

DGAP REPORT

US-Chinese Competition and Transatlantic Relations

Implications for Germany and Europe



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Foreword

This paper is the second report of a multi-year research project on the future of transatlantic relations sponsored by the *Friede Springer Stiftung*. In our first report, we outlined three long-term scenarios for transatlantic relations derived from different US grand strategies: (1) multilateral cooperation, (2) realist competition, and (3) protectionism-isolationism. We find that US foreign policy under President Joe Biden is firmly set on the path outlined in the realist scenario, where US-Chinese great power competition is the primary driver of US strategy. We also find that of the three scenario drivers we identified, it is the 'international system' that informs US strategy the most, while 'domestic politics' constrains individual policies but not overall strategy. 'Economic resource availability' has so far played a negligible role.

The research project was launched during the Trump presidency with a view to the increasing concerns among European policymakers about the future of the transatlantic alliance. With the Biden administration, however, US-European and German-US relations have improved dramatically, even before the Ukraine war. Neo-isolationist, unilateralist, MAGA-style foreign policy advocates continue to exist in US politics but are currently largely marginalized. In fact, confronting China and Russia is one of the very few policies to receive bipartisan support. American public opinion is broadly supportive of cooperating with partners and allies as well as of countering Russia and China. Nevertheless, the risk of a return of a MAGA-style US foreign policy geared toward unilateralism and the exploitation of security and economic dependencies has not been banished, and the tide could turn again after the 2024 presidential elections.

China's ascendance and other shifts in the international balance of power are locking Washington and Beijing into security and geo-economic competition and leading the Biden administration to counter China forcefully. Despite the Ukraine war, America's strategic attention will continue to shift toward Asia. European NATO countries have the economic

resources to balance Russia militarily. Meanwhile, the strategic balance in Asia hinges far more on the United States than it does in Europe. This will force America to shift its strategic focus away from Europe and redirect resources to Asia in order to deter China and to maintain the regional status quo.

The need to shift strategic attention and resources to Asia has the potential to lead to transatlantic tensions and even conflict. Undoubtedly, the Ukraine war has led the United States and Europe to move in lockstep. Washington will expect its European allies to align with and support US geo-economic and security policies vis-à-vis China. But short of an outright military conflict, Europe will be hesitant to lend unconditional support to US policies for fear of antagonizing China unduly. From a European perspective, the situation in Asia is very different from that in Europe: China carries far greater economic weight than Russia (Europe's energy dependence notwithstanding), and Europe feels less immediately threatened by geopolitical competition in Asia than by geopolitical conflict in Eastern Europe.

America's need to divert resources away from Europe will put Germany in a particularly difficult position. The country's continued dependence on American military power limits its room for strategic maneuver. Even if transatlantic disagreements remain manageable, the increasing US focus on Asia will force Germany to accept greater responsibility for European security and for balancing and deterring Russia. In this sense, the outbreak of the Ukraine war and the *Zeitenwende* have facilitated precisely such a strategic adjustment. As Europe's largest economy, Germany will have little choice but to step up. Berlin can also expect to come under pressure from Washington to actively support US policy on China. Yet Germany's significant economic dependence on China makes it potentially costly to support US geo-economic policies because this could invite Chinese retaliation.¹

US-Chinese great power competition will present Europe and especially Germany with challenges. Strategically, Germany should explore the possibility of greater intra-alliance cooperation with America in terms of managing common economic and security vulnerabilities. But Germany must also push for a greater national and European capacity to ensure its own military and economic security.

¹ Markus Jaeger, *The Economics of Great Power Competition*, German Council on Foreign Relations, 2022: <https://dgap.org/en/research/publications/economics-great-power-competition> (last accessed: October 16, 2022).

Introduction

Events, dear boy, events.
— Harold Macmillan

In a previous research paper, we presented three long-term scenarios of how US grand strategy and foreign policy might evolve over the next 5 to 15 years and outlined how the respective strategies might affect transatlantic and specifically German-US relations.² Over the past year or so, American policy has continued to shift toward what we have called a realist scenario, characterized by intensifying US-Chinese rivalry, a shift of US strategic focus to Asia, and US attempts to get its allies to support a more hawkish China policy geared toward 'strategic competition.'

Not only has US-Chinese competition intensified, but confronting China is today the single most important plank of America's grand strategy and foreign policy. True, the Ukraine crisis has forced the United States to pay greater attention to Europe and the transatlantic relationship. But medium- to long-term, US-Chinese competition will be the dominant driver of US policy and strategy. This will have important consequences for transatlantic and German-US relations.

The realist scenario posits that as US-Chinese competition intensifies, Washington will bring greater pressure to bear on its allies to get them to support a more adversarial geopolitical and geo-economic strategy vis-à-vis China.³ Admittedly, there has so far been only gentle nudging. And the Europeans themselves are currently re-assessing their own relationship with China, not least in the context of Chinese tacit diplomatic support for Russia's war in Ukraine. As such, Europe has become more receptive to the possibility of a less accommodating policy toward the Middle Kingdom. Whether this will lead America and Europe to see eye to eye on strategy or policy remains to be seen, however.

Meanwhile, the Biden administration has sought to revitalize America's traditional alliances in Europe and Asia. Several long-running economic disputes between the United States and the EU as well as the United States and Germany have been resolved, paused, or are being tackled (even though new ones loom on the horizon). Washington has sought to foster greater geopolitical and geo-economic cooperation with its allies, acting partially or even largely in view of countering an ascendent China.

At the same time, Washington has not hesitated to take unilateral action and upset its European partners, particularly when these actions were directly or indirectly related to its broader China strategy. Examples include the largely uncoordinated and chaotic Afghanistan pullout and the AUKUS deal between the United States, the United Kingdom, and Australia, which stunned America's European allies, in particular France. The fact that US pressure on European allies to align with a more hawkish American China policy has been relatively limited to date does not invalidate the logic underpinning the realist scenario.

As US-Chinese competition intensifies, Washington is certain to exert greater pressure on its European allies to support its China strategy. The Biden administration is offering its traditional allies a substantially more cooperative relationship than the Trump administration was willing to allow. But this more cooperative policy needs to be seen in the context of America's strategic concerns about China. And if this 'carrot' fails to garner sufficient European and especially German support, Washington will – so the realist scenario posits – increase the pressure on its allies to broadly support its China-focused grand strategy.

In the context of the so-called *Foreign Policy for the Middle Class*,⁴ the Biden administration has also been intensely focused on domestic rather than foreign policy issues. What may come to be known as the Biden Doctrine seeks to make good on electoral promises to address domestic economic challenges while also strengthening the United States in view of long-term strategic competition with China. Domestic reform and domestic strengthening are seen by Biden as prerequisites for sustaining such competition.

2 Mark Jaeger, *The Logic (and Grammar) of US Grand Strategy*, German Council on Foreign Relations, 2021: <https://dgap.org/en/research/publications/logic-and-grammar-us-grand-strategy> (last accessed: October 16, 2022).

3 Geo-economics can be defined as the use of economic means to pursue geopolitical ends. See also David Baldwin, *Economic statecraft* (Princeton 1985); Alan Dobson, *US economic statecraft for survival, 1933-91* (London 2002); William Norris, *Chinese economic statecraft* (Ithaca 2016).

4 Carnegie Endowment, *Making US foreign policy work better for the middle class*, 2020: <https://carnegieendowment.org/2020/09/23/making-u.s.-foreign-policy-work-better-for-middle-class-pub-82728> (last accessed: October 21, 2022).

Of the three major scenario drivers we identified – the international system, economic resources, and domestic politics – the international system, or more precisely the shifting international balance of power, remains the most important driver of US strategy. So far, the availability of resources (or lack thereof) does not represent much of a constraint. Finally, while domestic politics has impacted individual *foreign policies*, its impact on overall US *strategy* has been limited until now.

Domestic politics currently represents a greater constraint on selected US policies than resource availability. In other words, we are nowhere near the *isolationist-protectionist scenario* outlined in our previous research, where a combination of resource scarcity and domestic distributional and political conflict would undercut a China-focused US grand strategy. In that scenario, the United States would be led to shift toward unilateralism, protectionism, and, ultimately, isolationism. Quite the opposite is happening today. In an otherwise highly polarized political system, a hawkish China (and Russia) policy is currently just about the only issue capable of garnering bipartisan support. Politics, for now, does seem to stop at water's edge, as the adage goes.⁵

It is naturally too early to read much into the Biden administration's policy decisions and policies as far as longer-term US strategy is concerned. Monitoring developments at the margin is nonetheless helpful to see to what extent US policy tracks our scenarios and to evaluate to what extent the scenarios might be in need of adjustment or even broader modification. The evidence so far suggests that the United States is firmly set on the path outlined in the realist scenario, namely a strategic shift toward confronting China, even if the concomitant tensions in transatlantic relations have not yet materialized. If anything, the Ukraine war has strengthened transatlantic relations. But longer-term, the Ukraine war will likely prove a distraction rather than a factor which would force the United States to fundamentally rethink its strategy.

Building on our previous research, this paper will, first, provide a largely *descriptive* overview of US foreign policy under the Biden administration to assess to what extent our scenarios reflect US policies. This will include looking at the extent to which these policies reflect, or are consistent with, the underlying logic outlined in the realist scenario. Second, the paper will *analyze* to what extent and in what areas the drivers we previously identified as relevant to this scenario have actually affected US policy. This will also allow us to assess if other critical variables may need to be incorporated into our scenarios. Following description and analysis, we will finally present recommendations for managing the adverse consequences of intensifying US-Chinese great power competition for Germany and Europe.

5 Helen Milner, *Sailing the water's edge* (Princeton 2015).

MONITORING

Foreign Policy under the Biden Administration

This section provides an overview of US foreign policy under the Biden administration to assess to what extent our scenarios are able to predict decisions. The extent to which Biden administration policies have been consistent with our scenarios at this point should not be seen as providing *outsized* evidence in support of the veracity of our long-term, 5-to-15-year scenarios. After all, it is early days. But it should be seen as providing *some* evidence as to where US foreign policy is and where it will be trending – barring unexpected events.

1.1 FOREIGN POLICY FOR THE AMERICAN PEOPLE OR ANTI-CHINA STRATEGY?

The Biden administration has been intensely focused on domestic policy issues, notably fighting the pandemic, overcoming the economic crisis, and pursuing a broader agenda of economic and social reform. This is consistent with the so-called *Foreign Policy for the American Middle Class*. This policy is meant to reconcile domestic political and economic needs with international strategic goals. In domestic political terms, this policy allows the administration to make good on its electoral promises. In international terms, it is meant to lay the foundations for longer-term international competition with China –

or in the words of two senior administration officials, enable “competition without catastrophe.”⁶

The focus on domestic challenges and domestic strengthening was evident in the huge COVID-related fiscal stimulus worth \$2.2 trillion passed by Congress in early 2021 as well as the two proposed large-scale spending programs originally called the *American Jobs Plan* (AJP) worth \$2 trillion and the *American Family Plan* (AFP) worth \$1.8 trillion. Combined, they amounted to nearly \$4 trillion (corresponding to 20 percent of GDP).⁷

After much political wrangling, the AJP (also referred to as the Bipartisan Infrastructure Framework or BIF) was passed as the *Infrastructure Investment and Jobs Act*, albeit in a scaled-down version worth \$550 billion of new spending (or \$1.2 trillion in total).⁸ The AFP, largely focused on social and environmental spending (also referred to as Build Back Better or BBB), failed to garner bipartisan support.

