EUROPEAN COUNCIL ON FOREIGN RELATIONS
ecfr.eu

POLICY BRIEF

TOUGH TRADE: THE HIDDEN COSTS OF ECONOMIC COERCION

Jonathan Hackenbroich, with Filip Medunic, Pawel Zerka

February 2022

SUMMARY

- Chinese economic coercion against Europe is on a deeply worrying trajectory. Having moved from threats in 2020 to punishment of European companies in 2021, China is now interfering with the EU market as part of a diplomatic dispute with Lithuania.
- If Beijing pressures European companies to stop trading with Lithuania, businesses could face pressure to stop dealing with Taiwan, Slovenia, or other places when tensions rise. The threat of Russian energy coercion is real, too.
- The EU needs to develop an Anti-Coercion Instrument that acts as a powerful economic deterrent, but this alone will not sufficiently protect Europe against economic coercion.
- The EU also requires a comprehensive resilience architecture, including a strong agenda for improving economic strength and trade links, a Resilience Office, and a reformed Blocking Statute that can counter secondary sanctions with Chinese characteristics.
- A Resilience Office could provide strategic coordination of the EU's response and evaluate the costs of economic coercion, while the Blocking Statute could allow for targeted countermeasures against companies based in third countries.

1. Tough trade: The hidden costs of economic coercion

Jonathan Hackenbroich

The times of easy globalisation are over. As the European Union's economic weight declines relative to that of other powers, it has entered a new phase of globalisation characterised by increasing use of economic tools for geopolitical purposes (or geo-economics) and systemic rivalry with China. These tools include everything from positive economic instruments, such as trade deals, to coercive ones, such as curbs on imports, formal sanctions, and informal sanctions (including so-called "popular boycotts") – from investments in strategic competitiveness to regulations designed to change company behaviour. As states try out different strategies, this new era will see them alternate between a focus on positive and negative tools. Periods of escalating economic coercion will give way to a focus on strategic competition, and vice-versa. Yet the underlying trend towards the weaponisation of economic relations will remain. This means that economic coercion is here to stay.

China

China's geo-economic relations with Europe are on a worrying trajectory. Until recently, serious Chinese economic coercion was something that Europeans only observed from afar. This changed in 2020 – when, for political reasons, China began threatening to impose dire economic costs on Europeans. The first real economic punishment followed in 2021. And, in the last few months, China has blocked trade with Lithuania – including that between the country and other EU member states.

Beijing has used import curbs and what are essentially secondary sanctions to punish Vilnius for allowing Taiwan to open a de facto embassy in Lithuania (a Taiwan Representative Office rather than a Taipei office). China stopped Lithuanian rail freight and even kicked Lithuania off its customs clearance system. Then, it reportedly decided to go beyond bilateral trade with Lithuania, weaponising access to the Chinese market for German, French, Swedish, and other European companies. This approach – which left no paper trail but appeared to have at least some success – involved warning unrelated companies based in third countries, such as German Continental, that they would lose access to that market if they continued trading with Lithuanian firms. For some Europeans, such techniques are reminiscent of US secondary sanctions on Iran (even if these are formal measures, and even if the US has significantly further reach than China thanks to the power of the US dollar). By threatening German Continental and others, Beijing is trying to redirect global trade flows away from Lithuania and even prevent one EU member state from doing business with the others – a form of interference in the single market. This explains why the Lithuania case is particularly worrying: if China is willing and able to threaten European companies over a country it has political disagreements with – in this case, Lithuania – it is easy to imagine it doing so to curb European trade with Taiwan or another country whose political relations with China suddenly deteriorate.

In March 2021, China imposed de facto economic sanctions on European companies after the EU – in cooperation with the US and the United Kingdom – targeted four Chinese local officials with human rights sanctions. Firms such as H&M and Adidas disappeared from Chinese e-commerce apps and faced popular boycotts, an increasingly common Chinese sanctions tactic. Beijing also sanctioned European ambassadors, parliamentarians, and think-tankers.

Meanwhile, China has also enacted a range of 'squeezing' laws. The country's export control law allows for the punishment of foreign companies that change the end use or end user of controlled products from China in a way that Beijing deems a threat to the national interest. Companies and individuals could be targeted under China's anti-foreign sanctions law if they take part in or implement what Beijing considers "discriminatory limiting measures" by the EU, such as sanctions or human rights provisions in supply chain laws.

In April 2020, as the covid-19 pandemic gained momentum, China went so far as to threaten to block the Netherlands' access to critical medical supplies. And Beijing has used the threat of car tariffs or import curbs to try to pressure Germany into accepting Huawei's bid to build the country's 5G infrastructure.

China's use of economic coercion has steadily increased relative to its share of the global economy. When South Korea decided to take part in a US-led missile defence initiative, China shut down most stores of Korean supermarket Lotte, forcing it to withdraw from the Chinese market. Beijing also introduced measures that amounted to a ban on Chinese tourism to South Korea, which is a major source of income for the country. Many other countries in the Asia-Pacific have their own stories of when China's use or threats of economic coercion forced them to adopt a particular policy. And China stepped up its game in 2021: it massively curbed Australian exports and hit them with extra tariffs as punishment for Australia's call for independent investigations into the origins of covid-19, as well as its decision to exclude Huawei from Australian 5G infrastructure.

Beijing seems intent on increasing Europe's reliance on Chinese value chains, which would mean that Europe would have even greater difficulty resisting such coercion. This is probably one reason why, so far, China has not gone even further in its use of economic coercion against Europe. Thanks to its economic strength, the EU also has leverage over China in trade relations. But now that the US and

Europe are closely aligned once again – and that tensions with China are likely to persist – there is a significant risk that Beijing will have fewer inhibitions about using such measures. As its economic strength grows, China is becoming ever more likely to use economic coercion against the EU, and to achieve in its political aims when it does so.

Russia

There is a real threat of Russian economic coercion against Europe. As the US and Europe threaten Russia with heavy sanctions to deter it from invading Ukraine, they will need to prepare for the Russian response. One cannot rule out the possibility that Moscow will weaponise its energy relationships by halting gas deliveries to Europe. It is also possible that Russia will use other economic levers against Europe or will play with energy markets in more ambiguous ways. In fact, Russia has refrained from filling European gas storage facilities in recent months, in line with its narrow contractual obligations but in a break with past practice. Russia is allegedly withholding up to one-third of its gas exports. The International Energy Agency has identified "strong elements of tightness in the European gas market due to Russia's behaviour", according to the head of the organisation, Fatih Birol. Perhaps Russia's behaviour is intentionally ambiguous and forms part of a Russian strategy to divide Europeans over the question of whether its actions represent economic coercion. But, in fact, it is not overly important whether Russia's ambiguous conduct is an example of outright economic coercion. The mere existence of a European Anti-Coercion Instrument (ACI) could significantly deter Russian coercion. Under an ACI, the EU could investigate possible coercion, follow a clear-cut process for determining whether a certain act constitutes coercion (which would be less divisive than its current approach), and raise the prospect of EU countermeasures in a manner that would discourage Russia from engaging in such behaviour (be it in subtle or not-so-subtle ways).

