³²

IV. Conclusion and recommendations

The EU needs a change of mindset to address threats to its economic sovereignty. It must learn to think as a geopolitical power, define its goals, and act strategically. After decades during which priority was given to internal integration – through the single market, common regulations, common policies and the creation of a common currency – it needs to refocus its attention on its relationship with the rest of the world.

Building economic sovereignty does not imply turning one's back on globalisation or refraining from taking an active part in global collective action. Global competition and linkages are good for growth, innovation and consumer choice. Europe's aim is not, and should not be, to reduce trade or investment links with the global economy. It should be to strengthen the rules-based order, not to undermine it.

Building economic sovereignty also does not mean containing the spread of technology. Such an attempt would most probably be unsuccessful: even at the height of the cold war, technology diffused broadly within a matter of years. In the current much more interconnected world, technological leadership depends on continuous investment and innovation and benefits from engagement and cooperation. Concretely, the EU is bound to benefit from cutting-edge Chinese technology. The EU's aim should be common and effective rules for intellectual property, investment and subsidies. Simultaneously, it should strengthen Europe's capacity to protect core infrastructure where direct security interests are at stake and to respond effectively to foreign initiatives that undermine its economic sovereignty.

Building economic sovereignty, however, requires the EU to stop thinking and acting as a 'fragmented power'. Currently, European economic governance purposefully ignores geopolitical considerations. Because of a division of tasks in which Brussels deals with international economic concerns such as trade, while related

³² Uri Dadush and Guntram Wolff, 'The European Union's response to the trade crisis', *Policy Contribution* 5/2019, Bruegel, 2019.

geopolitical issues belong largely to EU member states, the EU has behaved as a fragmented power.³³ It has enormous potential power, but its decision-making structures are too disjointed to use that potential. It is high time to unlock this potential.

Building European economic sovereignty will involve patient negotiation between European partners on a series of specific, often technical measures, and a gradual implementation period. Not all EU countries have the same perception of their sovereignty and the threats it faces. Some are simply too dependent on the US security umbrella to oppose almost any US initiative. Some have built strong economic ties with China and refrain from criticising it. In the fields of trade policy or single market regulations, where policy initiatives are by nature common, compromises will need to be found. In others such as industrial policy or cyber security, variable-geometry approaches can be implemented.

Details matter. It is easy for economic measures justified on geopolitical grounds to be captured by special interests and to lapse into protectionism with lasting negative consequences for both economic growth and national security. State aid intended to maintain technological competitiveness can easily become inefficient jobs programmes. Efforts to broaden the use of the euro can easily morph into subsidies for favoured banks. These risks imply that such measures need to result from a considered process that is capable both of weighing the trade-offs between economic efficiency and national security and of maintaining a reasonable distance from special interests.

To both achieve a change in mindset and to give it institutional expression, we recommend a four part strategy for the EU:

1. An economic sovereignty agenda
2. A reformed policy toolkit
3. An effective machinery
4. A flexible implementation strategy

An economic sovereignty agenda

We propose an economic sovereignty agenda focused on European and national measures that will create opportunities and incentives to integrate economic and geopolitical considerations at the appropriate levels of governance. The agenda should have four key goals:

- Boost Europe's research, scientific, technology and innovation base;
- Protect assets critical to national security from foreign interference;
- Enforce a level playing field in both domestic and international competition;

³³ Andre Sapir (ed), *Fragmented Power: Europe and the global economy*, Bruegel, 2007.

- Strengthen European monetary and financial autonomy.

This effort should be top of the policy priorities of the new European Commission when it takes office in late 2019. We would suggest that the new Commission president should outline this economic sovereignty agenda in his or her first speech to the European Parliament, and should publish a more detailed proposal by early 2020.

A reformed policy toolkit

The EU has reasons to be proud of its policy system. It has been able to grow into a respected regulatory, trade, competition and monetary giant whose initiatives measure up to those taken by other major powers. It has done this while ensuring levels of transparency, integrity and effectiveness that meet the best global standards.

But the EU has to adapt its policy toolkit to cope with the new reality of greater geopolitical and geoeconomic competition. New initiatives are necessary in eight key fields:

1. **State-aid control should not be limited to EU companies.** The EU should vigilantly monitor distortions to international trade and investment resulting from support provided to industry by foreign governments. Direct and indirect subsidies should, if possible, be tackled in the context of the WTO. If not possible, the EU should consider reviewing its competition policy instruments and their possible application to state aid granted by foreign governments.
2. **Building on a strong and independent competition policy, the EU should define precise procedures to take into account economic sovereignty concerns in competition decisions.** European Commission merger control and the abuse of dominant position decisions should remain based on economic criteria and on independent, legally-grounded assessments. Importantly, competition policy exists to protect consumers not producers. The EU needs to avoid politicising competition enforcement or it risks capture by powerful producer interests. However, competition policy decisions should also take into account the broader scope of internationalised markets and whether incumbents' market power can be tamed by the threat of potential entry. To address cases in which competition policy decisions might raise security concerns, the EU's High Representative for Foreign Affairs and Security Policy should be given the right to evoke a security clause and object to a decision proposed by the competition commissioner.
3. **Because foreign investment gives access to the entire internal market, the EU cannot regard investment control as a purely national affair.** It should develop a common approach and common procedures for the screening of foreign investments and empower the Commission with the right to recommend on security grounds the prohibition of a foreign investment. The Council should be given the right to decide by qualified majority vote to block a foreign investment based on a Commission recommendation. The current investment-screening

mechanism is a step in the right direction but it is insufficient to tackle the common dimension of decisions relating to foreign investment. The EU should also develop instruments, such as a dedicated investment fund, to offer member states alternatives when foreign investments are disallowed.

4. **As the world evolves towards a multi-currency system, economic sovereignty will increasingly require a greater international role for the euro.** But the euro will not become a truly international currency without EU initiatives to support it in this role. Three conditions are crucial: first, a deep and integrated capital and banking market; second (and related), the creation of a euro-area safe asset; third, the ECB should be able to extend swap lines to partner central banks so they can serve as lenders of last resort to local banks conducting business in euros.
5. **The EU should prepare for the possibility of a politically or geopolitically motivated stalemate over the provision of IMF assistance to a neighbouring country.** It should consider how an external role could be given to the ESM or how to strengthen EU-budget funded balance-of-payments instruments available to third countries.
6. **The EU needs a strategy for development banks.** It should determine whether it intends to develop the external role for the EIB or rather to leverage its investment in the EBRD to turn it into a truly multilateral development institution based in Europe and controlled by European shareholders.
7. **The EU should also stand ready to respond to unilateral sanctions it disagrees with through appropriate and proportionate economic retaliation measures.** While it can explore ways to overcome secondary sanctions and permit domestic companies to continue to trade with third countries recognised by the EU as legitimate partners, the creation of special vehicles for such transactions will never lead to significant outcomes.
8. **The EU should preserve and leverage its influence over multilateral institutions.** But this requires giving consent to an accelerated rebalancing of quotas and votes, without which European countries could end up enjoying oversized power in diminished institutions. Rebalancing should also be accompanied by a consolidation of European chairs, although that might not in some cases increase European influence.

An effective machinery

European governance was not built to implement an encompassing economic sovereignty strategy, but rather to manage separately sectoral policies. Reforms are thus needed, as follows:

A European Commission Economic Sovereignty Committee: the European Commission has already prioritised making the EU a stronger global player. The

priority area brings together several relevant European commissioners (foreign and security policy, neighbourhood and enlargement, trade, international cooperation and development, civil protection and humanitarian aid under the chairmanship of the High Representative). Our proposal would reform this in several ways.

- First, it would introduce an economic security element by including key commissioners whose portfolios are not generally thought of as having sovereignty implications, including competition policy, economic and financial affairs, and research, science and innovation, under the chairmanship of the Commission first vice-president.
- Second, it would introduce a standing staff for the committee with the task of tackling cross-cutting issues and monitoring compliance among directorates-general. This staff should include economic experts alongside diplomats and security specialists.
- Finally, the staff would seek to create an organic link with the staff of similar bodies in key member states, to enable coordination of economic sovereignty efforts across the levels of governance.

In addition we would suggest that a **Committee on Foreign Investment in the European Union**, staffed by some of the economic sovereignty staff and containing representatives of relevant directorates-general, be charged with making recommendations on the national security implications of large foreign (non-EU) investments or mergers in the EU. This committee would present its recommendations to the High Representative and the College of Commissioners. Also, an office of **Financial Sanctions Enforcement** staffed by representatives of the European External Action Service, the Directorate-General of Economic and Financial Affairs, and relevant member state representatives would closely coordinate with banks and other financial institutions to ensure that European sanctions regulations are strictly enforced. It would also impose penalties on entities that violated sanctions.

A flexible implementation strategy

Implementing these changes cannot be just a Brussels-based EU-wide effort.

This is not only because many relevant powers remain with the member states, but also because economic sovereignty issues can be divisive within the EU. Perceptions of threats and attitudes towards Russia, China and the United States are far from uniform. It is also because the EU and its member states will need to coordinate closely with other European partners, starting with the post-Brexit UK, which is likely to share many of its neighbour's priorities and concerns.

While an EU-wide approach is desirable, a more flexible approach based on 'minilateral' groups of states is likely to be necessary.

As we have noted, EU member states differ significantly in their perceptions of security threats, their vulnerability to external pressures and their attitudes towards both the US and China, Whatever involves the functioning of the single market or the customs union will need

to be agreed on by the whole EU. For other aspects, a club-type approach similar to that advocated by Demertzis *et al* is likely to be the best short-term option.³⁴ The overarching intent is to create structures that integrate economic and national security considerations at both European and member-state levels.

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³⁴ Maria Demertzis, Jean Pisani-Ferry, Andre Sapir, Thomas Wieser, and Guntram Wolff (2018) 'One size does not fit all: European integration by differentiation', *Policy Brief* 3/2018, Bruegel, 2018.

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Harnessing artificial intelligence

Summary

- Artificial intelligence is impossible to disregard – it is set to transform society, the economy, and politics.
- Europe has not yet taken all the steps it needs to benefit from these advances or to protect itself from AI’s potentially dangerous aspects.
- The US, China, and Russia are alert to AI’s power to change modern warfare: they grasp the geopolitics of AI and may pursue techno-nationalist agendas in recognition of this.
- Europe can develop sovereignty in AI by beefing up the talent, data, and hardware it draws on; and as a “regulatory superpower” it can set standards the rest of the world will have to follow.
- If Europe does not address these difficult questions soon it will find itself surrounded by more powerful rivals deploying AI against it.

Artificial intelligence (AI) is changing the economy: it is impacting on the way we shop, on the way we communicate, on the way we do research. AI is, in short, set to be nothing less than “[vital to everything](#)”. Indeed, it is difficult to think of areas that AI cannot speed up, improve, or otherwise change. US investment bank Goldman Sachs argues that AI: “is a needle-moving technology for the global economy [...] impacting every corporation, industry, and segment of the economy in time”.¹ AI is an enabler that some have [likened](#) to the invention of the combustion engine or electricity – technologies that it is impossible to disregard. This paper examines where Europe stands on AI; how sovereign it is in this area; whether Europe can or should aim for AI sovereignty; and what the risks are if it does not acquire such sovereignty.

What is AI?

AI generally refers to efforts to build computers able to perform actions that would otherwise require human intelligence, such as reasoning and decision-making. It denotes a fundamental shift, from humans telling computers how to act to computers learning how to act. AI does this largely through machine learning, including ‘deep learning’ techniques. Although popular culture likes to speculate about ‘superintelligence’ and its consequences,² the focus of most research and development, and of this paper, is on more limited, focused AI applications (also called “narrow AI”).

¹ GS Research Unit, “Profiles in Innovation: Artificial Intelligence: AI, Machine Learning and Data Fuels the Future of Productivity”, 14 November 2016, p.3.

² Nick Bostrom, “Superintelligence”, 2014, Oxford University Press.

The term “AI” first appeared at the Dartmouth Artificial Intelligence Conference held in 1956. Since then, the field has gone through several cycles of hype and disappointment, with the latter dubbed “AI winters”. The field is currently enjoying an “AI spring”, with AI development accelerating significantly over recent years. Previously, limited access to large data sets and a lack of appropriate computing architectures held it back. Recently, though, computers have improved in performance and more data have become available: in fact, a 2017 [report](#) estimated that 90 percent of the world’s data had been created within the preceding five years. The same period saw a fifteen-fold growth in the number of developers of graphics processing units (GPUs) – hardware crucial for AI.³ Together, these developments have led to a significant increase in AI research around the world, resulting in better algorithms becoming more widely available. This, in turn, has generated more research.⁴ As advances continue, the public and media outlets have become ever more interested in AI – and the technology has begun to inspire [hype and hysteria in equal measure](#).

Why AI matters

AI’s potential can appear almost limitless. It is not only ‘dual-use’, in the sense that it can be used for both civilian and military applications, but ‘omni-use’, potentially able to [influence all elements of life](#). Although there is a danger of being drawn into exaggerated promises inspired by science fiction, AI applications already have significant economic and social benefits. In the health sector, AI is used to read scans and improve the accuracy of diagnoses. In agriculture, AI can help improve crop yields. Factories, server farms, and other energy-hungry businesses use AI to become more efficient in their energy consumption. According to Goldman Sachs, there is “potential for AI and machine learning to reshuffle the competitive order across every industry”. However, the bank also warns that: “Management teams that fail to invest in and leverage these technologies risk being passed by competitors that benefit from the strategic intelligence, productivity gains, and capital efficiencies they create.”⁵ Given that companies are warning of the risk of being overtaken by competitors that adopt AI, states should take a hard look at whether they do enough with regard to AI applications to guarantee their economies’ continued well-being.

In addition to its potential economic impact, AI has quickly become an element of geopolitical competition. Vladimir Putin may have been engaging in hyperbole when he [declared](#) that “The one who becomes the leader in this sphere will be the ruler of the world”, but China and the United States also see AI as a factor in geopolitical power. In fact, China and the US see each other as the main competitor and are racing to be the leader in AI. They directly compete for talent – Qi Lu, one of Microsoft’s top executives, left the company in 2017 to join Chinese competitor Baidu – and in research: in October 2016, the White House [conceded](#) that China had overtaken the US in the number of journal articles published on deep learning. This competition can even touch on matters important to the culture and history of each country, such as when a [reported 280 million people in China watched a machine owned by Google parent company Alphabet win at Go](#) against

³ GS Equity Research: Profiles in Innovation Revisited: AI hardware. 11 March 2018, p.7.

⁴ GS Research Unit, “Profiles in Innovation: Artificial Intelligence: AI, Machine Learning and Data Fuels the Future of Productivity”, 14 November 2016, p.7.

⁵ GS Research Unit, “Profiles in Innovation: Artificial Intelligence: AI, Machine Learning and Data Fuels the Future of Productivity”, 14 November 2016, p.4. Emphasis added.

one of the world's best human Go players. As one observer [noted](#) at the time, a Californian firm “had conquered a game invented more than 2,500 years ago in Asia. Americans don't even play Go.” Advances in US capabilities directly motivate Chinese research, and vice versa. Commenting on the event, former president of Google China Kai-Fu Lee remarked: “If AlphaGo was China's Sputnik moment, the [Chinese] government's AI plan was like President John F. Kennedy's landmark speech calling for America to land a man on the moon”.⁶

If AI is indeed like the combustion engine or electricity in its transformative potential, failing to adopt this technology will have both [economic repercussions and could lead to massive geopolitical gaps between countries](#). The first industrial revolution, associated with the invention of the steam engine, allowed first mover Great Britain to become the leading power in Europe, pulling away from France and Prussia. This advantage fuelled the expansion of the British Empire and gave Britain a lead that the rest of the world would take [decades to close](#).

Given the power and influence new technology can bestow, it is striking that most European countries (with the notable exception of France), as well as the European Union itself, do not appear to consider AI a factor in geopolitics – contrary to the attitudes of Russia, the US, and China. The recently published “Executive Order on Maintaining American Leadership in Artificial Intelligence” takes a clearly geopolitical approach, and [emphasises](#) that: “Continued American leadership in AI is of paramount importance to maintaining the economic and national security of the United States and to shaping the global evolution of AI in a manner consistent with our Nation's values, policies, and priorities”. In contrast, the European Commission's “AI Factsheet” only [emphasises](#) the importance of AI in sectors such as healthcare, transport, and public services. Although the EU has considerably [ramped up its AI efforts over the last year](#), it has been careful to avoid any appearance that it considers itself to be in a global AI competition. At a Council on Foreign Relations event on the “race for AI”, the EU's Peter Fatelnig [argued](#) that it was not really a race for the EU to run in: “for a race you need a goal, and I'm not entirely sure we actually have an idea where the goal is”.

This is worrying, given the distinct risk that states around the world may adopt techno-nationalist agendas, including increased protectionism to support national champions. In a noteworthy essay, Ian Hogarth, a machine learning engineer and AI investor, [warns](#) that: “machine learning will be such a dramatic cause of instability that nation states will be forced to put their citizens ahead of broader goals around internationalism”. A world of AI-turbocharged global competition may be on the horizon. This would militate directly against the EU's multilateral, pooled sovereignty approach to governance, as it places individual member states under pressure to respond. And it may leave the EU's model vulnerable to geopolitical competitors that overtake it in AI capabilities across a range of practical applications.

Finally, [AI is set to change warfare and military organisations](#). Armed forces around the world are showing an interest in it, including, but not limited to, AI-enabled autonomy. They are doing this because [AI can](#): help them to improve their operations' speed,

⁶ Kai-Fu Lee, “AI Superpowers: China, Silicon Valley, and the New World Order,” Houghton, Mifflin Harcourt, 2018, p.98.

stealth, precision, and efficiency; allow them to develop new military capabilities (such as swarming); lessen the need for manpower (thereby also limiting human error); and, potentially, reduce costs. However, the application of AI in warfare, particularly the potential use of lethal autonomous weapons, also raises questions about their legality and morality. This has [provoked public protests and ongoing debates](#) about a ban on such systems in the framework of the Convention on Certain Conventional Weapons.

In light of this, it is crucial that the EU, its member states, and European countries outside the EU more broadly avoid falling behind in AI research and use, and that they remain aware of the impact AI may have on their economies and societies. Where, then, does Europe currently stand compared to other actors? And what can it do to improve its position?

Elements of AI – and how the main players fare

Three elements, or key inputs, are crucial for AI: access to talent; access to significant amounts of data; and access to hardware and software, including infrastructure and computing power.⁷

1. Talent: The rapid development of AI and the resulting demand for researchers has led to a scarcity of AI talent around the world. Ian Hogarth [puts this nicely](#): “There are perhaps 700 people in the world who can contribute to the leading edge of AI research, perhaps 70,000 who can understand their work and participate actively in commercialising it and 7 billion people who will be impacted by it.” These numbers help to give a sense of the challenge, though it is difficult to say exactly how many AI researchers there are globally – or how many are needed. A December 2017 [report](#) by Chinese internet giant Tencent estimated that between 200,000 and 300,000 people were either AI researchers or industry practitioners. Another [report](#), by Element AI, puts this number considerably lower, at 22,000 globally. The scarcity of AI researchers has made them a precious commodity, with Microsoft Research chief Peter Lee comparing the cost of hiring a leading AI researcher to hiring a National Football League quarterback.⁸ This scarcity has even led to the practice of “acqui-hires”, whereby larger firms take over smaller firms with the primary aim of hiring their employees.⁹

2. Data: For the moment, most AI is trained by using large amounts of data – hence the related term “big data”. For instance, an AI system may be shown hundreds of thousands of pictures for it to learn to identify specific objects. However, AI can be trained without big data, using methods such as reinforcement learning, which generates its own data and trains by playing against itself. Several AI researchers argue that the future of AI lies in small data. But for now, [most of the time](#): without a lot of data, there is no AI.

Data that can be used for machine learning can be created by almost any means and in virtually any context. This includes, for instance, census data, weather data, and health

⁷ GS Research Unit, “Profiles in Innovation: Artificial Intelligence: AI, Machine Learning and Data Fuels the Future of Productivity”, 14 November 2016.

⁸ GS Equity Research: “China’s Rise in Artificial Intelligence”, 31 August 2017.

⁹ GS Research Unit, “Profiles in Innovation: Artificial Intelligence: AI, Machine Learning and Data Fuels the Future of Productivity”, 14 November 2016, p.11.

records. As an example, [Tesla's fleet of vehicles has accumulated more than 1.2 billion miles of driving data](#), and in 2011 alone [US Air Force drones amassed about 37 years' worth of video data](#). [Global annual data generation is expected to reach 44 zettabytes \(44 trillion gigabytes\) by 2020](#). And [data brokers](#) have become shadow power brokers; these firms collect and combine data from different sources, and then sell them for profit – creating major privacy concerns in the process.

3. Hardware: With the complexity of AI models growing fast, the standard central processing unit – the hardware in a computer that carries out the instructions of the software – has proved to be insufficiently powerful. This is leading to increasing interest in and development of GPUs, which are a more specialised electronic circuit fast emerging as the pillar of AI.¹⁰ Cloud companies (such as Google, Microsoft, Tencent, and others, which are primarily American and Chinese) are investing in such hardware. This allows them to charge considerably higher prices for the use of their application-specific processing units. For instance, Google charges \$6.5 per hour for its Tensor Processing Unit, while Nvidia can charge \$1.6 for its GPU. The standard CPU only costs \$0.06 per hour. The value of the AI-related hardware market (computing, memory, storage) is predicted to reach over \$100bn by 2025, with US and Chinese first-movers capturing most of it.¹¹

How do the two leading AI markets – the US and China – compare on these three elements? And how does Europe do?

The United States

When it comes to talent, the United States' world-leading research institutions train significant numbers of AI specialists, including foreigners who often stay in the country to start firms. The Element AI [report](#) aiming to identify AI researchers globally found almost half of them living and working in the US. The US-based 'GAFA' (Google, Amazon, Facebook, and Apple) and smaller Silicon Valley companies successfully attract talent from around the world. The industry also engages in the aforementioned acquires, such as Google's purchase of British firm DeepMind (the firm behind AlphaGo). At the same time, the scarcity of talent continues to grow: LinkedIn's 2017 "U.S. Emerging Jobs Report" finds that [employers' greatest need is for machine learning engineers, followed by data scientists](#).

On data, the GAFA companies' vast number of users means they have gathered enormous databases that they can use to develop their AI applications. This is helped by comparatively lax rules about data collection in the US, which [make it easier for companies to gather and handle data](#).

The US also leads in infrastructure, software, and hardware. Three American companies dominate the global chip market: Intel, AMD, and Nvidia.¹² In 2015 the US government [banned](#) Intel from selling high-end processors to China. The private sector also plays an enormously important investment role: in north America in 2016, it invested between

¹⁰ In addition to more specialised silicon such as FPGAs Field Programmable Gate Array, and ASICs Application Specific Integrated Circuit. GS Equity Research: Profiles in Innovation Revisited: AI hardware. 11 March 2018, p.4/7.

¹¹ GS Equity Research: Profiles in Innovation Revisited: AI hardware. 11 March 2018, p.3.

¹² GS Equity Research: Profiles in Innovation Revisited: AI hardware, 11 March 2018.

\$15 billion and \$23 billion in AI. That is [more than ten times what the US government spent on unclassified AI programmes the same year.](#)

China

While not quite as attractive for global talent as the US, the Chinese education system generates strong skills in maths, and the country has a tradition of language and translation research. Goldman Sachs believes that: “talent of the highest calibre has and will continue to drive the innovative nature of the industry in China”.¹³ While the Chinese BAT companies (Baidu, Alibaba, and Tencent) underspend Google and Microsoft slightly on Research and Development (R&D), they have higher percentages of R&D employees.¹⁴

China’s internet users are more numerous than those of any other country. And most of them access the internet using smartphones, which are more valuable than personal computers in generating data that is useful for AI.¹⁵ On the Singles’ Day shopping festival in 2016, Alibaba recorded 175,000 transactions per second.¹⁶ In addition, Chinese data privacy and data collection rules are lax, and Chinese users tend not to be as concerned about data privacy as the inhabitants of many Western countries are. As a result, *The Economist* has called China “the Saudi Arabia of data”.¹⁷ Chinese start-ups have also been progressing more rapidly than their Western counterparts, meaning that China now already has a herd of AI “unicorns” – start-ups valued at more than \$1bn. China uses AI in facial recognition software and other security-related technologies. Through international cooperation (such as that with [Zimbabwe](#) or [Venezuela](#)), it is acquiring more non-Chinese facial recognition data – while at the same time [increasingly exporting its surveillance systems to authoritarian regimes.](#)

Authoritarian states have advantages over democratic ones when it comes to data. China’s relatively weak data privacy protections give data aggregators a freer hand in what they can do with what they collect. And the government can access personal data for reasons of public or national security without the same legal constraints a democracy would face. In addition, authoritarian states have other ways of making companies follow their rules. In China, as political scientist Gregory Allen [notes](#), “essentially all major technology firms in China cooperate extensively with China’s military and state security services and are legally required to do so. Article 7 of China’s National Intelligence Law gives the government legal authority to compel such assistance, though the government also has powerful non-coercive tools to incentivize cooperation.” US companies, on the other hand, are much less national – “Google, Facebook, Amazon, Apple, and Microsoft consider themselves global companies much more than American”, as analyst Kara Frederick notes.¹⁸

On the hardware front, it appears that China has struggled more. Despite efforts since the early 2000s to develop its own PC processors (coming two decades later than the

¹³ GS Equity Research: China’s Rise in Artificial Intelligence”, 31 August 2017.

¹⁴ GS Equity Research: China’s Rise in Artificial Intelligence”, 31 August 2017. P.7.

¹⁵ *The Economist*, “China may match or beat American in AI”, 15 July 2017.

¹⁶ GS Equity Research: China’s Rise in Artificial Intelligence”, 31 August 2017.

¹⁷ *The Economist*, “China may match or beat American in AI”, 15 July 2017.

¹⁸ At WIIS DE conference, 15 November 2018.

US), China remains dependent on foreign suppliers for chips. The country fares better in supercomputer research: Sunway TaihuLight, a Chinese supercomputer, secured the [number one place](#) on the TOP500 list of supercomputers in June 2017, with the number two on the list also being Chinese.

Europe

Europe's AI capabilities have received a lot of bad press, with Kai-Fu Lee [claiming](#) that Europe is “not even in the running for bronze AI medal”. Overviews of the state of AI often do not even feature Europe as an actor. (This is why efforts to map the European machine learning landscape such as Project Juno .AI deserve praise.)

Indeed, Europe struggles to retain the AI talent it educates, with researchers leaving for the US in particular. One problem is that European companies do not pay competitive salaries, a fact recognised by Cédric Villani, a French mathematician and member of parliament. In the AI strategy the French government commissioned him to devise, Villani recommends “hefty salary top-ups” and a considerable reduction in administrative formalities in research institutions and universities. [The strategy aims to triple the number of people trained in AI in France in the next three years](#). Germany's AI strategy, meanwhile, envisages [100 new AI-related professor posts](#). And, noting Europe's difficulties in retaining AI talent, in late 2018 a group of European AI researchers founded ELLIS, the European Lab for Learning and Intelligent Systems. This is a professional body that aims to retain talent by creating a [network of research centres](#), a pan-European PhD programme, and close links with industry. That said, the Artificial Intelligence Index 2018 states that 28 percent of all research papers on AI on the abstract and citation database Scopus originate in Europe – the largest proportion of any region. [This points to good levels of education and research, though these do not always translate into commercial success](#).