After initial Democratic infighting prevented the bill from making progress, it was finally passed as the *Inflation Reduction Act* through budget reconciliation in August 2022, albeit in a much slimmed-down version. Legislative measures focused on energy security and climate change were worth \$369 billion, in addition to \$60 billion worth of extra health-care spending.⁹ Wafer-thin Democratic majorities in Congress limited or prevented progress on other Democratic legislative priorities. Last but not least, Congress passed the *CHIPS and Science Act* that provides for spending \$280 billion on R&D over the next ten years and includes \$52 billion worth of provisions to support the domestic production and research of semi-conductors.¹⁰

On the international front, the White House issued an *Interim National Security Strategic Guidance* in March 2021,¹¹ highlighting the need to “defend and nurture the sources of national strength” and “promote a distribution of power to deter and prevent adversaries from directly threatening the United States.” In October 2022, Washington published its quinquennial *National Security Strategy*, which

6 Kurt Campbell and Jake Sullivan, *Competition without catastrophe*, Foreign Affairs, 2019.

7 White House, Fact sheet: The American Jobs Plan, March 31, 2021, <https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan> (last accessed: October 21, 2022); White House, Fact sheet: The American Families Plan, April 28, 2021, <https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan> (last accessed: October 21, 2022).

8 Politico, House ships \$550B infrastructure legislation to Biden’s desk after months of delay, November 5, 2021.

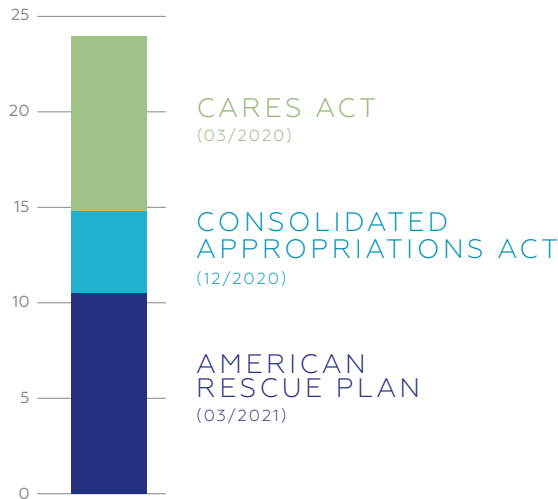
9 Financial Times, Fears over US energy security help unlock historic \$369bn climate bill, July 29, 2022.

10 Financial Times, Congress passes \$280bn Chips and Science Act, July 28, 2022.

11 White House, *Interim National Security Strategic Guidance*, March 3, 2021, <https://www.whitehouse.gov/wp-content/uploads/2021/03/NSC-1v2.pdf> (last accessed: October 21, 2022).

COVID FISCAL RELIEF MEASURES

PANDEMIC-RELATED FISCAL STIMULUS MEASURES (% OF 2020 GDP)



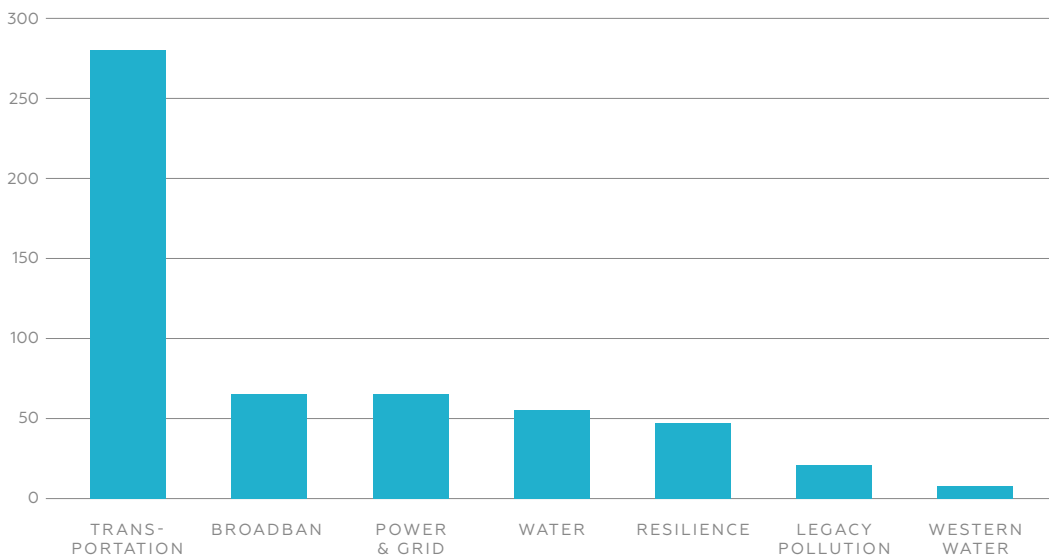
Source: US Treasury

bluntly states that “(t)he PRC is the only competitor with both the intent to reshape the international order and, increasingly, the economic, diplomatic, military, and technological power to do it. Beijing has ambitions to create an enhanced sphere of influence in the Indo-Pacific and to become the world’s leading power.”¹² The National Security Strategy pledges that the United States will effectively compete with China while reaffirming the need to for cooperation to address shared challenges.

The State Department’s *Foreign Policy for the American People*¹³ (modelled on the *Foreign Policy for the Middle Class*) lays out the challenges and priorities more explicitly. These include defeating the pandemic; overcoming the economic crisis; renewing democracy; creating an effective and humane immigration system; revitalizing alliances; confronting the climate crisis; maintaining technological leadership; and countering China, which is also referred to as the “biggest geopolitical test of the 21st century.” The first four issues are largely or purely domestic

SPENDING UNDER INFRASTRUCTURE AND JOBS ACT

USD BILLION



Source: White House

12 White House, National Security Strategy, October 12, 2022, p. 23, <https://www.whitehouse.gov/wp-content/uploads/2022/10/Biden-Harris-Administrations-National-Security-Strategy-10.2022.pdf> (last accessed: October 21, 2022).

13 State Department, A Foreign Policy for the American People, 2021, <https://www.state.gov/a-foreign-policy-for-the-american-people> (last accessed: October 21, 2022).

in nature. Again, this is consistent with the focus on addressing domestic challenges to fulfil electoral promises as well as to strengthen the United States politically and to sustain long-term competition with China economically.

The State Department's official China policy is explicitly focused on the defense of the rules-based order against Beijing's attempts to undermine it.¹⁴ It seeks to do so through a "invest, align, and compete" approach: (1) investing in competitiveness and innovation, (2) aligning and coordinating policies with allies, and (3) competing with China to defend American interests and preserve the status quo. Washington also intends to demand economic reciprocity, push back against unfair Chinese economic practices, and enhance supply chain security while seeking to avoid wholesale economic decoupling. The China policy also acknowledges the desirability of a cooperative approach in areas of common concerns like health, climate, arms control, and so on.

1.2 SECURITY POLICY

The Biden administration has not yet published its *National Defense Strategy*.¹⁵ Only a one-page, non-classified summary is available at the moment, and it is fairly generic, referring to defending the homeland, deterring strategic attacks, and deterring aggression from China or Russia, but with China being seen as "the most consequential strategic competitor."¹⁶ The Pentagon has also completed its *Global Posture Review*, again proposing virtually no changes (in the non-classified part of the review, at any rate), except for the upgrading of airfields in Guam and a minor increase in the number of military personnel stationed in Germany (scuttling for

good Trump administration plans to reduce the US military presence there).¹⁷

In the meantime, the 2018 *National Defense Strategy*¹⁸ issued under the Trump administration continues to guide US defense and security policy for now. The strategy, issued under Defense Secretary Jim Mattis, anticipates a return to 'great power competition' and seeks to prevent Russia and China from challenging the United States and its allies. Under Biden, China continues to be seen as the single greatest challenge to US interests, as was set out by the 2019 Department of Defense *Indo-Pacific Strategy*.¹⁹ US intelligence and law enforcement also regard China as the single greatest threat in the cyber realm.²⁰

Intensifying concerns about China were already apparent in the Obama-era 'pivot to Asia,' which was meant to move 60 percent of all US naval assets to Asia.²¹ In other words, there has been broad continuity across subsequent administrations, including the Biden administration, in terms of strategic objectives. Kurt Campbell, Biden's 'Asia czar,' succinctly summarized the administration's attitude toward China when he stated that "the period that was broadly described as engagement has come to an end" and that "the dominant paradigm is going to be competition."²² Although Secretary of State Antony Blinken stated more diplomatically that "[o]ur relationship with China will be competitive when it should be, collaborative when it can be, and adversarial when it must be," the adversarial aspects have no doubt dominated under Biden.

The Biden administration has taken a hard overall line vis-à-vis China. The administration has accused China of coercion and intimidation, while reiterating its long-held view of the Indo-Pacific region as "critically

14 State Department, The Administration's Approach to the People's Republic of China, May 26, 2022, <https://www.state.gov/the-administrations-approach-to-the-peoples-republic-of-china> (last accessed: October 21, 2022).

15 The NDS provides guidance for military planning, strategy, posture and modernization.

16 US Department of Defense, Fact Sheet: National Defense Strategy, 2022, <https://media.defense.gov/2022/Mar/28/2002964702/-1/-1/1/NDS-FACT-SHEET.PDF> (last accessed: April 15, 2022).

17 Department of Defense, Biden approves global posture review recommendations, November 29, 2021, <https://www.defense.gov/News/News-Stories/Article/Article/2856053/biden-approves-global-posture-review-recommendations> (last accessed: October 21, 2022).

18 Department of Defense, National Defense Strategy, 2018, <https://www.defense.gov/Spotlights/National-Defense-Strategy> (last accessed: October 21, 2022).

19 Department of Defense, Indo-Pacific Strategy, 2019, <https://media.defense.gov/2019/Jul/01/2002152311/-1/-1/1/DEPARTMENT-OF-DEFENSE-INDO-PACIFIC-STRATEGY-REPORT-2019.PDF> (last accessed: October 21, 2022).

20 Financial Times, FBI director warns China espionage is greatest to the US and allies, July 11, 2022.

21 White House, Fact sheet: Advancing the rebalance to Asia and the Pacific, November 16, 2015, <https://obamawhitehouse.archives.gov/the-press-office/2015/11/16/fact-sheet-advancing-rebalance-asia-and-pacific> (last accessed: October 21, 2022).