Europeans know Russia has used economic coercion against them before. In April 2021, Moscow threatened to restrict Russian imports of Czech products, especially beer, after Prague publicly identified the Russian intelligence services as responsible for the 2014 warehouse explosions in the Czech Republic. In 2014 Moscow banned the import of a vast array of EU agricultural products, especially those produced by Poland, in response to Western sanctions on Russia linked to its annexation of Crimea and invasion of Donbas. In Moldova, one of the EU's neighbours, Moscow recently showed that is willing to "weaponise" gas supplies, as EU High Representative Josep Borrell put it. He was referring to the fact that Russia had imposed significantly higher gas prices on Moldova in a push to weaken its trade ties with the EU.

United States

The United States' geo-economic policy is undergoing a generational shift independent of any one decision-maker – as is the transatlantic relationship. In the coming years, the US will remain deeply committed to strategic competition with China, and to using its economic power as its main tool of foreign policy. In contrast to its predecessor, the Biden administration has worked to strengthen the relationship between the US and its allies. But, in the next year, the administration will come under growing domestic pressure to show that its approach to China is succeeding – especially if the Republicans regain control of Congress following the November mid-terms. Accordingly, the administration will be increasingly tempted to use unilateral economic tools to counter China, and in other areas of foreign policy. Such measures would not be directed against US allies but could still damage them. Congress could try to force the administration's hand in this, and could even try to make it impose sanctions related to specific and highly controversial issues beyond Nord Stream 2 (where measures targeting the pipeline have already been attempted). More importantly, Europeans need to accept that Trumpism is here to stay: there is a risk that, after a new presidential term begins in 2025, the US will once again use direct economic coercion against the EU. With even the Democrats' shifting the focus of their foreign policy in this new era, the EU cannot expect the US to account for European interests at all times. Therefore, it would be a mistake for Europeans not to build up their own capacity to deter and punish economic coercion – no matter the results of US elections.

Recommendations

The world has changed. In the new era of globalisation, Europeans are right to intensify multilateral efforts such as the EU's initiative with the US and Japan to reform the World Trade Organisation (WTO) and the rules-based international order. And it is critical that the EU works with its like-minded partners on common standards. But the EU also needs to negotiate with other powers in an agile, autonomous, and effective manner – to ensure that they have an incentive to engage in fair and rules-based behaviour. No one instrument alone can guarantee success in this. The EU needs to develop a comprehensive agenda for the geo-economic era – including an ACI that, in grave cases of economic coercion, acts as both a deterrent and a measure of last resort.

The EU has launched a strategy for "open strategic autonomy" to reflect this balance. The EU is building up its resilience against economic coercion through measures such as the Enforcement Regulation; systems for screening foreign direct investment (which a growing number of member states are adopting); reformed export controls; the International Procurement Instrument; and, potentially, the reform of EU competition policy to address unfair competitive advantages through a foreign subsidies instrument.

The EU also has various other ways of increasing its resilience against economic coercion. The EU energy union, for instance, could help the EU diversify its energy supply and hedge against the weaponisation of energy exports.

To strike a balance between openness and strategic autonomy, the EU should focus on the following areas:

- **Economic strength and competitiveness**. Europeans need to think about how to build up their economic strength – as this is their main defence against coercion and a prerequisite of any credible and effective defensive instrument. It is crucial to preserve the vitality of the European economy: one cannot stand up to strong economies from a position of weakness. Besides, Europeans cannot be seen to advocate protectionism, not least because their prosperity and innovativeness rely so much on open and rules-based trade. For instance, the EU should make a substantive effort to complete the single market – which, in many places, is not even on the political agenda anymore but is rather something that people believe has been accomplished. In doing so, the EU should recognise that, to maintain strong trade relations with the rest world, it is important to ratify trade deals.

- **Positive strategic trade policy**. It is in the EU's interests to maintain the openness of its economy. This approach has made it strong in the past, as has its emphasis on competitiveness. There is also a risk that others will fill the vacuum the EU leaves if it is unable to conclude, ratify, or implement a trade deal. A strong network of deep trade relations facilitates diversification – thereby avoiding the kind of excessive dependence that another power could leverage for economic coercion. Of course, the EU needs to address legitimate public criticism of its efforts to combat climate change, and of its active trade policy. The union needs a new consensus on its overall trade policy – one with stronger positive and defensive pillars. The EU could explore sectoral agreements to advance a positive agenda, reduce trade costs, and set common standards. It could do so without having to deal with the difficulties that come with comprehensive free-trade agreements, while still acting in full compliance with WTO rules.

- **Ensure that the EU-US Trade and Technology Council quickly becomes a success**. As discussed, the Biden administration will soon come under mounting domestic pressure to show results from its alliance-based approach to confronting China. Europeans need to demonstrate to Washington that the US can best protect its interests in close cooperation with its allies (and, therefore, should take their interests into account). This should probably involve concrete European offers to the US at the Trade and Technology Council.

- **Build a geo-economics package that includes the ACI**. Those who see the ACI as addressing a critical European vulnerability should recognise the importance of avoiding protectionism – and vice versa. A poorly designed ACI would increase the risk of protectionism. At the same time, the EU needs to make it more costly for third countries to use economic pressure to affect European policy. The ACI would not provide sufficient resilience against economic coercion by itself. In formulating a comprehensive strategy for the geo-economic age, Europeans should agree on an ACI and on substantive positive measures.

- **Create a comprehensive resilience architecture**. An EU Resilience Office may be a prerequisite of any effective anti-coercion policy, including one that involves an ACI. This effort should focus not on creating a new institutional set-up but on building new capacity and enhancing coordination between member states, which may require some institutional changes. The EU could establish a permanent body to conduct strategic analysis and coordinate on geo-economics and economic coercion across directorates-general. This office could also act as a confidential point of contact for businesses experiencing coercion. Confidentiality is particularly important in this context, as many forms of economic coercion are informal and make use of legal grey zones. A Resilience Office could also help facilitate market substitutions when certain products are banned in a third country's market (as Lithuania's have been in the Chinese market) and could address the issue of compensation for the short-term damage companies incur in the heat of the moment. Finally, exchanges with the private sector are key: as European companies are on the front line of economic coercion, they understand the unintended effects that EU responses may have. The EU could establish a permanent dialogue on geoeconomics with the private sector to make sure it remains in touch with the issues businesses are facing.

- **Reform the Blocking Statute and make it fit for the China challenge**. China's actions against Lithuania are a forceful reminder that the EU needs to reform its Blocking Statute. The statute is meant to provide protection and deterrence in precisely the situation some European companies have found themselves in: where a third country leverages market access that is indispensable for these firms, aiming to force them to stop trading with a state targeted by the that third country. To transform the statute from a largely dysfunctional tool into an effective one, Europeans could change its philosophy. They could establish a new 'contract' between companies and the authorities. In the first part of this contract, the EU would maintain that it is, in principle, illegal to comply with the coercer's secondary measures (such as China's initiatives to block trade with Lithuania). At the same time, the new statute would make it easier for European companies to obtain a waiver that allowed them to comply with the coercer's secondary measures in specific situations. This is not because the EU would want to approve of such behaviour, but in recognition of the fact that some businesses simply cannot afford to lose access to the critical market or service that is under threat. For instance, banks could lose access to dollar trading under US secondary sanctions if they facilitated trade with Iran. So far, the Blocking Statute has put them between a rock (threats from third countries) and a hard place (Europe's prohibition on bowing to the threat). The way out of this is to make it easier for businesses to obtain a waiver – but only under certain conditions, including where they provide important information to the authorities on trade patterns and the coercive acts. The Blocking Statute could then coordinate with the ACI and a Resilience Office – which, using the new information it acquired, could impose the appropriate countermeasures against the third country in question. Alongside the large-scale countermeasures the EU could use under the ACI, the statute itself could also include the option of responding with targeted, or smaller-scale, countermeasures against certain companies based in third countries.