Another challenge for Europe is one that China and the US do not face to the same extent: collecting data. European countries' comparatively small size and their strong data security rules mean that, in comparison to their colleagues elsewhere, European AI researchers and developers have relatively limited access to data pools. As Angela Merkel has remarked, “In the US, control over personal data is privatised to a large extent. In China the opposite is true: the state has mounted a takeover.” She added that it is between these two poles that Europe will have to find its place.¹⁹ Where China and the US benefit from large, homogeneous home markets, Europe struggles because of its fragmented market. The EU has worked hard to create the digital single market, but data collection has not been unified to the extent that is possible within individual countries. Of 66 key AI companies featuring in one recent listing, only nine were European.²⁰

In terms of hardware, Europe remains dependent on US chipmakers. There are, however, areas in which European companies show strength, such as in natural language processing, where almost half of the 12 key companies are European.²¹ *The Economist*

¹⁹ *The Economist*, “Can the EU become another AI superpower”, 20 September 2018.

²⁰ GS Research Unit, “Profiles in Innovation: Artificial Intelligence: AI, Machine Learning and Data Fuels the Future of Productivity”, 14 November 2016, p.38.

²¹ GS Research Unit, “Profiles in Innovation: Artificial Intelligence: AI, Machine Learning and Data Fuels the

has observed that: “Germany has as many international patents for autonomous vehicles as America and China combined”.²² With DeepMind based in London, Europe does have one global champion in AI – though it was, of course, acquired by Google in 2014.

AI in Europe: Key issues

Europe is thus behind other global players because of gaps in the three key elements of AI. Existing dependencies, such as on chip companies, risk creating further dependencies, such as on foreign AI applications. This, in turn, creates opportunities for abuse – as seen in, for example, the [operations of Chinese apps with questionable data security in Europe](#). Beyond the problems pointed out above, Europe’s development of its AI sector also suffers from a politically defensive mindset and from economic factors such as a lack of venture capital.

It is also relevant that European populations tend to see AI, as with technological advances more broadly, not as an opportunity but as a threat: survey after survey has found higher levels of scepticism, if not outright rejection, of AI in Europe than the US and, even more so, China. One study of the issue [concludes](#) that: “Asian respondents were the most bullish about the positive effect of AI in the future, while Europeans were the least optimistic ... The proportion of consumers preferring the AI robot doctor is highest in Asia, unsurprisingly given they appear to be more willing adopters of AI tech (especially versus Europe).”

Another survey reveals that, on the trust dimension, China ranks first out of ten countries (the other nine are: the United Kingdom, Spain, the US, Australia, France, Germany, Italy, Russia, and Japan). Key findings of this study [include](#): “73 per cent of people in China [believe that] the future impact of digital technology will be positive overall, as well as in terms of its ability to create jobs and address societal challenges.” Although multi-country surveys rarely capture cultural nuances and should be used with caution, the results nevertheless point to generally higher levels of scepticism in Europe, and the impact of scandals such as that surrounding Cambridge Analytica. [Coverage](#) of these [scandals](#) could mean Europeans are [more aware of the risks of, and potential for, technology abuse than inhabitants of other countries are](#).

This lack of both trust and a sense of the opportunities technology provides may explain why most European states approach AI in a defensive way. The official German and Italian approaches to AI, for instance, are markedly driven by fear of lost economic opportunities. Germany, in particular, appears to be primarily motivated by the aim of preserving its favourable economic position, as expressed in its [national AI strategy](#).

A further hindrance to AI development in Europe is the absence of adequate (venture capital) funding. One bank remarks that: “The EU is prosperous, technologically advanced, and has a well-educated workforce. But when it comes to the availability of venture capital and an entrepreneurial (risk) culture, there is still a vast gap with respect to the US”.²³ In 2016, venture capital investment in the EU totalled about €6.5 billion,

Future of Productivity”, 14 November 2016, p.38.

²² *The Economist*, “Can the EU become another AI superpower?”, 20 September 2018.

²³ Deutsche Bank, Digital economics. How AI and robotics are changing our work and our lives, 14 May 2018.

while the comparable US figure was €39.4 billion.²⁴ And, as noted above, the EU's regulatory framework and free-market policies forbid a Chinese-style government approach to sheltering and nurturing its tech industry.²⁵

For Europe, the risks associated with missing the boat on AI are potentially enormous. Economic value is increasingly created by technology firms, particularly AI companies. Of the world's [ten most valuable companies in 2019](#), seven are technology companies and all of them are either American or Chinese. In 2008 only two of the world's largest listed companies were tech firms.

European hedging

There is no silver bullet for making Europe stronger and more independent in AI. The following five measures, however, can help Europe improve its standing and acquire greater sovereignty in this area.

- 1. Improve data collection and data sharing on a European level.** To improve their access to data, EU and non-EU member states alike should create shared, anonymised, cleaned-up European databases for research. This means accelerating efforts to complete a digital single market. The EU could also enshrine the movement of data as a new European freedom: on this, [recent efforts](#) by the European Commission in this direction are welcome. Europe should further incentivise companies to share their (anonymised) data. France's AI strategy is already heading in the right direction on this when it argues that: "The public authorities must introduce new ways of producing, sharing and governing data by making data a common good". It plans to achieve this by opening up data gathered as part of government and publicly funded projects, and by incentivising private players to make their data public and transparent. Policymakers can go further than even the French approach by ensuring regulators work with private sector technology experts to achieve true anonymisation that citizens can trust.
- 2. Increase investment and spend smarter.** While state spending can only be one part of the overall investment picture, European governments should support innovative start-ups and increase funding for AI research. [Europe spent \\$4 billion on AI research in 2016, but China spent \\$7 billion. Both numbers are dwarfed by the \\$23 billion for north America.](#) Europe's AI industry has made clear its concerns about falling further behind its international competitors: more than 2,000 experts from CLAIRE (the Confederation of Laboratories for Artificial Intelligence Research in Europe) recently [called for large-scale funding](#) from the EU to counter China's and America's rapid progress. In a positive development, the European Commission, in partnership with the European Investment Fund, set up a pan-European Venture Capital Fund-of-Funds [programme](#). This allocates €410m to funds to invest in the European venture capital market. It is [expected to raise](#) an additional €2.1 billion from public and private investment. However, it is not only the size of funds that matters, but how the money is spent, too. For instance, between 1958 and 2018, DARPA (the US Defense Advanced Re-

²⁴ Charlotte Stix, "A survey of the European Union's Artificial Intelligence ecosystem", March 2019, p. 19.

²⁵ Deutsche Bank, Digital economics. How AI and robotics are changing our work and our lives, 14 May 2018.

search Projects Agency) spent \$60 billion on – sometimes deliberately outlandish – research, resulting in inventions such as the internet and GPS. In comparison, the EU’s Horizon 2020 programme amounted to \$85 billion between 2014 and 2020 – \$25 billion more in a time period that was ten times shorter.²⁶ Projects that explicitly aim to fund “moon-shot projects”, such as the Franco-German JEDI (Joint European Disruptive Initiative), are therefore a step in the right direction. Given its disadvantage in data, Europe should focus on investing in a different kind of AI. There are promising subfields of AI, such as reinforcement learning, [which requires fewer data to begin with](#).

- 3. Regulation.** The strengths Europe has as a “regulatory superpower” could help it [improve its standing on AI](#). Because the EU has the world’s largest single market, most multinational companies depend on access to the region – which means complying with EU standards. The EU has made use of this power at various times over the years in the economic realm, such as in blocking the merger of General Electric and Honeywell, and in forcing Microsoft to unbundle its Explorer browser.

If Europe wants to compete in this arena, it should make regulation the fourth key element of AI, alongside talent, data, and hardware. In the digital realm, it already has a headstart: “Europe seems to be in the lead when it comes to setting standards for regulation and privacy protection in the digital age”, comments Deutsche Bank, specifically citing the General Data Protection Regulation as evidence of this strength.²⁷ Emmanuel Macron has been outspoken on this front too, [declaring that](#): “My goal is to recreate a European sovereignty in AI ... especially on regulation.” “Taking on the US and China will be hard”, *The Economist* notes, nevertheless recommending this course: “Europe has a shot at developing a more decentralised alternative, in which data are traded or shared between firms”. The newspaper proposes an agreement on rights to access data, comparing this to the establishment of property rights in the digital realm. It also [suggests](#) steps to codify the types of data that should be made open, on the basis of their social value.

Europe could branch out in AI by, for example, setting rules that cover governance, including on ethics. Several players have adopted this approach already: the European Commission’s [AI strategy](#) specifically aims to create an ethical and legal framework for AI “based on the EU’s values”. The “high-level expert group on artificial intelligence” set up by the European Commission [published](#) its “ethics guidelines for trustworthy AI” in April 2019. In the same vein, the German government sees “ethical and legal requirements” as an [integral part](#), and future ‘trademark’, of AI made in Germany. In addition to establishing such rules, Europe should aim to enforce them by, for instance, creating a ‘seal’ for ethical AI, which companies can gain by demonstrating good practice. Europe could also look to integrate ethical AI rules into future trade deals, forcing foreign companies to follow European requirements.

It is in this context that the EU could help citizens regain trust both in new technology – by making it safer to use – and in the EU as a political actor that has the best interests of its citizens in mind. Europe should, therefore, not compromise on its

²⁶ Remarks by a JEDI representative at ECFR’s Flexible Union workshop in January 2019.

²⁷ Deutsche Bank, “Digital economics. How AI and robotics are changing our work and our lives”, 14 May 2018.

principles and see them as disadvantages, but rather aim to turn them into virtues. Europeans' focus on data privacy, as Kai-Fu Lee [notes](#), “will cause the American giants some amount of trouble and may give local European entrepreneurs the chance to build something that is more consumer and individual-centric ... That would go further than American companies would ever contemplate in protecting privacy.” In this respect, Europe should also look for other likeminded partners among its liberal democratic allies, such as Canada or Australia, to further increase the area in which such rules are applied and thereby increase their impact.

- 4. Adopt AI in the military realm (within limits).** AI provides critical input into military power. Some European countries appear uncomfortable with this – Germany's AI strategy features just a single sentence on the military applications of AI, for example. Yet ignoring the impact that AI can have on warfare is not a viable long- or even short-term approach. Indeed, there may even be opportunities for European countries that they have not yet acknowledged: the new competitive landscape could, in fact, benefit middle powers, as they will have greater capacity to compete than they did in the creation of the complex – and expensive – military platforms used today, such as precision-guided missiles and nuclear-powered submarines. Political scientist Michael Horowitz argues: “As long as the standard for air warfare is a fifth-generation fighter jet, and as long as aircraft carriers remain critical to projecting naval power, there will be a relatively small number of countries able to manufacture cutting-edge weapons platforms. But with AI, the barriers to entry are lower, meaning that middle powers could leverage algorithms to enhance their training, planning, and, eventually, their weapons systems. That means AI could offer more countries the ability to compete in more arenas alongside the heavy hitters.” Horowitz even goes as far as to say that it is “possible, though unlikely, that AI will propel emerging powers and smaller countries to the forefront of defense innovation while leaving old superpowers behind”. He issues a [warning](#) against complacency to the US in particular.

European states can take advantage of this by adopting AI in their military systems – which does not mean that Europe should accept or employ lethal autonomous weapons, as many European states have adopted clear positions against the development and use of such weapons. Beyond lethal autonomous systems, whose possible development and use have become a [hotly debated issue and given rise to public protests](#) (for good reason), there are many AI applications in the military realm that are attractive for armed forces, as they can help to lower costs, reduce need for human operatives, and improve planning and foresight. Intelligence analysis is one of the first examples of AI use in military contexts – a fact that became known to the wider public in June 2018, when, following protests from its employees, Google ended ‘[Project Maven](#)’, a joint initiative with the US Department of Defense that aimed to use AI to analyse data collected by drones. Given the greater concern about military applications of technology among Europeans, it is likely that Europe will face even more pushback from firms and researchers on working with the military. In addition, Europe is under pressure because of its ageing population and financial limitations, so it may want to invest in AI for military maintenance and logistics.

- 5. Education of the population and policymakers.** In a world potentially dominated by AI, it is important to adequately train the general population in AI. An educated and informed population may also be more resistant to handing over too much of its data to US (or Chinese) firms and insist on better privacy laws, thereby strengthening Europe's regulatory power. Europe may want to take Finland as an example: the [Finnish AI strategy](#) aims to train 1 percent of the population in AI. Equally, Europe should aim to train policymakers and diplomats in AI, as AI-related provisions are likely to be part of trade agreements and other negotiations in the future.

Conclusion

AI is set to influence Europe and the world in many ways. It is crucial that European states and the EU take steps to benefit from AI, while mitigating some of the negative effects on their citizens and their own power.

AI could also provide a chance for the EU to showcase one of its most important strengths: that of the power to set standards, to cooperate, and to benefit from a single market. For Europe to become truly sovereign in AI, it will need to strengthen its access to talent, data, and hardware – the three key elements of successful AI. Europe also needs to add a fourth key element: regulation. Indeed, it is in this element that Europe has a chance to go beyond mere sovereignty to become a norm-setter, embedding its ethics and values into AI governance and development, and serving as an example to fight back against AI nationalism. In doing so, it will need to take significant steps itself, such as rapidly educating its own citizens and policymakers, as well as substantially increasing investment in AI and carefully choosing which subfields of AI to fund. This could involve some tough conversations with European voters, especially on navigating the tricky ethical waters of AI's military applications. But if Europe does not address these difficult questions – and soon – it is liable to find itself surrounded by more powerful rivals that have set the ground rules for AI, leaving it unable to compete or to provide citizens with the protection that they expect and deserve.

Ellie Geranmayeh and Manuel Lafont Rapnouil

Meeting the challenge of secondary sanctions

Summary

- Secondary sanctions have become a critical challenge for Europe, due to the Trump administration's maximalist policy on Iran and its aggressive economic statecraft.
- Europe's vulnerabilities mostly result from asymmetric interdependence with the US economy, due to the size of US markets and the global role of the US dollar.
- In future, states will likely weaponise economic interdependence with the EU to target countries that are more important to the European economy than Iran, such as China and Russia.
- European countries should demonstrate that, despite their economic interdependence with the US, they control EU foreign policy.
- The EU and its member states should strengthen their sanctions policy, begin to build up their deterrence and resilience against secondary sanctions, and prepare to adopt asymmetric countermeasures against any country that harms European interests through secondary sanctions.
- They should also attempt to bolster the global role of the euro and lead a robust international dialogue on the role of sanctions.

Europe's exposure to US secondary sanctions is a major foreign policy challenge for which there is no easy solution. The Trump administration's withdrawal from the Joint Comprehensive Plan of Action (JCPOA) and imposition of such sanctions have harmed European countries' interests in nuclear non-proliferation and laid bare their limited ability to implement an independent strategy on Iran. Although Europe and the United States continue to closely coordinate their sanctions policies in other situations, disagreements between them – such as on the JCPOA – have led to not only a sharp divergence in their approaches to sanctions but also a clash between their respective foreign policies.

Indeed, last summer, European capitals were reminded of the harsh reality that, through secondary sanctions, Washington can use access to the US markets as a source of immense

political power. As the US is one of Europe's largest trade and financial partners, it is hard to find any European business that does not have direct or indirect exposure to these markets and systems. Given its extensive power to investigate and fine European actors – and to cut them off from the US market – the US Treasury's influence prevails when US and EU regulations and foreign policy diverge. As such, the mere threat of US secondary sanctions on European entities has led to an exodus of EU companies from Iran and undercut a nuclear deal that once stood as a signal achievement of European foreign policy.

While past US governments have also adopted secondary sanctions, the administration led by President Donald Trump has used such measures in ways that create unprecedented problems for Europe. Many European officials worry that secondary sanctions are increasingly addictive for both the White House and the US Congress. Under the Obama administration, the US tried to gain international support for its extensive sanctions on Iran through the European Union and the United Nations. But, under Trump, secondary sanctions are proving to be a hugely powerful measure, at least in the short term – meaning that all bets are off as to how his administration will use them in future.

The Obama administration's secondary sanctions against Iran were part of a foreign policy more or less coordinated with that of the EU. Under Trump, European governments have, for the first time, begun to think seriously about how to escape or even counter the measures. Their efforts have the support of the many European companies and political figures who see a robust response to US secondary sanctions as indispensable insurance – both economic and political – against possible US interference in Europe's relationships with other countries, including Russia and China.

Despite their scramble for countermeasures that can minimise the impact of these sanctions on their commercial and – more importantly – strategic interests, the EU and its member states have been unable to significantly shift Washington's stance. They have also failed to dissuade European companies from pre-emptive alignment and overcompliance with US secondary sanctions.

More than the nuclear deal is at stake: regardless of whether the agreement survives in the coming months, it is clear that European governments need a better response to secondary sanctions. European countries need to reassure companies that they can conduct business within the contours of EU law and policy. And they must demonstrate to the world that, despite their interdependence with the US, European capitals ultimately control EU foreign policy. The Iran case has fully exposed European capitals' weakness in this area, reducing their bargaining power vis-à-vis both Tehran and Washington.

Europe's vulnerabilities to US secondary sanctions result mostly from its economic interdependence with the US. Political scientists Henry Farrell and Abraham Newman challenge the argument that globalisation results in reciprocal dependence, which tends to make coercive strategies less effective. On the contrary, as they [note](#), asymmetric network structures, such as global financial platforms that flow through the US, "create a condition of 'weaponized interdependence' in which some states are able to leverage interdependent relations to coerce others". Due to its dominant position in global economic networks, the US has not experienced asymmetric dependence on trade with Europe as an obstacle to imposing its coercive strategy.

Europe could respond by reducing such interdependence – but this would not be in its broader interests, either economically or politically. A more viable option is to minimise Washington's opportunities to use US-EU interdependence in ways that restrict European freedom of action. This can be done by both reducing the asymmetry in such interdependence and by showing a determination to leverage other aspects of interdependence for Europe's benefit where necessary.

This paper assesses Europe's main vulnerabilities to secondary sanctions and proposes policies that will restore its freedom of action – or, at least, minimise these measures' impact. It argues that, beyond the immediate issue of Iran, there is a need for European capitals to create longer-term plans for responding to any third country's enforcement of secondary sanctions against the EU. The US stance on sanctions could grow ever more aggressive – even under a new administration. Other countries, such as China, could start to use similar measures to increase their geopolitical influence. European actors must build up their resilience against secondary sanctions and create a process for responding to such measures in ways that better serve their interests.

The weaponisation of US sanctions

In recent years, the US executive and legislative branches have increasingly resorted to sanctions in ways that limit choices for European governments and companies. Given that there is bipartisan support in the US for expanding the use of secondary sanctions, future presidential elections are unlikely to substantially reverse this trend.¹ A growing number of voices in Europe's commercial and policy spheres caution that the US is likely to often use secondary sanctions in ways that have "damaging consequences" for European commercial and security interests.

The current situation has precedent. A major showdown between the US and Europe over sanctions policy came under President Ronald Reagan's administration, which targeted Moscow's plans to build a gas pipeline running from Siberia to Europe by imposing a ban on related equipment sales to the Soviet Union. Then as now, European countries decried Washington's use of extraterritorial sanctions. Even UK Prime Minister Margaret

¹ Comments from a former senior US Treasury official, February 2019.

Thatcher was outspoken on the issue and, despite her close relationship with the US president, joined a European effort to push back against this policy. However, unlike today, European company executives [openly said](#) that, if their government ordered them to disregard US sanctions, they would do so. Following political uproar in Europe, the US eventually lifted the sanctions.

In the mid-1990s, the US Congress imposed extraterritorial sanctions on Cuba, Libya, and Iran that angered many European leaders. This time, European governments lodged a complaint at the World Trade Organisation (WTO); adopted a new Blocking Regulation that prohibited EU entities from complying with the US sanctions; and engaged in extensive political negotiations with the Clinton administration. Together, these responses [persuaded the US](#) not to impose the sanctions on European entities – although the Trump administration recently rescinded these waivers.

Primary and secondary sanctions

Primary sanctions prohibit companies and individuals in the sanctioning country from engaging with their counterparts in the sanctioned country. Such sanctions apply to US persons, as well as US-origin goods and transactions that take place on US territory or in which the US can assert its jurisdiction.

Secondary sanctions are as Jack Lew, then US Treasury secretary, said in 2016: “generally [directed] towards foreign persons. These measures threaten to cut off foreign individuals or companies from the U.S. financial system if they engage in certain conduct with a sanctioned entity, even if none of that activity touches the United States directly.”

The expanded global reach of US sanctions and the enhanced influence of the US Treasury on European companies came to light under the Obama administration. By then, US and European economies and financial institutions had become so integrated with one another that, by leveraging the dominance of the US dollar, Washington turned secondary sanctions into one of its most powerful and effective trade restrictions to date.

The Obama administration took [unprecedented steps](#) towards strengthening its secondary sanctions through its oversight of, and expansive reach into, global financial institutions. According to one senior banking executive based in Europe: “when the US began using its secondary sanctions, it didn’t know if it would work. There was trial and

error involved. If, at that time, all of the European central banks resisted these measures, it is uncertain if the US could target them” – either politically or by including them on its specially designated nationals and blocked persons (SDN) list.²

While the US perfected its ability to impose secondary sanctions on companies, European countries fell in line with US foreign policy on Iran. During 2010-2012, the EU and the US introduced their most crippling sanctions on Iran’s energy sector to date. They did not clash over the issue because their sanctions policies were broadly similar. For example, in 2012, Congress [introduced legislation](#) to disconnect Iranian banks from the Belgium-based SWIFT – the key financial messaging company for global payments. Seeking to present a united front with the US, the EU passed a similar regulation shortly thereafter.

By choosing not to push back against US sanctions on SWIFT in this instance, Europeans joined decisive efforts to coerce Iran. But they also set a dangerous precedent that the United States’ lawmakers and executive branch have followed in targeting Iranian banks – and could follow in targeting [Venezuela](#) or even [Russia](#). As several European but also US policymakers involved in the decision on SWIFT in the Obama era now admit, they would have been more cautious had they believed that Trump would become president.³

Part of the effectiveness of US secondary sanctions stems from the power of the Office of Foreign Asset Control (OFAC), which can dedicate unparalleled resources to sanctions designations, implementation, and enforcement. According to one former senior US Treasury official, US district and appeals court rulings imply that the executive branch has significant discretion in this area.⁴ While no case has been brought before the US Supreme Court, several legal experts believe it is highly likely to favour executive discretion on sanctions policy.⁵

The uncertainty surrounding the operation of secondary sanctions has also enhanced their impact. A lack of clarity on how to interpret the measures and how they will be enforced has led to a high degree of overcompliance by European companies and banks, which prefer to cut ties to Iran rather than risk inadvertently falling foul of the sanctions framework. OFAC has responded slowly or inadequately to European governments’ repeated efforts to gain clarity on these issues; most commentators see this pattern of behaviour as deliberate, since it increases the impact of US measures. As demonstrated by the Trump administration’s approach to waivers for continued purchase of Iranian oil, the limited and temporary exemptions the US may issue to European companies only add to the measures’ aura of unpredictability.

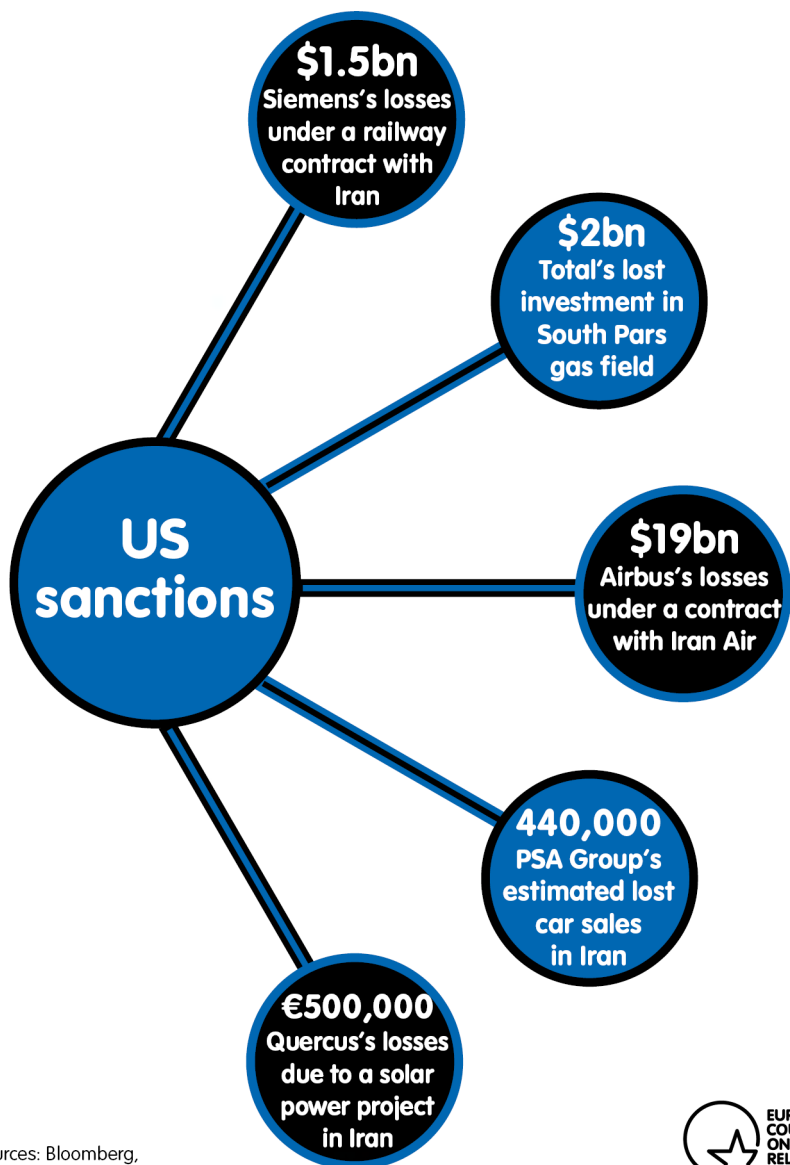
² ECFR interview, December 2018.

³ Interview with an EU diplomat, December 2018, and comments from a former senior US Treasury official, February 2019.

⁴ Comments from a former senior US Treasury official, February 2019.

⁵ ECFR interview with legal experts, April 2019.

Estimated cost of US sanctions for European companies: select losses



Sources: Bloomberg,
Financial Times, Reuters



The likely development of secondary sanctions

US officials have suggested that they could enforce the secondary sanctions the Trump administration imposed on Iran in November 2018 in a draconian manner, with National Security Advisor John Bolton [noting](#) that “it’s possible” the US will target European companies with the measures. These firms take such threats extremely seriously. The US has, in some rare instances, added European entities to its SDN list, leading to their assets being frozen and effectively disconnecting them from global financial markets.¹ Such designations could have a tenuous justification that goes beyond the reasonable due diligence expected of a company. For example, the Trump administration surprised many in Europe by [adding](#) Parsian Bank, a well-known Iranian private company, to its SDN list for allegedly having links with the Islamic Revolutionary Guard Corps. This forced European banks to sever their ties to the institution.

In future, the US could, in theory, add any European entity, including central banks and SWIFT, to its SDN list. (Listing SWIFT would be a bizarre move, given that it would harm US banks by preventing them from using the organisation’s unparalleled financial messaging services.)