22 Bloomberg, Biden's Asia czar says era of engagement with China is over, May 26, 2021.

important to our nation, its security and prosperity.”²³ It has also reiterated its long-standing commitment to freedom of navigation as well as to the security of Taiwan.²⁴ Debates inside and outside the administration are continuing over whether Washington should shift from a policy of ‘strategic ambiguity’ to a policy of ‘constructive clarity.’²⁵ In brief, US strategic goals under President Biden differ little if at all from those of the Trump or Obama administrations. They also remain diametrically opposed to Chinese policies, including many of China’s so-called ‘core’ interests. Those are interests that from Beijing’s perspective cannot be subject to negotiation, among them its claims on Taiwan, Hong Kong, and Tibet.

At the diplomatic level, Biden has also sought to re-energize the *Quadrilateral Security Dialogue* between the United States, Japan, India, and Australia while reaffirming and strengthening bilateral ties with both Japan and Korea and even the Philippines.²⁶ The so-called Quad²⁷ is meant to focus on issues such as vaccine diplomacy, infrastructure investment, and technology (aka ‘techno-democratic statecraft’). At least for now, it is envisioned as the non-military complement of a more adversarial US security policy and US force posture in the Indo-Pacific region.

In 2021, the United States, the United Kingdom and Australia concluded AUKUS,²⁸ a security agreement under which Australia will acquire nuclear-powered submarines from its partners. The pact also includes the sharing of other advanced military technology (long-rang strike capabilities). It was later expanded to include cooperation on developing hypersonic weapons.²⁹ AUKUS unambiguously signals the Biden administration’s firm intent to push back strongly against a more assertive China, to expand

US and allied military capabilities in Asia-Pacific, and to strengthen its regional security alliances.³⁰

The administration’s *Indo-Pacific Strategy* explicitly states and restates US commitments to modernizing long-standing regional alliances, strengthening emerging partnerships, investing in regional organizations, reinforcing deterrence, supporting India’s rise, and expanding US-Japan-Korea cooperation.³¹ Alliances are seen as force multipliers by the Biden administration. The Indo-Pacific security strategy is to be flanked by foreign economic policies laid out in the so-called *Indo-Pacific Economic Framework* (IPEF). The IPEF includes twelve Indo-Pacific countries and is meant to provide countries with an alternative to China’s trade and financial policies in the region. The IPEF will focus on trade, supply chains, clean energy, and infrastructure, as well as tax and anti-corruption – but not on market access.³²

Other major decisions, such as the US withdrawal from Afghanistan, also need to be understood in the context of Washington’s broader strategy of reducing its non-strategic overseas commitments to be able to concentrate on Asia. Leaving aside the potential risk of having Afghanistan reemerge as a base for international terrorism, American interests in the country are limited. Ending the so-called ‘forever wars’ is consistent with the US strategic shift to Asia. Estimates have put the cost of the Afghanistan war, including nation-building and reconstruction efforts, at roughly \$1 trillion dollars³³ or an annual cost of \$50–80 billion. To put this into perspective, the total costs of the war amounted to five percent of American GDP, and annual costs were equivalent to ten percent of its defense outlays. By comparison, the United States Pacific Command (USPACOM) initially sought \$27 billion in additional spending

23 White House, Remarks by Vice President Harris on the Indo-Pacific Region, August 24, 2021, <https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/08/24/remarks-by-vice-president-harris-on-the-indo-pacific-region> (last accessed: October 21, 2022). See also Blinken’s speech in Jakarta, Financial Times, Antony Blinken blasts ‘aggressive’ China in Indo-Pacific policy speech, December 14, 2021.

24 Financial Times, Joe Biden pledges to defend Taiwan militarily if China invades, May 23, 2022.

25 Foreign Affairs, American support for Taiwan must be unambiguous, 2020, <https://www.foreignaffairs.com/articles/united-states/american-support-taiwan-must-be-unambiguous> (last accessed: October 21, 2022).

26 Financial Times, US and Philippines increase military ties over China threat, September 24, 2022.

27 Financial Times, Quad group’s role under scrutiny after AUKUS submarine deal, September 24, 2021.

28 Financial Times, US builds bulwark against China with UK-Australia security pact, September 15, 2021.

29 Financial Times, Biden to announce US, UK and Australia co-operation on hypersonic weapons April 5, 2022.

30 Bilateral US-Japanese security cooperation is also intensifying. Closer security cooperation between the US and Japan is also intensifying. Politico, Japan not closing door on hosting American INF missiles, January 31, 2022.

31 White House, Indo-Pacific Strategy, February 11, 2022, <https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/02/11/fact-sheet-indo-pacific-strategy-of-the-united-states/> (last accessed: October 21, 2022).

32 Financial Times, Joe Biden launches trade agreement with 12 Asian nations, May 23, 2022.

33 Brown University and Boston College, United State Budgetary Costs and Obligations of Post-9/11 War through FY2020, 2019.

between 2022 and 2027 as part of the *Pacific Deterrence Initiative*.³⁴ If nothing else, the Afghanistan pullout will allow the United States to free up resources and redirect them to the Asia-Pacific region.

Defense spending under the Biden administration has continued to increase. Congress is proving more hawkish than the administration and upped Biden's 2022 defense budget proposal. The increase was supported by large majorities in both the Senate and the House. In terms of capabilities, the *National Defense Authorization Act* approved the building of 13 new ships and 347 new aircraft (way above the 290 units requested). This represented much larger increases than requested for the Pacific Deterrence Initiative.³⁵ Not surprisingly, spending increases were concentrated on the Navy and the Air Force and, geographically, on the Pacific region. Shortly after the outbreak of the Ukraine war in February 2022, the administration submitted its 2023 defense budget request. Again, Congress and especially Republicans demanded greater increases.³⁶ By way of separate legislation, Congress also approved substantial civilian and military aid for Ukraine.³⁷

In brief, US security policy vis-à-vis China has become more hawkish. China is seen as “the biggest geopolitical test of the 21st century” by the Biden administration, leading America to play the ‘long game’.³⁸ Biden's foreign policy vis-à-vis China is not much different from that of the Trump administration, at least as far as the ends are concerned, even though the means differ significantly. Trump administration policies were unilaterally oriented, while Biden seeks to mobilize and revitalize alliances to confront China. Effectively, and rhetoric aside, the United States today is pursuing – in the guise of the *Foreign Policy for the American People* – a strategy of

internal and external balancing.³⁹ External balancing, according to International Relations scholars, involves the strengthening of alliances, while internal balancing involves enhancing a state's economic and military power to balance a geopolitical antagonist.⁴⁰ Both types of balancing contribute to Biden's goals of countering an ascendant China and keeping Asia from falling under Chinese hegemony.⁴¹

1.3 FOREIGN ECONOMIC POLICY

Biden has also largely left unchanged his predecessor's geo-economic, geo-financial, and geo-tech policies vis-à-vis China. And in some areas, he has become even more hawkish. While his administration has reached out to its European allies to settle long-standing economic and trade disputes, it has left in place or even tightened the geo-economic and geo-financial measures targeting China. This may in part be explained by domestic politics, particularly by the political-electoral promises to defend the interests of blue-collar workers in the face of ‘unfair’ Chinese competition (whatever the economic merits of such a claim). But it must also be seen as an attempt to maintain geo-economic leverage vis-à-vis China. The administration's hawkish geo-economic and geo-financial policies reflect its strategic preoccupation with China.

The United States Trade Representative, Ambassador Katherine Tai, has accused China of having “retained and expanded its state-led, non-market approach to the economy and trade.”⁴² Tai proposed to update domestic trade law tools to secure a level playing field and to engage more deeply with allies to tackle the China economic challenge. She charged both the EU-US *Technology Council* (see below) and the US-Japanese

34 Congressional Research Service, *Renewed Great Power Competition*, August 2021, <https://crsreports.congress.gov/product/pdf/R/R43838> (last accessed: October 21, 2022). The Pacific Deterrence Initiative is a regionally focused defense initiative that seeks to counter China

35 Senate, *Summary of the Fiscal Year 2022 National Defense Authorization Act*, 2021

36 Politico, *Biden requests \$813B for national defense*, March 28, 2022.

37 Financial Times, *US Senate sends \$40bn Ukraine aid package to Joe Biden's desk*, May 19, 2022.

38 Rush Doshi, *The long game* (Oxford 2021).

39 Kenneth Waltz, *Theory of international politics* (Boston 1979).

40 See CNAS, *Risky business: future strategy and force options for the Defense Department*, July 2021, <https://www.cnas.org/publications/reports/risky-business-future-strategy-and-force-options-for-the-defense-department> (last accessed: October 21, 2022). CNAS suggests the United States has three options: high-end deterrence, day-to-day competition, and full-spectrum competition.

41 Elbridge Colby, *The strategy of denial* (New Haven 2021).

42 United States Trade Representative, *2021 Report to Congress on China's WTO compliance*, February 2022, <https://ustr.gov/sites/default/files/files/Press/Reports/2021USTR%20ReportCongressChinaWTO.pdf> (last accessed: October 21, 2022). United States Trade Representative, *National Trade Estimate Report on Foreign Trade Barriers*, April 2022, <https://ustr.gov/sites/default/files/2022%20National%20Trade%20Estimate%20Report%20on%20Foreign%20Trade%20Barriers.pdf> (last accessed: October 21, 2022).

Partnership for Trade to work on strategies to address (Chinese) non-market policies and practices.

Nevertheless, overall US trade strategy remains more unilateralist than many of the country's allies, especially in Europe, would wish. While it would make sense for the United States to re-engage with its major trade partners and allies across the Atlantic and especially across the Pacific as part of a global anti-China strategy, the Biden administration has so far failed to modify its broader trade strategy, at least as far as market access is concerned. It did make some progress resolving or pausing long-standing transatlantic disputes, such as the Airbus-Boeing and steel tariff disputes – some might say by sweeping them under the proverbial rug. But it has not made any significant changes to its trade strategy, including its stance on WTO reform, its stance on WTO reform, where it continues to block appointments to the appointments to the organization's appellate body.

Without the *Trade Promotion Authority* (TPA), a fast-track process for expediting congressional approval of free trade deals, which expired in 2021, the administration is not eager to revive trade talks. No efforts have been made to restart the transatlantic free-trade agreement (*Transatlantic Trade and Investment Partnership* or TTIP) or to join its transpacific cousin (*Comprehensive and Progressive Agreement for Trans-Pacific Partnership* or CPTPP, formerly TPP). Although market access policies are a crucial element of a broader geo-economic strategy toward China, Biden is, for the time being, prioritizing domestic political and partisan electoral concerns over a broader geo-strategically oriented trade policy. While his administration agreed to roll back some Trump-era tariffs on allies, such as the EU, Japan, and the UK,⁴³ the tariffs on solar panels were extended for another four years.

The Biden administration's eagerness to use trade as an instrument in support of its broader geopolitical strategy is nonetheless reflected in its willingness to coordinate trade- and investment-re-

lated policies with its allies. While traditional free-trade agreements and bilateral investment treaties are not on the (domestic) political agenda, the *EU-US Trade and Technology Council* (EU-US TTC) and various other forums and working groups, such as the Trilateral Group which includes the United States, the EU, and Japan, or the *US-Japan Partnership on Trade*⁴⁴ are effectively focused on confronting third parties (read: China) that pursue 'non-market policies and practices.'⁴⁵ These initiatives reflect US preoccupation with China (regarding, among other, supply chain security, technological cooperation and standards, and coordination of export control and investment policies).⁴⁶ It is no coincidence that most of the economic, trade, and technology issues on the EU-US Trade and Technology Council's agenda are more or less directly related to national security, national economic security, and technological leadership.