- **Establish an export bank**. A European export bank could attempt to open blocked payment channels for humanitarian trade – and, possibly, for other purposes too. The strategic goal of this would be to enable trade when a third country interfered with access to critical financial services – and where this interference limited Europe's capacity to act. For instance, the EU's stabilisation policies are sometimes ineffective because, due to sanctions imposed by third countries, banks cannot transfer financial packages from the EU to crisis zones. Chinese payment systems and the digital renminbi could also cause such problems in future. Such scenarios involve a range of challenges – not least those related to interactions between export banks and commercial banks, as well as the wider financial system.

- **Use the ACI strategically in relations with the US**. Many in the US are interested in a stronger Europe that can deter economic coercion by third countries, especially China. The ACI has the potential to strengthen transatlantic relations, as it would help the EU become a resilient partner with an economic deterrent. A key strength of the proposed ACI is that it is country-agnostic. The instrument focuses on an objective assessment of the 'facts of the case' of economic coercion and would be used to deter and counter a third country's interference in the sovereignty of an EU member state. Washington may prefer the instrument to be explicitly limited to non-market economies.

The EU could not limit the ACI in such a way legally, but this situation provides it with a two-fold strategic opportunity. Firstly, the EU could reinforce Americans' view that it is in their interests for Europe to become stronger and more resilient. It could openly discuss the ACI's economic deterrent with the US, underscoring how the instrument would enhance the bloc's geopolitical capabilities.

Secondly, Europeans can emphasise that they have no desire to use the ACI against the US, as they assume that an ally would not interfere with EU member states' sovereignty. Indeed, it would be strategically wise for both the US and the EU to avoid targeting each other with punitive measures – such as section 232 and section 301 tariffs, the removal of access to dollar trading, and other extraterritorial coercive measures that the Trump administration used to try to change European policies. A strong EU economic deterrent would remind both Americans and Europeans to think about how they can strengthen their strategic relationship, while making Europe a more capable and attractive partner for the US in relations with third countries.

2. The proposed Anti-Coercion Instrument

Jonathan Hackenbroich, Pawel Zerka

The European Council on Foreign Relations published a comprehensive guide to designing the Anti-Coercion Instrument (ACI) in June 2021. Its title is 'Measured Response: How to design a European instrument against economic coercion'. This essay provides an overview of key questions about the ACI the European Commission proposed in December 2021.

The new Anti-Coercion Instrument (ACI) the European Commission proposed on 8 December 2021 could be a big step towards greater resilience. As these authors argued last June in a comprehensive assessment of an anti-coercion instrument, the European Union needs to adapt to an age of weaponised trade. But the devil is in the details.

In the past two years, there has been much talk about the emergence of a geopolitical Commission that would learn to speak the language of power and protect European values. Through the ACI, the Commission is fulfilling its commitment to strengthen Europe against economic coercion. The instrument could provide the Commission with an impressive tool of last resort, one that deters acts of economic coercion by signalling to third countries that they could face European countermeasures. Of course, the best structural defence against economic coercion is investment in Europe's economic development and capacity for innovation (see the essay in this paper on the strategic landscape). But the ACI could provide a deterrent to more serious incidents of economic coercion, by incentivising other powers to play by the rules and allowing the EU to hold firm in a dire situation.

The Commission has presented an ACI that is rooted in international law: the instrument requires any move to impose countermeasures on a third country to be preceded by various stages of investigation of and engagement with it. A European answer to economic coercion is an economic deterrent that is country-agnostic and purely reactive – in other words, one that is not based on an ever-widening definition of national security or on the more arbitrary decisions of an authoritarian leader.

The European Parliament and the European Council – the Commission's co-legislators – will now consider whether to adopt the proposal for the ACI. They will only do so if they are confident that the EU would be stronger with a powerful, well-calibrated economic deterrent than without it, and if they could manage the risks it involves. In this, it will likely be particularly important for them to consider five key areas.

Scope

Through the ACI, the EU could use economic means to respond to a third country's violation of its sovereignty, or the sovereignty of its member states, through measures that affect trade or investment. The instrument could also allow the EU to respond not just to punitive tariffs and import curbs but also more informal measures in a legal grey zone, such as 'popular boycotts', arbitrary border or food safety checks, and certain secondary measures.

Nonetheless, the proposed ACI might be unable to cover all illegal secondary or extraterritorial measures that, while they do not interfere with the sovereignty of an EU member state, still disrupt European foreign policy by changing European companies' behaviour. To address this problem, the EU could include a flexible resilience mechanism in the ACI (see 'Measured Response'). Under such a mechanism, the EU could specify that particularly grave instances of secondary or extraterritorial coercion would trigger countermeasures in specific situations – if member states agreed to this course of action.

Countermeasures

The annex to the ACI proposal lists 13 areas in which it could impose measures, ranging from trade and investment to financial markets, public procurement, and exports. Measures in these areas could establish a credible deterrent. Export controls might be critical in relations with some third countries where counter-tariffs might not affect the political calculus of the coercer. For example, the Trump administration's tariffs on China did not change Chinese policy to a great degree. As the authors of this paper have previously observed, in certain situations, highly targeted sectoral divestment could prove more effective than counter-tariffs. In some sectors, a third country might welcome EU investment that integrates its value chains with European ones. Therefore, by withholding such investment in a targeted way, the EU could gain leverage over that country. It would not be easy to include this type of measure in the ACI but, as these authors have argued

, it can be done.

The Commission emphasises the ACI's capacity to trigger a response that is finely calibrated to the situation at hand, by proposing broad trade and investment measures, and by counter-listing measures that could target individuals or companies linked to the coercive government (and, possibly, those directly involved in coercion). The instrument would give companies the opportunity to recover damages caused by listed natural or legal persons. This means that the EU's response need not always involve broad and potentially damaging countermeasures such as tariffs.

For more details on the opportunities and challenges involved in various categories of possible ACI countermeasures, see these authors' comprehensive report on an anti-coercion instrument.

The ACI's decision-making mechanism

The proposed framework of the ACI includes a 'red light procedure' in which a qualified majority of member states can stop the Commission from imposing countermeasures. However, one could argue that, on tougher countermeasures and in highly tense scenarios, EU member states should have more say on the matter. For example, there could be a case for a 'green light procedure', which would require a qualified majority of member states to approve the Commission's decision to impose countermeasures. At the same time, this approach may not fit with trade policy procedures. There is a danger that the ACI would not allow for the swift imposition of tough countermeasures if many member states had to approve them first. In this scenario, the ACI would not be an effective deterrent. In any case, member states would be closely involved in the design of countermeasures under a 'red light procedure' – perhaps more so than if their role was limited to straightforwardly approving or rejecting measures proposed by the Commission. Member states will need to account for these difficult trade-offs – and remember that, formally and in practice, they will have a pivotal role as a check on the Commission's actions.

Risks

Broad powers to impose countermeasures could lead to protectionism unless the EU manages the ACI well. The instrument's definition of economic coercion is vague. At the same time, if the definition was narrower, this could leave the EU vulnerable to new kinds of coercive measures that are not covered by the current version of the ACI (or that are even designed not to fall under the EU's definition). Ultimately, the key question concerns how the EU wields the instrument in practice: if it does so cautiously, it can minimise many of the risks involved. Uncontrolled protectionism or threats to the World Trade Organisation (WTO) system would meet with opposition from EU member states, which the Commission – a body that pays close attention to WTO rules – would have to take seriously.