The US could also impose travel bans or asset freezes on Europeans who facilitate forms of trade subject to US secondary sanctions. Given the effectiveness of US secondary sanctions as a tool of foreign policy, it is likely that both Democrat and Republican leaders will continue to adopt them.² OFAC is also likely to maintain its deliberate ambiguities as well as its heavy-handed approach to enforcement, or at least threaten to do so in ways that cause European companies to pre-emptively fall in line with the US sanctions framework. Moreover, the current US government is almost certain to remain indifferent to the kind of international support for sanctions the Obama administration sought as its preferred option.

So far, US sanctions on Iran have had limited economic consequences for Europe. But if Washington were to impose secondary sanctions on a far more important European trade partner, such as Russia or China, the hit to Europe would be far harder.

The stakes for Europe

Europe’s vulnerability to secondary sanctions

Washington maintains that its secondary sanctions are not extraterritorial but rather present foreign companies with a choice between access to markets in the US or in the targeted country.

The importance of the US market, in both absolute and relative terms, is enough to change the business decisions of most major European companies. But even small and

¹ ECFR interviews with European officials, January 2019.

² Comment from a former senior US official, February 2019.

medium-sized enterprises (SMEs) that may have no direct exposure to the US market still need to use banks that want to retain access to the US dollar, US financial markets, and their US clients. As a consequence, Europe is also vulnerable due to the integration of its financial markets with the much larger US one – and not just through its extensive trade, investment, and technological relationship with the US.

Other aspects of the financial system – such as the role in transactions of Visa, Mastercard, and other US companies (which can be leveraged in sanctions on individuals), or the impact of US sanctions policy on SWIFT – only exacerbate this vulnerability.

The relatively passive European response to US secondary sanctions has also increased this vulnerability. According to one former US Treasury official, the Trump administration and some members of Congress see Europeans as posing far less of a challenge to the enforcement of the measures than, for instance, the Chinese. In response to US sanctions on Iran under Obama, China set up a financial payments system that ran parallel to dollar-denominated channels, drawing the interest of countries that would like to set up their own systems of this kind, such as Russia. In comparison, Europe's most forceful response has been to establish the Instrument for Supporting Trade Exchanges (INSTEX), which is currently confined to facilitating the kind of humanitarian trade with Iran that is permissible under US sanctions.

However, Europe is not alone in feeling the pressure of US secondary sanctions. For decades, China, India, Russia, and Turkey have attempted to bypass the impact of such US unilateral measures. Yet, in response to the latest wave of US secondary sanctions on Iran, each of these countries has felt more exposed to US sanctions – even though they (especially Russia and China) have less exposure to the US than Europe. The impact of this has been seen in the notable drop in [trade between Iran and China](#) in the initial months after the US reimposed sanctions in November. China, India, and Turkey have also seemingly linked negotiations with the US over exemptions to these sanctions to an array of political factors, such as China-US trade talks. China is looking closely at European plans for establishing a special purpose vehicle (SPV) and European officials privately note that China has [expressed interest](#) in collaborating on such a mechanism to trade with Iran.⁸

In large part, the US does not take Europe seriously due to the continent's political fragmentation. Many European countries – particularly, but not exclusively, those in the east – are careful to avoid a confrontation with the US over secondary sanctions out of fear of undermining transatlantic relations. This phenomenon would likely play an even bigger role in other cases, such as sanctions targeting Russia, on which European divisions run deeper.

These intra-European differences are also evident on the tactical level: some European countries having sought preferential arrangements with the US through exemption

⁸ ECFR interviews with European officials, January 2019.

requests. This approach not only provided minimal, piecemeal US waivers on oil imports in November 2018 but also ran against other EU members' call for collective rather than bilateral negotiation of exemptions. In any case, such waivers are intended to be limited in scope and duration to prevent Europe and Iran from establishing longer-term business ties. Indeed, the US [announced](#) in April that it would not prolong its waivers to Italy and Greece (as well as a handful of non-EU countries) to continue purchases of Iranian oil.

Unity will be key, especially at a time when the US is explicitly playing on European divisions and multiplying transatlantic disputes – on trade and other issues. Internal divisions will weaken Europe's hand in talks with the US and in establishing a more formal response to secondary sanctions.

The risk for Europe: A test for European foreign policy autonomy and credibility

Given all these vulnerabilities, the EU has struggled to determine its economic and strategic relationship with Iran. What is at stake here is not Europe's relationship with the US – at least, no more than in any case in which the EU protects its trade interests or imposes its competition policy decisions on US companies. Rather, this is about Europe's ability to freely determine its foreign policy without being coerced, or seeing its economic actors being coerced, into following another power's policy.

In responding to secondary sanctions, the union needs to understand how it can use interdependence to rebalance the relationship without undermining transatlantic relations, and to share risks between member states in a fashion that promotes European unity. Should it fail to uphold one of its major foreign policy achievements, the JCPOA case would set a terrible precedent for the EU's ambition to be an autonomous and credible actor.

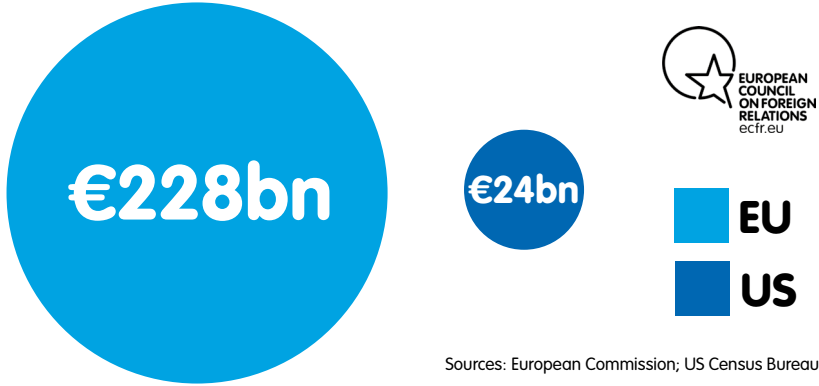
Arguably, the transatlantic dispute over Iran has already diminished Europe's diplomatic influence: third countries are now liable to ask why they should negotiate with European capitals if Washington, through its secondary sanctions, has the final say on European policy. Accordingly, the EU's sanctions will lose some of their value as an autonomous foreign policy tool – if it cannot effectively lift them when its goals and conditions are met – even as it increasingly adopts such measures.

A broader risk lies in the fact that the current US administration can act more aggressively even while it goes against an agreement signed by its predecessor and remains mostly isolated on the international stage. This underlines the credibility of US sanctions and the reality that a similar situation could arise again.

This risk is not just hypothetical. Until recently, the US only resorted to secondary sanctions in cases involving relatively closed economies, such as those of North Korea, Libya, Iran, and Cuba. However, in 2017, Congress passed [legislation](#) that imposed secondary sanctions on Russia, including the country's energy sector. There is a real

possibility that the US will [further expand](#) this legislation through what some of its supporters call the “sanctions bill from hell”. This bill is meant to target the Russian energy and banking sectors in ways that present what former US official Richard Nephews [calls](#) a “real risk of secondary sanctions application”.

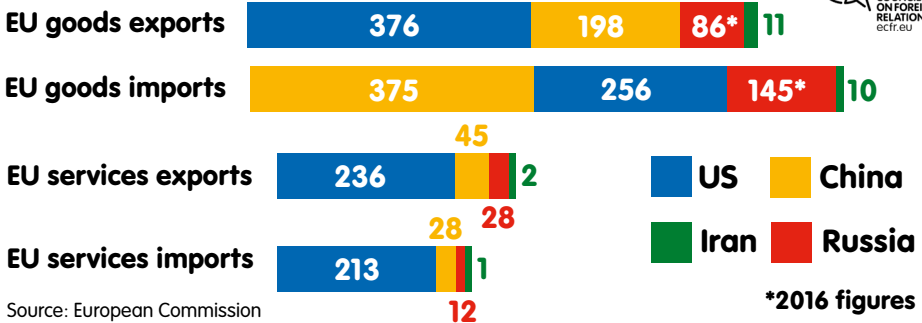
Russia’s goods trade with the EU and the US, 2017



Meanwhile, OFAC has continued to add Russian entities to its list of targets of secondary sanctions. This can have a significant impact on European companies, as [demonstrated](#) by the unintended economic effects on commodities markets – [and on European economic interests](#) – of the inclusion on the list of firms linked with billionaire Oleg Deripaska, especially aluminium giant Rusal. Washington’s focus on Moscow is particularly worrying for an EU that engages in roughly ten times more trade with Russia than the US does, and that includes member states that see the Russian-owned Nord Stream 2 pipeline as important to their energy security.⁹ Recent US threats to disconnect Russia from SWIFT over its role in the Ukraine conflict have alarmed at least some EU member states.

⁹ Comments from a senior EU official, January 2019.

EU trade in goods and services, 2017 (€billion)



Source: European Commission

Finally, the risk for Europe would not only be that of direct tension with the US. One can envision a scenario in which similar economic statecraft could be used against European interests by other powers, including those without the same level of economic and financial integration. China could try to leverage economic asymmetries or dependencies against Europe through trade restrictions (on, for example, products such as rare earths). Europeans should take this risk all the more seriously because China, while [denying](#) that it uses sanctions, already resorts to several types of coercive economic measure – de facto and informally, at least.

Europe would also be especially vulnerable to a sanctions war between great powers due to its reliance on the global economy and a rules-based international order. The EU may well have been naive to assume that this order and the economic relationships it underpins could be insulated from great power competition and coercive strategies. However, the EU must now recognise that persistent international tension over US sanctions and other extraterritorial measures – such as those that have been developed in the fight against corruption or financial crime, or to control foreign investments – can harm long-term European interests. Such a scenario would both lead to the fragmentation of the global economy and weaken collective security and multilateral cooperation, especially if most or all major powers began to use secondary sanctions.

Building resilience against secondary sanctions

In this context, it is important for the EU to build up its deterrence and resilience against secondary sanctions, including by developing countermeasures that can act as a deterrent against them. This is necessary to minimise the impact of US secondary sanctions on Europe's security and commercial interests. In the Iran case, EU governments have [responded](#) with firm statements that oppose US sanctions and reiterate their support for the JCPOA. They have also revived the 1996 Blocking Regulation to cover US secondary sanctions on Iran. EU unity on the issue, along with the launch of INSTEX, has frustrated the US administration, prompting it to [attempt to divide member states](#). Yet all these steps have failed to affect the calculations of major European companies and banks. Overall, the measures EU countries have taken so far have not definitively protected European interests, nor been quick enough to suggest bold determination.

From the perspective of European policy, perhaps the most important effect of Washington's increasing use of secondary sanctions has been to awaken the EU to the dangers of such measures. As such, European countries are devoting greater resources than they once did to responding to US secondary sanctions. But while they all acknowledge the need to formulate a better response to the measures, they disagree on how much they are ready to pay for doing so, and on how to absorb these costs.

If the EU wants to be a global player on security and economic issues, member states must – in pursuing their strategic objectives – establish a process for sharing these costs

and proving they have the will to resist secondary sanctions. Part of this involves sharing the costs across member states, to ensure that the US does not see, and therefore target, any one European country as confronting secondary sanctions alone. European decision-making on INSTEX demonstrates how this risk-sharing process can work: established in Paris, the mechanism is [headed](#) by a German and includes senior German, French, and British diplomats on its supervisory board.

As part of this effort, European countries must implement a road map that will eventually be credible enough to change the behaviour of European commercial actors. This will involve supporting European firms with clear measures that are sustainable in the medium term, to nullify the current impact of the asymmetries the US government exploits. Such measures should also seek to persuade the US administration to change the way it enforces secondary sanctions – making this an intergovernmental issue rather than leaving individual EU companies to face OFAC directly.

In responding to secondary sanctions, European governments and the EU should work with the kind of unity and purpose they displayed in resisting the Trump administration's trade tariffs. Over time, familiarity with the process will ease European governments' concerns about the risks of angering Washington. This will gradually socialise the risk associated with secondary sanctions among European capitals. The EU and its member states should focus their medium-term responses to US secondary sanctions on the courses of action discussed below.

1) Enforce EU sanctions more stringently

There are some important differences between the ways in which the US and the EU use sanctions. The US takes a more expansive approach and adopts a more aggressive enforcement policy. The EU generally resorts to relatively limited sanctions – fewer regimes, comprehensive provisions, and designations – and, in parallel, usually sustains its diplomatic efforts for more than just coercive purposes. While Europe considers its sanctions to be more politically minded, targeted, and reactive, the US regards them as ineffectual.

In particular, the US administration considers Europeans to be weak on enforcement. Some US officials have commented that they struggle to find a major case in which European governments or courts have enforced EU sanctions on European companies.¹⁰ It is true that, on the whole, Europe's systems for implementing and enforcing the measures are less developed than their US counterparts, and this is not just because of the division of labour between the EU and national levels.

Indeed, the EU system for implementing and enforcing sanctions relies on member states: the European Commission is tasked with monitoring the uniform implementation of sanctions in the EU and supervising their enforcement. And, as officials are quick to

¹⁰ Interviews with former US Treasury officials, November 2018-March 2019.

point out, the EU has a different culture in punishing entities that breach its sanctions. In Europe, enforcement action takes place in a more restricted and less public manner than in the US – which usually seeks to name and shame sanctions-evaders.¹¹

Still, as ECFR has confirmed in interviews on both sides of the Atlantic, the US believes that Europeans are not properly enforcing their own sanctions. The EU will not be able to address the challenge of secondary sanctions without tackling this deeper transatlantic credibility problem. Some European leaders, such as the French finance minister, have recognised this and [suggested](#) that the EU should establish a European equivalent to OFAC.

In theory, such an organisation could significantly improve oversight of sanctions enforcement in Europe, while acting as OFAC’s main interlocutor on secondary sanctions.

But it will be very difficult for the EU to create its own version of OFAC. The EU is built on the subsidiarity principle, which makes national governments rather than the union responsible for the enforcement of sanctions. And, politically, member states are unlikely to relinquish what they see as a core function of national sovereignty. However, EU member states could develop their own version of OFAC along the lines of the [pan-European enforcement authority](#) to combat money laundering that some of them recently called for. Member states could also create a pan-European organisation to help European companies respond to secondary sanctions imposed by third countries.

In any case, there is a need to build more consistent and credible EU mechanisms for sanctions implementation and enforcement: member states could authorise the European Commission to improve coordination between national authorities on this. This effort could help the union deal with the implementation of US sanctions when it affects European companies. It could also provide EU institutions with a more comprehensive overview of the measures and help them put the union’s combined political and economic weight behind exchanges with the US authorities, thereby lending credibility to the deterrent Europeans should aim to establish (as discussed below). A similar approach proved effective in pressing the Trump administration to lift congressional sanctions on Rusal.¹²

2) Develop mechanisms to minimise the impact of US secondary sanctions

Improve the credibility of INSTEX

In response to Washington’s secondary sanctions, European countries have looked to establish an SPV that circumvents the traditional financial networks the US uses to establish its jurisdiction for enforcing sanctions. INSTEX has been created to be that vehicle. If it proves to be a viable mechanism for trade with Iran, INSTEX could eventually

¹¹ Comments from an EU official, June 2019.

¹² ECFR interview with a senior European official engaged in the process, January 2019.

act as the keystone of a European trading system that runs in parallel to conventional, US-connected routes – thereby providing an alternative for European companies that wish to remain in markets targeted by US sanctions.

Much hard work is still needed to ensure that INSTEX works in the long term, which implies an operational counterpart structure on the Iranian side (one that abides by [international financial norms](#) on money laundering and terrorist financing). The mechanism will only be workable if European banks are willing to cooperate with it to move funds in European territory. Moreover, there must be a sufficient number of European trading actors that are willing to use it. Unlike China and Russia, Europe does not want to force its companies to use these facilities but rather to provide them with greater freedom to decide which markets they operate in.

For now, INSTEX has [narrow ambitions](#), with an initial focus on what European officials call “the sectors most essential to the Iranian population – such as pharmaceutical, medical devices and agri-food goods”. Widening its scope beyond trade permissible under the US sanctions framework would run the risk of placing INSTEX on the United States’ SDN list. And there is already a threat of designation given that the US could find fault with European due diligence on, for instance, the nature or final beneficiary of these transactions. Still, the scope of trade under INSTEX is too narrow. Therefore, European leaders should view the current version of the mechanism as a base on which to expand.

European governments must be prepared to take the risk that the US will target INSTEX, as well as companies that will be connected to it, with sanctions. Although national governments’ support for INSTEX provides a high degree of protection, the US could still apply sanctions to traded goods as much as to the financial flows used to pay for them.¹³

One important factor in avoiding this, and in INSTEX establishing its international credibility, will be whether most, if not all, EU member states join the mechanism. Pan-European involvement in INSTEX would help socialise the risks associated with it. Eventually, companies from other nations could also use it. States such as Russia and China – as well as India, Turkey, South Korea, and Japan – have expressed interest in collaborating on such a mechanism.

Create other parallel financial channels with limited exposure to the US

Beyond expanding INSTEX, EU countries should consult one another on the costs and benefits of creating a new financial system that runs in parallel to existing frameworks. So far, there has been no such initiative in Europe. Despite receiving the support of the European Commission, the European Investment Bank also declined to deal with Iranian business, out of concern that this would hamper its ability to access US capital markets. Similarly, French state-owned bank Bpifrance initially declared that it would

¹³ ECFR interview with a former US official involved in sanctions policy on Iran, December 2019.

establish this type of financial mechanism, but eventually decided not to proceed with its plan. [According](#) to one Bpifrance representative, it was possible to insulate the bank's transactions from US primary sanctions, but companies engaged in a specific transaction involving Iran would find it much more difficult to eliminate their exposure to the US, and Bpifrance itself could have been shut out of US financial markets.

The Chinese have essentially developed a dual banking system, which allows them to direct one set of banks to work with the US and another to deal with countries subject to US secondary sanctions. But, even in China, the deterrent effect of the latest US secondary sanctions can be [felt](#), and [Chinese banks](#) and other companies act with caution given the prudent approach Beijing takes to the issue, to avoid damaging sensitive trade negotiations with the US.

Regardless of whether such a dual system had been established, parallel payment channels – which might involve a fully developed INSTEX – could at least give companies the option of choosing between markets. This approach would also provide protection to individuals who are currently exposed to the effect of US secondary sanctions through US-owned credit card and other electronic payments systems.

Protect SWIFT

SWIFT has quickly become so important that disconnection from it is, as Joanna Diane Caytas [argues](#), “the financial market equivalent of crossing the nuclear threshold, due to the vital importance of the embargoed services and near-complete lack of alternatives with comparable efficiency”. In the context of US sanctions, there is much talk in Europe (both among [experts](#) and within [government circles](#)) about creating an independent replica of SWIFT. As a European entity operating under Belgian law, the organisation has some independence. But the Iran case has [shown](#) that US policy retains an overriding influence on it and its staff and board members.

European countries have frequently discussed the idea of establishing an alternative to SWIFT that benefits from the same kind of governmental backing provided to INSTEX. But creating an alternative to SWIFT would be a lengthy process; the time would be better spent devising ways to protect the existing system.

As a relatively soft step towards protecting SWIFT, European countries could push for an agreement between members of the International Monetary Fund to preserve the independence and political neutrality of financial messaging services such as SWIFT. European governments should make the case that SWIFT's systemic importance to global trade makes it worthy of special protection. Such an international pact should state that SWIFT will not be restricted by any unilateral measures, even justified on the basis of national security. An exception could be made for banks subject to UN Security Council sanctions.

Another measure would be for Belgium to use the Blocking Regulation in relation to SWIFT by insisting that banks subject to US secondary sanctions remain connected to the system. But a more effective use of the regulatory provisions would be for the European Commission to draft a new iteration of the Blocking Regulation that prevents financial mechanisms in Europe from complying with a third country's secondary sanctions. This would leave no room for doubt about EU legislation, forcing European entities to comply with it. Such an approach would be an effective form of *ex ante* financial regulation. For example, it could pre-empt Washington's introduction of further restrictions on SWIFT vis-à-vis connections with Russian or Chinese banks. Here, Europeans could leverage SWIFT's central role in global banking to, essentially, test the United States' willingness to sanction the organisation and its board members. Given the importance of the services SWIFT provides, the prospect of severe harm to the US banking sector could act as a powerful deterrent. By taking up such a defiant position, the EU would make it much more difficult for the US to implement secondary sanctions on SWIFT.

A more aggressive approach would be for the EU to press Belgium to nationalise SWIFT – or, at least, to threaten to do so should the US impose draconian sanctions on the organisation. As it stands, the EU is reluctant to make the threat because of the likely political fallout in transatlantic relations, the possible need to compensate banks affected by nationalisation, and the damage the process would do to confidence in European markets and the rule of law. Moreover, such a threat might prompt the US to create its own alternative to SWIFT. Nonetheless, the centrality of the organisation to European economic interests justifies a healthy debate on various options.

Expand the role of central banks

Regardless of the method Europe chooses to counter secondary sanctions, the Iran case illustrates just how difficult it can be to restore financial connections on a large scale. Even during 2015-2018, when the US was party to the JCPOA, its ambiguous policy on sanctions relief preserved extensive blockages in European banking connections with Iran. The failure prompted European leaders to briefly consider the idea of directly connecting European central banks to Iranian entities.¹⁴ They returned to the concept after the US withdrew from the JCPOA, hoping that the public status of these institutions would help shield the transactions.

For both financial and political reasons, no one central bank wants to be the first to test the theory. However, European governments should thoroughly consider the role that central banks can play in facilitating trade with entities targeted by US secondary sanctions where the political and economic stakes are high.

To ensure the approach is technically workable, European central banks would need to make fundamental changes to the way they operate. One way to involve central banks would be to establish special commercial accounts for European companies that trade

¹⁴ ECFR interview with a senior European official, January 2019.

with entities subject to US secondary sanctions. To do so, they could build upon existing practices and structures most central banks already use to hold accounts for their staff, as well as for some non-profit organisations and public organisations.

A central bank with this type of account could then receive funds from an entity sanctioned by the US and – rather than transferring them through the commercial banking system – deduct the amount from the debts to governmental authorities (such as taxes and social security) owed by that entity’s European trade partner. This mechanism would contain the direct flow of funds, and thereby the associated risks, within public institutions.

Reduce denial of services between European entities

While it served as a useful political signal, updating the 1996 Blocking Regulation has not proved effective in countering the impact of US secondary sanctions. Most of the European companies and legal experts interviewed for this paper did not believe that European countries would enforce the Blocking Regulation. Indeed, in its research, ECFR was unable to confirm whether any EU member state had opened investigations into, or imposed penalties on, European companies that left the Iranian market due to US secondary sanctions – as the companies did not wait until the US had begun procedures against them before making these decisions. Thus, commercial actors have opted to abide by, and even over-comply with, the US sanctions framework.

A more realistic course would be to change the behaviour of European entities through trade that is permissible under US sanctions. One way to do so is for the European Commission to strengthen existing measures, and to investigate instances in which a European entity makes a reasonable case that it has been discriminated against or denied services by another European entity on the basis of US secondary sanctions. The process of opening investigations into some companies’ decision-making processes and compliance protocols could help change calculations in firms’ boardrooms. This effort should aim to reduce the number of instances in which European banks over-comply with US secondary sanctions in transactions related to humanitarian trade, as well as other trade permissible under US sanctions.

Account for disruptive technology

Facing major barriers to international banking, Iran has in recent years begun to experiment with financing some transactions using hard-to-trace bitcoin. This type of currency, which operates via blockchain and thereby bypasses commercial and central banks, has opened the way for some SMEs to trade with their counterparts in Iran. The US Treasury has [attempted](#) to impose restrictions on these transactions, including by sanctioning traders and preventing Iran-based buyers and sellers from using some trading platforms. Nonetheless, it is currently difficult to systematically regulate or effectively sanction cryptocurrency traders, as they operate through a decentralised system.

To encourage greater use of cryptocurrencies, Iran's government and central bank are attempting to provide an attractive market for companies that mine bitcoin. Russia, Venezuela, and North Korea have also done so, in the hope that this will allow them to evade US sanctions.

Yet, for all the hype about cryptocurrencies, there are significant limitations to their use. Countries under sanctions may find it difficult to back their own cryptocurrencies: the supply of bitcoin and other non-state currencies is tiny in comparison to that of US dollars currently in circulation, and there are relatively few opportunities to convert cryptocurrencies into a state-backed currency. More importantly, most cryptocurrencies are pseudonymous rather than completely anonymous and, therefore, the long arm of US sanctions will eventually reach those who use them.

There are also major regulatory and transparency questions about the use of cryptocurrencies. European governments remain concerned about the dark commerce and money laundering networks that they facilitate. Yet it is possible that a major technological disruption to sanctions policy will come from innovation in blockchain and other distributed ledger technologies.

As discussed above, the United States' capacity to impose sanctions on foreign entities largely stems from its role as a gatekeeper in international finance – its ability to impose its jurisdiction based on its centrality to the global system. Therefore, [decentralised technological innovations](#) in the financial sector could, by assisting efforts to create parallel payment channels, pose a serious challenge to the US. European governments should actively consider how such blockchain technology can be integrated into efforts to create alternative payment channels that have minimal exposure to US secondary sanctions but fall under the purview of EU regulation.

3) Strengthen the euro as a viable alternative to the dollar

The technical solutions outlined above can only truly improve European resilience against secondary sanctions if the EU significantly strengthens the global role of the euro. Benoît Cœuré, a member of the European Central Bank's governing board, has [stated](#) it is imperative that Europe raise the "global standing" of the euro, using the currency as "a tool to project global influence". Although this is not the only rationale, he has directly linked this goal to the issue of US sanctions, noting that "being the issuer of a global reserve currency confers international monetary power, in particular the capacity to 'weaponize' access to the financial and payments systems".

The EU is not the only major power that aims to bolster its currency in the hope of one day competing with the US dollar. Moscow's attempts to set up an electronic payments system to rival Visa and Mastercard, as well as its own financial system, have been significantly hampered by the weakness of the Russian rouble, which has prevented its

efforts from gaining much traction with major commercial actors. Meanwhile, China has sought to elevate the renminbi by establishing a system for making oil trading payments in the currency, setting up [foreign exchange agreements with other nations, including Russia](#), and encouraging the use of its currency in infrastructure projects under its Belt and Road Initiative. China too has faced limits to its ambitions, as a result of its high debt levels and the overall slowdown in its economic growth, among other things.

The good news for the euro is that it remains unchallenged as the [second-most-important currency](#) in the international monetary system, after the US dollar. And there have been a [series of calls](#) for the euro to assume a stronger international role. But the euro still has several disadvantages relative to the dollar. For a start, the share of global trade in US dollars is far higher. And the dollar plays an important role in EU countries' trade: member states pay 80 percent of their energy import bills in dollars, even though just 2 percent of their energy comes from the US. Moreover, exchanges between euros and a third currency often involve the dollar in an intermediate stage.

Lastly, as one European Central Bank official has [noted](#), the list of factors that “prevented the euro from rising more forcefully as an international currency” include Europe's tendency not to speak “with one voice on international matters, including national security”. Factors specific to the euro area are also likely to have prevented the euro from rising more forcefully as an international currency.

The main obstacle to much-needed reforms is EU countries' unwillingness to implement the painful measures required to internationalise the euro. There is an emerging consensus among EU institutions, beginning with the [European Commission](#) and the [European Central Bank](#), on the need to be more ambitious with the euro – but some governments maintain their traditional reluctance to act.