The Biden administration issued an executive order to scrutinize foreign companies seeking to invest in high tech, such as AI, biotechnology, or quantum computing, to 'protect America's technological leadership.' While it did not provide the foreign direct investment screening mechanism with new powers, it reemphasized the need to focus on the resilience of critical supply chains.⁴⁷ Biden further tightened export controls related to technology, making it very difficult for Chinese companies to acquire or produce advanced computer chips. This was squarely aimed slowing down China's progress with respect to the development of artificial intelligence and quantum computing and other advanced research.⁴⁸

1.4 TRANSATLANTIC AND GERMAN-US RELATIONS

During his first trip to Europe in 2021, Joe Biden sought to mend fences with the United States' European allies at the G7 meeting, the EU-US and NATO meetings as well as the bilateral German-US meeting in Washington. There, the Biden admin-

43 Financial Times, Biden renews Trump tariffs on imported solar panels for 4 years, February 4, 2022. Financial Times, US and EU agree deal to ease tariffs on steel and aluminum, October 30, 2021. Financial Times, US and Japan reach deal to roll back Trump-era steel tariffs, February 7, 2022.

44 USTR, United States and Japan announce the formation of US-Japan partnership on trade, November 17, 2021, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/november/united-states-and-japan-announce-formation-us-japan-partnership-trade-0> (last accessed: October 21, 2022).

45 Financial Times, US trade representative admits need for 'course correction' in Asia, November 18, 2021.

46 National Security Commission on Artificial Intelligence, Final Report, 2021, <https://www.nscai.gov/wp-content/uploads/2021/03/Full-Report-Digital-1.pdf>, (last accessed: October 21, 2022). Financial Times, Biden to use Korean war-era powers to boost supply of EV battery minerals, March 30, 2022.

47 Financial Times, White House sounds alert on inbound Chinese investment, September 15, 2022.

48 Financial Times, US hits China with sweeping tech export controls, October 7, 2022

TRANSATLANTIC AGENDA UNDER BIDEN

G7	NATO	EU-USA	WASHINGTON DECLARATION (BILATERAL)
Tackle digital tax and tax havens	Reaffirmation of commitment to spend 2 percent of GDP on defense by 2024	Resolve steel tariff dispute by year-end	Reaffirmation of commitment to NATO, democratic values, rule of law etc.
Commitment to mobilize \$100 billion to help developing countries tackle climate change	Strengthen technology cooperation, particularly with respect to critical and disruptive technologies	Creation of Transatlantic Green Technology Alliance	Launch of Climate and Energy Partnership
Delivery of a billion units of COVID vaccines	Development of the Strategic Concept to guide NATO's political and military adaptation	Creation of an EU-US Trade and Technology Council to set standards with respect to emerging technologies as well as strengthen and diversify supply chains	Creation of a US-German Futures Forum
		Establishment of a Joint EU-US COVID Manufacturing and Supply Chain Taskforce	Establishment of a US-German Economic Dialogue
		US-EU Energy Council to improve energy security and transition and cooperate on energy transition	

Source: Author's compilation

istration reaffirmed its commitment to NATO and the revitalization of transatlantic and specifically German-US relations.

The transatlantic rapprochement has yielded benefits. Long-standing economic disputes have been solved, paused, or are being tackled. Meanwhile, the Ukraine war not only revitalized and strengthened transatlantic security relations in view of the Russian military threat, but also led to unprecedented cooperation in terms of economic sanctions. At the same time, the Ukraine war also caused NATO to label Beijing as “a challenge to our interests, our security and our values” in the context of NATO's Strategic Concept.⁴⁹

Under the Trump administration, there were disputes over trade (steel and aluminum tariffs, digital tax, Airbus-Boeing subsidies, WTO), energy (Nord

Stream 2), climate policy, technology (regulation, competition, taxation), and US sanctions policy. With an agreement on international taxation, the suspension of the digital services tax, and the suspension of the Airbus-Boeing dispute as well as the deal on US steel and aluminum tariffs, tangible progress has been made in resolving those disputes. However, other disagreements have cropped up (e.g., Buy American regulation, American tax breaks for green technology).⁵⁰

The resolution of the transatlantic steel and aluminum dispute, while desirable in it itself, has an anti-China edge. The ‘carbon-sectoral arrangement’ proposed by the EU-US steel deal will effectively be discriminatory as far as Chinese steel exports are concerned.⁵¹ Even the Airbus-Boeing deal can be interpreted as an indirect response to Chinese competition in civil aviation. Similarly, the various commitments under the

49 Financial Times, Nato to confront China risk alongside Russia threat at leaders' summit, June 28, 2022.

50 Politico, EU braces for steel quotas to end trade war with Biden, October 28, 2021. Politico, Trump-era tensions set to cool under U.S.-EU deal, October 30, 2021. Financial Times, EU urges US to rethink tax break in landmark green legislation, October 9, 2022

51 Washington Post, The EU-US steel deal could transform the fight against climate change, October 31, 2021.

US-EU TRADE AND TECHNOLOGY COUNCIL TEN WORKING GROUPS

WORKING GROUPS	TOPICS
Technological standards and cooperation	Additive manufacturing, robotics, blockchain, other emerging technologies
Climate and clean technologies	Climate, energy and environmental initiatives that involve trade and technology
Secure supply chains	Semiconductors, batteries, critical minerals, active pharmaceutical ingredients
ICTS Security and competitiveness	Data security standards, secure, resilient, and diverse telecommunications and ICT infrastructure supply chain, 5G/ 6G
Data governance and technology platforms	Establish responsibility of technology platforms, content regulations, targeted advertising, and use of big data
Misuse of technology threatening security and human rights	Counter cyber threats and technology used for violating human rights.
Exports controls cooperation	Align export controls, improve information sharing, and assess risks for sensitive and emerging technology
Investment screening cooperation	Improve information for screening of inbound foreign investment
Promoting SME access to and use of digital technologies	Empower EMS to reach more clients, ensure digital technologies benefits underserved communities
Global trade challenges	Align trade policy toward nonmarket economies; avoid new technical barriers to trade with each other; consult on trade and labor issues

Source: Peterson Institute

so-called *Build Back Better World* in the context of the 2021 G7 meeting are clearly meant to counter China's *Belt and Road Initiative*.⁵² In 2022, the G7 upped the ante and proposed a \$600 billion plan to counter China's Belt and Road Initiative and to push back against increasing Chinese geo-economic influence, particularly in Asia and Africa.⁵³

Meanwhile, several fora have been created, or are to be created, to facilitate and deepen transatlantic and

German-US coordination and cooperation. As mentioned, the *EU-US Trade and Technology Council*⁵⁴ is to focus on trade and investment, including the coordination of export control policies, on inward FDI screening, setting standards for emerging technologies, and on boosting innovation and protecting critical supply chains. It is also meant to help promote critical and emerging technologies as well as a democratic model of digital governance. Other fora have been created at both the transatlantic level, such as

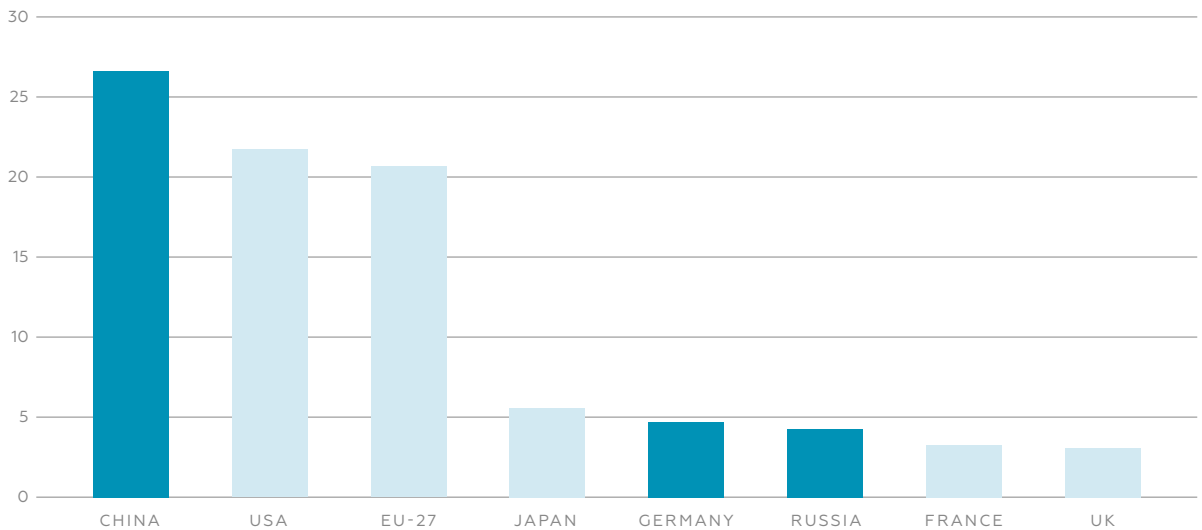
52 Financial Times, EU plans EUR300bn global infrastructure spend to rival China, November 29, 2021

53 Politico, G7 unveils \$600B plan to combat China's Belt and Road, June 26, 2022. The Economist, The G7 at last presents an alternative to China's Belt and Road Initiative, July 7, 2022.

54 European Commission, EU-US Relations: EU-US Trade and Technology Council, 2021, https://ec.europa.eu/info/strategy/priorities-2019-2024/stronger-europe-world/eu-us-trade-and-technology-council_en (last accessed: October 21, 2022); Peterson Institute, What is the US-EU Trade and Technology Council? 2021, <https://www.piie.com/blogs/trade-and-investment-policy-watch/what-us-eu-trade-and-technology-council-five-things-you> (last accessed: October 21, 2022)

RUSSIA PALES NEXT TO CHINA A LONG-TERM SYSTEMIC CHALLENGER DUE TO ITS MUCH SMALLER ECONOMY

COMPARISON OF GDP IN USD TRILLION / 2021 / PPP



Source: International Monetary Fund

the *Transatlantic Green Technology Alliance* or the *Joint EU-US COVID Manufacturing Taskforce*, and at the bilateral level, such as the *Climate and Energy Partnership* and the *US-German Economic Dialogue*.

All this demonstrates Washington’s desire to re-engage with its allies as well as Europe’s desire to mend fences with a more multilaterally oriented administration. This desire to revitalize traditional alliances and cooperate within rather than across security alliances has much to do with American concerns over China.

In terms of transatlantic security, the war in Ukraine has led Germany and the United States to reaffirm their commitment to NATO and geo-economic cooperation. The German government announced major increases in defense spending and military modernization, including the purchase of US-made F-35 aircraft. This has bolstered transatlantic and German-US relations.