Having said all this, the ACI proposal seems designed to promote the de-escalation of disputes, which is crucial to improving the EU's trade relations. Throughout its implementation of procedures under the ACI, the Commission would offer to resolve tensions with bilateral dialogue or in international forums. The EU could immediately suspend its measures if the coercer did so. This approach seems grounded in a commitment to existing rules, as it emphasises the need to resolve differences through dialogue wherever possible.

Burden-sharing and moral hazard

EU countermeasures could easily have an uneven impact on EU member states, given that they would have negative consequences for some industries but not others. This is why continuous dialogue with the private sector is key (see separate chapter on the Resilience Office). The EU could also think about creating burden-sharing mechanisms that could provide short-term compensation for companies that needed to adapt to coercion by third countries.

But the EU solidarity that would come with the ACI could also create moral hazard. Under the ACI, the EU could use trade measures (a competency that is centralised in Brussels) to respond to instances of economic coercion that originated in the pursuit of a member state's independent foreign policy, or in tensions between one member state and a third state – or even a business decision made by one company. The EU would set a dangerous precedent if it assured member states that they would automatically benefit from European solidarity. Such acts of solidarity could impose economic costs on member states that were uninvolved in the tensions that prompted coercion by a third country. This could encourage actors such as China and Russia to try to persuade individual member states to take a stance that would prompt a change in the EU's overall policy.

At the same time, Europeans need to remember that effective economic coercion is, almost by definition, that which divides the EU. A coercive third country will do everything it can to prevent the 27 EU member states from unifying against it. This suggests that, in their response to economic coercion, Europeans should not only weigh the substance of the policy at hand but also the gravity of the coercive act targeting a member state: there needs to be an implicit line beyond which the EU shows solidarity with a member state even if many of its allies in the union did not agree with its conduct in the context of (or that even prompted) the coercive act. This is not simply because EU solidarity is valuable in itself. It is also because, when a coercive act crosses that line, it would be less costly for other Europeans to demonstrate that solidarity requires some sacrifices than to refrain from deterring or countering a third country's coercive behaviour. Generally, the EU will only be able to determine when a coercive act crosses the line once it knows the details of the situation. But if, for instance, a third country's measures blocked all trade between one member state and the others, it would be crucial for the EU to defend the integrity of the single market.

Conclusion

As these authors wrote in June 2021, the decision on whether to establish an ACI "is not straightforward. But, if the EU decides not to do so, it should know that this could risk damaging rules-based international trade in this new era of geo-economic competition. Inaction can be provocative and politicising, too." Such inaction could invite third countries to blackmail the EU and erode rules-based international trade, possibly at no cost to themselves. The question is: will member states believe that a strong ACI is too risky and opt for the lowest common denominator (thereby defeating the purpose of an economic deterrent) – or will they instead seek a fine balance between opportunity and risks? Ideally, they should create a geo-economic package that includes the ACI, and should pursue a comprehensive strategy that focuses on both the EU's economic strength and an ambitious, positive trade policy.

3. An EU Resilience Office for Economic Security

Jonathan Hackenbroich

A Resilience Office for Economic Security could enhance the European Union's capacity to act in the geo-economic age. The EU needs a more integrated, holistic view of how third countries use economic policies for geopolitical advantage and geopolitics for economic advantage. The EU should consider building such an office for the following purposes:

- **Strategic coordination across directorates-general (DGs)**. Brexit offers a key lesson for how the EU should deal with a cross-cutting issue such as economic coercion. The EU established a central task force for strategic coordination of its relations with the United Kingdom following the country's departure from the union. The union did so not least because only a centralised, strategic service for EU-UK agreements could prevent the UK from pitting parts of the EU against each other. Competences in economic relations with the UK are scattered across different DGs in the Commission, and across various departments in member states' governments – as are competencies in economic coercion. It was necessary to establish a central team within the European Commission's Secretariat-General that would coordinate and clear all actions on the EU's relations with the UK.

This kind of strategic coordination is even more important when it comes to strengthening the EU's defences against economic coercion. Third countries that use economic coercion against the EU are frequently more distant partners than the UK. And, if they use economic coercion effectively, they can pit DGs and member states against each other.

- **Strategic analysis**. The EU already has a substantial capacity to analyse international trade and external markets, but this lacks strategic integration. The EU has already established many of the necessary competencies – from market access and third-market analysis in DG Trade to supply chain dependencies analysis in DG Grow, to foreign subsidy analysis in DG Comp, to the new EU Resilience Dashboards. But a Resilience Office could match insights from one area with developments in another to assess the full strategic picture. It could create analytical capacities that the EU currently lacks. For instance, the union currently has no capacity to assess the strategic costs that third countries' measures impose on Europe's companies and economy (even if it has a database of some such measures).

- **A point of contact for businesses**. European companies currently have the hearing officer and Access2Markets tools. And they can reach out to various parts of the European Commission or the European External Action Service with their concerns about economic coercion. But they often find themselves alone when confronted with problems in third countries, such as when agencies in these countries pressure them through coercive actions, complex compliance requirements, unexpected costs, or requests for sensitive data transfers. These firms may not always find it easy to share information on such experiences with EU institutions – especially when they do not have a central interlocutor to contact and are unconvinced that doing so would lead to a strategically effective response. Companies have important insights into the policies that will increase Europe's economic strength – which is the greatest defence against economic coercion and is critical to preserving the EU's geo-economic capacity to act.

A Resilience Office could eventually become a central representative of European interests in negotiations and other dialogue with entities such as the Chinese administrative departments for export control and the US Office for Foreign Assets Control.

Ultimately, a Resilience Office would be most successful as a 'service provider' that had real benefits for the Commission, member states, and companies. It could provide coordination, analytical, and reporting services, and would require no treaty changes or transfers of competencies to the EU level. By setting up such an office, the EU would improve the efficiency of its analysis and response capabilities through resource pooling – thereby reducing the costs of the union's responses to economic coercion for its institutions and member states.

Capacity

To justify its existence, a Resilience Office would need to have clearly outlined responsibilities. The most important of these responsibilities – many of which would apply in the short to medium term – are listed below. It could take the office a little longer to assume some of these responsibilities than others. But most are urgently needed.

- **The Anti-Coercion Instrument (ACI) and the Blocking Statute**. The EU could establish a high-level strategic unit that is responsible and provides analysis for the ACI, given that it is a powerful instrument. A Resilience Office could take on the governance of the ACI and the Blocking Statute. It could launch an investigation into suspected acts of economic coercion, determine whether these acts constituted such coercion, and work closely with the relevant DGs whose competencies will be needed to impose countermeasures on those responsible (especially DG Trade). In this scenario, a Resilience Office could coordinate these and other tasks as part of the EU's geo-economic governance, tying together the work of relevant DGs across the European Commission. The office could inform the European Council about its proposals or make its own proposals to the Council.

- **A geo-economic scoreboard**. The EU is well-placed to raise its voice in defence of rules-based trade and its fact-based approach. The Commission could monitor geo-economic actions and assess instances of economic coercion with the same meticulous approach it currently applies to member states' implementation of internal market regulations. As part of this, the Commission could publicly name and shame actors that use economic coercion.