There are no quick fixes for the euro. Leading European economic powers such as France and Germany will need to agree on how to strengthen and deepen the Economic and Monetary Union, to increase the stability of – and, therefore, trust in – the euro. There is also a need to [address the inconsistency](#) between current account surpluses and the bigger global role of the euro.

Moreover, the EU will need to provide incentives to develop low-risk assets denominated in euros, such as European bonds. The strongest euro-denominated investments come from German bonds. These are in short supply due to the German government's reluctance to finance spending with debt acquired through the sale of bonds. In combination, these measures could create more liquid capital markets, reducing Europe's dependency on the US dollar and thereby limiting its exposure to US sanctions.

Still, even if the euro gains strength globally, it will not replace the dollar but rather coexist with it in a more multipolar monetary system for many years to come.

European countries are now beginning to realise how much they would benefit from reduced dependence on the dollar. Such a shift is already a point of concern for the US. In 2016 Jack Lew, then US Treasury secretary, [warned](#): “the risk that sanctions overreach will ultimately drive business activity from the U.S. financial system could become more acute if alternatives to the United States as a centre of financial activity, and to the U.S. dollar as the world’s preeminent reserve currency, assume a larger role in the global financial system.”

4) Adopt asymmetric countermeasures

EU member states should engage in a serious debate on how to use the mutual dependency of Europe and the US to raise the costs for the US of enforcing its secondary sanctions. For instance, where the US threatens to fine a European company or cut it off from its markets, the EU could respond by targeting US companies’ access to specific European markets. Or it could freeze the assets of US firms in proportion to the penalties imposed by the US Treasury.

One way would be for the EU to create its own extraterritorial measures that can be imposed on US interests. Indeed, the Trump administration’s policy on Iran has already prompted a [discussion](#) on this issue. The union should not adopt secondary sanctions but rather develop a capacity to use countermeasures – ideally, for deterrence purposes only. Yet the EU would need to establish a formal legal process for such countermeasures.

In “weaponising” asymmetries in its economic relations, the union would not have to take a more expansive approach to establishing its legal jurisdiction.

Dispute settlement at the WTO

Challenging US secondary sanctions at the World Trade Organization (WTO) could be one way to counter the US position, but so far this has been put on hold for three reasons. Firstly, dispute settlement at the WTO is a lengthy process.

Secondly, and more importantly, current tension around the organisation makes it perilous to add to the list of grievances the current US administration may have against it, particularly dispute settlement mechanism.

Thirdly, there are concerns in some European quarters that a case against US secondary sanctions could produce a backlash against sanctions in general, including the ways in which the EU uses them. Still, this should not be totally discarded in the context of discussions with the US. After all, the US administration itself has brought new cases to the WTO since the Trump administration came to power. And, in any case, there are already active cases in which the scope of the “national security exemption” will be litigated. The US administration’s April 2019 decision to end the waiver on sanctions related to Cuba under the Helms-Burton Act could eventually help prompt the EU to sue the US at the WTO.

The EU already has a credible track record of using economic clout to impose its preferences on foreign entities, as seen in its enforcement of established competition standards and measures such as the General Data Protection Regulation.

Similarly, to protect core European strategic interests, the EU could leverage access to European markets in ways that would deter the US from imposing secondary sanctions on European entities when they undermine core European strategic interests.

The EU could, for example, require foreign banks operating in Europe to apply for licences that it could revoke if they comply with secondary sanctions on European entities – at least, where such compliance adversely affects the European banking sector. The EU could also leverage access to its market in relation to norms and constraints on environmental protection, data privacy, and other issues where there is a considerable [divergence](#) between EU and US practice.

Of course, these instances of divergence deserve to be dealt with on their own merits, not just as a bargaining chip in negotiations on sanctions policy. But the EU could certainly ensure that, in its attitude to sanctions, it is only as accommodating as the US is willing to be. By enforcing such countermeasures, Europe could gain leverage in negotiations with the US.

Such steps would show that US-EU dependence is mutual, thereby rebalancing the sides' relationship. At a time when WTO mechanisms seem unlikely to help settle such a dispute (see box), the use of countermeasures is a valuable route to push for a negotiation that the US has so far refused.

Some EU member states may object to this kind of assertiveness. Yet the union has become comfortable with implementing – and threatening to implement – countermeasures in trade disputes. And it has proved effective at doing so – as seen in its success in resisting some of the Trump administration's planned tariffs without damaging transatlantic relations, which helped reopen negotiations between the sides. The approach could be equally effective in dealing with secondary sanctions.

As discussed above, greater European assertiveness would not entirely counteract US secondary sanctions, but it would raise the costs of enforcing them. The extent to which some member states resist EU countermeasures against secondary sanctions will depend on the country that has been targeted. For example, there is likely to be greater European disunity on Russia than on Iran (so long as the JCPOA is being implemented). To overcome this hurdle, a coalition of willing member states should take the lead in persuading less committed countries that devising a more integrated EU process for countermeasures against secondary sanctions is vital if Europe wishes to be a leading economic player.

5) Lead a global dialogue on the use of sanctions

Amid growing divergence in how global powers adopt and enforce sanctions, Europe could lead the way in calling for both a transatlantic dialogue and a more global discussion on resolving their differences over the measures. At the transatlantic level, Europe should [clearly outline](#) the dangers of the current situation, while calling for greater strategic cooperation on sanctions. It should also make a sober assessment of how the last three decades of sanctions have affected the behaviour of target entities such as Iran, North Korea, and Russia. The need for such a transatlantic dialogue has been apparent since the Obama era – if only in relation to issues such as SWIFT, technical definitions, and legal instruments (including licences and letters of comfort).

This EU-US dialogue would also create an opportunity for a more political discussion. Europeans should underscore Lew's [warnings](#) that “secondary sanctions should be used only in the most exceptional circumstances, where – as with Iran – the threat is severe, where we have international consensus, and when ordinary sanctions have fallen short of their mark”. Europe should stress the need for international cooperation on sanctions, to increase their effectiveness where states have shared policy interests. But it should also warn against the use of secondary sanctions as a means of coercion where these interests diverge, and/or in the absence of multilateral backing.

A more global dialogue could eventually lead to the creation of an international framework for regulating the use of international sanctions, not just between G7 countries (which have traditionally held narrow consultations on sanctions issues) but also with other powers such as Russia and China. These other powers not only have to implement and enforce UN sanctions but also resort to more or less informal sanctions on a national basis. While the dialogue should begin as soon as possible, it will most likely require the advent of a new US administration to produce tangible results.

Until then, Washington will only change its position on the use of secondary sanctions if they begin to not just impose greater costs on its strategic, particularly economic, relationships with key partners but also threaten its interests more directly in the ways outlined above.

Europe's political will

European countries need to prepare for a steady increase in the use of sanctions and other economic measures in international relations. [Economic asymmetry and interdependence](#) will sometimes work against Europe – and not only in its relations with the US. As a consequence, the EU should hedge against countries' desire to exploit them. It could do so by, for instance, diversifying its international relationships and enhancing its own economic dynamism to avoid excessive dependence on any one power; reinforcing member states' collective ability to take countermeasures against

economic coercion; and establishing compensation mechanisms for European entities hit by sanctions.

Europe should treat the steps discussed above as a mixture of medium- and long-term measures. Strengthening the credibility and organisational structure of the EU's sanctions policy, reinforcing the euro's international status, and leading a global – particularly transatlantic – dialogue on sanctions will remain useful beyond the current disagreement between Europe and the US over the JCPOA, as they are central to other strategic issues. Meanwhile, European governments should resort to asymmetric countermeasures only in an ad hoc fashion, in response to significant threats to its interests.

For the EU, there is no panacea for US secondary sanctions. Rather, the issue is how to persuade the US that escalating its sanctions dispute with European countries is not in its interests. Member states need to show that they are willing to use countermeasures against the US if it does not change course – even where they disagree on the technical aspects of these countermeasures. Credibility and determination are key to this, as is the aim of improving transatlantic cooperation or, at least, containing the effects of current sanctions and preventing escalation.

European capitals must be prepared to act on their rhetoric. In any case, they should avoid sending mixed signals to the US and other powers. Unfortunately, this is exactly what they have sometimes done. For example, after promising to establish INSTEX, they appeared weak in taking months to agree on which country would host the mechanism. The European Investment Bank's refusal to make investments in Iran, after EU diplomats suggested that it should take on that role, only reinforced this impression. Even if it is unlikely to play a central role in settling the transatlantic sanctions dispute, the Blocking Regulation has suffered from a lack of high-profile cases of its enforcement – and, even more importantly, some countries' failure to transpose it into national legislation. Due to this seeming indecisiveness, neither European companies nor the US authorities take the EU seriously on sanctions.

Unity between Europeans will also be key to changing the EU's international image. In the context of Brexit, it was important that the United Kingdom stayed in close alignment with France and Germany in setting up INSTEX – especially given the central role that the three countries play on the JCPOA. The EU will be stronger in its negotiations with the US if it can keep the UK on side in dealing with secondary sanctions. More broadly, establishing a consensus within the EU is indispensable to both sending credible political signals and adopting the kind of measures suggested in this paper. Tension with the US on security guarantees, trade interests, and other issues will test European countries' unity, particularly given their differing threat perceptions and priorities.

To robustly respond to US secondary sanctions while maintaining internal unity, the EU must create an acceptable level of shared risk. A coalition of large European countries

must demonstrate the political will to accept and share the costs of the response for the transatlantic relationship (at least temporarily). Europe will need to create a clear road map for responses it can make in the short, medium, and long term to minimise the damage of future US secondary sanctions. This need not begin with grand, revolutionary steps but rather those such as operationalising INSTEX.

Some of the steps proposed above may seem partial, at best, in their ability to offset Europe's vulnerability to secondary sanctions. But some US experts are [increasingly concerned](#) about how the [overuse of sanctions](#) could affect the United States' global financial dominance in the long term. These [concerns](#), which Obama-era US officials also shared, have only been [amplified](#) by Trump's maximalist sanctions policies – especially, but not only, in the case of Iran. Europe should emphasise these concerns in discussions with the Trump administration and Congress, as well as with interlocutors who may play a role in the next US administration. This approach will carry greater weight in combination with a credible threat that Europe will impose painful costs on the US for enforcing secondary sanctions on European companies.

Europe's mission should not be to reverse the process of integration and globalisation that it and the US have long championed. Instead, it should be to find a more equal transatlantic footing, on which Europe's interests and positions become a serious factor in bargaining with the US over foreign policy and trade priorities. In sanctions policy, the overarching objective for European countries should be to change their mindset and internal narrative on their collective ability to respond to these measures, with a view to retaining control of their strategy and foreign policy.

The US has set unilateral rules on secondary sanctions in ways that abuse its global financial dominance. It is time for Europe to better preserve the multilateral order by drawing its own red lines.

Nick Witney

Building Europeans' capacity to defend themselves

Summary

- With their world becoming more dangerous and the US security guarantee less certain, Europeans know they must now do more for their own defence. But there is little consensus on how or even why they should do so.
- To hedge against US disengagement without precipitating it, Europeans should converge on the narrative of “taking a greater share of the burden of defending Europe” – with an emphasis on capabilities and operational commitments, not cash.
- Realism and pragmatism should guide Europeans' choice of institutional vehicle. The CSDP offers new promise of technological and industrial progress.
- Capability development should focus on NATO, where Europeans should define their own “level of ambition” for force provision – and do more for the alliance's Enhanced Forward Presence.
- The European Intervention Initiative should help revive operational culture, and could usefully generate a (virtual) European Air Intervention Group; Europeans should undertake new commitments in Kosovo and Africa.
- Above all, Europeans must stop outsourcing their strategic thinking to Washington. A new European Security Council might help them engage with each other on the big, difficult issues – such as how, leveraging French and British nuclear capabilities, they can move towards establishing a European deterrent.

In May 2020, US President Donald Trump, infuriated by the slowness of many European capitals to comply with his instruction to move their embassies in Israel to Jerusalem, tweeted his intention to pull US troops out of Europe. Confusion reigned. When? All US troops, or just some? Russia's bot factory lost no time in playing on European disarray – and, in particular, on the discontents of Russian-speaking minorities in the Baltic states. Street violence escalated into border clashes and, behind a barrage of diplomatic menace and obfuscation, a Russian “peacekeeping” force rolled into Estonia.

Moscow had miscalculated both the speed with which Europeans would capitulate on the Jerusalem question and the reluctance of the US military establishment to stand by and be humiliated. So, NATO resisted with its available forces. But, [outranged and outgunned](#), it was [unable to stop](#) the Russians reaching the gates of Tallinn and Riga 60 hours after they entered NATO territory. Russia massively reinforced Kaliningrad, including with ostentatious deployments of its new intermediate-range nuclear forces – but made no effort to press further into Europe, allowing a de facto ceasefire to take hold and calling for negotiations.

Slowly, NATO set in train its mobilisation and reinforcement processes. The alliance issued an ultimatum for the withdrawal of Russian forces from Europe and, when this was ignored, NATO troops massed in northern Poland in preparation for a full-scale offensive – at which point the Russian military struck a German armoured division there with a nuclear missile.

Within 24 hours, it was clear that Trump had no intention of retaliating in kind. It was game over. Military forces slowly stood down. Politicians and diplomats took over, confirming the reabsorption of the Baltic states into Russia and the withdrawal of American troops from Europe.

The need for greater self-sufficiency

A few years ago, the scenario sketched out above would have seemed not so much improbable as fantastical, the stuff of airport fiction. Today, it remains improbable – but not so implausible that responsible European defence planners can entirely dismiss it from their minds. Russia may be a failing state, with an economy that is now smaller than that of Italy, but it has restored its conventional forces to the point that NATO would be unable to prevent a surprise Russian attack from achieving significant progress in its opening phase. It has also, of course, maintained devastating nuclear capabilities. And there is not much room for doubt that its ruthless, revanchist president, a man who has shown no scruples about using chemical weapons, would resort to the kind of nuclear use Russian forces regularly rehearse, if he thought the risk calculus justified it.

Of course, this risk calculus will turn, as it has since the dawn of the nuclear age, on whether the US president would be willing to retaliate in kind – to “risk Chicago for Berlin”. With the US nuclear codes in the hands of a man who has gone out of his way to disparage the NATO alliance and shown no compunction about pulling the plug on his Kurdish allies in Syria, the US security guarantee to Europe looks less reliable than at any point in the last 70 years. No wonder European defence – the notion that Europeans need to take more responsibility for their own defence – is now firmly back on the political agenda.

Yet, of course, it is not all about Trump. Indeed, the European Union adopted the [European Global Strategy](#) – the point of departure for the recent spate of defence

initiatives – in June 2016, when the prospect of a Trump election victory still seemed remote. But, even then, the strategy reflected a deteriorating security environment – as much, or perhaps more, to the south as to the east – and a world in which the long-term US “pivot to Asia” could not be ignored. Europeans’ acceptance of the need to achieve some unspecified degree of “strategic autonomy” preceded Trump.

There has been much satisfaction expressed in Brussels – in the EU quarter, at any rate – over the degree of progress on European defence under the Global Strategy. Progress has undoubtedly been made, but it is important to keep it in perspective. It is not just that, at this point, such progress comprises new plans and processes rather than concrete results. There is also general uncertainty about the adequacy of the scale of the effort – which, of course, begs the question of whether the ambition remains just to complement NATO and do enough to propitiate Trump, or to make a serious push for strategic autonomy and reduced dependence on the United States.

It does not help that the political mood in the EU has seldom been so fractious, with Brexit only the most prominent example of rising nationalism and the erosion of solidarity. Inevitably, this is reflected in the strategic field, with sharply differing views not only on the old fault line of NATO versus the EU, but also on the reality and importance of the various security threats the continent faces, the scale and nature of the right defence response, and the trustworthiness of different partners and allies.

States have long had to balance the competing demands of classic defence against armed attack with requirements that are traditionally viewed as part of internal security – but that nowadays include hybrid, especially cyber, threats. As the 2003 European Security Strategy observed, the internal and external aspects of security had become “indissolubly linked”. But in the absence of institutional developments responding to this reality – we await the creation of the first ministry of security to bring these issues together in any EU state – Europeans still lack effective means to weigh the respective values of investing in a new anti-tank regiment or new anti-hacking software.

Moreover, the acceptance of the need for, and the mechanisms to enable, collective action for external defence at the European level is – despite the inadequacies of the results so far achieved – much more developed than that for internal security. In the intelligence and cyber fields, a patchwork of intergovernmental exchanges and cooperation predominate, given the dearth of pan-European structures. We are still at the stage of sporadic initiatives by NATO or the European Commission. In defence, there is broad consensus that Europeans should be doing more together, even if there are arguments about what and where. The NATO secretary-general and the EU high representative are widely recognised as authority figures, even if their advice is too rarely heeded. But there is no comparable focus on advocating and organising collective action on the security front – though the recent creation of a security commissioner could help.

Against such a turbulent background, this paper argues, a determined European effort to move towards greater self-sufficiency in defence is indeed essential. But the right narrative is crucial. The objective should be [framed](#) as “assuming a greater share of the burden of defending Europe” – while shifting the metric away from “cash” to the other two elements in the NATO secretary-general’s new trinity: “capabilities” and “commitments”. The respective roles of NATO and the Common Security and Defence Policy (CSDP) should be developed with a hard-headed pragmatism; what matters is what works. While Europe’s industrial and technological capacities should be expanded through the CSDP, NATO may be – for now – the better bet for capability development. Accordingly, this paper proposes two specific initiatives for transatlantic burden-sharing: a challenging European level of ambition within NATO; and a “division of operational labour” between NATO and Europeans working without the US, whether through the CSDP or through arrangements such as the European Intervention Initiative. Both approaches should be pursued as a conscious strategic bargain between those Europeans who focus on Russia and those who look more to the south.

Finally, this paper ends with an unwelcome reminder that, as global arms control crumbles, Europeans must re-engage with nuclear issues, including the question of a European nuclear deterrent. Nor will they move away from excessive dependence on US protection without finding ways to develop their own, independent, strategic thinking.

Conceiving, and talking about, a stronger European defence

There is no need here to catalogue the various Trump utterances and behaviours that have led many to conclude that he is not to be trusted with Europe’s defence. Some of his recent moves – abrogation of the Intermediate-Range Nuclear Forces (INF) Treaty; withdrawal of US forces from Syria – might almost have been designed to alarm his European allies. It is, of course, a fact that the Trump administration has increased the US commitment to Europe, developing his predecessor’s 2014 European Reassurance Initiative into a European Deterrence Initiative with a budget of nearly \$7 billion for 2019. Welcome though this is, it is hard to see it as anything other than confirmation that, with the Trump administration, there is simply no predicting how the chips will fall. This is an unstable base on which to rest one’s future security.

There is little use in arguing that Trump is just a temporary aberration. A possible six more years of him is a long “temporary”. And Trump is only a particularly acute manifestation of the steady evolution of the transatlantic security partnership since the collapse of the Soviet Union. With the disappearance of the existential threat Europe and the US once shared, the interests and ambitions of the two sides have inevitably begun to diverge. The first signs were apparent in the Clinton administration’s evident reluctance to become involved in the Balkans crises of the 1990s. Then came 9/11 and the Bush administration’s “war on terror” – in which Europeans found that the price of continued US protection was to be (expensively) paid through support for American military

misadventures in Afghanistan and Iraq. President Barack Obama seemed to promise better, but it was his administration that, with its “pivot to Asia”, showed how the US strategic focus was set to shift away from Europe and towards the coming confrontation with China in the western Pacific.

Thus, America downgrading Europeans’ strategic interests has been the consistent trend of the last 30 years – accompanied, naturally enough, by a growing mood of frustration with European reluctance to bear a fairer share of the burden of their own defence. Along with this has gone a settled US determination to secure a degree of compensation through the international arms trade, by restricting European access to the US market and to US technology. Indeed, the US has used the International Traffic in Arms Regulations to obstruct European competition in third-country markets, and it has aggressively lobbied against Europeans’ efforts to develop their defence industrial and technological base.

In short, Europeans would be wise to view transatlantic divergence not just as a Trump aberration but as a long-term structural shift in geopolitical interests. With a revanchist Russia now flexing its muscles on Europe’s eastern border, one European response could be to work even harder at retaining America’s interest, essentially by paying an even higher price for US protection. Such thinking seems to lie behind Poland’s recent offer to pay for “Fort Trump”, a US base on Polish territory. But it is not hard to see how the price would inevitably rise to include items such as European support for US foreign policy in the Middle East. No wonder that most Europeans support the opposite approach: hedging against transatlantic divergence by increasing Europe’s strategic autonomy. The logical end state of such a policy is a Europe that is able to defend itself against Russia without relying on the US.

The trouble with this proposition is not that it is infeasible. Europe has both the financial and technological resources to achieve the aim. In 2018 the 28 member states of the EU collectively [spent](#) four-and-a-half times more on defence than Russia. And European spending is set to continue rising. France and the United Kingdom are both nuclear powers (and, though it may be exiting the EU, the UK insists that it remains fully committed to Europe’s security). The problem is the scale of Europeans’ defence deficiencies: making up for what the US currently provides and achieving genuine defence autonomy would be the work of decades rather than years. A new [study](#) by the International Institute for Strategic Studies estimates that, if European members of NATO wished to prevail against Russia without the US in a conventional regional conflict not dissimilar to that described at the start of this paper, they would need to invest between \$288bn and \$357bn over 20 years.

To put that investment into context, the lower end of the range is roughly what the EU28 now collectively spend on defence in one year – while, if all of them increased their defence budgets to 2 percent of GDP, around \$100bn more per year would become available. So, conventional defence self-sufficiency, measured against today’s most

potent conventional threat, should be well within Europeans' grasp (how useful or indeed necessary that would be without a nuclear underpinning is another question) if they make a determined and sustained effort over a couple of decades.

But, during that period, Europeans would have to display the kind of unity of purpose and willingness to pool their defence efforts and resources they have never so far achieved during the 20 years of the "European defence project". This will require a political narrative (or "policy", if you prefer) that both motivates Europeans and avoids antagonising Americans (the US reaction to recently revived talk of a "European army" highlighted the dangers here). Any effort to insure against a loss of US commitment must, first and foremost, avoid precipitating that very outcome. At the same time, the narrative must focus European defence efforts on fixing the key vulnerabilities that would arise from a weakening or withdrawal of the US security guarantee – while avoiding accusations that Europeans are wasting resources by duplicating US capabilities and undermining NATO.

Thus, while it may be tempting to talk of "[the hour of European sovereignty](#)" – the subtitle of European Commission President Jean-Claude Juncker's 2018 State of the Union address – Europeans would do well to stick to the less controversial narrative of "assuming a greater share of the burden of defending Europe". That said, there is scope for more creative thinking about just how to frame this burden-sharing narrative. It will be essential to move away from the crudely financial (and mercantilist) terms in which the US president conceives of the transatlantic defence relationship. "Because Trump says we must" will never play well as a reason to increase defence budgets. And anyway, as noted above, the real problems of European defence are less about how much Europeans spend than how they spend it. Besides, no matter how much they spend, it will always be less than the US. In response to the NATO secretary-general's invocation of his new trinity, Europeans need to frame a new burden-sharing offer that is less about cash and more about capabilities and commitments – output, not input.

How much weight can the CSDP bear?

Aided by economic recovery and a return to growth in defence budgets, the 2016 Global Strategy has been the foundation for new European defence initiatives, notably Permanent Structured Cooperation (PESCO) and the European Defence Fund. Together with a new Capability Development Plan, these initiatives have been widely hailed as constituting a new "Defence Union" for the EU. The hope is that they will work together as a sort of mutually reinforcing ecosystem for developing European defence capabilities: the plan will identify priorities that member states should then take up as PESCO projects, subsidised by the EU budget via the European Defence Fund. Meanwhile, the new Coordinated Annual Review on Defence should improve mutual visibility of member states' defence investment plans, highlighting opportunities for cooperation and leading to a convergence of systems and processes.

Moreover, the Global Strategy prefigures a new degree of CSDP ambition. As conceived at the turn of the millennium, the CSDP was all about crisis-management operations. This focus avoided conflict with NATO's primacy in territorial defence – and, anyway, looked to be the way of the future, providing a role for European militaries of greater relevance than preparation for a threat from the east that seemed to have evaporated. But what a difference 20 years make. Reflecting the new strategic reality, the Global Strategy adds to the CSDP's historical crisis-management mission an emphasis on: building partners' capacity to look after themselves (a move away from traditional interventionism); and the need for Europeans to "be ready and able to deter, respond to, and protect ourselves against external threats" (an acknowledgement of the revived Russian threat). The EU needs, its member states agreed, "an appropriate level of ambition and strategic autonomy".

All this is promising – but it is a good start rather than a job completed. As experience shows, what matters in European defence is less new processes and political declarations than how member states decide, over time, to spend their defence budgets and to prepare and deploy their armed forces. This will, in turn, be decisively influenced by the extent to which chiefs of defence staff across Europe accept the new Defence Union as an effective means to define and meet the priority needs of their armed forces. Even in the CSDP's initial heyday, when political confidence was high and a raft of new crisis management operations was being launched, most of Europe's militaries – Sweden was a conspicuous exception – never wholly bought into the CSDP. Ambiguous peace-support operations in Africa, where the risks were a good deal clearer than objectives, had limited appeal; and working with the Americans, with all the most advanced equipment and doctrines to match, had an irresistible allure for European military leaders.

Today, with the Russians back and liberal interventionism discredited or, at least, out of fashion, there is a prevailing sense that NATO is the appropriate forum for serious military business. This sense is compounded by the EU's failure to follow up the Global Strategy with a compelling level of ambition – a definition of the forces Europeans aim to generate collectively, and for what purposes. A clear level of ambition is the essential starting point of any authoritative capability development process – the sort of methodical analysis which identifies the key capability priorities upon which combined efforts should be concentrated, and generates new collaborations that appeal as much to chiefs of defence staff as to defence industrialists and national armament directors.

The Foreign Affairs Council [glanced](#) at this requirement in a few short paragraphs entitled "Level of Ambition" in the conclusions of its November 2016 meeting. But there is nothing here that is of practical use to military planners or as a guide to defence investment. The document avoids the phrase "strategic autonomy". It references the two new "strategic priorities" of the Global Strategy – building partners' capacities and protecting the union and its citizens, which sit alongside traditional external crisis management – but makes no suggestion of building autonomous European defence

capabilities. The council namechecked a clutch of “[priority areas](#)” – old favourites such as drones, communications, and other “strategic enablers”; commissioned more work on modelling scenarios; and encouraged member states and EU military staffs to work with the European Defence Agency on the 2018 revision of its Capability Development Plan.

Fatally, however, all seven of the scenarios used to model capability needs reflect the conservative nature of the 2016 level of ambition and relate solely to external crisis management. So, no conclusions can be drawn, except through inference, about defending against the Russians in the absence of the US; and the qualitative element is largely missing. (It may not be sufficient to conclude that “we should have enough combat aircraft” if we know nothing about the availability of smart munitions or the aircraft’s ability to deliver them; whether the aircraft/aircrew are able to fly in the dark, or “hot and high”; and whether adequate defensive aids suites are fitted, relative to today’s threats, and tomorrow’s.)

In sum, when the European Defence Agency came to work on the 2018 Capability Development Plan, the key guidance document for EU defence investment in the coming years, the input derived from the level of ambition was of little help. Furthermore, the agency had to add to the “pull” of perceived military need the “push” of technological development – such as that in artificial intelligence and cyber capabilities – and of industrial interests.