Washington also sought to gain European support for a more confrontational stance vis-à-vis China at last

year’s G-7 meeting, including greater NATO engagement in the Indo-Pacific. Prior to the Ukraine war, the major European powers politely pushed back, despite having their own misgivings about China.⁵⁵ In part, this reflected the European concern about diverting European resources and attention to tackle American concerns in Asia rather than focusing on European interests in Europe. One year on, the war in Ukraine has made Europe and Germany more willing to take a harder stance vis-à-vis Beijing, particularly in view of China’s diplomatic support for Russia.

Nevertheless, policies regarding China retain some potential to weigh on US-European and US-German relations. The United States expressed significant misgivings about the EU’s attempt to deepen economic relations with China in the guise of the now effectively defunct or at least frozen *Comprehensive Agreement on Investment*. Berlin is currently re-evaluating its policy toward China, but an extensive economic relationship limits its flexibility. Therefore, the potential for disagreement between Washington and Berlin (and Brussels) over how to deal with China remains significant. This suggests

55 European Commission, *EU-China Strategic Outlook, 2019*, <https://ec.europa.eu/info/sites/default/files/communication-eu-china-a-strategic-outlook.pdf> (last accessed: October 21, 2022); Financial Times, *Nato to expand focus to counter China*, October 18, 2021.

that transatlantic relations may come under renewed strain as Washington begins to increase diplomatic pressure on Europe in view of a more hawkish China policy.

All in all, greater transatlantic engagement appears to be part of an alliance-focused US strategy that is in part motivated by Washington's desire to confront a rapidly rising and geopolitically and geo-economically more assertive China. For its China policy to be successful, the United States needs to mobilize greater resources domestically (internal strengthening) as well as internationally (external strengthening). Reviving traditional alliances and wooing European allies in the hope that they will line up behind a more hawkish China policy makes perfect strategic sense. China is and remains front and center in terms of US grand strategy.

Until the Ukraine war, Russia featured relatively little in US foreign policy under the Biden administration, except for strategic arms control talks. Russia's invasion of Ukraine has changed that. The United States has increased its commitments to European security in words and deeds. It has provided by far the largest amounts of military aid to Ukraine. Russia presents a major immediate concern, but it is much less of a long-term challenge to the United States than China. Russia's economic base will continue to weaken, not least due to extensive sanctions, and it will emerge from the Ukraine war as a much diminished, even if nuclear-armed power.

Eager to mend fences after four years of an America First policy, Biden has so far put relatively little pressure on America's European allies. If the logic outlined in the *realist scenario* is correct, however, German-US and US-European relations will come under strain in the coming years as Washington continues to focus on China, thereby diverting resources and attention away from Europe. More importantly, it will also expect Europe, and particularly Germany, to line up behind its hawkish China strategy, including in the geo-economic realm. For maintaining a military balance with China, the United States will rely on Asian regional allies. But US geo-economic policies require a global approach: Targeting China will only be effective and credible if it is supported by Europe and other partners – for example Japan, South Korea, and Australia – and particularly by Europe's largest economy, which also happens to have the most extensive economic ties with China: Germany.

ANALYSIS

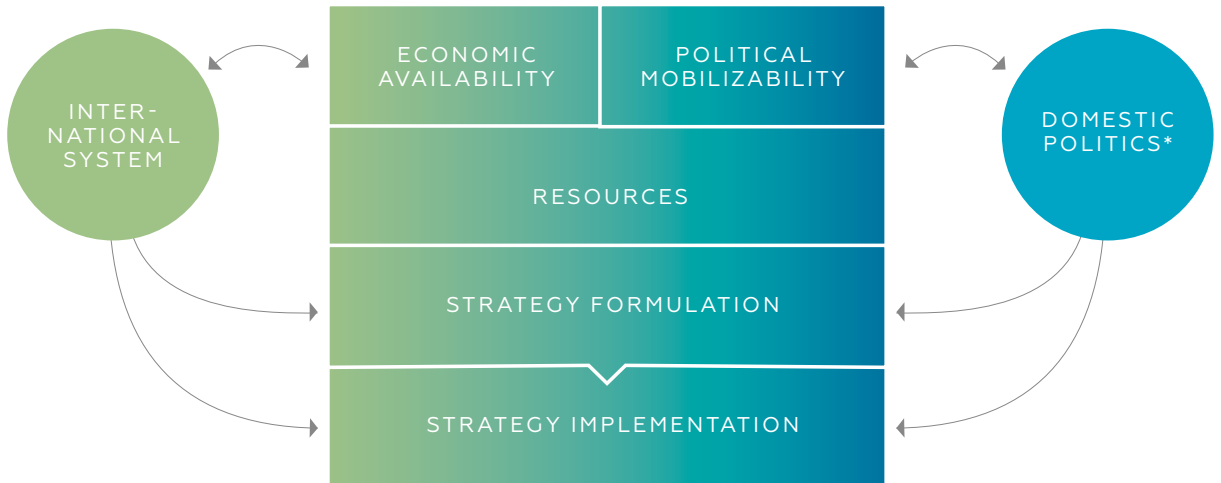
Evaluation of Drivers and Critical Variables

In our previous analysis, we identified three critical variables, namely (1) the international system, (2) resource availability, and (3) domestic politics as the major drivers of, and constraints on, the long-term evolution of US foreign policy and strategy, and hence our scenarios. In this section, we will evaluate the extent to which these variables can help account for the direction of Biden's foreign policy and strategy. We will evaluate whether, to what extent, and in which policy areas international competition, resource availability, and domestic politics have shaped US policy and strategy thus far. This will allow us to consider whether in view of recent events our scenarios are in of adjustment and further drivers should be added.

2.1 INTERNATIONAL SYSTEM

US-Chinese relations have continued to deteriorate under Biden. Recent trends point to the continued long-term structural deterioration of bilateral relations in the context of what International Relations scholars call a security dilemma. A security dilemma describes a situation where the actions taken by one state to enhance its security lead the other state to feel less secure, leading it to enhance its military capabilities in turn, and so on. In that sense, China's increasing power and assertiveness is leading the United States to a more antagonistic policy toward China. Words (documents and speeches), deeds (policies), and capacity building (institutions) unambiguously point to concerns over China as the major driver and shaper of US grand strategy and foreign policy.

SCENARIO DRIVERS



*Especially Institutions & Distributional Politics
 Source: Author's own compilation

In terms of words, the *National Security Strategy* and virtually all other documents providing guidance to US foreign policy and strategy make explicit reference to China as the most important foreign policy challenge for the United States. According to the influential US-China Economic and Security Review Commission, US policymakers (and the commission itself) view China as aggressive and uncompromising. China's leadership is seen as "increasingly uninterested in compromise and willing to engage in destabilizing and aggressive actions in its efforts to insulate itself from perceived threats or to press perceived advantages [over the US and its allies] ... [It] will likely continue escalating its combative approach absent coordinated action from the United States and its allies and partners."⁵⁶ The Director of National Intelligence regards China as the broadest, most active, and persistent cyberespionage threat to the United States' public as well as private sector.⁵⁷ Kurt Campbell, the National Security Council's Coordinator for the Indo-Pacific and Biden's top Asia hand, quoted above, states that engagement has come to an end and competition is now the name of the game. There is broad agree-

ment among American policymakers that countering China is America's strategic priority.

In terms of policies, the revitalization of the Quad, the creation of AUKUS, US attempts to rally its European allies behind its China policy as well as the strengthening of bilateral diplomatic and security relations with Australia, Korea, and Japan reflect Washington's preoccupation with China. Furthermore, the United States has stationed military personnel in Taiwan to train local military forces to stand against a possible invasion. In the meantime, the gradual shift of the local military balance in China's favor has led US policymakers to debate whether to drop their long-standing policy of strategic ambiguity in favor of an explicit and unambiguous commitment to defending Taiwan.⁵⁸ In fact, President Biden has repeatedly stated that the United States would come to the defense of Taiwan if the latter were attacked.⁵⁹ Nevertheless, senior administration officials have publicly acknowledged what has been a long-held view inside successive US administrations, namely that Taiwan is an 'unsinkable aircraft carrier' and a 'vital strategic

56 US-China Economic and Security Review Commission, Report to Congress 2021, 2021, <https://www.uscc.gov/annual-report/2021-annual-report-congress> (last accessed: October 21, 2022), pp.1-2.
 57 Office of the Director of National Intelligence, 2022 ATA DNI Opening Statement as Delivered, March 8, 2022, <https://www.dni.gov/index.php/newsroom/congressional-testimonies/congressional-testimonies-2022/item/2281-2022-ata-dni-opening-statement-as-delivered> (last accessed: October 21, 2022).
 58 Washington Post, US troops have been deployed in Taiwan for at least a year, October 7, 2021; RAND, How the United States could lose a great-power war, 2019; Richard Haass and David Sacks, American support for Taiwan must be unambiguous, Foreign Affairs, 2020.
 59 Financial Times, Biden says US would defend Taiwan from Chinese attack, September 22, 2022

node.⁶⁰ Washington remains strongly committed to preserving the status quo.⁶¹ And the US military has warned that China might invade Taiwan sooner rather than later. The Russian attack on Ukraine will have done nothing to alleviate American concerns. Meanwhile, Washington and Taipei agreed to begin trade and investment talks.⁶² The United States has also increased arms sales and military aid to Taiwan.⁶³

In terms of capacity- and institution-building, intensifying concerns about technological competition and supply chain vulnerabilities have led the Biden administration to launch reviews of its existing vulnerabilities and current policies. Agriculture, energy, healthcare, materials, technology, and defense have been designated as deserving support. Washington has also taken practical measures aimed at fostering closer cooperation with its closest allies (for example, by setting up the EU-US Trade and Technology Council or the EU-US Energy Council). Congress has pushed through major legislation regarding infrastructure and technology, in part driven by concerns about Chinese competition, including the *CHIPS and Science Act*.⁶⁴ At the bureaucratic level, the CIA has set up a China Mission Center.⁶⁵ All of these actions show how US policy toward China has hardened, rhetorically and institutionally.

Meanwhile, Beijing officially pursues 'comprehensive national power.' Ever since the 2008 global financial crisis, China has become more assertive. Switching from a policy of 'strategic patience' to a policy of

'strategic opportunity,' China continues to strengthen its asymmetric military capabilities. It is expanding its ability to project military power overseas and is intensifying efforts to develop advanced weapons systems.⁶⁶ Purportedly, it also intends to increase the number of nuclear weapons significantly, potentially suggesting a move away from its traditional 'minimum deterrence' policy⁶⁷ – not to mention the expansion of its cyber-capabilities and the increase in military activities surrounding Taiwan.⁶⁸ Strategically, China remains committed to building a 'world class' military. Chinese defense expenditure continues to increase at a rapid clip.