- **Documentation of third countries' coercive behaviour**. A Resilience Office could map economic coercion – partly by drawing on its analyses of the phenomenon across the EU system. Coercive measures often have indirect effects that the authorities do not register. A Resilience Office could generate a central database of these issues. Business actors could inform the office about threats or disadvantages a third country has imposed on them, perhaps through a new channel (as discussed below).

- **Cost assessments**. Many of the costs of economic coercion will remain unclear without in-depth analysis, as affected sectors might find substitute markets for their products to help ease the pain. In this, the office could focus on three critical effects:

  - **Collateral damage**. The office could notify third countries' agencies about the collateral damage their coercive policies inflict on Europe even without directly targeting it.

  - **Impact on European policy**. The office could outline the policies that third countries' coercion has prevented the EU from pursuing.

  - **Market distortion and costs for European businesses**. The office could periodically issue public reports on the direct, indirect, opportunity, and transatlantic costs of economic coercion. Such transatlantic costs would include losses of market share that EU and US companies suffered due to economic coercion – be they caused by third countries or by a US administration such as former president Donald Trump's (see ECFR's previous work on market distortion).

- **Dialogue with third countries**. The office's experts could serve as a permanent interlocutor with relevant third-country agencies that implement coercive policies.

- **Biannual reports to the European Council**. These reports could contain a geo-economic scoreboard, the results of efforts to map economic coercion, and cost assessments.

- **An early warning system**. A Resilience Office could issue private and public warnings to one or several member states, and even European companies. It could share information about a case of economic coercion against one member state with all member states. And it could warn them about the trends and strategies underlying third countries' behaviour. This could include flagging up types of businesses and sectors in which there is a relatively high risk of coercive acts. The EU currently has some tools to identify member states' economic dependencies, but they are not integrated into a legal and economic analysis of how these dependencies could be exploited. As part of its early warning system, the office could explain how member states could protect their interests.

- **Data analysis**. A Resilience Office could privately assess the data on economic coercion available to the EU and its member states, and could identify the type of data it would need to make more accurate assessments of the threats they face. This could involve a requirement for businesses to share some of these data – as part of, for example, their duties under a reformed Blocking Statute (see the section of this paper that focuses on the statute).

- **Trust-building with companies through dialogue and a secure reporting mechanism**. Confidentiality and trust will be key to this. A Resilience Office would need a strategy for systematic engagement and trust-building with private sector actors. Much would depend on the EU's capacity to respond to economic coercion – in other words, its ability to move closer to the statecraft of third countries. But a public-private forum and technical mechanism would also be important. The Commission could establish a permanent dialogue with the private sector on geo-economic matters, which the Resilience Office could oversee. This could ensure that political and business leaders did not increasingly fall out of sync in building up Europe's economic strength, and that the EU could account for business perspectives when crafting its responses to economic coercion. One way to do this could be to add a geo-economic track, which would cover economic coercion, to the EU Industrial Forum – a new format that Brussels has established for permanent dialogue with the private sector, aiming to ensure the EU receives the information from companies it needs for effective implementation of the digital and green transitions. A Resilience Office could also establish secure mechanisms for data-sharing and communication based on the cutting-edge technology available from some European providers. All the office's staff should have security clearance, to ensure they handle information confidentially.

- **Support for companies in their relations with third countries' authorities**. The office could provide European businesses with expert advice on how to deal with pressure from third countries, especially in their bids for waivers and exemptions.

Institutional set-up

Quick results are key to the success of a Resilience Office. Therefore, the EU could start building this office as soon as possible, ensuring that it can perform the functions discussed above. By incrementally combining the analytical capabilities it already has, the Commission could take steps towards the creation of a fully fledged Resilience Office. The Commission could begin to do so immediately, before engaging in a more comprehensive restructuring process of anti-coercion institutions under its next mandate, which will begin in 2024. EU member states could also include the following recommendations on a Resilience Office in the final law on the ACI that they are currently negotiating:

- **Link to the Commission's leadership**. The office would coordinate with different parts of the European Commission, reporting to a group of external policy commissioners under the president.

- **Daily management**. The deputy secretary-general of the Commission could both oversee the work of a Resilience Office and provide a link between the office and the Committee of

Permanent Representatives.

- **Link to the Council**. A Resilience Office's work would touch on many matters of foreign policy, and would support the EU's commercial policy. It is important to ensure that there is a strong link to the Council through the high representative for foreign and security policy, who would head the group of external policy commissioners.

- **National experts**. EU member states could second experts to a Resilience Office to increase its capacity and provide a link between it and them.

The EU's resilience architecture

The EU needs to think about its resilience architecture. It is not overly important whether this architecture takes the form of an EU Resilience Office per se, so long as the EU establishes efficient and competent structures that achieve the goals discussed above. In this sense, the EU could establish a resilience architecture by taking one of the following three approaches.

Option 1: A strategic unit within the Commission

The Commission has a strategic unit for technology and the European Green Deal. But it lacks a similarly strategic unit at a high level just below the president of the Commission for geo-economics and economic coercion.

In option 1, a Resilience Office would be responsible for coordinating and supporting the competencies of the European Commission. The office's staff would be made up of experts from EU institutions and could work closely with economists, legal advisers, and strategists (given that geo-economic matters require collective analysis from all these perspectives). The office could be headed by a special representative for geo-economic policy, who would lead the dialogue with third countries' authorities.

A Resilience Office could consult with the EU representatives responsible for the Common Foreign and Security Policy. It could do so through the high representative, who could provide a link between the Commission and member states, and who could play an important role in taking political ownership of the EU's economic coercion policy.

Option 1 would help the EU take a more strategic approach to economic coercion, making it more difficult for third countries to exploit the differences between DGs or member states. It would be fairly easy to set up a Resilience Office in this way, which could create a point of contact for the private sector that offered effective responses. Depending on the exact decision-making mechanism for countermeasures under the ACI, member states and the Council may wish for a stronger link between them and the Resilience Office (see the essay on the ACI in this paper).

Option 2: A liaison committee attached to the Council

In option 2, the EU would set up an economic intelligence unit attached to the Council. It could staff the unit with experts from DGs, but it would remain independent from the Commission.

This option would create a strong link to member states while accumulating knowledge from across the EU. But it would not truly break down siloes between DGs and agencies in Brussels – a flaw that has the potential to weaken the EU's resilience and response to coercion.

One idea could be for the secretariat-general of the Council to coordinate the process, as it does through the Integrated Political Crisis Response mechanism. But this would be an ad hoc arrangement rather than a structural, strategic, and permanent response to the threat.

Option 3: Development of an EU resilience architecture

The EU might need a resilience architecture, or geo-economic ecosystem, rather than just one office. The union requires a well-coordinated policy approach to economic coercion across DGs and agencies, a permanent dialogue on geo-economics between the Commission and the private sector, a point of contact for businesses, and a strong link to the Council. Moreover, a Resilience Office would be unable to tackle the necessary resilience tasks at the EU level on its own, while some member states lack national authorities that are both responsible for addressing economic coercion and have the capacity to do so. There is also a risk that such authorities would not share information on economic coercion with EU institutions (due to protectionist or other concerns). The EU and its member states need to build an anti-coercion system on both levels that is efficient and effective, and that has close links to the Council, companies, and a strategic unit in the Commission.