Inevitably, the resulting Capability Development Plan is very widely drawn. An intensive exercise in consultation with member states and other stakeholders resulted in the identification of [11 EU capability development priorities](#) and [12 key technologies](#) in the medium term.

Examples of the 11 priorities are information superiority, ground combat capabilities, and air superiority. Each has a plethora of sub-capabilities, all of them identified – rightly, no doubt – as in need of attention. But as guidance, it risks amounting less to “fix these” than to “take your pick”. A similar criticism applies to the first two rounds of PESCO. Though these have launched 34 new cooperative projects, they are a mixed bag in their relevance to Europe’s most pressing military needs; to date, the selection looks more like “a hundred flowers blooming” than the product of careful landscape gardening. Unsurprisingly, an early [academic assessment](#) of PESCO implementation found that it has made little progress, due to a lack of prioritisation and lead nations’ often lax management of various projects. (The lead-nation model for running new collaborations was tried in the European Capabilities Action Programme of the 1990s; its failure was part of the reason for setting up the European Defence Agency, to shepherd such efforts. It seems that a reversion to “agency lead” for PESCO projects may be necessary.)

Of course, the new ecosystem needs time to bed down before it can reasonably be expected to achieve significant results. But it is for just that reason that, today, countries

that are members of both the EU and NATO tend to attach more weight to the latter's capability planning system. Thus, if Europeans are to achieve quick results in capabilities burden-sharing, they will have to do so in the context of NATO rather than the CSDP.

Moreover, today's CSDP does not look like a promising vehicle for demonstrating European burden-sharing in operational commitments. Only six of the 16 current CSDP missions are military and, of these, two are partly civilian while two others are naval. The early days of the CSDP, when Europeans were prepared to deploy a significant number of ground forces to dangerous environments in countries such as Chad or the Democratic Republic of the Congo, seem a long time ago.

Advice and training are now the mainstays of CSDP activity. And in kinetic operations – be it participating in US-led bombing of the Islamic State group (ISIS) or supporting France's anti-terrorist activity in the Sahel – European member states now prefer to operate in ad hoc coalitions. Last autumn, when the United Nations applied to Brussels – NATO in the first instance, but also the EU – for contingency preparations to extract its personnel from Libya, it met with a profound lack of enthusiasm. There could be no more telling indication of Europeans' reluctance to revive CSDP military operations than the fact that – some 15 years after it was first proposed and long after it has ceased to be a bone of transatlantic contention – the essential step of setting up a proper European Operational Headquarters has still not been taken.

The absence of a vibrant operational culture matters, for two reasons. Firstly, because it is energising: there is nothing like a whiff of avgas in the corridors to impart real enthusiasm to efforts to build capabilities and address deficiencies. Secondly, the lack of an operational perspective – and the steadily growing role of the European Commission in European defence affairs – risks focusing the enterprise too much on its industrial and technological aspects, to the detriment of the essential military purposes of defence budgets and armed forces. Certainly, the latest [American broadsides](#) suggest that Washington will need early evidence of the real military utility of European defence efforts if it is not to conclude that the new initiatives are just a new disguise for unfair European trade practices.

The point of these criticisms of the current condition of the CSDP is not to disparage recent progress. The European Defence Fund, in particular, has the potential to have a real impact on the long campaign to induce EU member states to integrate their defence investment efforts – thereby providing greater defence capability from their defence resources, and creating a stronger and, yes, more autonomous European defence technological and industrial base.

If, however, Europeans' overarching aim is to assume an increasing share of the burden of their own defence – and to demonstrate this in the capabilities they develop and the operational commitments they undertake – then the CSDP of 2019 does not

provide all the answers. The following sections of this paper propose two separate but complementary initiatives that could achieve this aim without expecting the CSDP to bear all the weight.

Strengthening NATO's European pillar

A distinct European pillar within NATO is an idea dating back to the last century – as French diplomat Jean-Marie Guéhenno [noted](#) in his 2017 article proposing its revival. Talk of a stronger “European defence identity” within NATO went nowhere in the 1990s because Europeans conceived bolder ambitions – the CSDP as, in effect, a successor to NATO – and because Americans feared that their leadership of the alliance would be undermined by the development of a separate European caucus within it. Neither issue remains relevant: NATO has not faded away as once expected, while the CSDP has not developed as its more enthusiastic proponents hoped; and Americans have come to care less and less about what Europeans do in matters of defence, provided only that they do something. The current US administration may be suspicious of European efforts to build their defence industrial capability, but it is hardly likely to object if Europeans volunteer to assume more of NATO's military burden.

Various timescales are relevant here. Most urgently, the extraordinary recent confusion over US deployments in Syria and Afghanistan has confirmed that Trump's instinctive priority will always be domestic political advantage, even at the cost of throwing allies under the bus. A precipitate, total withdrawal of US troops from Europe may seem a nightmare too far, but who can confidently discount a sudden, significant unilateral drawdown?

Some minimum residual American military presence on the ground is essential if the US security guarantee, with its ultimate foundation in the US nuclear capability, is to retain any credible deterrent effect: put crudely, Russia needs to understand that any attack on Europe must inevitably spill American blood. But it does not follow from this that the main burden of bolstering NATO's military presence in central and eastern Europe, as agreed at the 2014 NATO summit in Wales, must fall on the Americans. Nor does it follow that forward basing of allied forces is only of value if those forces are American.

European allies would, therefore, do well to reflect on the possibility that US support for the European Deterrence Initiative could go into reverse – especially now that Trump regards himself as exonerated of any “collusion” with Russia. Indeed, they should anticipate such a development – not by immediately offering to take over current US efforts, but by proposing to emulate them. The US leads one of the four multinational battlegroups that constitute NATO's Enhanced Forward Presence (roughly 1,500-strong multinational units based in Estonia, Latvia, Lithuania, and Poland, led by the UK, Canada, Germany, and the US respectively), and plays the lead role in the Tailored Forward Presence in the Black Sea region. In addition, the US is now continuously rotating an armoured brigade combat team comprising around 5,000 personnel through

countries covered by its Operation Atlantic Resolve (the three Baltic states, Germany, Poland, Hungary, Romania, and Bulgaria), and is prepositioning equipment to support two incoming US brigades. With its rotational combat aviation brigade (which comprises more than 2,000 personnel and almost 100 helicopters) alternating between Latvia, Poland, and Romania – and with American forces frequently conducting naval, air, and marine deployments and exercises in eastern Europe – the US has a presence, familiarity, and credibility in the region that its western European allies have never had. They should change this now.

Such efforts need not be limited to rotational deployments: Europeans should contemplate more forward bases of their own. Poland's Fort Trump idea is objectionable both because it heads the wrong way in asking more of the US and because it circumvents NATO. But it at least has virtue in its implicit recognition that the Wales summit erred in stopping short – out of deference to Russian sensitivities – of permanently stationing forces on the territory of former Warsaw Pact allies. Having just invaded Ukraine, Russia would have understood a more muscular NATO response; the Wales summit was to that extent a missed opportunity. Regrettably, this is unlikely to be the last occasion on which President Vladimir Putin presents the alliance with such a challenge. Next time he does so, European allies should be ready with plans to respond with forward deployments. Even a small “Fort Charlemagne” in Poland would be a powerful demonstration of European defence solidarity.

Even more immediately, and despite the uncertainties of Brexit, Berlin and London should urgently consider whether it is opportune to proceed with the planned withdrawal of the last major British combat unit in Germany (an armoured brigade) in 2019.

In the medium and long term, there are other considerations. Two American defence analysts recently [floated](#) the interesting suggestion of a European level of ambition within NATO. They argue that “NATO's current level of ambition is for the entire alliance to maintain the capabilities for collective defense against a near-peer competitor, in what is termed a Major Joint Operation-Plus (MJO+), or to conduct concurrently eight less demanding missions, two at the Major Joint Operation (MJO) level and six Smaller Joint Operations (SJO). Under a new European level of ambition, NATO's defense planners could be instructed to develop European capabilities needed to conduct one MJO and three SJOs for crisis management with limited or no American support. Alternatively, NATO's European members could commit to providing half the firepower needed to conduct an alliance wide MJO+.” As it happens, a new version of NATO's Comprehensive Political Guidance (the relevant alliance document) has just been agreed – so this suggestion may be too late to catch that train. But that is no bar to its adoption and implementation in future.

The great virtue of the idea is that it would link European capability development to the only system for setting defence priorities that, for better or worse, top European military

figures are currently prepared to take seriously. As argued above, most of Europe's chiefs of defence staff never really bought into the CSDP, regarding NATO (even in its period of political near-irrelevance) as the real gold standard of military planning. Military establishments across Europe are more likely to seriously consider a European level of ambition within NATO than CSDP capability guidance derived from the inadequate and unconvincing post-Global Strategy level of ambition. (This is even the case in Sweden and Finland – which, although they are not members of NATO, have a close partnership with the organisation.) And, critically, a European level of ambition within NATO would tie in important non-CSDP European states, notably Norway, Denmark, and the UK (assuming it leaves the EU).

Division of operational labour

As well as making a greater contribution to capabilities and forward deployments, Europeans should offer to relieve the US of some part of its operational burden, in areas where American involvement is not essential. Kosovo is a case in point. It was long assumed that here, as in Bosnia, responsibility for keeping the peace would in due course devolve to Europe. Yet the Kosovo Force remains a NATO responsibility, while the EU has progressively run down its rule of law civilian mission in the country. There is seemingly nothing to prevent the EU from volunteering to take over the Kosovo Force, not least since Europeans already provide its force commander and most of its 4,000 troops.

More ambitiously, Europeans could make plain their willingness to do more in Africa. America's tendency to feel that Europe could take greater security responsibility here, "in its own backyard", can be traced back at least as far as the Obama administration's pivot to Asia. Under Trump, the US has talked of withdrawing a significant proportion of the roughly 7,000 military personnel it has deployed in Africa. And the US is, for both financial and ideological reasons, attempting to reduce UN commitments on the continent – most recently, by vetoing UN support for the G5 Sahel Joint Force. The happy arrangement whereby Europe has [outsourced](#) much of its security interests in Africa to the UN and various regional organisations is, therefore, coming under increasing strain. Given the inescapable nature of Europe's strategic interests in Africa – as a source both of many natural resources it lacks and of migratory pressures on its southern border – greater European investment in African security and stability is probably inevitable. Europe would be wise to anticipate this shift and make a virtue out of necessity. Better that, after all, than to face demands to backfill for the US in Afghanistan or Syria.

These arguments may raise several objections: is this not just an appeal for a return to the old CSDP crisis-management agenda that the EU now seems to have moved away from? And how would such a focus for European defence efforts help the development of the high-end, war-fighting capabilities that strategic autonomy and the combination of Russian revanchism and American unreliability demand? Are Europeans not going

back to objectionable suggestions that their role is just armed policing, leaving serious military operations to the US?

A division of labour narrative certainly suggests that Europeans will have to put more into the promotion of African stability and security through capacity-building – i.e. bolstering local forces – and greater recourse to their chequebooks. But these uncontroversial steps could and should be complemented by greater European operational activity. And, if the EU does not currently look like a conducive forum in which to discuss and prepare for such activity, then the right answer must be to do so among like-minded Europeans outside the EU framework.

Of course, this is exactly what the European Intervention Initiative has been set up to do. Naturally, it will be up to its participants to determine the direction of work under the initiative. But one obvious option would be to concentrate on the sort of operations that Europeans traditionally undertake. From the Balkans in the 1990s to Libya in 2011 and anti-ISIS operations more recently, this means air campaigns.

Thus, an obvious move would be for relevant member states to form a European Air Intervention Group, to plan and exercise the conduct of future such operations without relying on NATO or US assets. To be sure, this would be a virtual group, as any sort of standing force would be unaffordable and would undermine NATO. But willing Europeans could gain much from planning together how best to constitute an effective air intervention force – without having to fall back, as in the Libya campaign, on NATO or US command and control, air tanking, and smart munitions. Collective exercising would flush out interoperability problems and highlight capability deficiencies, including those in intelligence, surveillance, target acquisition, and reconnaissance; electronic warfare; and the suppression of enemy air defences. Such an Air Group could also usefully consider what it would take to mount sustained no-fly operations of the kind the West should have imposed on the Assad regime before the Russians became involved in the Syrian conflict. It might even provide the framework, in due course, for common air-policing of European airspace. Today, this may seem a far-fetched notion – but, then, so did the idea of a common European coastguard when it was first floated, in the early days of the EDA.

Formation of a European Air Intervention Group would also be an uncontroversial way to address some of the key challenges associated with territorial defence – and thus to start hedging against the possibility of one day having to fight the Russians without the Americans. Russia has greatly improved its capabilities in the past decade, particularly in anti-access/area denial: its long-range precision strike and air defence systems would hamper NATO efforts to counter a sudden Russian attack through rapid reinforcement and the establishment of air superiority. There is no doubt that Russia would eventually lose a conventional war with NATO. But war-gaming [suggests](#) that these anti-access/area denial capabilities, together with advantages of surprise and force concentration,

could leave NATO unable to prevent Russia from reaching Tallinn and Riga within 60 hours of opening hostilities.

As Russia exports these new capabilities, particularly the S-400 air defence system, anti-access/area denial challenges proliferate. A European Air Intervention Group that considered how to deal with them in, say, a Middle East intervention scenario would highlight some of the most critical capability gaps that a Europe bent on greater autonomy in territorial defence should prioritise.

An unwelcome reminder: The nuclear dimension

For Europeans, perhaps the most unsettling part of greater self-reliance in defence is the requirement to think again about nuclear deterrence. Since the end of the cold war, the subject has largely dropped out of the public – and, indeed, official – consciousness. And that, of course, is how Europeans like it. A recently published [ECFR survey](#) of attitudes towards nuclear deterrence confirms a widespread determination among Europeans to approach the issue with their “eyes tight shut”. But any serious debate about European strategic autonomy has to face up to two profoundly unwelcome and dangerous developments.

The first is the palpable shift in Russia’s attitude towards using a nuclear weapon against NATO. The country’s modernisation of its armed forces, and its increasing willingness to use them, has in the past decade been accompanied by a growing emphasis on nuclear use in Russian military thinking and exercising. Taken together with its development of a slew of new nuclear weapons (at least one of which breaches the INF Treaty) and its deployment of dual-capable missiles in Kaliningrad, the scenario with which this paper opened can no longer be dismissed as wholly fanciful. Russia may deny that it has a formal “escalate to de-escalate” doctrine; but its [embrace](#) of this concept seems clear and poses a specific threat that, after achieving rapid early success with a drive into the Baltic states, Russia could aim to freeze the situation with a single nuclear strike against, say, a key NATO reinforcement node in northern Poland. How confident can Europeans be that Kremlin hawks will view the benefits of such a strategy (not just territorial gains but also, in effect, psychological mastery over Europe) as not worth the risk of an increasingly improbable American nuclear response?

Secondly, Russia’s deployment of a new intermediate-range nuclear missile in breach of the INF Treaty, followed by Trump’s renunciation of the treaty, means that, however reluctant Europeans may be to acknowledge it, the Euromissile Crisis is back. Only this time, the White House is occupied by a president who has so little regard for his European allies’ interests that he did not warn them of his intentions beforehand. And it could be as little as two years before Washington proposes to deploy a new dual-capable ground-launched cruise missile in Europe.

These developments now require Europeans to start thinking hard about nuclear issues again – loath though they may be to do so. Firstly, they must find a way to agree on how they will approach the INF Treaty crisis, with all its implications for not just the continent’s security but also the future of global arms control. Trump’s [recent announcement](#) of new plans for missile defence, which involve the militarisation of space, chucks another huge rock into the strategic pool. Europeans who accept responsibility for their future security cannot simply close their eyes to these developments.

Beyond this, they need to revisit the old question of whether and how Europe should develop its own nuclear deterrent capability. For, as then French president François Mitterrand’s Defence White Paper expressed it in 1994, “with nuclear power, Europe’s autonomy in defence matters is possible. Without it, it is excluded.” The ECFR report referenced above discusses the “Euro-deterrent” issue in some detail, concluding that the ultimate answer must be for France and the UK to offer extended deterrence to their European partners and neighbours – and for these partners and neighbours to welcome, support, and engage with it. The ultimate model for this is current NATO arrangements for risk- and responsibility-sharing with the American deterrent.

The difficulties with, and objections to, such a course are obvious. And any such development would take years to accomplish. But Europeans should take the first steps now. Broadly, France and the UK should tighten their nuclear partnership and develop their declaratory policy, to make it increasingly clear that they see their partners’ “vital interests” as coterminous with their own. They might also (as suggested in [another recent ECFR report](#)) give thought to developing a new dual-capable, air-launched cruise missile. Meanwhile, other European countries should re-engage with nuclear issues, relearn the grammar of deterrence, and renew strategic thinking that they have been only too happy to outsource to others since the end of the cold war.

Filling the strategic void

The last point above – the need to re-engage in serious, collective strategic thinking, as opposed to waiting to be told what to do by the Americans – may be the single most important step towards a Europe that is significantly more capable of defending itself. Such a Europe is more likely to survive the twenty-first century as a protagonist rather than prey.

The dilemmas that this paper has addressed persist largely because Europeans lack the institutional and political capacity to think strategically about their shared geopolitical situation and future. Neither the European External Action Service nor the various European Council formations have the bandwidth to deal with both the fundamentally important and the pressingly urgent – as recently underlined by the hijacking of the scheduled discussion of China policy at the March 2019 EU summit by the latest twist in the Brexit crisis. From time to time, the EU recognises and responds

to this deficiency through a one-off exercise such as the 2003 European Security Strategy or the 2016 Global Strategy. Both worked well. But between such efforts, collective strategic reflection lapses, centrifugal tendencies reassert themselves, and – in the absence of the time or mechanisms needed to address crucial but slow-burning issues – the default option has been to outsource the continent’s strategic thinking to the Americans.

Nuclear issues are perhaps the toughest and most controversial matters that a Europe with aspirations of strategic autonomy must find a way to grapple with. But they are hardly the only ones. After almost two decades of involvement in Afghanistan, it might be time for Europeans to take collective stock of what has been achieved and at what cost, and to consider whether their individual and collective interests are still best served by treating their engagement in that country as simply a tribute they must pay to Washington. The rising military power of China, marked by its ever-growing global reach and increasingly belligerent attitude towards Taiwan, is another issue that a Europe that aspires to take greater responsibility for its own security cannot ignore forever.

Presumably, it is this vital missing element in any serious European efforts to take control of their collective destiny that has prompted German Chancellor Angela Merkel’s recent references to the need for a European Security Council. It may also be what French President Emmanuel Macron had in mind when he [echoed](#) the call for such an institution in his recent, widely published “address to the citizens of Europe”.

Fundamentally, however, Europe’s strategic vacuum may owe as much to psychology as it does to institutional or political shortcomings. After all, it is easier to fall in with Washington’s world view than to conduct the sort of European debates that must inevitably expose transatlantic and internal differences. The old fault lines between Europeanists and Atlanticists run deep, and have recently been overlaid by profound differences in strategic outlook – not least between those who look east and those who look south. When some member states see Russia as an existential threat while others view such fears as little short of paranoia, and when some regard turmoil in the southern neighbourhood as something requiring proactive management while others see no need for anything but fences, the temptation to despair of any possibility of agreement, and to leave the leadership responsibility to America, is understandable.

Understandable, but fatal – and unnecessary. The EU would never have got anywhere if it confronted only issues on which there was unanimous agreement. What has ensured progress has been the habits of solidarity and compromise – a readiness to expose and ultimately accept differences in outlook and priority, and then to strike deals that may not totally satisfy anyone but leave everyone better off than they were before.

So it is with the imperative of building Europeans’ capacity to defend themselves. Proposals to strengthen the European pillar of NATO in terms of force deployments

and capabilities, and to offer the US some level of operational burden-sharing through a division of labour, will inevitably leave different European constituencies feeling that one or other initiative is misdirected, even retrograde. But they should embrace both, in the recognition of the fact that collective progress towards a safer and more autonomous Europe is possible only with efforts to address the security priorities of all.

Uniting Europeans around a shared defence agenda

Europeans' deteriorating security environment demands that they develop greater self-sufficiency in defence. This will require the right political narrative; a stronger European defence technological and industrial base; an effective way of focusing on agreed capability priorities; a revived operational culture; and a renewed readiness to confront the most uncomfortable strategic issues, including nuclear deterrence.

The right narrative is one of fairer burden-sharing with the US – but with the emphasis not on inputs (money) but outputs (capabilities and operational commitments). This narrative can unite Europeanists and Atlanticists, both hedging against US disengagement and making it less likely.

The recent revival of interest in the CSDP is encouraging. But, at least initially, it will do more for the industrial agenda than for joint capability development. Improvements in readiness and force posture in eastern Europe should be pursued in the NATO context; and European allies should declare a challenging collective level of ambition for their share of future NATO capabilities, thereby strengthening NATO's European pillar and building European conventional self-sufficiency.

Europeans should also propose a burden-sharing division of labour with the US whereby they revive their military activities – taking over the Kosovo mission and assuming greater responsibility in Africa. The European Intervention Initiative should compensate for the de-operationalisation of the CSDP; the formation of a virtual European Air Intervention Group as part of the initiative would both prepare for the most likely future European interventions and bring some key future capability objectives into focus.

Europeans' biggest challenge may be to start thinking for themselves, together, about the big, uncomfortable strategic problems they face. Creating a European Security Council may help with this. Immediately, these problems include the recent body blows to the global arms control regime. The future of nuclear deterrence in Europe must follow, in due course. And persuading today's strategically divergent Europeans to converge on a shared, multi-stranded, and multi-institutional approach to building European defence capacity should be the first order of business.

Protecting Europe against hybrid threats

Summary

- Geopolitical rivals to Europe are increasingly incorporating hybrid threats into their armouries – and deploying them.
- This amorphous set of threats exists below the level of war, enabling other powers to exploit existing societal divisions and sow confusion and instability.
- To deal with hybrid threats on their own, EU countries will need to more thoroughly investigate such hybrid activities – and go public with their findings.
- Europe should pursue a ‘dual track’ approach of confrontation followed by dialogue with unfriendly cyber powers.
- EU member states should also jointly invest in offensive cyber capabilities within PESCO, expand Europol’s remit to include counter-intelligence, and improve personal cyber hygiene standards in government and among citizens.

On 12 October 1983, Ronald Reagan signed off the top secret National Security Decision Directive 108 on “Soviet Camouflage, Concealment and Deception”. The document bluntly stated that:

The Soviet Union has developed a doctrine of “maskirovka” which calls for the use of camouflage, concealment and deception (CC&D) in defense-related programs and in the conduct of military operations. They define maskirovka as a set of measures to deceive, or mislead, the enemy with respect to Soviet national security capabilities, actions, and intentions. These measures include concealment, simulation, diversionary actions and disinformation. A Soviet Directorate for strategic maskirovka has been established ... Several recent discoveries reveal that the Soviet maskirovka program has enjoyed previously unsuspected success and that it is apparently entering a new and improved phase.

This quote could easily come straight from a defence white paper of an average NATO member state in 2019. Europe’s current geopolitical circumstances are not the first in which it has had to face threats of a “hybrid” nature. They are unlikely to be the last.

The situation may not be wholly new, but it is certainly strained nevertheless. After a decade of economic crisis, Europe’s political systems are worn out. Relations are worse than usual among some of the European Union’s member states, between Europe and the United States, and between social groups within member states. And it is now cheaper

and easier than ever for those wishing to exacerbate those cleavages to do so through cheap social media adverts, a few bots, and a handful of hacks – all backed up with some shady finance schemes. Without relying on the US, can Europe really be sovereign in the face of hybrid threats? This paper assesses how and to what extent the states of the EU can deal with such threats if they have to act alone.

From Trojan horse to Trojan malware: What are ‘hybrid threats’?

The term ‘hybrid threats’ has doubtful conceptual value. Various definitions have attached themselves to it, and other terms compete with it too, such as ‘non-linear war’, ‘asymmetric conflict’, and ‘subversion’. But, in short, ‘hybrid threats’ refers to the use of state-sponsored, but not officially affiliated (deniable), actors that do not resort to physical violence. The purpose of hybrid threats is to coerce the object of a threat into complying with the aggressor’s strategic interests. There is an implicit warning of the use of force behind such threats. As one EU member state official with the newly bestowed title of “ambassador for hybrid threats” recently told the European Council on Foreign Relations: “There is no such thing as a ‘hybrid threat’ [on its own]. Hybridity comes into play when threats from various policy fields are fused together.”¹

Hybrid tricks have been used throughout history, from the Trojan horse devised by Odysseus to the Trojan malware written by hackers today. Indeed, even periods of peace are ‘hybrid’, punctuated as they are by assassinations, corruption, spying, disinformation, manipulation, and economic pressure. Public debate about hybrid threats concentrates on fake news, information warfare, and social media manipulation. This attention is understandable: fake news is the most visible element of a hybrid campaign. But states’ means of using undisclosed and unattributed assets to weaken their adversaries go far beyond these elements. And disinformation is rarely an end in itself, but rather a preparatory stage for further subversive action. Extensive intelligence, conspiratorial, and subversive efforts can weaken an opponent’s society in a way that allows a foreign power to enter and take advantage of the situation. Most western Europeans were surprised by the speed and determination of Russia’s hybrid war against Ukraine, but they would not have been had they witnessed the extensive subversive effort Russia made in pre-war Ukraine. Russia’s destabilisation of Ukraine eventually culminated in the invasion of Crimea. That direct action, with Russian deployment of ‘little green men’, retained the characteristic of deniability. That said, non-direct action remains the principal manifestation of hybrid threats – although its use by powerful players such as Russia contains within it the latent threat of potential follow-up violence.

Europe today: Fertile territory for hybrid threats

The EU today provides several opportunities that external adversaries can exploit. Three main factors matter: the changing post-cold war geopolitical environment; technological and legal vulnerabilities inherent in globalisation and the common market; and a post-historical zeitgeist still prevalent in Europe that does not accept that subversion, let alone direct military action, is a threat to the European way of life.

¹ Telephone interview, 7 February 2019.

In the 1990s Europe was largely surrounded by reforming states or infant democracies preoccupied with their own transformation. Now, the continent neighbours ambitious powers that seek to project both hard and soft power in Europe. Many of them work with anti-system forces in Europe as well. This power projection can have a variety of aims, including that of spreading states' repressive instincts and ideologies to Europe, which may involve silencing, suppressing, or even eliminating dissidents residing there. Such states may also want to control the narrative on their domestic developments through information operations targeting emigrant communities, but also by gaining control of cultural and religious organisations. In Europe, Russia is the best-known actor in these respects, but Turkey and Iran are also active. Saudi Arabia's influence operations concentrate on the US, but some of them are visible in Europe.

Another development is the rise of China and the increasing assertiveness of its state apparatus. While Chinese influence operations are less visible than Russian ones, Chinese economic espionage is very active; China sees Europe as a softer target than the US. It concentrates on launching skilled cyber attacks against industries and research facilities, but its programme also encompasses strategic investments in key technology industries.

As these changes have taken place, the EU's digitalised economy and increasingly open and interconnected society have provided hostile foreign actors with a wide range of attack points. Digital infrastructure – from military communication to 5G transmitters, to voting machines – enables hostile actors to successfully access an increasing amount of data and intelligence. Attack points are increasing in number, with the coming of the internet of things – with Alexa speakers, WiFi-activated lights, and smart thermostats used by European ministers and Uber drivers alike. Non-state cyber criminals will make use of these vulnerabilities, but hostile states can also exploit them.