Geo-economically, the Biden administration has not deviated much, if at all, from the confrontational policies of the Trump administration, at least as far as China is concerned. In fact, it is even considering ratcheting up antagonistic trade policies. At one point, it was considering launching a probe into Chinese subsidies and targeting key Chinese industries with additional tariffs.⁶⁹ Biden has also maintained geo-financial pressure on China, including, among other measures, adding more companies with ties to the People's Liberation Army to a list of companies US investors are prohibited from investing in.⁷⁰

Most consequentially, Biden has sharply tightened export controls and enhanced inward investment screening (via the Committee on Foreign Investment in the United States or CFIUS) to deny China access to advanced US technology.

60 Senate, The Future of US Policy on Taiwan, December 8, 2021.

61 Politico, Austin: U.S. 'determined' to keep Taiwan's status quo, June 10, 2022. Financial Times, US pledged to maintain military capacity to defend Taiwan, June 11, 2022.

62 Financial Times, US and Taiwan to hold trade talks amid China tensions, August 17, 2022.

63 Financial Times, US unveils \$1bn weapons package for Taiwan, September 3, 2022. Financial Times, US Senate panel approved \$6.5bn bill to fund weapons for Taiwan, September 14, 2022.

64 White House, Building Resilient Supply Chains, Revitalizing American Manufacturing and Fostering Broad-Based Growth, 100-Day Reviews under Executive Order 14017, June 2021, <https://www.whitehouse.gov/wp-content/uploads/2021/06/100-day-supply-chain-review-report.pdf> (last accessed: October 21, 2022). White House, Executive Order on America's Supply Chains, February 2022, <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/02/24/executive-order-on-americas-supply-chains> (last accessed: October 21, 2022). The Biden administration also hosted a supply-chain conference with 17 countries (mostly allies and partners) as well as the EU to effectively strengthen supply chains. Wall Street Journal, Blinken to highlight Ukraine war in push for supply-chain cooperation, July 19, 2022.

65 See Washington Post, CIA creates new 'mission center' to counter China, October 7, 2021.

66 Financial Times, China tests new space capability with hypersonic missile, October 16, 2021.

67 Financial Times, China plans to quadruple nuclear weapons stockpile, Pentagon says, November 3, 2021; Defense Department, Military and Security Developments Involving the People's Republic of China, Annual Report to Congress, 2021, <https://media.defense.gov/2021/Nov/03/2002885874/-1/-1/0/2021-CMPR-FINAL.PDF> (last accessed: October 21, 2022). The war in Ukraine appears to have intensified the Chinese nuclear buildup, see Wall Street Journal, China is accelerating its nuclear buildup over rising fears of US conflict, April 9, 2022.

68 RAND, US Strategic Competition with China, 2021, <https://www.rand.org/pubs/perspectives/PEA290-3.html> (last accessed: October 21, 2022). Financial Times, China's extended naval reach in western Pacific fuels Taiwan tensions, January 23, 2022.

69 Financial Times, White House officials consider probe into China's industrial subsidies, September 10, 2021. Politico, White House debates to delay Biden's plan for tariffs on key Chinese industries, October 29, 2021.

70 Financial Times, Wall Street's new love affair with China, May 28, 2021. AmCham, China Business Report, 2021. Financial Times, China opens up bond market in bid to woo foreign investors, May 27, 2022. Financial Times, SEC set clock for delisting Chinese companies over US audit demand, March 10, 2022.

The US-China Economic and Security Review Commission issued a recommendation to further tighten geo-economic and geo-financial measures to counter China's increased political, economic, and financial influence and assertiveness.⁷¹ Meanwhile, Congress and parts of the administration continue to try to establish outward investment to enhance supply chain security and restrict US funding for the Chinese defense and technology sectors.⁷² After much wrangling but ultimately with bipartisan support, Congress also passed the *Chips and Science Act* worth \$280 billion, providing \$52 billion in subsidies for US chip manufacturers and more than \$100 billion in technology and science investments.⁷³ In the geo-tech realm, the Biden administration has warned US companies against sharing technology with 'civil-fusion' potential, namely, artificial intelligence, quantum computing, biotechnology, semiconductors, and autonomous systems, with China.⁷⁴

Meanwhile, China is taking action to counter or neutralize US geo-economic measures. This is accompanied by a major shift in economic policy: As recently as 2013, Beijing announced its intention to let the market play a 'decisive role.' Today, it is prioritizing the need for greater self-reliance and greater government control and oversight over parts of the economy deemed to be of critical importance.⁷⁵ Beijing is pursuing a so-called 'dual circulation' policy, which seeks to expand the domestic market through greater consumption and foster domestic innovation to reduce China's vulnerability to antagonistic American geo-economic policies.

Enhancing China's indigenous innovation capacity, building domestic production capacity for critical goods, securing access to overseas supply through the Belt and Road Initiative, and supporting indigenous technologies and standards are all part and parcel of a broader strategy aimed at reducing vulnerability vis-à-vis the other countries, and especially the United States. China has also designated several industries, including information technology and advanced materials, as "strategic emerging industries."⁷⁶

Tighter restrictions on cross-border data transfers and limits on the overseas listing of Chinese tech companies are also part of a broader national security-oriented foreign economic policy, while the creation of tools and policies such as the 'unreliable entity list' or, more recently, the creation of blocking statutes and anti-sanction tools are meant to create an effective deterrent or retaliatory capacity in view of increased US geo-economic pressure.⁷⁷

In other words, US-Chinese competition is in full swing, and this has important implications. From a systemic point of view, the world is witnessing the weakening of the multilateral, liberal order created after the Second World War. What is emerging is a less institutionalized and less multilateral regime which is characterized to a greater extent by competition and increasingly rests on geo-political and geo-economic power. Given its lesser vulnerability and greater leverage, the United States has been willing to partly weaponize economic interdependence, forcing Beijing "to play defense." But China has also resorted to geo-economic tools in situations where it has geo-economically the upper hand (e.g., vis-à-vis South Korea, Australia, Lithuania). All this translates into geo-economic and geo-financial competition and selective 'decoupling' in areas closely tied to national and economic security. This has important implications for Europe and transatlantic relations, as will be discussed below.

Not surprisingly, US-Chinese competition also affects international institutions and governance regimes. China has started some time ago to lay the foundation of an alternative economic regime, at least in part to reduce its dependence on – and vulnerability to – a largely US-dominated international economic, financial, and technological infrastructure and the respective governance regimes. This is happening at many levels: China is promoting the yuan as a reserve currency (including RMB-based cross-border interbank payment systems, CIPS) and creating parallel international financing regimes and institutions (e.g., *Asian Infrastructure Investment*

71 US-China Economic and Security Review Commission, Report to Congress 2021, 2021, <https://www.uscc.gov/annual-report/2021-annual-report-congress> (last accessed: October 21, 2022).

72 Politico, 'We're in an economic war': White House, Congress weighs new oversight of US investments in China, February 19, 2022. Politico, White House split delays plans for investment controls in China, March 7, 2022.

73 Financial Times, Congress passes \$280bn Chips and Science Act, July 28, 2022.

74 Financial Times, US intelligence officials warn companies in critical sectors on China, October 22, 2021.

75 Financial Times, China unveils five-year plan to strengthen control of economy, August 12, 2021.

76 Financial Times, China outlines strategic industries, August 4, 2021.

77 Peterson Institute, Can China blunt impact of new US economic sanctions? Policy Brief, 2021; Financial Times, News of China's unreliable entity list spooks foreign business, June 4, 2019; Financial Times, China launches measures to protect companies from US sanctions, January 9, 2021; Financial Times, Beijing avoids Hong Kong showdown by delaying anti-sanctions law, August 20, 2021.

Bank). At the same time, it is trying to establish a parallel or alternative physical or digital international infrastructure (*Belt and Road Initiative*, including the *Digital Silk Road*), supporting regional free trade agreements (e.g., *Regional Comprehensive Economic Partnership*, China's application to join CPTTP), and seeking to set international technology standards (*China Standards 2035*). China's efforts to build a blue water navy can also be seen as an attempt to reduce its dependence on the United States for sea lane protection. All these steps are designed to both limit China's vulnerability and help it become a technological leader (e.g., *Made in China 2025*). Constructing alternative, China-centered regimes also increases or will increase Beijing's power. Washington will, of course, see them as challenging the status quo. Such is the nature of the security dilemma.

In many cases, US-provided public goods, including the international monetary and financial regime, technological networks,⁷⁸ technological diffusion, free trade, access to the global commons,⁷⁹ and so on, are seen by Beijing as potential and actual sources of Chinese vulnerabilities due to Washington's ability to restrict third-party access to them. Competition and conflict will endure, and concomitant decoupling will undermine multilateralism.

While Russia represents a more immediate security challenge to US interests, primarily in Europe, it

does not challenge the United States as universally as does China. And in the longer term, Russia's economic potential simply does not compare with China's. Systemic competition with China, exacerbated by the existence of a security dilemma, is the single most important driver of US policy and strategy. US diplomacy as well as its security and foreign economic policies are predominantly focused on China,⁸⁰ as demonstrated by words (e.g. National Security Strategy), actions (antagonistic geo-economic policies), and the creation of new capabilities and institutional mechanisms (e.g. *CHIPS and Science Act*). China and the United States truly are engaged in a full-spectrum and systemic competition concerning security, economy, finance, and technology.

2.2 ECONOMIC RESOURCES

Resource availability is a key factor enabling or constraining grand strategy and therefore an important scenario driver. Strategy is alignment of means and ends. Preventing Chinese hegemony in East Asia is the single most important US strategic objective (end), while the availability of resources determines (or affects) whether ends can be realized as well as how they are pursued (means). As per our scenarios, intensifying US-Chinese competition and relative resource scarcity determine *how*

78 Henry Farrell and Abraham Newman, How global Economic networks Shape state coercion, *International Security*, 44(1),

79 Barry Posen, Command of the commons: the military foundation of U.S. hegemony, *International Security* 28(1), 2003. Michael McDevitt, China as a Twenty-First-Century Naval Power (Annapolis 2020).

80 Richard Baldwin and Rebecca Freeman, Risks and global supply chains, Bank of England, 2021.

81 Financial Times, Jacinda Ardern and Joe Biden forge closer security ties after China's Pacific push, June 1, 2022.

82 Department of State, Joint Statement on the US-EU Energy Council, February 7, 2022, <https://www.energy.gov/articles/joint-statement-us-eu-energy-council> (last accessed: October 21, 2022).

83 Financial Times, China's ruse pushes Asia-Pacific nations to embrace NATO, July 3, 2022. Financial Times, US and allies launch initiative to help Pacific Island nations, June 25, 2022. Financial Times, US pledged \$210mn to Pacific Islands to counter China's influence, September 29, 2022

84 Chief of Naval Operations, Navigation plan, 2022.

85 Congressional Research Service, China Naval Modernization, August 3, 2021, <https://crsreports.congress.gov/product/details?prodcode=RL33153> (last accessed: October 21, 2022).