4. Reform of the EU Blocking Statute

Pawel Zerka and Filip Medunic

Much has changed since the authors of this paper argued in October 2020 that the European Union should defend its economic sovereignty by reforming the Blocking Statute. Most of all, the European Commission's new Anti-Coercion Instrument (ACI) proposal could change the context in which it is effective to use the Blocking Statute (see the essay on the ACI in this paper). At the same time, a different branch of the European Commission has carried out a public consultation on the reform of the Blocking Statute and plans to submit its proposal for this before summer 2022. The Commission has also published a report on notifications that sheds light on both the useful elements and the limitations of the current statute.

However, the Blocking Statute continues to be widely seen as having only a limited impact. The protections it provides only extend to the laws listed in its annex, which happen to be select pieces of US legislation. So far, the statute does not cover other forms of secondary economic sanctions or pressure on European companies (such as those applied by China). But, as the Lithuania case illustrates, gone are the days when Europeans only had to worry about secondary sanctions or measures from the United States (see the strategic overview essay in this paper). While those measures may come increasingly from China, and the Blocking Statute could be part of the toolbox for addressing them, analysts and policymakers still disagree on whether and how the EU can reform the statute effectively.

An opportunity for the EU

The EU adopted the Blocking Statute in 1996 with the specific aim of countering the Helms-Burton Act, US legislation that implements an embargo on Cuba. It was not until 2018 that the union amended the statute to also cover US sanctions on Iran. The EU updated the statute the following year, in response to Washington's reactivation of Title III and Title IV of the act. Elements of the statute have proven their worth: Article 4 (concerning the non-recognition of judgements or decisions based on the acts listed in the annex to the Blocking Statute) has allowed EU companies to argue in American courts that there is a conflict of norms between the Blocking Statute and the Helms-Burton Act. As a result, some American courts have temporarily suspended the review of claims by US nationals, thereby giving EU companies more time to prepare their defence and prolong the procedure. Ultimately, this deters such claims under the act by increasing the legal cost of filing them.

However, the Blocking Statute has had little effect in other areas, including US sanctions on Iran. Most notably, China has also started to impose coercive secondary sanctions informally and without a paper trail – which means that, currently, the statute cannot capture them. As it stands, EU companies often choose to comply (or even overcomply) with coercion by third countries rather than with the Blocking Statute. In practice, companies rarely report the effects of extraterritorial sanctions on them – apparently, because they usually do not see this as being in their interest. This shows not only the limitations of the prohibitive part of the Blocking Statute (Article 5) but also the way in which the statute makes it harder for the European Commission to build trust with EU firms. Such trust is vital to understand the full picture of economic coercion – and to respond to it effectively.

One solution could be to change the underlying philosophy of the Blocking Statute. Instead of focusing on blocking and flagging conflicts of norms, the statute could focus on building trust and gathering intelligence. At the very least, the EU should seriously consider such an approach to make the Blocking Statute truly effective. This could involve the steps discussed below.

Establish a new dynamic between companies and the EU authorities

Brussels could significantly streamline the process of providing EU firms with waivers (authorisations for compliance with specific foreign laws) – so long as they could prove that they had been subject to substantiative external pressure, and that their receipt of a waiver would have no significant side-effects on other EU companies. In this way, EU firms that had to comply with third countries' laws could do so in compliance with EU law. Equally, when EU firms were not subject to substantive pressure, the Blocking Statute would prevent them from pre-emptively complying with third countries' laws – and those that complied with the statute would be granted effective protection (with the EU even covering some of the costs that they would face).

The European Commission could – through the type of Resilience Office discussed in another essay in this paper – become more active in other ways, such as by supporting EU companies in external legal proceedings (as a friend of the court, for instance) and by identifying when informal secondary measures such as China's on Lithuania should trigger the Blocking Statute. The Commission could be quicker and more consistent in updating the annex to the Blocking Statute, which could list not just the foreign laws but even the grey zone measures that the EU would like to block. The Commission could also create some form of mechanism to compensate EU firms for losses resulting from economic coercion. In exchange, these companies would provide the Commission with some information on the coercion that they have experienced (such as lists of business partners and types of transactions).

Equip the EU with countermeasures

Through trust-building and information-gathering with EU firms, the EU would develop effective and credible techniques for responding to economic coercion such as trade measures and other withdrawals of privileges for third parties. To demonstrate its resolve, the EU would need to develop the capacity to punish the coercers rather than just EU companies.

The proposed ACI could achieve this, particularly given that it should cover some secondary and extraterritorial sanctions and other measures – at least those that interfere with the sovereignty of EU member states, such as China's secondary measures to curb European trade with Lithuania. Therefore, the Blocking Statute and the ACI could be complementary, with the former supporting companies and the latter deterring and responding to economic coercion.

But the EU could still include some small-scale countermeasures in the Blocking Statute itself, not least to facilitate a response in cases not covered by ACI – in other words, when it could be far-fetched to view the use of secondary measures as a threat to the sovereignty of the EU or particular member states. This could create a sort of functional division of labour between the ACI and the Blocking Statute: the former would operate on a large scale, focusing on countries and threats to sovereignty, while the latter would concentrate on non-EU companies, institutions, and individuals.

Use the Blocking Statute to begin a political dialogue

The EU should use the Blocking Statute as more than just a strict regulatory tool. The statute should also provide Europeans with political leverage. When EU companies are in trouble, diplomacy could prove key to resolving the situation – but the Blocking Statute would strengthen the EU's negotiating position in this.

The original idea of the Blocking Statute was to confront third countries' coercive measures and thereby develop a political solution. The EU cannot make third countries change their coercive policies but it can make enforcing them more costly, and make a political compromise more attractive.

The Blocking Statute needs to work against several third countries, as China's secondary coercion against Lithuania demonstrates. Therefore, it needs to be a flexible tool that is connected to the EU's other instruments for dealing with economic coercion – such as pre-existing trade defence instruments and the ACI, and perhaps a Resilience Office and an export bank.

Challenges

Compliance by companies and effective implementation

Ultimately, the utility of an amended Blocking Statute will depend on whether it will be more effective in ensuring compliance with EU laws, and whether member states commit to making it work.

The European Commission could achieve this by showing the private sector that it had established credible countermeasures, regardless of whether these countermeasures were formally part of the Blocking Statute or of the ACI. The establishment of an EU Resilience Office would be important for creating more certainty on this crucial question. The Commission also needs to ask for as much information as it can from economic actors while minimising the administrative burden on companies.

To be sure, the Commission should not grant waivers almost automatically. Otherwise, the EU would lose one of the original purposes and values of the Blocking Statute – in this case: to demonstrate the union's rejection of secondary and extraterritorial measures.

The EU could, in theory, consider minimising the scope of the Blocking Statute. This could ensure that the Blocking Statute continued to be useful to companies subject to the United States' sanctions on Cuba, such as by allowing them to receive compensation for damages – and by seeking to integrate the other functions of the statute into the ACI or other instruments. But this approach would not sufficiently address the challenges posed by Chinese secondary measures and possible secondary sanctions under a different US administration. These secondary measures are one of the key problems created by economic coercion.

A capacity to deliver

As with any policy instrument, the Blocking Statute will only be credible and effective if it is backed by a sufficient capacity to enforce it. Therefore, the effectiveness of the relationship between the ACI and the Blocking Statute is inseparable from analytical and enforcement resources available to them in the Directorate-General for Trade (DG Trade) and the Directorate-General for Financial Stability, Financial Services, and Capital Markets Union (DG FISMA). In other words, the EU needs to establish enforcement capacities that correspond to the Blocking Statute's ambitions.