Europe's increased vulnerability to hybrid attacks is not a risk inherent in technological progress and globalisation: it is a matter of choice. Europe has settled on a *laissez-faire* approach to these issues. Both Europe's public and political elite alike have largely developed a Fukuyaman, end-of-history world view that does not measure up to the harsh global and regional reality Europe faces. The wars in Ukraine and Syria have made some small dents in this world view, but most Europeans remain fundamentally untroubled by the dangers swirling around them. Despite modest increases in recent years, European overall defence spending has only returned to 2008 levels.

All this is reflected in Europe's political culture, which remains one that very much seeks resolution through dialogue rather than confrontation. As a result, when confronted with geopolitical bullying – such as through hybrid threats or hyper-aggressive intelligence action – European governments' first instinct is that patient engagement will resolve issues. The option of a strong response is deeply uncomfortable for the public and politicians in most of the EU.

Fundamentally, the flipside of Europe's diversity and openness is that it retains a patchwork of approaches to hybrid threats. There are huge differences between the urgency, importance, and methods with which European countries combat these threats. For some states, and even political parties, taking these threats on is a full-time

state activity; for others, ‘hybrid threats’ is a temporarily fashionable term peddled by geopolitical scaremongers. Thus, resources, competencies, and political choices focused on hybrid threats vary wildly across the EU.

The EU’s role

Parts of the EU’s machinery have been very active on these matters, but it still lacks a holistic approach to them. In recent years, new communications, laws, strategies, task forces, funding, and member state working groups have emerged to bolster the EU’s security and resilience. For example, in 2017 the EU set up a Cyber Diplomacy Toolbox. The EU’s cybersecurity agency, the European Union Agency for Network and Information Security (ENISA), is set to receive a revamped, and stronger, mandate. Speaking to ECFR, one senior European official dealing with cybersecurity characterised ENISA as “frankly, a think-tank”.² Even with the revamp, it will remain a tiny agency by any standards: the number of staff it employs is set to rise from 84 to 125, and its budget is set to increase from €11m to €23m, over the next few years.

This process has been somewhat reactive and still lacks high-level political leadership. One senior member state diplomat has remarked that: “The EU Council and member states’ response to hybrid threats in Brussels have been mostly driven by the Skripal affair. The Commission has been doing a lot of work on cyber and the security union. The [European External Action Service] has done plenty of good things on the working level – good action plans, task forces, conceptual work. But Mogherini does not want to touch the subject. And there is little sense of coordinated and strategic work on the matter. And many think [it is] just another irritant on the agenda of EU-Russia relations.”³

Increasing adhocism accompanies this incremental institutional progress – which takes the form of coalitions of the willing cobbled together on a case-by-case basis, beyond the realm of EU bodies. These developments point to a lack of ambition for a more coordinated EU-level response. This is especially the case on the most threatening hybrid attacks. For instance, diplomatic expulsions over the Skripal affair took place outside the EU framework. And so did public attribution and indictments against Russian operatives who tried to hack into the Organisation for the Prohibition of Chemical Weapons (OPCW). When that incident became public, non-EU member states such as New Zealand, Australia, Canada, and the US released statements in support of the Netherlands that were more forceful than those from half a dozen EU member states. And this was despite the fact that the OPCW headquarters is located in EU territory. One senior EU official recounts excruciating meetings in which some member states stonewall others when they try to obtain support to attribute attacks to state-backed hacking groups. This is despite reams of cyber forensic evidence and intelligence assessments.⁴

Some EU member states that acknowledge hybrid threats as a major priority have appointed special ambassadors or created dedicated units within the government or their foreign affairs ministries, to coordinate responses to these threats. Among them are Sweden, Finland, Poland, Lithuania, and Spain. This list suggests a particular concern with

² Interview with EU official, Brussels, 12 March 2019.

³ Telephone interview with EU member state diplomat dealing with hybrid threats, 25 January 2019.

⁴ Interview with EU official, Brussels, 12 March 2019.

Russia. Spain is a geographic outlier but, as one European diplomat explains, the 2017 independence referendum in Catalonia forced Spain to rapidly prioritise hybrid threats.⁵ The biggest EU countries, France and Germany, have not really internalised the notion of hybrid threats yet, but both have been seeking ways to respond to them. States such as Austria, Hungary, and Italy do not yet appear to be much concerned with hybrid threats.

Overall, despite increased EU and member state activity on cyber issues, a lack of coordination and leadership from the top means that hybrid attackers continue to have diverse opportunities to conduct operations. Some of the EU's external competitors are less than fearful of its efforts. Vladimir Putin's special representative on information security has compared Russia to a cyber elephant and the EU to a small, irrelevant barking dog. So, the question for Europe concerns how it can build up its capacity to resist hybrid attacks, while also adopting a foreign policy posture that is not simply defensive but actually contributes to a gradual reduction of the threats directed at it.

Intelligence agencies and hybrid threats

Intelligence activities are central to efforts to combat hybrid threats: intelligence agencies are usually the first to do everything from tracking cyber attacks to identifying foreign funding for violent anti-system forces. Other investigative forces, such as police and prosecution services, rely heavily on them. However, a multiplicity of actors is involved in intelligence: the military, the police, national intelligence services, national cybersecurity agencies, private companies (which also have cybersecurity obligations), media actors, NATO, the EU, Europol, and ENISA.

This institutional hotchpotch is mirrored by a wide variation in national bureaucratic security cultures. One official working on this subject outlines the challenge in the following way: "Hybrid threats come from outside the EU, but the way you combat it is through institutions that deal with domestic issues – police, media watchdogs, education systems, border guards, anti-corruption watchdogs."⁶ However, it is not just, or even mostly, the proliferation of agencies and actors that had created the EU's inadequacies in this area. A lack of political leadership is also responsible. The same official adds that: "the [agencies] don't have the culture and often the desire to be combating external threats. Especially because some of these threats are certainly no good, but they are not illegal: fake news, conspiracy theories, trying to influence history narratives or manipulate identity issues and feed culture wars is not illegal. Quite the contrary. They often are part and parcel of domestic political practices." Aggressors take advantage of this legal patchwork by picking the jurisdictions with the weakest regulations as bases from which to conduct operations in other countries.

A basic lack of resources is also a major problem. There are few fields in which Europe as a whole is so dependent on American support, and where the discrepancies between the haves and have-nots within the EU are as great, as in intelligence. Today, only the United Kingdom and France have the requisite legal frameworks and capabilities to conduct intelligence and counter-intelligence operations in all spheres. And there are many strands to this:

⁵ Telephone interview with an EU member state diplomat, 11 March 2019.

⁶ Telephone interview with EU member state diplomat, 11 March 2019.

- Strategic intelligence: predicting or anticipating the moves and interests of other countries' leaderships, as well as their decision-making preferences.
- Operational intelligence: detecting, identifying, and monitoring the enemy's operational assets (including diplomatic, economic, military, and paramilitary assets) and anticipating their moves, orders, operational priorities, and use of tactical means (such as troops, money, and propaganda).
- Signals intelligence: intercepting the enemy's communications before decrypting and analysing them to gain access and insight into its command-and-control processes.
- Electronic intelligence and corresponding intelligence on other emissions and signatures: collecting emission fingerprints (signatures) of enemy weapons systems, sensors, platforms, and communications systems to detect their deployment and activity, work out their capabilities, and find ways to intercept, decrypt, deceive, or defeat them.
- Counter-intelligence: detecting, monitoring, and foiling the enemy's attempts to gather intelligence on oneself in all the areas mentioned above.

After the end of the cold war, European armies refocused on expeditionary warfare and asymmetric threats. Most intelligence services went through a similar adaptation process. Hostile sub-state groups, terrorist networks and radicalised individuals – rather than hostile state actors – became intelligence services' main focus. While this was necessary, state actors have made a comeback in recent years.

Currently, most European intelligence agencies rely on human intelligence – people with personal knowledge of foreign decision-making processes – to tell them what is going on in other countries and anticipate the moves of these states. They do not have a chance to validate – or invalidate – this intelligence through other sources, particularly signals and electronic intelligence. This means that they do not know whether their intelligence is accurate and, therefore, whether they should act upon it. In addition, European intelligence efforts are often confined to operational intelligence in theatres close to Europe (such as north Africa and the Balkans), where European troops and foreign assistance programmes are at risk. Only a few European states are capable of systematically developing sources in countries such as China, Iran, Russia, Saudi Arabia, and Turkey to gain insight into what their governments and bureaucracies are up to. For most other states, strategic intelligence is little more than guesswork.

Yet even the EU's best-equipped intelligence services are not equal to those of the US or China. They still rely on cooperation with the US to safeguard their countries' interests. For some European countries, this dependence is particularly great. Indeed, the truth is that most European states would not be able to prevent terrorist attacks without intelligence provided by US agencies. Most European states have effectively outsourced intelligence to their US ally, enabling them to make out that they have not engaged in activity their citizens may dislike but nevertheless benefit from.

Current 'hybrid threat' policy challenges

Despite creating a series of strategies to combat hybrid threats, Europe's response to the issue is generally still in the thinking, rather than acting, phase. Several ongoing policy debates are illustrative of the divergence between European countries' views, and of the reluctance to decide how to deal with the regulatory and administrative consequences, of such threats. These debates include those on how to deal with Russian election interference, how to respond to Russian cyber attacks, and whether to use Kaspersky and Huawei products.

Russia and election interference

Europe lacks a unified understanding of the level and scale of Russian attempts to interfere in European electoral processes and referendums. Most Westerners assume that Russia has indeed tried to influence some elections. By now, most European and American citizens know much more about the exact scope, techniques, and even operators that tried to influence the 2016 American presidential election than about any Russian interference in European elections and referendums. In the US, the Mueller investigation has helped publicise evidence of the Russian effort to influence the presidential election. So far, 25 Russian citizens involved directly have been named. Their indictments give specific and credible details of names, procedures, and money flows. Even Russia seems to no longer dispute these activities. In this sense the US has made more progress than Europe has in understanding the exact nature and scope of Russia interference. This is despite the fact that, in all likelihood, the Dutch informed the US of Russian cyber intrusion into the presidential election early on.

In Europe, while there is much talk about Russian interference in European elections, a lack of proper investigation into these activities means there is also much scepticism about the reality and scale of such interference. Sections of the European public and political elites see Russian attempts to influence elections everywhere. Equally large sections of the public and political elites do not see them anywhere. The discussion on both sides is often speculative.

The activity of Russian state-backed news outlets such as RT suggests that bodies linked to the Russian government at least play a role in seeking to shape European domestic opinion. RT appears to support whatever destabilises European politics at any given moment: referendums in Scotland and Catalonia, *gilets jaunes* protests in France, and the activities of populist parties across the continent. This is all in plain sight.

In a recent analysis of 24 million Brexit-related tweets, cybersecurity company F-Secure concluded that there had been systematic, often automated, efforts to boost pro-Leave groups from abroad. Many pro-Brexit Twitter accounts have also been active in supporting the *gilets jaunes* protests in France. In countries such as Georgia, Poland, Romania, and Ukraine – each of which has a reasonably strong anti-Russian political consensus – Russian information operations have mostly focused on promoting anti-EU and anti-NATO sentiment and 'neutralism', or equidistance between Russia and the Western alliance.

However, it is unlikely that Russia is involved in every disinformation campaign that takes place in Europe. In some of these campaigns, Russian disinformation activities have been absent or modest, or have paled in comparison to local political parties' manipulation of the media. For instance, when [Facebook took down 168](#) accounts trying to influence elections in Moldova, most of the accounts were local, not Russian. The Macedonian referendum held in September 2018 also attracted claims of Russian interference. But none of the multiple political players ECFR asked about this on a visit to Skopje during the campaign – from the prime minister to political party operatives and pollsters – had seen a massive Russian operation to sway the vote. And Donald Trump, Brexiters, and the French far right have had much greater success than RT or Russian trolls at spreading fake news and conspiracy theories.

European countries' law enforcement agencies and parliaments have barely even begun any sort of systematic and detailed attempts to untangle myth from reality in Russian attempts to influence European elections and referendums. This allows intra-European mistrust to grow. Even states with similarly critical views of Russia do not entirely trust each other on this question, underlining the difficulties of forging a unified understanding of the threat. For example, one Nordic diplomat interviewed for this paper was convinced that the UK's Conservative Party had deliberately stonewalled a full investigation into the Russian role in Brexit because this would have been embarrassing for it – as the champion of Brexit. If they aim to devise policies that strengthen their sovereignty, European countries must gain a coherent shared understanding of the threat that Russian interference poses to their domestic politics.



Russia Today on Twitter and Facebook – Europe

| Branch | Twitter | Facebook |
|---------------|-----------------------------------|-----------------|
| RT in Spanish | 516,000 tweets; 2.95m followers | 7,033,759 likes |
| RT in English | 288,000 tweets; 2.7m followers | 5,425,677 likes |
| RT in German | 55,600 tweets; 42,800 followers | 389,408 likes |
| RT UK | 37,900 tweets; 83,900 followers | 351,033 likes |
| RT France | 109,000 tweets; 112,000 followers | 967,116 likes |

Data reviewed on 14 January 2019

Russian intelligence

Russia's interference in European elections has primarily been an issue of disinformation, igniting a controversial debate on media standards and political accountability of internet companies – Facebook and Twitter above all. But the issue of how to deal with Russian intelligence operatives is even more explosive for European cohesion. For example, after the Skripal attack, EU member states Austria, Cyprus, Greece, Hungary, Slovakia, and Slovenia did not expel Russian diplomats. This led to a discussion on solidarity among EU states such as the UK – having witnessed a Russian-sponsored chemical attack on its soil – wanted to send as strong a message as possible. The Austrian government's explanation of its reluctance to expel diplomats – that it should not take sides but serve as a "bridge" between east and west – further irritated other European governments, as it suggested an equivalence between an external aggressor and the EU member that had been targeted.

The activities of Russian intelligence services increasingly pop up in public security debates. In some cases, the known activities of Russian operatives involve classical espionage. In others, their activities hint at much more robust subversive aims: cultivation of anti-system forces, the purchase and preparation of infrastructure for future military incursions, training for paramilitary resistance groups, and the assassination of perceived enemies. These actions are top-tier covert actions. One may assume that other actions that provide the basis for this sort of activity – such as strategic reconnaissance, cyber penetration and espionage, excavation of data, the placement agents in positions of power, and reconnaissance of critical infrastructure – have progressed as well. Europe has a mixed record of disrupting these preparations.

While EU member states on the eastern flank have adopted very robust counter-intelligence laws and invested significant resources in monitoring Russian operatives, other states are more reluctant to do so. France has the legal framework for such action, but counter-terrorism is its first priority. Germany and Austria – both countries that were under Allied supervision and occupation after 1945 – have comparatively weak laws, and their decision-makers maintain a 'hands-off' mentality. In the past, bilateral cooperation with US services addressed these imbalances. As a legacy of the post-war situation, US and British services have the right to engage in counter-intelligence work in Germany. And Berlin, which has historical issues with counter-intelligence, has been happy to outsource this politically toxic work. In doing so, Washington – and to a lesser extent London – became an external balancer in intra-European affairs. And while the Trump administration and its sometimes erratic personnel have significantly undermined confidence in the US government, the US intelligence community has remained much more stable and able to preserve working contacts throughout Europe. But if relations with Washington deteriorate further, there is no tangible policy or political actor that could replace the US.

Kaspersky and Huawei

What should Europe's defence and foreign ministries, intelligence services, and telecommunications giants do about Kaspersky's anti-virus programmes and Huawei's telecommunications equipment? Are companies such as these a potential conduit for the

collection of intelligence and data by foreign powers? Can they hold critical infrastructure in the EU hostage in the event of a major crisis between Europe and Russia, or Europe and China? These two companies currently find themselves in the eye of a political storm, but there are likely to be similar controversies involving other non-EU companies as well. These could include ZTE, Xiaomi, Lenovo, data centres around Lake Baikal, or even Uber-style taxi services such as Yandex Taxi.

The European Parliament has already singled out Kaspersky and called for a ban on malicious cyber products. The UK, Lithuania, and the Netherlands have followed the US in banning Kaspersky software from government agencies. Lithuanian officials have been advised against using Yandex Taxi, for fear it would transfer personal data, including location data, to Russian state structures. Others disagree, however: Belgium, Germany, and Interpol have given Kaspersky anti-virus programmes a clean bill of health.

Even within countries, approaches can differ. Several years ago, Kaspersky won a tender for the French ministry of defence. Now, the ministry is weaning itself off Kaspersky anti-virus products, gradually replacing them with anti-virus software from British and Japanese companies. At the same time, the head of the French National Cybersecurity Agency seems more sanguine about Kaspersky. In his view: “Kaspersky is clearly in the centre of a conflict pitching the Anglo-Saxon world against Russia.”

Anti-virus programmes can at least be used under controlled conditions, or easily replaced in what is a competitive market. States disagree on whether Huawei equipment could be used to spy on or disrupt entire telecommunications sectors. Some, such as France, have been sceptical of Huawei for years, while others, such as the UK, have been more welcoming.

Huawei participation in the deployment of 5G mobile networks has become a political hot potato and a source of diplomatic tension and political rows between the US and some European countries, within governments such as those of Italy and the UK, and between private sector companies and governments. There are new twists in the Huawei story every week in Europe.

Another problem is that, even if EU institutions and some European governments were ready to engage in more forceful diplomacy with China over cyber espionage, many, if not most, affected companies and some other countries do not even want to talk about the problem, let alone act against it. This is due to fear of Chinese retaliation and a potential loss of access to China’s markets.

The issue of European sovereignty in software and hardware is not confined to questions around Russia and China. For instance, take the case of Palantir, a US software company that is widely used by law enforcement agencies and intelligence services for big data analysis. French members of parliament have raised questions about Palantir. One asked the chief of the French cybersecurity agency the following question: “The software of Palantir, a company linked to the CIA, is used by the general directorate for internal security since 2016 to analyse billions of units of online data. Is it technically possible to disconnect from Palantir? Would it be possible to replace it?”

The agency director responded: “I confess I do not understand why we are not capable of creating a European Palantir. I think this is achievable. If we give up analysing data ourselves, we will be condemned to be data vassals.”

As with the question around Russian interference in elections, the use of Kaspersky and Huawei, or even Palantir, demonstrates that Europe has not even begun to agree on what the problem is. Hundreds of technical experts have been looking into these companies’ performance, and they have reached no consensus. And, were a significant number of EU member states to agree to prevent these companies from operating altogether, it would remain unclear how they should go about this. A failure to resolve these issues could put at risk cooperation and exchanges between intelligence services or military services if they did not trust each other’s anti-virus software and telecommunications gear.

Cyber attacks

Cyber threats have increasingly moved beyond financial theft, cyber criminality, and intelligence collection into much more aggressive actions designed to shape national debates, referendums, and elections in European countries. According to Europol, a growing share of these attacks are the work of state-supported hackers, rather than just criminal cyber syndicates or bored teenage hackers working from their bedrooms. And there continues to be a lack of preparedness for this on the part of EU and member state institutions. ENISA states that: “Should a crisis arise from a large-scale cyber incident, Member States would lack a harmonised framework to effectively respond to the challenges posed by this incident.”

France and fake news

Fears of combined cyber and information attacks are driving some countries to patch up their electoral practices. Anti-fake news campaigns, laws, and other efforts are under way in several EU countries. France is a relevant case in point. “MacronLeaks” was an attempt to influence the French presidential election in 2017 by hacking and dumping information from Emmanuel Macron’s campaign headquarters. This attack was attributed to Russia. The attempt largely failed not just to influence the campaign, but to even get traction in the media and the wider public. One key reason that it failed was because there was no well-oiled transmission belt connecting the darker corners of the internet, where the hacked information was posted, to the wider public. No major French media outlets reported details from the dump, and whoever wanted to spread disinformation had no network of French Twitter or Facebook followers through which to do so. Since 2017, France has adopted an anti-fake news approach, but the problem is now that the transmission belt for similar attacks in the future is in place in the form of the popular, and reasonably ‘nativised’, RT France, which launched in early 2018. Should an operation such as MacronLeaks be conducted in 2019, it would probably be more successful than the effort two years ago. In 2017 MacronLeaks was played on a tiny speaker for a tiny audience; in 2019 it would use a powerful surround-sound system of television, websites, and social media.

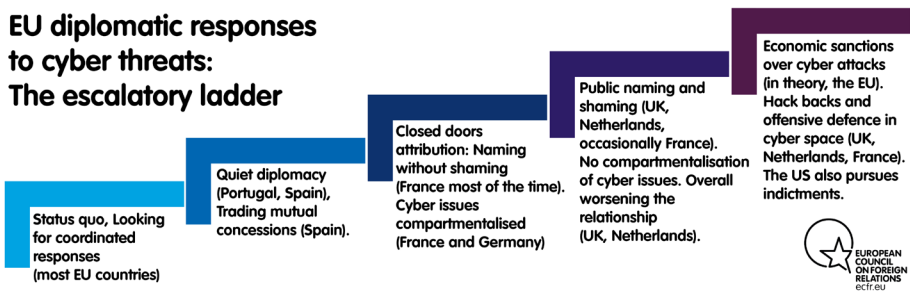
Cyber attacks have also taken a political turn, thereby demonstrating their hybrid potential. Unfriendly states have done this in several ways, from releasing hacked information to seeking to discredit and intimidate political actors, to using fake or automated accounts. Disinformation, rumours, and manipulation have always existed in politics, and have always been driven by both domestic and external players. Now, they can reach directly, through social media, into a much wider spectrum of society. This is especially the case because of the current political turbulence in Europe and the lack of agreed-upon, Europe-wide safeguards.

EU member states currently pursue one of what might be termed ‘two and a half’ approaches to countering these dangers.

The ‘half’ approach involves maintaining the status quo. This has evolved from a *laissez-faire* response to soul-searching on what to do about hybrid threats. Most EU countries are still at this stage. Many have identified hybrid threats as a priority and, as mentioned above, some have appointed special ambassadors as a result. But these countries are still very much in the search phase on specific policy issues such as how to respond to cyber attacks and how to handle RT.

When the search phase draws to an end, it usually results in countries selecting one of two types of approach. One is to pursue a more or less formal ‘cyber dialogues’ with external powers, which could be official-to-official or minister-to-minister. Another is to start pushing back through public attribution, by ‘naming and shaming’, and even contemplating indictments, sanctions, or cyber counter-attacks (so-called “hack backs”).

EU diplomatic responses to cyber threats: The escalatory ladder



Options for the EU

Dialogue

Talking to those who launch hybrid operations is an option perfectly in tune with the European predilection for dialogue. The philosophy that guides this is that a good talk is always better than a good fight. And it is the right approach when it works. But it often does not work, such as in the US-China cyber dialogue initiated by Barack Obama in 2015, which resulted in an agreement to hack each other less and, seemingly, only a short-lived lull in aggressive cyber behaviour.

Some states have taken this road. For instance, France has launched cyber dialogues with Russia. In late 2018 Spain and Portugal also launched their own bilateral cyber dialogues with Russia. Moscow has allegedly offered to conduct such a dialogue with London as well. The aim of these efforts is to persuade the originator of the hybrid threats to cease acting in a hostile manner, including by agreeing to an implicit code of conduct or even a non-aggression pact. Such dialogue could result in agreements not to hack each other's critical infrastructure or election infrastructure. Cyber dialogues have their limits, though: it is hard to believe they would ever cover hacking for cyber intelligence collection, given the sensitivity of this area.

For a country engaged in such a dialogue, what can it offer a state such as Russia? For those with more or less significant offensive cyber capabilities, such as France, an exchange of mutual favours in the cyber domain might be feasible – as was the case with the US-China agreement. But, because most EU member states have only meagre cyber capabilities, they are unable to offer many cyber concessions to trade with a country such as Russia. Thus, the mutual exchange of favours can only become meaningful if it includes mutual concessions from other policy domains, and not just cyber. Witness, for example, the following exchange between the Russian foreign minister and his Spanish counterpart in November 2018, a year after the Spanish foreign and defence ministries openly railed against hostile online activities designed to fuel the independence movement in Catalonia:

Sergey Lavrov: I spoke with the minister about this today. He said that some Russian media go beyond their journalistic mission and are involved in unacceptable interference in domestic electoral processes in other countries. I told the minister, as I am telling you now, that we prefer to discuss such issues professionally rather than with a microphone. We do not want our relations with Spain, our good friend, to go awry. I reminded my colleague that we have repeatedly suggested to our European and US partners establishing bilateral working mechanisms on cybersecurity issues. We stand for discussing emerging issues through dialogue. It seemed to me that our Spanish partners are interested in the idea of establishing a working group on cooperation in ensuring cybersecurity.

Josep Borrell: We never said it was the government of Russia, but it is true that [the false news] came from Russian media.

Borrell thanked Russia and Putin for indicating that they: “will always support the sovereignty and territorial integrity of Spain at a time when pro-independence groups have been trying to proclaim the independent republic of Catalonia.” Three days after this exchange, the Spanish port of Ceuta, in north Africa, was reopened to Russian naval vessels on their way to Syria.

Such dialogues may form part of Russia's tactics to either block organised responses to its hostile operations or to drive wedges between European states. Russia has long sought to divide the EU on policy issues such as energy, visas, and foreign policy. Now, it applies the same approach to the cyber domain. Dialogues can thus serve the purpose

of enabling endless, or at least excruciatingly long, rounds of cyber talks that do not force Russia to change its cyber behaviour. Alternatively, such dialogues can also lead to genuine cyber *détentes* for some EU member states, but not others, leaving plans for a pan-EU response or strategy in tatters. The launch of cyber dialogues with Spain and Portugal happened just around the time when tensions between Russia and the UK and the Netherlands reached a peak over the Skripal affair and Russian attempts to hack into the Hague-based Organisation for the Prohibition of Chemical Weapons.

Pushback

Where polite diplomacy fails, states have adopted more assertive ways to push back against hybrid and cyber threats. In these states' view, the *laissez-faire* approach to attribution and the lack of pushback against aggressive cyber tactics has turned the cyber field into a free-for-all for rapacious cyber entrepreneurs, one in which the costs of aggressive misbehaviour are virtually zero.⁷

France is an interesting case of a state that started a dialogue on cybersecurity issues with Russia in mid-2018, but has since publicly attributed several operations to Russia. One French diplomat told ECFR that: “aggressive public attribution with Russia will not work, and is not in the style of French-Russian relations. We tell them what we know with a firm voice, but behind closed doors.”⁸ But such patience is periodically punctuated by public attribution at the highest political level. Emmanuel Macron has accused RT of acting as a state-backed agent of influence, and the French defence minister has pointed to Russian state-supported hacker group Turla as being a major and constant source of cyber attacks against the defence ministry.

A key reason to publicly attribute attacks is not just to persuade foreign actors to back down, but also to shore up support for government action among the wider public and allied countries. In this, attribution is also an exercise in building greater resilience: preparing and educating the public and parliamentarians about what has really happened, drawing attention to the matter, and building support for possible diplomatic or sanctions responses. In the Skripal case, the UK responded with a vigorous campaign that laid the blame firmly at Russia's door and that involved sharing intelligence with partners across Europe. Such tactics met the goal of ensuring the UK did not stand alone in a major international incident, at a time when its relations with the rest of Europe were strained over Brexit.