86 Financial Times, China launches new aircraft carrier in bid to catch up with US capability, June 17, 2022.

87 Politico, US admiral says China has fully militarized islands, February 20, 2022.

88 Wall Street Journal, China seeks first military base on Africa's Atlantic coast, US intelligence finds, December 5, 2021. Financial Times, Beijing closes in on security pact that will allow Chinese troops in the Solomon Islands, March 24, 2022. China has a lot of catching up to do given that the United States has about 800 overseas military bases in 80 countries. Politico, Where in the world is the US military? 2015. You know rivalry is in full swing when the United States dispatched its Indo-Pacific 'czar' to counter growing Chinese influence in the Solomon Islands, see Financial Times, US to send officials to Solomon Islands due to tensions over Chinese security pact, April 8, 2022.

89 Financial Times, China denies building naval bases but fear of its military reach grows, June 20, 2022. Financial Times, China seeks more island security pacts to boost clout in Pacific, May 20, 2022.

90 White House, Building Resilient Supply Chains, Revitalizing American Manufacturing and Fostering Broad-Based Growth, 100-Day Reviews under Executive Order 14017, June 2021, <https://www.whitehouse.gov/wp-content/uploads/2021/06/100-day-supply-chain-review-report.pdf> (last accessed: October 21, 2022).

91 Financial Times, Pentagon bankrolls rare earths plant as US plays catch-up to China, June 14, 2022.

92 Financial Times, US and Taiwan launch trade 'initiative', June 1, 2022.

93 Financial Times, China merges 3 rare earths miners to strengthen dominance of sector, December 23, 2021.

94 Financial Times, China to set up centralized iron ore buyer to counter Australia's dominance, June 16, 2022.

WORSENING US-CHINESE RELATIONS SELECTED ISSUES

	United States	China
Alliance policies and strategy	<ul style="list-style-type: none"> Prevent Chinese hegemony in Asia Strengthening of alliances (G7, NATO, USA-EU, bilateral alliances in Asia) QUAD, outreach to Asian allies⁸¹ EU-US Trade and Technology Council; EU-US Energy Council⁸² Free Open Indo-Pacific 	<ul style="list-style-type: none"> Enhance security and secure sea lines of communications Aspiration to become a maritime great power (defense, security, commodities, recovery of lost territories) Does not recognize International Court of Justice's decision on maritime status quo in East Asia Global Security Initiative
Defense	<ul style="list-style-type: none"> Preserve military balance of power in East Asia Air-Sea Battle military doctrine AUKUS deal Pacific Deterrence Initiative Deployment of US troops to Taiwan CIA China Mission Center, State Department China House Greater engagement in Pacific through reinvigoration of Pacific Island Framework⁸³ US Navy's Navigation Plan 2022 aiming to preserve American maritime dominance⁸⁴ 	<ul style="list-style-type: none"> Aspiration to have a world-class military by 2049 (2035) Nuclear modernization and expansion (minissile silos, SLBNs)⁸⁵ Naval modernization and expansion⁸⁶ Asymmetric capabilities; advanced weapons systems; A2/AD Completed "militarization" of islands in the South China Sea⁸⁷ Move from 'offshore defense' to far-seas protection (incl. blue water navy and soon-to-be-launched third aircraft carrier) Establishment of military bases in Africa and the South Pacific⁸⁸ and expansion among smaller Pacific Island countries⁸⁹
Trade	<ul style="list-style-type: none"> Continuation of Trump administration trade policies vis-à-vis China Resolution of trade disputes with allies; intra-alliance supply chain cooperation⁹⁰ Secure supply chains of critical goods necessary for defense production⁹¹ Launch trade talks with Taiwan⁹² 	<ul style="list-style-type: none"> 'Dual circulation' Regional Comprehensive Economic Partnership (RCEP), application to join CPTPP Consolidation of rare earth miners to enhance market power/ strategic control⁹³ Increase control of 'strategic commodities'⁹⁴
Investment, Finance & Currency	<ul style="list-style-type: none"> Partnership for Global Infrastructure and Investment/Build Back Better World US promises \$150 million of investment to ASEAN countries Committee on Foreign Investment in the United States (CFIUS) Threat to delist selected Chinese companies (refusing to submit to US audit inspections) by 2024 Banning of investment in debt, equity, funds containing securities linked to defense and surveillance Regulator revokes license of Chinese telecoms provider; greater market entry restrictions 	<ul style="list-style-type: none"> Belt and Road Initiative (including bilateral financial support to Sri Lanka, Pakistan, Laos etc., and expansion of investment in strategically important Panama Canal zone); Asian Infrastructure and Investment Bank; Global Development Initiative RMB internationalization; e-yuan Security checks on overseas listings (sensitive data not obtained by foreign regulators) Delisting of Chinese firm from US stock exchange and moving them to Hong Kong (on national security grounds). Prohibition of VIEs/ foreign investors for Chinese tech companies China Interbank Payment System (CIPS)
Export Controls & Technology	<ul style="list-style-type: none"> Investment and Competition Act Export, reexport and in-country transfer controls ('entity list') Foreign direct product rule Restrictions on 'foundational and emerging technologies' (e.g., quantum computing, aerospace, semiconductor technologies) 	<ul style="list-style-type: none"> China 2025; 'Dual circulation' China Standards 2035 Data localization under national security legislation
Sanctions	<ul style="list-style-type: none"> Primary sanctions targeting Chinese entities Secondary sanctions forcing third parties to comply with US sanctions 	<ul style="list-style-type: none"> Unreliable entity list Blocking statute Anti-foreign sanctions law (applying to Chinese subsidiaries of foreign companies)

and – in the isolationist-protectionist scenario – if the grand strategic objectives can and will be pursued. If strong Chinese economic growth continues and if China continues to convert economic resources into military and geo-economic power, the United States will be forced to mobilize significantly greater resources. While resources can also be mobilized externally ('external balancing'), domestic resource constraints will be an important factor shaping US strategy longer-term. But to what extent has resource availability or scarcity had an impact on US policy and strategy under Biden?

The COVID-19 pandemic caused significant economic dislocation, leading the administration to implement large-scale macroeconomic stabilization measures. While massive policy support helped the American economy regain its pre-pandemic level of output more quickly than in many other countries, the debt burden is also meaningfully higher today.⁹⁵ The Biden administration spent 30 percent of GDP to stabilize the economy – an unprecedented amount in peacetime. Federal government debt is now projected to double from 100 percent of GDP today to 200 percent of GDP by mid-century.⁹⁶ Meanwhile, the US international investment position has continued to worsen,⁹⁷ deteriorating from negative 20 percent of GDP in 2010 to negative 70 percent of GDP today. Stripping out equity-type liabilities and leaving aside valuation issues, net external debt today amounts to a tangible 50 percent of GDP.

However, with interest rates until recently at near-record lows in both nominal and real terms, the Federal Reserve engaging in large-scale asset purchases, and the dollar maintaining its reserve currency status, the Biden administration has faced virtually no economic-financial constraints. Medium-term, the outlook is less clear in view of debt dynamics, significant implicit liabilities, and rising nominal and real interest rates.⁹⁸

US external liabilities are largely denominated in dollars, further reducing external financial risks. Nonetheless, if external debt continues to increase, the United States will sooner or later face constraints in terms of its ability to mobilize sufficient resources to compete with China, particularly if China's economy continues to grow faster,⁹⁹ allowing for a relatively greater expansion of military spending.

America's ability to mobilize resources has so far been constrained by politics rather than economics. Small Democratic majorities in both houses of Congress and intra-party squabbles forced the Biden administration to scale back the size of its various ambitious investment and infrastructure programs. However, resource mobilization that is specifically geared toward US-China competition (or marketed as such) continues to benefit from broad bipartisan support, as opposed to policies geared toward primarily domestic economic, social, and environmental objectives. The so-called 'hard' infrastructure program attracted limited Republican support, while the 'soft' program received none at all. The CHIPS and Science Act was also passed on a bipartisan basis.¹⁰⁰ Higher defense spending, too, continues to enjoy significant bipartisan support.¹⁰¹

In short, economic resource scarcity and the related guns-versus-butter¹⁰² trade-off have not been a significant constraint on Biden's foreign policy and concomitant domestic 'strengthening policy' yet. If there was a constraint, it was political, not economic or financial. Nonetheless, even with increased infrastructure investment and increased spending on technological innovation, the US-China growth differential points toward a medium- to long-term need to mobilize additional resources. In brief, resource scarcity has not yet had a tangible effect on US grand strategy. But on current trends, it will become a constraint over time.

95 IMF, *World Economic Outlook*, April 2022, <https://www.imf.org/en/Publications/WEO/weo-database/2022/April> (last accessed: October 21, 2022).

96 Congressional Budget Office, *The Long-Term Budget Outlook*, 2021, <https://www.cbo.gov/publication/56977> (last accessed: October 21, 2022).

97 Bureau of Economic Analysis, *US International Investment Position, Second Quarter 2021*, 2021, <https://www.bea.gov/data/intl-trade-investment/international-investment-position> (last accessed: October 21, 2022).

98 IMF, *Fiscal Monitor*, 2021, Annex.

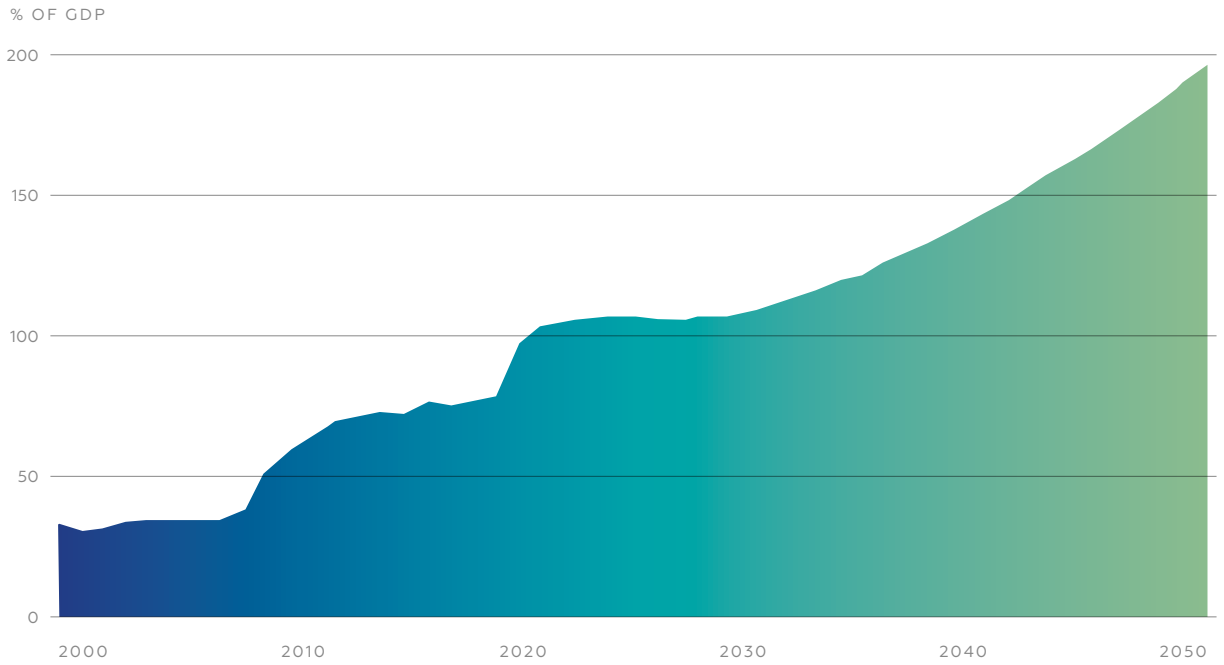
99 Evidently, should China succumb to a major financial crisis and economic stagnation and turn inward, the scenarios will need to be rethought completely.