The Blocking Statute could serve as a platform on which the European Commission builds trust with companies and gathers information from them – while the job of implementing large-scale countermeasures could fall under the ACI. DG Trade would be well-positioned to oversee the Blocking Statute in some ways. But DG FISMA has all the experience of working on sanctions. This is why a cross-DG Resilience Office would probably be best suited to oversee the Blocking Statute – or, at least, to coordinate efforts related to it.

Recognition of the Blocking Statute's current benefits

The EU needs to discuss how to reform the Blocking Statute in a way that preserves its current benefits. This concerns, most of all, how EU companies address the conflict of norms that arises when dealing with claims based on the Helms-Burton Act in American courts.

At the same time, the EU will need to decide whether and how to reform the Blocking Statute in the context of any new evidence about the regulation's practical impact. On 21 December, the European Court of Justice released its decision on the case of Bank Melli Iran versus Deutsche Telekom. The decision largely follows the earlier opinion of the attorney general, thereby significantly strengthening the provisions of the Blocking Statute. For instance, an EU company wishing to work with Cuba or Iran should be allowed to compel banks or other partners to provide the necessary services.

Conclusion

The Blocking Statute has, as discussed, already developed away from the logic on which it was founded. It is now time for the EU to draw conclusions from where it has and has not worked, and to make it fit for secondary coercive measures that might come from countries other than the US. To achieve this, the EU could restructure the Blocking Statute – and even change its philosophy – while incorporating it into its wider approach to countering economic coercion.

5. Resilient European payments channels

Filip Medunic with Jonathan Hackenbroich

Resilient payments channels are key to the European Union's capacity to act in adverse economic environments. In recent years, global measures to combat money laundering and the financing of terrorism have increased, while restrictive measures on financial transactions have become one of the go-to tools of US foreign policy. This is especially true of measures imposed by Congress, which make use of financial network effects and cannot be removed by a presidential decision.

If a future administration is not as benign in its use of sanctions to influence European policies, and does not actively push back against Congress, Europe will likely face sanctions of the kind it experienced under the Trump administration. The ongoing decline in correspondent banking relationships ('de-risking') has created an environment that firms find difficult to navigate – and that has had a chilling effect on payments processing services in regions affected by restrictive measures such as sanctions. There is often no way to preserve secure payments channels in either the public or private sector.

In this environment, the effects of European governments' stabilisation and humanitarian policies diminish when they cannot use payments channels to assist those in need, limiting their capacity to implement foreign policy. Meanwhile, European firms often face insurmountable obstacles in doing business with entities in politically difficult regions – obstacles that frequently constitute state interventions in free and fair trade, and that thereby erode the rules-based order Europeans need to defend.

These trends could accelerate in the coming years. Europe is more dependent on international trade than any other region, and is one of the world's largest contributors of international aid. In both cases, when payments channels close because of their non-alignment with the policies of third states, EU companies may incur high costs through the loss of vital connections to affected regions. This is a particularly acute problem for the EU, given that its power primarily stems from its economic prowess (rather than its military strength, for example).

Opportunities

Broadly speaking, Europeans have the following four ways to improve the resilience of payments channels.

Option 1

The EU could establish a European Export Bank (EEB) as a public entity with a network of correspondent banks in select third countries. This EEB would comply with EU law, specialise in operating in adverse environments, provide account management and payments services, and engage in refinancing only in euros and within Europe.

To mitigate the risk that importers default on payments, the EEB could engage in forfaiting (a trade finance practice in which an intermediary buys an exporter's claim against an importer and thereby guarantees immediate payment to the exporter), cooperate with national export credit agencies (potentially even through the European Export Credit Facility, depending on how the initiative developed), and provide covered supplier and buyer credits, as well as – in the most extreme cases – loans to third states. An EEB would then establish a network of correspondent banks that would hold foreign currency deposits at the institution. The EEB would process payments between these accounts and European exporters' accounts either internally or at these banks. To this end, the EU would have to identify the extent to which an EEB could gain access to non-European clearing systems, beyond TARGET2.

Option 2

An EEB could establish a local presence in regions that are affected by payments processing issues. This would involve opening branch offices in places such as Kabul. The EEB would then engage in transactions with its local branch office without having to involve banks based in third countries. Depending on the situation on the ground, cash payments could be one way to facilitate payments for local recipients. As part of this approach, an EEB would conduct due diligence for each of these transactions before making them, and would check whether it could use euros for cash payments – which, on a sufficient scale, could be one alternative to other currencies.

Option 3

The EU could establish a privately managed bank, founded by a group of investors in one member state under national law. The firm would engage not only in trade that other commercial banks avoided but would also establish a broad client base and would be a fully functioning export bank for any destination. Its seed capital could be a mix of private and public funds. In case it encountered difficulties with third states' measures, the bank would have a fund for legal proceedings to support its clients, which would be backed by national governments. The bank could outsource due diligence to legal advisers. In cases of overcompliance, the bank could directly engage with national authorities to clarify the exact scope of restrictive measures, to ensure that firms knew which transactions were legal.

Option 4

By making payments channels more resilient for aid and for working with commercial banks, the EU could also ensure that they were more viable for commercial business transactions. The EU could develop a tool for facilitating aid transactions in restricted contexts that tracked each payment to its final recipient and made the transaction fully transparent. The sending institution could exclude critical entities or individuals that were subject to sanctions listings or other restrictive measures (other than those that fall under official exemptions) – and could prove that it had done so to its clients, partners, and the authorities. In this way, a trusted relationship with commercial banks could be developed, since there would be proof that the payments in question went to people in need (in the case of aid) or to individuals and entities that create stabilisation programmes. Due diligence would be conducted by the sending entity and the tracking entity, which would have personnel on the ground to verify recipients, and would confirm that payments had been received in a two-stage process. Even US banks (which are most often needed for clearing) would begin accepting this service and would not object to the payments. Such an approach could facilitate transactions that would otherwise fall into a legal grey zone, in which it is impossible to guarantee sufficient transparency for operating banks. This could also create opportunities to increase commercial transactions by EU firms.

New solutions: A step-by-step approach?

A combination of options 1 or 2 and 4 could gradually improve the resilience of payments channels. Political backing from the highest levels of the EU and its member states would be crucial to ensure that companies trusted in the solution they chose. An EEB could provide this political backing and could operate at the necessary scale. For example, the institution could process the salaries of local personnel in the health sector of a third country as part of EU stabilisation efforts. In this way, the EEB would become the go-to entity for European aid payments. As the next step, the EEB could begin to facilitate commercial transactions and, by tracking them, build a relationship of trust with commercial banks and other entities connected to European businesses. In addition, the EEB could engage with policymakers in third countries that imposed restrictive measures. Under the leadership of an EU Resilience Office, the EEB could reassure its clients and partners that no restrictive measures would target them. As part of this approach, the institution could label certain EU firms as 'trusted economic operators'.

Opacity versus transparency

Economic coercion has made many transactions impossible because companies currently lack the capacity and willingness to guarantee full compliance with exemption regimes. This even affects some payments that would be fully in line with third countries' measures. However, in the short term, Europeans may not be able to establish a payments system that is fully shielded from outside interference. Commercial banks need to access the dollar system based on SWIFT. And any other system could face political resistance within the EU. With powers such as China and Russia setting up alternative payments infrastructure, a fully separate European system would only accelerate the fragmentation of international payments channels. This would come with higher costs for end users. And states could further weaponise the choice of which system to use, leaving EU companies with even more of a dilemma. In contrast, the EU could push European companies to process payments through existing transparent systems for opening blocked payments channels. If this occurred on a sufficient scale, it could encourage EU firms – especially commercial banks – to be more confident in engaging in transactions with entities in regions under restrictive measures such as sanctions.