Furthermore, by adopting an aggressive name-and-shame approach, the UK forced Russia into a defensive mode in which it made several mistakes that all but confirmed its involvement. When the UK accused two alleged Russian intelligence officers of the poisoning, the two individuals went on Russian television to deny their involvement. But they did so with such ineptitude and lack of plausibility that the British version of events suddenly looked much more persuasive – even to the staunchest doubters. This then sparked a search for the real aliases of the two Russian operatives, leading to the exposure of a whole network of Russian operatives – up to 305 – by Bellingcat, a network

⁷ Member state diplomat, remarks at ECFR EU-Russia Strategy Group, Madrid, 22 March 2019, under the Chatham House rule.

⁸ Interview with French foreign ministry official, November 2018.

of citizen activists who cross-referenced a car registration plate with a GRU address. So what started as a name-and-shame exercise by the UK ended up in a major diplomatic and intelligence debacle for Russia. Attribution also helped unify the European response, which resulted in the more or less simultaneous expulsion of Russian diplomats by 19 EU member states, and ten non-EU states.

The pitfalls of attribution

Attribution of attacks in the cyber domain is notoriously difficult, though not impossible. Several high-profile cases have helped reduce public trust in professions of certainty based on intelligence, such as that preceding the military intervention in Iraq on the grounds that it had weapons of mass destruction. Attribution can rely on cyber forensics, but it has often relied more on intelligence sources, which can be harder to deploy publicly to change opinion and win wider support. Providing more detail may help adversaries close their security loopholes. For example, just three weeks after US intelligence services issued a report on Russian cyber activities around the 2016 presidential election, [the Russian intelligence services arrested one head of department and his deputy from the FSB Cyber Centre for Information Security for being CIA moles](#). In such circumstances, Western intelligence services are often reluctant to engage in public attribution that can devalue or endanger their sources.

Private companies can also be reluctant to publicly attribute cyber attacks to foreign states. It was not always this way: companies used to be happy to blame cyber attacks on foreign state-backed actors as they looked less inept if their cyber defences had failed in the face of supposed Russian or Chinese state-backed hackers rather than criminal cyber groups or teenage amateurs. But this is changing. Insurance companies now hold that a hack supported by a foreign state is cyber warfare and, therefore, refuse to provide compensation. This happened in the fallout from NotPetya, the world's costliest virus attack, which started in Ukraine but then affected dozens of companies around the world. The UK government [accused](#) Russia of attacking Ukraine's digital infrastructure with NotPetya. But when the virus spread and one of the affected companies – the maker of Cadbury chocolate – made an insurance claim for the attacks, [its Swiss insurer refused to provide compensation](#), invoking the UK government's attribution of the attack to Russia as [proof that NotPetya was an act of cyber warfare not covered by its insurance](#).

Beyond naming and shaming, states have started to make greater use of indictments, counter-offensive cyber strategies, and even hack backs. Their goal is to change the calculations of foreign state-backed cyber actors by starting to impose costs – on the cyber actors themselves and the states supporting them. The US pioneered this approach, which has been increasingly adopted by the UK, the Netherlands, and, on a smaller scale, France. All three countries have changed their cyber doctrines to move from an almost exclusive focus on cyber defence and cyber intelligence collection towards the

possibility of counter-offensive cyber actions. What drives this greater assertiveness is an understanding that toothless cyber diplomacy is not enough to combat the state-sponsored cyber threats to Europe.

Conclusion and recommendations

Dealing with hybrid threats involves action on several fronts. The first is the political front. The second is the digital home front. The third is the intelligence front: setting new goals and standards for intelligence services, and improving the coordinated approach within Europe. And, finally, EU member states and the EU itself can take steps on the diplomatic front to deal with foreign powers that conduct hybrid operations against them.

The political front

The European conversation on hybrid threats is polarised between political actors that see Russian interference in every European election and those that are completely dismissive of such fears. Europe would benefit if accusations of foreign interference were better supported with facts and details – such as those the Mueller inquiry provided in the US. Despite a plethora of journalistic investigations, and periodic statements from politicians, European legislative and judicial bodies have released few details about their assessment of the situation. This certainly does not help the EU arrive at a more united understanding of the scope of threats it faces.

Key instruments for creating a more unified awareness across Europe lie in the hands of national elites. These include more systematic use of parliamentary or UK-style public inquiries (such as the Chilcot and Leveson inquiries) and more systematic law enforcement work to pursue those who broke electoral law by attempting to influence votes through digital or financial activities.

The digital home front

On issues such as election interference, one way to hedge against the vagaries of the digital age is to return to analogue methods. The Netherlands reverted to paper ballots and hand counting in elections in 2017 as insurance against cyber tampering with voting machines and digital infrastructure. On some occasions, internet giants have chosen not to run political adverts at all – Facebook took this course during the recent Nigerian election. And, after Canada introduced strict requirements on the transparency of electoral adverts, Google decided not to run these. This is not a long-term solution, but it could be a temporary one until governments and these companies flesh out transparency rules governing campaign ads.

Dealing with cyber threats presupposes investment in the EU's capacities to deal with such issues. This requires several types of action:

- Transform ENISA into a well-staffed and well-financed cybersecurity institution in which multiple functions are centralised: computer emergency response

teams (CERTs), cyber forensic teams, and legislative teams that drive up cyber hygiene standards across the EU.

- Within or outside ENISA, it is in the EU's interest to acquire a sovereign, pan-European capacity to investigate the sources of major cyber attacks directed at sensitive state institutions or critical infrastructure. This means beefing up European capacities for both cyber forensics, but also focusing and pooling together intelligence collection on cyber issues. Six EU member states have been leading the EU effort to build an EU Cyber Rapid Response Force that would help member states tackle serious cyber attacks. But once a crisis has been resolved, the EU also needs the capacity to conduct systematic, sophisticated, and post-factum analysis of the potential sources of cyber attacks. This would improve future protection and create the basis for subsequent diplomatic responses against suspected perpetrators (see below).
- EU member states should jointly invest in offensive cyber capabilities within PESCO. Lead nations such as France or the UK (if it stays affiliated with EU defence cooperation after Brexit) could provide the core capabilities that other states can build on. This would also avoid duplication of basic capabilities in every national cyber agency at the expense of more sophisticated cyber weapons, which can only be jointly developed. This is highly controversial for most EU member states. But key European states – and global or regional powers such as the US, Russia, China, and Israel – are already employing sophisticated cyber weapons. Even states that are sceptical of the ethical legitimacy of this will be affected by the employment of offensive cyber weapons by third states. And, sooner or later, they will want to benefit from the deterrent effect of European cyber weapons (and the threat to use them). Still, it remains to be seen whether such policies can be developed with all European states on board or whether it will be left to the most capable EU member states to spearhead the process.
- All European countries should improve personal cyber hygiene standards, both among the general public and in government. For example, European delegations consisting of diplomats from different member states behave in different ways when visiting state institutions in foreign countries that are perceived as aggressive in cyber space and electronic intelligence collections. Some European foreign ministries make their diplomats keep their mobile phones in Faraday cage bags when entering public buildings, while others do not. Indeed, many diplomats do not know what Faraday cages are. So, even a strong push to coordinate and spread core cyber hygiene standards for European diplomats, militaries, parliamentarians, and other officials would already constitute a step forward. The undertaking could include policies on: Faraday cages for European delegations travelling abroad; bans on the use of manufacturers' passwords in the public sector; and compulsory use of minimally safe passwords (checked against databases of compromised or leaked passwords).

The intelligence front

A European Investigative Service and a general prosecutor that works independently from member states would be best suited to tackling interference in domestic affairs and the subversion of state institutions by foreign intelligence services, as this would cut short attempts to suppress investigations for political reasons. That said, there is little chance that the EU will do this.

Any new European capacity would have to come on top of existing national capacities, to amplify and reinforce them. This will not make up for intelligence cooperation with the US in the short or even medium term. But it would certainly enhance European capabilities. The EU and its member states should consider the following actions:

- **Expand Europol's remit to include counter-intelligence:** Europol has long supported European countries' fight against organised crime, money laundering, and other transnational criminal activities. It has come across foreign intelligence operations in the past, some of which intersect with organised crime. Europol members should now create counter-intelligence bureaus, analytical cells, and data exchange formats to tackle cross-border activities. This would be particularly beneficial for small states fighting against foreign intelligence services' activities.
- **Set common legal standards on subversion and hostile intelligence services:** the legality of some intelligence activities varies between European countries. Counter-intelligence will not work without clear, legally binding definitions of what constitutes espionage, subversion, conspiracy, and hostile influence operations. Common standards would also facilitate cross-border cooperation between authorities, particularly in the indictment of suspects.
- **Tighten standards for financial supervision and investment screening of foreign state-affiliated actors:** Like organised crime, foreign intelligence operations require logistical infrastructure such as illegal residences; anonymous bank accounts or opaque financial schemes to funnel money to sources; fake companies and information networks; and fake news outlets to use for agitation. Greater transparency on real estate and corporate ownership would facilitate the fight against organised crime as well.
- **Establish a centre of excellence on subversion and counter-intelligence:** The NATO Cooperative Cyber Defence Centre of Excellence does a good job of analysing threats and compiling national situation reports. The constant exchange of information between various branches of government has increased member state bureaucracies' knowledge and understanding of this matter. The same approach would be helpful for counter-intelligence.
- **Introduce common procurement of strategic intelligence, surveillance, and reconnaissance platforms:** On hybrid threats, domestic counter-intelligence is often the focus of policy discussions. But in an

escalating confrontation, the capacity to predict adversaries' military moves is pivotal. Europe needs to acquire airborne and shipborne strategic intelligence platforms. It currently lacks electronic- and signals-intelligence aircraft with long endurance and corresponding ground-based surveillance stations, particularly in the Black Sea. It also lacks stealthy autonomous aerial vehicles to collect intelligence in highly contested airspaces, such as Syria or Crimea.

The diplomatic front

European cyber diplomacy needs to become much more ambitious in developing a strong diplomatic infrastructure that reduces hybrid, cyber, and intelligence risks to the EU. It needs to do so jointly with potential allies. This infrastructure would need three layers: working with existing allies, fostering new cyber alliances, and developing assertive dialogues with states that are testing EU countries' defences with their hybrid tools.

Working with allies

The EU will never be entirely sovereign in the defence sphere without a nuclear deterrent. But there is no prospect of this unless France extends its nuclear protection to the entire EU and all other EU states accept it.

Even in other spheres, Europe is a long way from establishing a self-sufficient capacity to push back against hybrid, cyber, and intelligence threats. And even if it attains self-sufficiency, the EU's sovereign action will only become stronger if it can sustain strong allied responses to these risks coordinated with the post-Brexit UK, the US, Canada, and NATO. So, whether the EU has its own capacities to combat such threats or not, the first port of call will still be its closest allies in NATO – where a clear division of labour, or joint action with NATO, is likely to be the rule of thumb.

For NATO, the first task is deterrence (including nuclear deterrence) and defence. On hybrid threats, the picture is less clear. Hybrid operations are often a prelude to more intense pressure or even aggression. They are intended to erode the opponent's will or capacity to resist. The EU will remain the prime legal arbiter countering most hybrid threats to Europe. This is due to the EU's common space on security and justice, the close cooperation between its member states on homeland affairs, and the EU's legal authority over the common market (which is important on energy issues, fighting financial crime and illegal financial transactions, and border security) and its evolving competences in the digital space.

However, the EU should aim to closely coordinate its own procedures and policies with those of NATO. While Turkey blocks formal EU-NATO coordination, it is possible to circumvent this: EU member states can push for the same agenda and programmes within both organisations. This is particularly the case in planning and exercises for: NATO troops reinforcing local police detachments in frontline states in response to hybrid threats; NATO support capabilities (such as air transport, cyber troops, engineers); and emergency situations in Europe.

Finally, military and civilian intelligence sharing within NATO is important to Europe's overall preparedness for all sorts of threats – ranging from hybrid threats to traditional military threats. Exchange of experts and officials between Europe's inward-looking institutions (such as Europol and the European commissioner for justice and home affairs) and NATO's outward-looking assets and experts could improve their situation awareness. Here, too, member states need to circumvent the diplomatic impasse between Turkey and Cyprus by creating exchange forums on their own initiative.

Fostering new cyber alliances

The EU should expand its partnerships to combat hybrid and cyber threats in conjunction with friendly governments – in countries ranging from those in the western Balkans to Ukraine and New Zealand.

Friendly cyber partnerships can have multiple aims: capacity-building; providing assistance in establishing national cybersecurity strategies; addressing cyber crime; instituting cybersecurity standards; protecting critical infrastructure; and helping defend electoral processes from interference.

To a degree, the EU should conduct lawfare against its cyber adversaries. It is in EU's interest to become one of the driving forces of a global alliance promoting a crackdown on aggressive state-sponsored cyber behaviour through legal means. State-to-state dispute resolution is always difficult, not least in the cyber domain. Various models have been discussed in this respect. Some legal scholars have argued that state-sponsored cyber attacks fall well within the jurisdictional scope of the International Court of Justice, as they constitute potential violations of state sovereignty. Another form of legal and institutional pushback is to seek to create a World Trade Organisation-style dispute settlement mechanism for inter-state cyber affairs, in which an international body would have investigatory and adjudicatory powers. The EU should forge a global alliance of states that push for more assertive legal mechanisms to combat cyber threats through international law and international legal bodies.

Hard cyber talks

European efforts to forge global cyber partnerships should be matched by cyber dialogues with problematic cyber players such as Russia, China, North Korea, and Iran. One dictum of conflict resolution is that peace deals arise during mutually painful stalemates.⁹ In the cyber domain, there is currently no stalemate: the situation is painful only for EU states. The nuclear détente in the 1970s was possible because each side was armed to the teeth and competition between them was costly. So, both had an incentive to slow things down. Today, most of the EU is a punch bag for hybrid and cyber operations.

Europe should pursue a 'dual track' approach of confrontation followed by dialogue with unfriendly cyber powers. EU member states are currently split – some prefer dialogue on cyber and hybrid issues, while others have started to opt for confrontation because dialogue seems to be failing. To be more efficient, and to keep the EU united, Europeans will need to combine both approaches. Europe should actively work towards a series of

⁹ Jonathan Powell, *Talking to Terrorists: How to End Armed Conflicts*, Vintage, London, 2015.

cyber détente by starting to be more confrontational about hostile behaviour directed at it.

A more adversarial dialogue will involve attribution behind closed doors, as well as periodic public attribution and even indictments of attackers if things do not improve. Hard-nosed trading of mutual concessions would supplement this approach. It could include mutually agreed red lines for cyber attacks: penalising attacks on critical infrastructure, including electoral infrastructure, but also tacitly accepting that some forms of hostile cyber activities will probably continue.

One can also look to gain leverage over the cyber field by conditioning free trade, investment screening, and development assistance on 'polite enough' cyber behaviour. Cooperation on combating cyber threats should become part of major EU partnership agreements.

Ultimately, to become more capable of dealing with hybrid threats on its own – to become more sovereign – the EU will have to start acting more like the US. This will involve investigating hybrid activities directed against European countries in much greater detail, and transparency about the findings of these investigations. European countries also need to move more quickly from the 'soul-searching' and assessment stage to fully acknowledgement of the scale of the problem and the adoption of a more robust form of engagement. This will involve a combination of dialogue with friends and adversaries alike, and engaging pushback such as public attribution. Without these measures, it is unlikely that Europe will attain any true degree of sovereignty in a world in which countries are increasingly liable to incorporate hybrid threats into their armouries.

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Anthony Dworkin and Richard Gowan

Rescuing multilateralism

Summary

- Multilateralism is core to Europe's approach to foreign policy, but in recent years this has weakened as EU countries disagree among themselves.
- The US, China, and Russia have each sought to challenge or disrupt the existing, post-1945 world order; and each seeks to divide Europeans from one another.
- The turmoil in the current system represents an opportunity for Europeans to shape a new order that meets their strategic needs.
- In addition to the fight against climate change, European interests include: increasing stability on its troubled periphery; managing migration more effectively; and defending the open world trading system.
- European countries will need to transform EU foreign policy decision-making processes, deepen their cooperation in multilateral settings, and set multilateral standards for emerging technologies.

January 2023: Mali's latest collapse took nobody by surprise. The Security Council's failure to respond with anything more than a press statement might have done in the past. When jihadi forces last came close to seizing total control of Mali ten years ago, in January 2013, the United Nations supported France's intervention to restore order with peacekeepers and sanctions. This time around, after a decade of failed UN and African peacekeeping efforts, US ambassador Ivanka Trump told the council: "it's not America's job to prop up failed European security policies in the deepest Sahara."

While Paris called for European Union assistance for a new intervention, most other members of the bloc shrugged. Italian politicians waspishly pointed out that France had failed to support their 2020 "reconstruction pact" with Syrian president Bashar al-Assad – the source of a major rupture in the European Council at the time – so they owed Paris nothing on other crises. Many other EU capitals emphasised that, in the absence of strong multilateral frameworks for managing refugee and migrant flows from Africa, their voters simply want to block off contact with the Sahel, full stop.

But there is a glimmer of hope for Paris – from Beijing. After its de facto victory in the unregulated battle to supply artificial intelligence (AI) and surveillance technologies to west African governments, China does not want to see the whole region implode. Its officials have signalled that they will offer military and substantial financial support to a fresh French-led intervention in Mali, but only if Paris rescinds recent criticisms of Chinese harvesting and manipulation of African population data.

France has little choice but to take the deal seriously. After all, the total paralysis of the international trade system and a lack of multilateral frameworks for managing AI mean that it has no real means to challenge China anyway. And with signs that climate-induced droughts and violence will soon lead to the implosion of Chad, another French priority, France needs to deal with Mali immediately.

The scenario sketched out above is not quite as distant or outlandish as some may hope – and there is good reason to fear it to be fairly near at hand. It is a truism to say that multilateralism is at the heart of the European project, and that the European Union and – historically – its member states have sought to replicate the multilateral approach on the international stage. It is also a truism to point out that this approach has come under increasing pressure over the last year as the solidarity within Europe has weakened and external actors, including old ally the United States, have explicitly rejected it.

This paper addresses: the challenges Europe faces in its bid – should it still wish to pursue it – to preserve and enhance multilateralism in the global system; and the challenges that European countries face in remaining – or, perhaps, merely becoming – “sovereign” within this system. It sets out why multilateralism matters for Europe and its interests; what the nature of the current crisis of multilateralism is; and what opportunities and risks this represents for a Europe still determined, despite recent internal ructions and external threats, to defend and promote a rules-based world order.

The paper investigates how Europe can protect and promote its sovereignty within already-existing multilateral systems, from improving the security situation on Europe’s periphery to the challenge of migration. It considers ways in which Europe can shape the future rules of multilateral frameworks, and it concludes with proposals for improving Europeans’ coordination with each other within existing multilateral frameworks. In sum, this paper identifies both the opportunities as well as the threats for Europe in this domain. Multilateralism can offer Europe’s adversaries the chance to divide Europeans from one another as much as it can offer Europeans the chance to stand together and be stronger for it.

Multilateralism’s crisis, Europe’s opportunity

A well-functioning multilateral system is a fundamental interest of the members of the EU, for at least three reasons:

- *Strategically and conceptually*, the EU’s credibility as a multilateral entity rests on broader rules and norms of international law and cooperation;
- *Diplomatically*, the EU’s members wield great influence in organisations such as the UN and the World Bank, preserving and extending their leverage in a time of flux;
- *Practically*, the EU depends on multilateral organisations to manage threats to its security and prosperity, in areas ranging from tackling broad challenges

such as climate change to peacekeeping in trouble spots on Europe's periphery, including Mali and Lebanon.

Recent history shows that, when EU members work smartly together, they can have a decisive impact on multilateral affairs. France and its European partners played a brilliantly executed diplomatic game in the run-up to the 2015 Paris climate change conference to ensure that potential spoilers and laggards such as Russia signed up to the eventual agreement. The EU's members also recognise that new trends in international affairs – such as the rise of AI – could create enormous disruption unless they craft multilateral responses to manage them. Yet EU members face a growing crisis of multilateralism that threatens to undo global cooperation and reduce Europe's leverage in the international system.

Europe currently faces at least three strategic challengers in the multilateral domain: the US, China, and Russia. The US is the most immediately disruptive. As the primary creator and long-time guarantor of the post-1945 system, it enjoys exceptional powers in forums such as the Security Council and the International Monetary Fund board. The Trump administration is increasingly systematic about using its formal powers to undermine institutions it distrusts. Its most concerted spoiler tactic has been to block the appointment of jurists to the World Trade Organization (WTO) Appellate Body, which could stop the dispute resolution mechanism functioning from mid-December this year. Washington has also used its veto power in the Security Council to push back against European initiatives that it does not approve of, such as France's efforts to strengthen a regional counter-terrorism force in the Sahel.

China is becoming assertive in international institutions, partly because it has spotted an opportunity in the leadership gap created by the US. It has aimed to both co-opt and split the EU. In 2017 Beijing allegedly [used its economic leverage](#) over Athens to persuade Greece to stop the Europeans taking a common position against China in the UN Human Rights Council. In mid-2018, by contrast, European diplomats noted that their Chinese counterparts in New York had launched a charm offensive towards EU missions, apparently in the hope of widening EU-US divisions. European officials differ over how fast and boldly Beijing will move to consolidate its power in the multilateral system, but many fear that rising tensions between China and the US will infect multilateral institutions, paralysing diplomacy and reducing Europe's room for manoeuvre.

Russia's multilateral influence is more limited, but it has used its status as a permanent member of the Security Council to reassert itself on the global stage over the last decade. It has opposed European positions at the UN on crises from Syria to the Central African Republic. As ECFR's Kadri Liik [warns](#), "Russia will not take

Western rules and norms seriously until it realises that the norms, and the West as a norm-setter, will be there to stay in the new, changed world."

Facing this pressure, EU members have displayed worrying signs that they cannot agree on what norms and interests they still hold dear. In the 1990s and the 2000s, there was

a notable, albeit never complete, convergence of EU members' positions on issues such as human rights in multilateral forums. This remains the case much of the time, but EU member states have failed to hold together in several symbolically important multilateral cases in recent years, most notably in the dispute over whether to sign the UN Global Compact for Migration (GCM) in December 2018. The UN launched the GCM process in 2016 largely as a favour to European governments looking for ways to 'internationalise' the response to that year's migration crisis. Two years later, the EU could not agree on the outcome of the process and some member states spread specious arguments against the legally non-binding document. European and UN officials fret in private that this process has dented the EU's credibility as a negotiating bloc.

Nonetheless, the turmoil in the multilateral system represents a strategic opening for the EU, as well as a strategic threat. Many non-European states are simultaneously: unnerved by the US attack on international institutions; worried about China's emerging ambitions to rival or surpass the US in this sphere; and disgusted by Russia's behaviour in Ukraine and Syria. Against this backdrop, the EU's overall, if imperfect, commitment to international cooperation makes it an appealing alternative pole in multilateral affairs. As a major economic power, the EU also has the weight to act as a leader both in supporting existing trade and financial institutions, such as the WTO and the International Monetary Fund, and in helping craft rules around emerging industries such as cyber technology and AI.

In the past, non-Western countries have often distrusted European action in forums such as the UN because of colonial legacies. Such suspicions linger but, in the current environment, many states are likely to put aside their historical tension with Europe in multilateral forums. Marc Limon of the Universal Rights Group, a think-tank based in Geneva, notes that EU members and Muslim countries have managed to minimise their long-standing rows over religious freedom in the Human Rights Council, in part to protect the body from US attacks. India and China have signed up to European reform proposals in the WTO. Such cooperation does not always signal fundamental convergence with Europe on multilateralism, but a wide range of states feel the need to maintain the global system in the face of American scepticism.

Protecting and promoting European sovereignty in multilateralism

European policymakers have recognised this strategic opening and pursued it with the aim of increasing their influence. They have already made some progress towards providing concrete responses. Germany, for example, has proposed an "[Alliance of Multilateralists](#)" to protect cooperation, while France's [Paris Peace Forum](#) held in late 2018 aimed to stir up thinking on the same theme. French, German, and other European members of the Security Council (including the United Kingdom) have invested in staking out their common positions as an EU caucus more clearly in New York. European Commission and European Council officials have increased their visits to the General Assembly and other multilateral public forums, and have become better at coordinating their messaging at big international events.

There is, therefore, no shortage of discussion of the EU's commitment to multilateralism. But there is also a risk that European initiatives in this field will duplicate one another and be poorly prioritised. To counter this, Europeans can engage in specific areas of action that are directly connected to their vital interests.

The EU's vital interests in multilateral forums

What does "European sovereignty" in multilateral affairs mean? This question is not straightforward to answer. Participation in multilateral organisations generally means giving up some degree of autonomy. European diplomats have spent years lecturing their non-Western counterparts on the need to put human rights and international legal obligations ahead of sovereign power. Conversely, the leaders of states that want to keep the UN out of their business frequently use sovereignty as a catch-all excuse to ignore multilateral bodies. Indeed, some of the European countries that opposed the GCM used precisely this argument.

Talk about "European sovereignty" in this field should, therefore, proceed with care. Nevertheless, three dimensions of Europe's strategic autonomy are relevant:

- Which of the EU's vital interests are at stake in current multilateral contests?
- What can EU members do to protect the elements of the multilateral system that serve these interests, and how can they shape new arrangements for emerging issues such as AI?
- What are the implications of these challenges – and of the overall degradation of international relations – for internal EU coordination mechanisms over multilateral affairs?

EU members are active in innumerable international institutions and forums. All of these may have value, but not all areas of multilateral activity are relevant to Europe's collective vital interests. For the purposes of this paper, four stand out:

- **Securing Europe's troubled peripheries:** Multilateral mediators and peacekeepers have a significant role in crisis management on Europe's periphery, often in parallel with EU-flagged efforts. Humanitarian agencies such as the Office of the UN High Commissioner for Refugees and the World Food Programme also play an important role in crisis mitigation. With the violence in Syria, Yemen, and other war zones potentially easing, there is now an emerging debate about how to fund postwar reconstruction in extremely unpromising political and security environments. How can EU members maximise their ability to shape these multilateral security, humanitarian, and reconstruction efforts?
- **Managing migration:** Migration's rapid rise as a political issue within Europe has both put the EU under strain and – as noted in the case of the GCM – complicated European decision-making in multilateral frameworks. Although much debate about migration is fatuous or toxic, it is nonetheless true that the EU's capacity to manage its borders and people flows is a key dimension of its collective sovereignty. Now that the GCM process is over, what

can EU countries (including non-signatories to the agreement) do to pursue a more effective European approach to multilateral migration management?

- **Maintaining an open trade framework:** The Trump administration's attack on the WTO has already impelled the EU to table reform proposals for the body. Yet it remains unclear whether the US will accept these, raising questions about whether the EU can either find alternative mechanisms to protect the WTO or construct a parallel trade architecture.
- **Shaping multilateral frameworks:** Multilateral mechanisms for discussing technology issues, such as the UN's [Group of Governmental Experts](#) on cyber security, have frequently been unproductive. But there is growing need to address both the economic implications of emerging technologies and the need for new arms control regimes to limit the weaponisation of these technologies. How can EU members lay the foundations of robust international regimes to address these matters, given the scepticism of other powers?

This list excludes a number of issues that are important to the EU. The most pressing – as the Green surge in this year's European elections showed – is continuing the battle against climate change. While the 2015 Paris Agreement was a major victory for EU diplomacy, there are disturbing signs that the world will fail to meet its targets to stop global warming. EU members are also divided over the bloc's own carbon emissions goals. There is a risk that, if multilateral climate diplomacy breaks down in the coming period, many states' willingness to cooperate on other issues will also decline. EU members need to stay at the forefront of climate change reduction efforts, and also to deepen their plans to mitigate its looming social and political effects. The next milestone in climate diplomacy is a climate summit at UN headquarters in New York this September, which will act as a platform for states to table new commitments to limit carbon emissions. A number of EU members are leading planning groups on different aspects of this event, which the US is ignoring – Europe's immediate priority should be to make this latest UN conference a success.