Challenges

Connections to commercial banks

Connections to commercial banks are key to functioning payments channels. In an effective system, third parties should see transactions as free of suspicion and believe that it is in their interests to accept payments. Legal requirements or transparency measures could help create such a system, but each approach has certain consequences:

- Legal requirements to accept payments from an EEB would put commercial banks and actors between a rock and a hard place once again: they would have to comply with the laws of both the EU and the third country in which they operated. The EU could use other tools to ease the pressure, but this would likely create a significant burden for many banks and other companies.

- Transparency measures in aid transactions would not shield European entities from a third country's restrictions if their dealings did not fall under the EU's exemptions.

Due diligence

The EU needs to ensure that any new payments channels fulfil know-your-customer and anti-money laundering requirements. This would require thorough processes and well-prepared staff in the centralised entity that states could task with upholding due diligence standards for all parties involved in a transaction. An EEB would have to select its clients carefully, to ensure that they had the administrative capacity to operate in adverse environments.

An attractive work environment

The EU would have to shield EEB senior staff from the economic measures of third countries. And, to help attract the most talented experts in the field, the union should ensure that they are paid at commercially competitive rates.

Local branch offices

To establish local offices in third states, an EEB would have to make a substantial logistical and financial investment.

A privately managed bank

An export bank for any destination might not operate at the scale required to address the threat of economic coercion. This is because the firm's clients might be hesitant to conduct all their business through it. A privately managed bank might also generate concern, to varying degrees, about the extent to which it would do business with clients affected by third countries' restrictive measures. The EU would have to carefully evaluate the political and financial support it provided to the bank, and condition this on the nature of its operations.

A step-by-step approach

If the EU took a step-by-step approach to improve the resilience of payments channels, it would have to do so on a large scale to have a significant impact. This would require coordination with institutions in member states to streamline their aid efforts and use a common platform, a process that the EU could then extend to commercial transactions.

Conclusion

The EU will need to provide high-level political support to European payments channels if it is to make them more resilient. But, while operating within the constraints outlined above, EU member states could probably do much more to improve the resilience of these channels for many transactions involving aid or small and medium-sized enterprises. Greater transparency in payments channels would make it much harder for third countries to legitimise restrictive measures or punish EU companies for certain types of transactions, thereby reducing the chilling effect of such measures (which may be intended or otherwise). To further limit the effects of such measures, the EU will need to increase the costs of imposing them – which it can only achieve by coordinating all the instruments at its disposal. However, it is likely that complexities in both trade and financial aid will remain a feature of international politics for years to come. Therefore, the EU needs to continue to explore ways of making its payment channels more resilient.

This paper is a product of the European Council on Foreign Relations' work and the opinions expressed in it are those of the authors. The paper presents ideas for the European debate. It is based on a systematic consultation with high-level public and private actors from the Czech Republic, France, Germany, the Netherlands, Spain, and Sweden. ECFR's Task Force for Strengthening Europe against Economic Coercion worked on these proposals during 2021. Members of the task force discussed several possible responses to economic coercion. The paper does not reflect a consensus in the task force. The authors of the paper took into account how participants from diverse backgrounds in the public, economic, and financial sectors, as well as academia, collectively viewed the opportunities and challenges in Europe's response to economic coercion.

About the authors

Jonathan Hackenbroich is a policy fellow for economic statecraft and the head of ECFR's Task Force for Strengthening Europe against Economic Coercion. His work for ECFR's European Power Programme focuses on economic coercion and geo-economics, especially trade and sanctions policy. His previous publications for ECFR include 'Defending Europe's Economic Sovereignty: new ways to resist economic coercion' and 'Measured response: How to design a European instrument against economic coercion'.

Pawel Zerka is part of ECFR's Re:shape Global Europe project, which seeks to develop new strategies for Europeans to understand and engage with the changing international order. Zerka is also engaged in analysis of European public opinion as part of ECFR's Unlock Europe's Majority initiative, and in research into Europe's economic statecraft.

Filip Medunic is the lead coordinator of ECFR's Task Force for Strengthening Europe against Economic Coercion. His work for ECFR's European Power Programme focuses on economic coercion, geo-economics, sanctions, and energy policy.

Acknowledgments

The authors wish to thank all those who have contributed to their work by sharing information, comments, and suggestions. In particular, they would like to thank members of the European Council on Foreign Relations' Task Force for Strengthening Europe against Economic Coercion. Special thanks go to ECFR's co-chair Carl Bildt and ECFR Council Member Joaquín Almunia for their support of the project. The authors are also grateful to all those external experts who have discussed various aspects of economic coercion with them over the past six months. These experts include Tom Ruys, Hervé Jouanjean, Katrin Kamin, Charlotte Beaucillon, Edwina Thompson, Mark Daniel Jäger, Erica Moret, and Anthonius de Vries. Within the ECFR family, the authors appreciate the helpful input of Mark Leonard, Vessela Tcherneva, Jeremy Shapiro, Susi Dennison, Susanne Baumann, Janka Oertel, and Andrew Small, all of whom helped sharpen the paper's argument. Chris Raggett has performed miracles in the editing process, while Andreas Bock, Swantje Green, Angela Mehrer, Marlene Riedel, and Katharina Egle have tolerated our flurries of ideas about events and outreach.

The most important acknowledgments often come last, and this is the case here: the authors would like to highlight the crucial contribution of external researcher Pau Ruiz Guix – and to express their gratitude for his painstaking efforts to check facts and meet deadlines. Despite all these many and varied forms of input, the authors remain responsible for the views and any remaining errors in the text.

ABOUT ECFR

The European Council on Foreign Relations (ECFR) is the first pan-European think-tank. Launched in October 2007, its objective is to conduct research and promote informed debate across Europe on the development of coherent, effective and values-based European foreign policy. ECFR has developed a strategy with three distinctive elements that define its activities:

- A pan-European Council. ECFR has brought together a distinguished Council of over two hundred Members – politicians, decision makers, thinkers and business people from the EU's member states and candidate countries – which meets once a year as a full body. Through geographical and thematic task forces, members provide ECFR staff with advice and feedback on policy ideas and help with ECFR's activities within their own countries. The Council is chaired by Carl Bildt, Lykke Friis, and Norbert Röttgen.

- A physical presence in the main EU member states. ECFR, uniquely among European think-tanks, has offices in Berlin, London, Madrid, Paris, Rome, Sofia and Warsaw. Our offices are platforms for research, debate, advocacy and communications.

- Developing contagious ideas that get people talking. ECFR has brought together a team of distinguished researchers and practitioners from all over Europe to carry out innovative research and policy development projects with a pan-European focus. ECFR produces original research; publishes policy reports; hosts private meetings, public debates, and "friends of ECFR" gatherings in EU capitals; and reaches out to strategic media outlets.

ECFR is a registered charity funded by the Open Society Foundations and other generous foundations, individuals and corporate entities. These donors allow us to publish our ideas and advocate for a values-based EU foreign policy. ECFR works in partnership with other think tanks and organisations but does not make grants to individuals or institutions. ecfr.eu

 ISBN: 978-1-914572-31-9 . Published by the European Council on Foreign Relations (ECFR), 4th Floor, Tennyson House, 159-165 Great Portland Street, London W1W 5PA, United Kingdom.