Another crucial concern is nuclear arms control: the deterioration of Russian-American coordination on nuclear matters creates fundamental threats to European security. But solutions to this challenge lie in great power negotiations beyond the scope of this paper – as one [recent ECFR study found](#), many European policymakers need to relearn the basics of nuclear affairs before they can engage with such issues.

A theme that comes more naturally to Europeans is the promotion of human rights and international law. In an era in which several big powers are profoundly suspicious of human rights and legal talk – topics that sometimes generate unease even within the EU – there is relatively little space for the EU to promote major values-based innovations comparable to the creation of the International Criminal Court.

Europeans should take steps to defend and strengthen their “sovereignty” in multilateral forums, seeking to demonstrate the value of multilateral cooperation through substantive actions and initiatives in each of the four areas of strategic priority outlined above. Doing so will reinforce multilateralism as both a concept and in practice, and thereby significantly help Europe protect its interests.

i. Securing Europe's troubled peripheries

In the course of the current decade, the EU's members have invested politically and financially in multilateral operations to stabilise its southern and eastern flanks; in some cases, they have done so with troops and civilian personnel too. This has included supporting UN mediation efforts covering Libya, Yemen, and Syria, in addition to longer-standing UN envoys for Cyprus, Kosovo, and Western Sahara. They have also supported large, blue-helmet missions in Mali, Sudan and South Sudan, and Lebanon. European states and EU institutions have provided crucial financial support to African military missions in Somalia and the Sahel, while the Organization for Security and Co-operation in Europe has gained a new lease of operational life with monitors in Ukraine.

While it deploys military and civilian missions on its periphery, the EU heavily relies on multilateral actors in security matters. However, this means that it is also vulnerable to other powers' interference in these multilateral operations. Recent examples of this include Russia's manipulation of successive UN envoys to Syria, and Saudi Arabian and US efforts to limit the UN's political options in Yemen. The Trump administration has also used its veto power in the Security Council to interfere with some of these operations. In both 2017 and 2018, the US blocked French efforts to secure greater European support for a regional counter-terrorism force, for example. In 2017 the US also threatened to veto the UN Interim Force in Lebanon, which contains a considerable European component, over the peacekeepers' cautious approach to Hezbollah.

There are signs that tensions in the Security Council will complicate a growing number of crisis management missions: France, Russia, and the US [fell out quite badly](#) over a routine mandate for the UN Multidimensional Integrated Stabilisation Mission in the Central African Republic in November 2018. In December 2018, the US also shot down a Security Council resolution – strongly backed by both African and European states – that would have opened the way for the UN to fund African forces such as the G5 Sahel Joint Force. If the EU continues to rely on UN-led and Security Council-mandated mediation and stabilisation efforts in its neighbourhood, it risks allowing other powers to persistently interfere with these missions. China's and Russia's growing presence in Africa and the Middle East means that – while there is still some space for positive cooperation on conflict management – Beijing and Moscow are likely to grow more and more assertive in UN debates on both regions. In addition, the current US administration is very suspicious of such multilateral missions, on both budgetary and ideological grounds. The EU's overall dependence on multilateral conflict management in its neighbourhood means that it risks having to ask for a 'permission slip' from Washington, Beijing, and Moscow for projects that improve security there.

Compounding these challenges is the dilemma of whether and how European governments should invest in the reconstruction of Syria after Bashar al-Assad's de facto victory there. Russia has for some time been pushing the EU to pay for this process despite its political qualms, and some governments – such as Italy – appear to be moving in this direction. “Rather than allowing individual countries to move forward unilaterally, European governments should work together to maximise their leverage

over Assad,” ECFR’s Julien Barnes-Dacey [argues](#), as the Syrian leader “does want international legitimization of his victory.” To complicate matters, EU members are also likely to face calls to pay for the reconstruction of Yemen while they fund large-scale humanitarian relief programmes across the Middle East and north Africa (MENA). The EU has sunk large amounts of reconstruction funding into Afghanistan and Iraq over the last two decades, often with nothing to show for it. Now it faces a similar slog in other parts of the Middle East.

EU members may feel compelled to make these investments, but they should be wary of putting money into UN-led and other multilateral reconstruction efforts in the Middle East if, in political terms, the main beneficiaries will be Russia and Saudi Arabia. To navigate the coming decade of challenges in MENA, the EU needs to ensure that its support for African partners such as the G5 Sahel is not vulnerable to interference from other powers, and that it retains maximum leverage over the use of its funds. EU members have already recognised the need for – in the words of the [2016 Global Strategy](#) – an “integrated approach to crises and conflicts”, and it is necessary to build on this to address current problems. To maximise the ability to shape security in their periphery, EU members should consider the following ways forward.

- Establish a **European Reconstruction Authority** with a specific mandate to oversee EU assistance for the reconstruction of Syria and Yemen. This organisation would pool funds provided by the European Commission and member states. It would also negotiate with the Syrian government, multilateral agencies, and other actors – including Russia, Iran, and Arab countries – to ensure that it maximises its clout.
- The US and other powers are likely to continue to interfere with the mandates and funding of multilateral crisis management missions in the Sahel. EU members should, therefore, build on the – admittedly troubled – experience of the G5 Sahel to **establish a more robust framework for planning, funding, and running European-African missions in the Sahel region**. This could involve merging existing European training initiatives in the Sahel into a single civil-military system, possibly adding a new initiative to support regional forces with drones.

This does not mean that European policymakers should aim to work around the UN and other multilateral agencies. These frameworks are still often the only structures able to frame cooperative crisis management operations. As ECFR [has noted](#), there may be particular openings for cooperation with China on peacekeeping. European states could also streamline their crisis management contributions to increase their impact: Ireland and a group of allies recently [tabled a promising initiative](#) for EU members to coordinate their deployments in UN missions more rationally. Nonetheless, if the EU wants to prevent other powers from undercutting its interests in multilateral crisis management, it needs to take a more hawkish approach to the use of its funds. The EU also needs to remain open to backing African and other crisis management missions without UN support, to prevent other powers from holding it hostage via the Security Council.

ii. Restoring unity on migration

While focusing on security on Europe’s periphery, EU members also need to restore some sense of unity over how to handle large movements of people through Africa and

the Middle East. The EU's very public struggles over migration have not only poisoned its domestic politics but also damaged its credibility in debates on refugees and migrants in the eyes of governments around the world. The fact that roughly one-third of EU members refused to support the GCM, which contains solid language on the human rights and security of migrants, will make it harder for the bloc to take strong stances on other human rights issues in future. Revelations about the ways in which some of Europe's partners in migration management mishandle the problem – as seen in [the presence of slave markets in Libya](#) – have also hurt Europe's moral standing globally.

Migration continues to be a source of significant dissension within the EU; if left unattended, this will only worsen. The sense that the bloc has lost control of people flows remains a major source of discontent, meaning that it is necessary to tackle this head on. In reality, EU officials work closely with their UN counterparts on the ground in MENA. The political challenge for EU leaders is to re-establish a baseline level of cooperation on this issue in multilateral forums, to permanently close the rifts of 2018.

At the multilateral level, it may still be possible to salvage something from the GCM debacle. Contrary to scare-mongering by its detractors, the UN compact is essentially a long list of good ideas for helping states cooperate on all aspects of migration management, ranging from hard questions of border security to initiatives for facilitating regular migration to meet labour market needs. As Shoshana Fine has [underlined](#) for ECFR, the EU member states that refused to back the GCM largely did so because of nebulous concerns over national “sovereignty” (and more noxious anti-immigrant scare-mongering) rather than because they disliked specific clauses in the text. In doing so, they ignored the reality that the most effective means of managing migration is through inter-state cooperation, whether at the European or the global level. Against this backdrop, EU members should work together to identify the substantive parts of the GCM that they can all agree are useful in practical terms, leaving aside ideological and semantic debates over the compact's political and legal implications.

On this basis, and in reference to the EU Global Approach to Migration and Mobility, EU members could work with the International Organization for Migration to:

- Establish a **new EU-UN Action Plan on Migration** containing GCM policy proposals that all EU countries can support, without requiring those who opposed the GCM to adopt the document as a whole. This emphasis on a more action-orientated approach to the problem could put European debates about migration on a more stable footing. While some of the GCM's harshest critics, such as Hungary, might demur even on this, the move would provide an opportunity to states that broadly support multilateralism – but could not bring themselves to sign the GCM – to demonstrate that they are not neo-isolationists. Countries such as Italy and Austria fall into this camp.

iii. Preserving the world trade system

While regional security and migration represent long-term dilemmas for European policymakers, the most direct challenge to their multilateral interests today remains the US attack on the WTO. As noted above, the Trump administration threatens to neuter

the WTO by blocking the appointment of judges to its dispute resolution mechanism, the Appellate Body. The EU has already emerged as the primary interlocutor with the US on the reform of the organisation, tabling a series of proposals to the body that have secured the support of China, India, and other significant non-Western WTO members. In this sense, the WTO situation already provides an example of the EU working most effectively as a unit. European officials also agree that there is a genuine case for WTO reform. But the US has repeatedly rejected the EU's proposals.

Broadly speaking, the EU's reform proposals to date have been substantively sound; Brussels should continue on its present course for now. This may be an opportunity to induce China, which the US accuses of abusing its position in the WTO, to make some concessions on trade policy, thereby avoiding a broader crisis in the WTO system.

If it proves possible to cut a deal with the US on the dispute resolution issue, the EU could also expand its reform agenda to address a range of recurrent complaints about the WTO system, including the inefficiency of its committee system. Yet previous efforts to negotiate with the US over its multilateral bugbears, such as talks on the UN Human Rights Council in 2016-2017, suggest that Washington may hold its line and push the WTO over the edge if it does not get everything it wants.

So, at a minimum, the EU needs to prepare for a scenario in which the Appellate Body is frozen, obstructing the governance of world trade. Trade experts have suggested one way out: Article 25 of the WTO Treaty allows the organisation's members to submit to arbitration of disputes rather than turning to the Appellate Body. An alternative proposal is for the EU and other actors to set up dispute resolution mechanisms on the basis of preferential trade arrangements (PTAs) lodged with the WTO. This would be especially favourable to the EU, as it has some 70 PTAs in place, with more under negotiation. This ruse would allow the EU to bypass US obstruction.

At one level, this would be a neat demonstration of European sovereignty: the EU would be able to show that the US cannot use its institutional muscle to constrain it completely. But there are a lot of problems associated with this route. The biggest is that, despite its impressive trade network, the EU does not have PTAs with the US, China, India, Brazil, Australia and other countries with significant economies. It is in talks with many of these players, but time is not on its side.

As analyst Silke Trommer has [noted](#), trying to channel trade dispute resolution through PTAs more generally is likely to be difficult because "their dispute resolution provisions remain institutionally incomplete and are therefore unlikely to rival WTO adjudication in reliability, accessibility, and legal certainty." Similarly, Article 25 of the WTO Treaty may give members an alternative route to arbitration to the Appellate Body, but it does not stipulate what this would look like. One advocate of the Article 25 route points out that: "WTO arbitration can mostly be the current form of WTO dispute resolution by another name". States could, therefore, [agree to procedures similar to those of the Appellate Body](#) and even nominate the remaining jurists from the body to handle their cases on an ad hoc basis. In theory, the EU and other powers could create a simulacrum of existing WTO procedures and foil the US that way. But this rests on the assumption

that all WTO members would play the game by the same rules, when many would have strong incentives to play differently. If the WTO Treaty allows members to arbitrate their differences in line with Appellate Body norms, they could equally legitimately insist on alternative mechanisms. Either the Article 25 route or the PTA route is likely to lead to the fragmentation of global trade rules.

In this context, the EU needs to build as much certainty as it can into its ‘no deal’ planning for the WTO. While continuing to engage with the US on this issue, the EU should also:

- Make contact with all other WTO members to agree on an **emergency set of “rules of the road” for arbitration** in the absence of the Appellate Body. This is to ensure that states commit in principle to using methods as close to those in place as possible, or even an improved version of them, if US talks fail.
- Table a **broader WTO reform agenda** extending beyond the immediate dispute resolution agenda. The EU should also look for other WTO members to support this in order to help shift the US towards a more constructive approach to reform than it has adopted to date.

iv. Preparing for a new generation of multilateral challenges

If the challenge facing the EU in the WTO is an immediate one, questions about the future governance of technologies – including cyber technology, robots, and AI – are long-term priorities that are rapidly emerging as sources of multilateral tension. For instance, the US and Russia [fell out in the UN General Assembly](#) in 2018 over the basic issue of the format in which they should discuss cyber security.

Future technologies also present risks and opportunities for the EU in multilateral terms. On the downside, China, Russia, and the US are all pursuing new technology aggressively, with a focus on its security applications. All have little incentive to submit to multilateral regulations. In contrast, European countries’ thinking on AI is at widely varying stages of development, with some, such as France, having formulated detailed national strategies. Others, such as Italy, lag far behind. The European Commission issued a detailed strategy in April 2018 that provides a useful starting point. Overall, there is a danger that China and the US will dominate debates over the future of technology and – whether for statist or financial reasons – block any serious global governance in the area. This would be a historic reversal for the EU’s members, which have been deeply involved in shaping and revising the rules of existing international institutions, giving them lasting influence.

Nonetheless, the EU may still have the ability to shape the rules of technological innovation, relying on its economic and regulatory clout rather than multilateral diplomacy alone. Through the General Data Protection Regulation (GDPR) process, the EU has had a [global impact](#) on data-sharing norms. This is a [clear demonstration of Europe’s reach in this area](#). And, while the GDPR process annoyed almost everyone who received an email about it (which was everyone with an email account), some non-Western states may actively welcome European interventions on technological issues. The One Earth Future foundation notes, for example, that: [“the African continent will be](#)

[forced to face negative challenges with negative AI](#)” due to weak governments and social divisions. In this context, European efforts to establish multilateral rules for technology governance may appeal to other actors that lack the capacity to manage the problems that arise from innovation by themselves.

In this context, the EU’s members are likely to face a recurrent challenge. They may have the clout to corral small- and medium-sized states around multilateral solutions to technological challenges, but in doing so they may still alienate the US, China, and other more capable powers. A case in point was last year’s Paris Call for Trust and Security in Cyberspace, issued by France, which won the support of over 60 states and hundreds of non-state actors – but not that of Brazil, China, India, Russia, or the US. Unless there is a marked change in its strategic relations with the US and other major powers, the EU may be rebuffed like this again.

Nonetheless, there is still a strong case for the EU to carry out exploratory work in establishing an international framework for managing new technologies. There is long history of challenging conditions in which states gradually built up international norms and tools that eventually gained wider traction, in areas ranging from human rights to environmental policy. The EU may not be able to persuade Washington or Beijing to accept its ideas in this area in full at present. But, if it can generate ideas with other states now, it may still shape future multilateral structures.

At present, there is no shortage of talk about technology in the EU: one slightly jaundiced observer [notes](#) that “in October [2018] alone, AI was discussed at a summit in Estonia, a forum in Finland, and several conferences and hearing in Brussels”. But it is not yet clear how coherent these efforts will become. France’s and Canada’s December 2018 decision to launch an International Panel on Artificial Intelligence (IPAI), modelled on the Intergovernmental Panel on Climate Change, may be an [especially useful step](#) towards establishing common perceptions of AI inside and outside the EU.

In this context, EU members may be able to frame future international reforms by:

- Undertaking an **intergovernmental push to develop and harmonise national strategies on AI** and other areas as far as is possible, to create a genuinely EU base for action.
- Launching further initiatives similar to the 2018 Paris Call for Trust and Security in Cyberspace to **establish basic norms for managing conflict in new technological domains**. This should include rules about the uses of new biotechnologies that states and corporations can sign up to on a voluntary basis.
- **Investing in the IPAI and in similar agenda- and norm-setting panels and research projects** to promote transparency and exchanges around technologies that are largely developed in secret.
- Establishing the basis for inclusive multilateral processes around new technologies in future, offering **assistance to African partners and other developing countries** to agree on national AI strategies and to persuade them to see the EU as a natural friend in this domain.

Conclusion: Improving EU coordination across multilateral policy fields

This paper has highlighted the diversity of short- and long-term challenges to the EU in multilateralism. In reality, multilateralism is not a single policy space at all: the rules of the game and policy communities involved in security, finance, human rights, and other areas are very different from one another and do not always interact.

Nonetheless, no discussion of the EU and multilateralism should conclude without at least some reference to the question of European coordination across multilateral policy fields. More specifically, it is important to ask whether establishing a stronger ‘EU identity’ in particular policy areas would be advantageous or cumbersome.

It is notable that there has recently been a small flurry of proposals and initiatives to promote greater coherence in multilateralism, including:

- **Increased interest in reinforcing an EU presence at the UN Security Council.** In 2018 Sweden kicked off a successful initiative to encourage existing and incoming EU members of the council to make joint statements as the “EU8”. The practice has continued sporadically this year, while France and Germany organised a well-coordinated “joint presidency” of the council in March-April. Although more concrete talks about a formal EU seat on the Security Council linked to the new Franco-German friendship treaty foundered, there is momentum towards a [coherent European presence in the body](#).
- **A related effort by France, Germany, and the UK to strengthen the “E3” as a resilient diplomatic format** despite the shadow of Brexit, with officials in all three countries projecting that they could work together on issues other than the Iran deal in future. The trio is not entirely stable, but it is functional.
- **Ambitions for more fundamental changes in EU foreign policy decision-making relating to multilateral affairs.** These include a push by the European Commission for member states to agree on their positions in multilateral debates on human rights through qualified majority voting (QMV). More ambitiously still, Emmanuel Macron has revived talk of a “European Security Council”, possibly involving the UK.

These initiatives run counter to the fragmentation of European diplomacy over the GCM. In the meantime, the EU’s ability to act as a unit in the debates on the WTO show how the bloc can be more flexible – if not inevitably more successful – when it works as one. But many topics that have a multilateral element, such as migration and the focus on the Sahel, continue to create divides within the EU. It is unclear whether the EU can feasibly forge a strong, unitary presence in many multilateral forums in the near term.

Nonetheless, if the EU is to take steps to protect its “sovereignty” in multilateral forums, it will need to make changes to the way it does business. More specifically, the EU should:

- **Flesh out “EU8”-type cooperation** – and deepen E3 cooperation in the run-up to Brexit. To date, the EU8 have confined themselves to making joint statements. But current European members of the Security Council (assisted by recent members such as Sweden and the Netherlands, and candidates for membership such as Ireland) should work together on drafting and promoting UN resolutions of common concern, pooling the bloc’s expertise on Security Council affairs in a flexible manner. The UK (a regular member of the EU8) could engage in this process, in addition to expanded E3 cooperation efforts.
- In light of the split over the GCM – and the need to **restore at least some European unity over migration and values issues** in multilateral spaces more generally – all EU members will need to engage in dialogue on how to approach such topics in future. The EU’s next high representative for foreign affairs should appoint an informal “multilateral ambassador” to GCM non-signatories to craft such a dialogue and avoid further splits. The central European countries that made up a large part of the anti-GCM faction have not always been given a fair hearing in European debates on multilateralism (as they are not major aid donors, for example). Equally, to avoid further embarrassing splits, EU members will have to decide whether they are willing to accept some sort of binding formula on how to address values issues – such as the European Commission’s recent proposal to introduce QMV on human rights issues – or look for other ways to manage disagreements.
- In technology, the main driver of European coordination is likely to involve **deepening existing efforts to analyse trends in new technologies and agree on common standards in the area**. The more that EU members build a common analysis of how technologies are evolving, and the associated benefits and risks of this, the more likely they are to cohere around a broadly consensual approach to the issues at hand. The more that they agree on common standards, the more they can shape global rules. But, to get there, EU members that are in the lead will need to share ideas, information, and, in some cases, intelligence with others to help create a level playing field.

Beyond these case-specific proposals, it is also necessary to return to one of the factors reshaping Europe’s multilateralism noted earlier: the fact that China and the US are increasingly treating the EU as a target to split or co-opt in multilateral settings. Europeans do not have the luxury of making multilateral decisions in splendid isolation from other powers. Instead, they must be prepared for other actors to try to lobby, pressure, and coerce them over their positions in the international system. Facing down this pressure is ultimately a matter of political will rather than policy design. EU foreign ministers and heads of state would be well advised to hold one or two informal sessions to share notes on how Beijing and Washington – not to mention Moscow and other players – are targeting their representatives in New York, Geneva, and other multilateral centres. If the EU cannot work out how to hold together in multilateral diplomacy, it will find that there are a disturbing number of players who are keen to work out how to pull it apart.

Authors

Anthony Dworkin is a senior policy fellow at the European Council on Foreign Relations. He leads the organisation's work in the areas of human rights, democracy, and justice. Among other subjects, Dworkin has conducted research and written on European and US frameworks for counterterrorism, the European Union's human rights strategy, and the pursuit of justice in the international response to mass atrocities.

Ulrike Franke is a policy fellow at the European Council on Foreign Relations and part of ECFR's New European Security Initiative. Her areas of focus include German and European security and defence, the future of warfare, and the impact of new technologies such as drones and artificial intelligence. Franke has published widely on these and other topics, among others in *Die Zeit*, *FAZ*, *RUSI Whitehall Papers*, *Comparative Strategy*, *War on the Rocks*, *Zeitschrift für Außen- und Sicherheitspolitik*, and regularly appears as commentator in the media. She co-hosts the *Sicherheitshalber Podcast*, a German-language podcast on security and defence.

Ellie Geranmayeh is a senior policy fellow and deputy head of the Middle East and North Africa programme at the European Council on Foreign Relations. She specializes in European foreign policy in relation to Iran, particularly on the nuclear and regional dossiers and sanctions policy. Geranmayeh advised European governments and companies on the nuclear negotiations between Iran and world powers from 2013-2015 and continues to brief senior policy makers on how to effectively safeguard the implementation of the nuclear agreement. Her research focus also covers wider regional dynamics including post-ISIS stabilisation and geopolitical trends in the Middle East.

Richard Gowan is an associate fellow at the European Council on Foreign Relations. His topics of focus range from the UN to conflict management. Gowan teaches at Columbia University's School of International. He was previously research director at New York University's Center on International Cooperation, and has recently worked as a consultant with the International Crisis Group, the Simon-Skjodt Center for the Prevention of Genocide at the U.S. Holocaust Memorial Museum, and the UN Department of Political Affairs.

Gustav Gressel is a senior policy fellow with the Wider Europe Programme at the European Council on Foreign Relations' Berlin office. His topics of focus include Russia, eastern Europe, and defence policy. Before joining ECFR, Gressel worked as a desk officer for international security policy and strategy in the Bureau for Security Policy of the Austrian Ministry of Defence from 2006 to 2014, and as a research fellow of the Commissioner for Strategic Studies with the Austrian Ministry of Defence from 2003 to 2006. He was also a research fellow with the International Institute for Liberal Politics

in Vienna. Before beginning his academic career, he served in the Austrian Armed Forces for five years.

Manuel Lafont Rapnouil is a senior policy fellow and head of the Paris office of the European Council on Foreign Relations. His topics of focus include defence and security affairs, French foreign policy, the UN, and the Middle East and North Africa. From 2011 to 2015 Lafont Rapnouil headed the Political Affairs Division of the Department for UN affairs at the French Ministry of Foreign Affairs and International Development; in this capacity, he was responsible for French foreign policy at the United Nations Security Council, including peacekeeping and sanctions. Prior to that, he held various postings within the French diplomatic service, including in Washington and at the Policy Planning Staff (Centre d'Analyse, de Prévision et de Stratégie). Lafont Rapnouil was also a rapporteur for both French White papers on Defence and National Security and on Foreign and European Policy (2008). From 2008 to 2010, he was a Visiting Fellow at the Europe Programme of the Center for Strategic and International Studies (CSIS), a Washington-based think tank.

Mark Leonard is co-founder and director of the European Council on Foreign Relations. He writes a syndicated column on global affairs for Project Syndicate and his essays have appeared in numerous other publications. Leonard is the author of *Why Europe Will Run the 21st Century* and *What Does China Think?*, and the editor of *Connectivity Wars*. He presents ECFR's weekly World in 30 Minutes podcast and is a former chair of the World Economic Forum's Global Agenda Council on Geo-economics.

Jean Pisani-Ferry holds the Tommaso Padoa Schioppa chair of the European University Institute in Florence and is a senior fellow at Bruegel, the European think tank. He is also a professor of economics with Sciences Po (Paris) and the Hertie School of Governance (Berlin). In the first half of 2017, Pisani-Ferry contributed to Emmanuel Macron's presidential bid as the director of programme and ideas of his campaign. Beforehand, he served from 2013 to 2016 as commissioner-general of France Stratégie, the ideas lab of the French government. Prior to this appointment, he was from 2005 to 2013 the founding director of Bruegel, the Brussels-based economic think tank. Before creating Bruegel, he was executive president of the French PM's Council of Economic Analysis (2001-2002), Senior Economic Adviser to the French Minister of Finance (1997-2000), Director of CEPII, the French institute for international economics (1992-1997), and Economic Adviser with the European Commission (1989-92).

Elina Ribakova is a visiting fellow at the Institute of Global Affairs at the London School of Economics and Political Science. She was a visiting fellow at Bruegel. At LSE, she is responsible for a number of policy initiatives, ranging from global financial architecture to migration. She has over 15 years of experience in both the financial industry and policy making. Over the last seven years, she held senior roles in economic research and strategy

at a hedge fund, an institutional real asset manager, and a large international bank. Prior to moving to the financial industry, Elina worked as an economist at the International Monetary Fund (1999 - 2008). She is a graduate of the University of Warwick and now lectures on international macroeconomics with policy and finance applications.

Jeremy Shapiro is research director at the European Council on Foreign Relations. Previously, he was a fellow in foreign policy at the Brookings Institution in Washington, where he edited the “Order from Chaos” blog. From 2009-13, he served in the US State Department as a member of the policy planning staff and was a senior adviser in the Bureau of European and Eurasian Affairs.

Nick Witney is a senior policy fellow at the European Council on Foreign Relations. His topics of focus range from the European Security and Defence Policy to the Middle East Peace Process. Witney previously served as the first chief executive of the European Defence Agency in Brussels. High Representative Javier Solana chose him in January 2004 to lead the project team charged with developing the concept and blueprint for the agency. The European Council approved the team’s proposals in July 2004, an achievement recognised by European Voice in nominating Witney as one of its 50 “Europeans of the Year”. After that, he was appointed to establish and run the agency for its first three years.

Guntram Wolff is the director of Bruegel. His research focuses on the European economy and governance, on fiscal and monetary policy and global finance. He regularly testifies at the European Finance Ministers’ ECOFIN meeting, the European Parliament, the German Parliament (Bundestag) and the French Parliament (Assemblée Nationale). From 2012-16, he was a member of the French prime minister’s Conseil d’Analyse Economique. He is also a member of the Solvay Brussels School’s international advisory board of the Brussels Free University. He joined Bruegel from the European Commission, where he worked on the macroeconomics of the euro area and the reform of euro area governance. Prior to joining the Commission, he was coordinating the research team on fiscal policy at Deutsche Bundesbank. He also worked as an adviser to the International Monetary Fund.

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