100 Financial Times, *US lawmakers push for more money to counter China in Indo-Pacific*, June 19, 2022.

101 Politico, *House passes \$768b defense bill, supersizing Biden's Pentagon plans*, September 23, 2021.

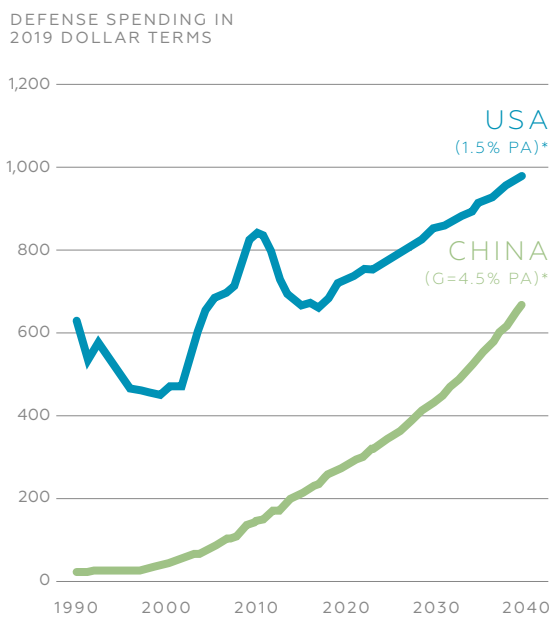
102 Empirically, the relationship between defense expenditure and economic growth is more complicated depending on the extent to which expenditure supports R&D. See *The Economist*, *Guns and butter*, April 16, 2022.

GOVERNMENT DEBT



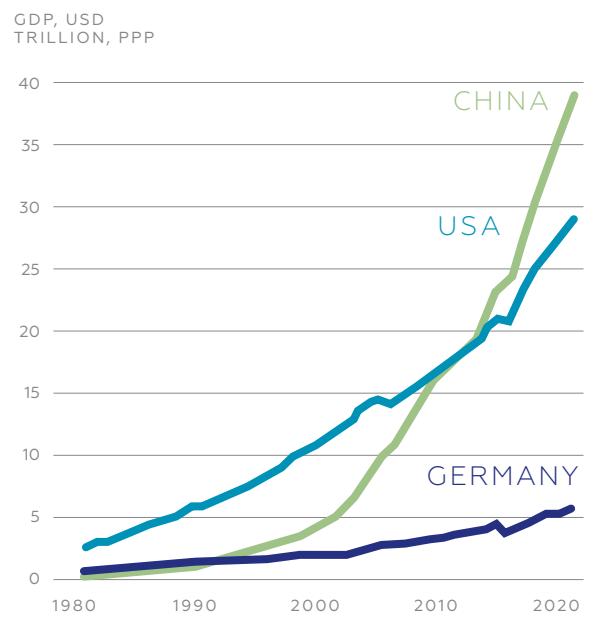
Source: Congressional Budget Office

DEFENSE OUTLAYS*



*Projected annual real GDP growth
Source: SIPRI, own projections

ECONOMIC SIZE



Source: International Monetary Fund

2.3 DOMESTIC POLITICS

The formulation of strategy and the implementation of foreign policy are largely the prerogative of the executive, not Congress. Yet Congress has manifold ways to influence or obstruct foreign policy given its constitutional prerogatives (especially over war, trade, budget). Typically, domestic political issues, such as immigration, voting rights, and taxes, find far greater resonance among the electoral base and financial supporters than foreign policy issues, for both ideological and distributional-economic reasons.¹⁰³ This tends to give the president a fair amount of leeway in conducting foreign affairs despite a highly polarized,¹⁰⁴ or at least highly sorted,¹⁰⁵ political system and antagonistic congressional politics.

And the political system is polarized, as is public opinion. Supporters of the Republican and the Democratic Party appear more fiercely set against each other than ever. A poll conducted in late 2021 showed that there was an 88-point partisan gap in the president's approval rating, the largest gap ever recorded in more than 80 years of polling (except for a 92-point gap for Trump just before the 2020 presidential election); 92 percent of Democrats approved of Biden's performance, while 94 percent of Republican disapproved.¹⁰⁶

So how have domestic politics and political polarization affected Biden's foreign policy against the backdrop of wafer-thin majorities in Congress? Broadly speaking, high levels of political and congressional polarization have had little effect in terms of the United States' China strategy and transatlantic relations. This is less surprising than it sounds. In addition to relatively limited congressional influence on foreign

policy, neither Congress nor public opinion are isolationist or significantly opposed to the general direction of US foreign policy and strategy. It is important to remember that senior Republican lawmakers, for example, opposed the Trump administration's isolationist tilt, including its decision (later reversed by the Biden administration) to reduce the US military presence in Germany. Similarly, Congress was very united in passing a bill in 2017 that forbid the president to suspend Russia sanctions. All this points to a broad foreign policy consensus among key actors in Congress, despite plenty of domestic political noise.¹⁰⁷

But it is not just lawmakers who broadly support, or at least do not oppose, the thrust of US foreign policy. Opinion polls show that more than two thirds of Americans support the United States playing an active part in international affairs, compared to 30 percent who do not.¹⁰⁸ Respectively, 68 percent and 59 percent of Americans say alliances with Europe and East Asia benefit the United States and its allies. 73 percent support maintaining or increasing US commitments to NATO. (And this was before the war in Ukraine.) Between 70 percent and 80 percent of those surveyed support increasing or maintaining America's military presence overseas. Interestingly and significantly, however, 58 percent of Americans say that trade between the United States and China weakens US national security. Then again, 68 percent of Americans believe that globalization is mostly good for the United States.¹⁰⁹

In short, public opinion at large remains supportive of US international engagement. And while a majority is opposed to so-called 'forever wars,' this should not be seen as a 'new isolationism' that would have the

103 Cf. footnote 1.

104 Alan Abramowitz, *The great alignment* (Yale 2018).

105 Morris Fiorina, *Unstable Majorities: Polarization, party sorting and political stalemate* (Stanford 2017); Lilliana Mason, *Uncivil disagreement* (Chicago 2018). Mason leans toward political-psychological or socio-psychological, including 'affective polarization' as well as identity-based polarization in terms of ideology, religion, and race, rather than institutional explanations. The so-called 'asymmetric polarization' thesis, whereby polarization is largely the consequence of a Republican shift to the right rather than a Democratic shift to the left is another important contribution to the contemporary debate. Cf. Pew Research, *Which party is more to blame for political polarization?* June 17, 2014. Institutionally speaking, congressional polarization is significantly driven by gerrymandering and the disappearance of competitive voting districts. (Only ten percent of House seats in the 2022 mid-term elections are competitive.) See Politico, *House moderates inching toward extinction*, January 26, 2022. More than 20 percent of US counties voted 80 percent or more in favor of Biden or Trump, reflecting deep-seated and deepening polarization due to redistricting as well as a widening white/ rural vs diversity/ urban split. Larry Sabato, *The growing number of blowout presidential counties*, Sabato's Crystal Ball 20 (13), 2022. Polarization is only partly explained by gerrymandering, as states and counties, where electoral districts have not changed, have also experienced increased partisan polarization. See Alan Abramowitz, *Redistricting and competition in congressional elections*, Sabato's Crystal Ball 20 (15), 2022.

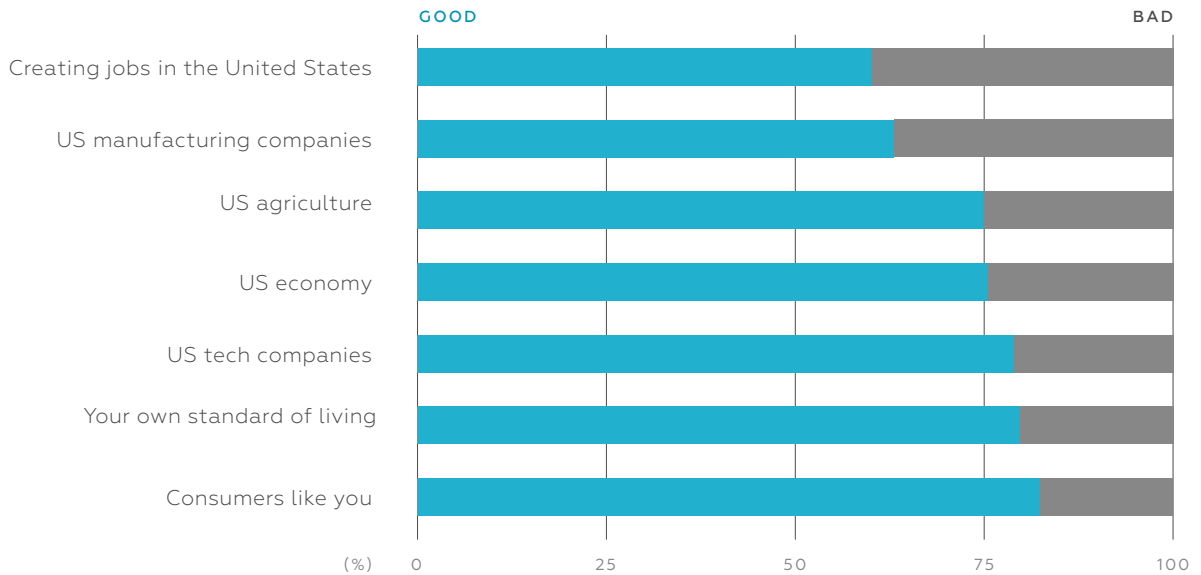
106 Gallup, *Biden job approval steady at lower level*, October 22, 2021.

107 US Congress, *Countering America's Adversaries through Sanctions Act*, August 2, 2017, <https://www.congress.gov/bill/115th-congress/house-bill/3364/text> (last accessed: October 21, 2022). This is not to deny that there is a MAGA isolationist fringe in the Republican party. But so far, it has had relatively little discernible impact on the general thrust of US foreign policy. Arguably, rhetoric and public relations stunts aside, Trump foreign policy was quite conventional.

108 Chicago Council on Global Affairs, *2020 Chicago Council Survey*, 2020; Chicago Council on Global Affairs, *2021 Chicago Council Survey*, 2021. Admittedly, how a question is phrased matters. But overall support remains solid. Brookings, *Measuring the impact of partisanship on attitudes toward the US response to the Russia-Ukraine war*, May 24, 2022.

109 Although it is the narrative that matters, the evidence that economic inequality is driven by globalization is a problematic diagnosis, if not empirically unsupported. It is worth noting that automation seems to be pushing some workers – mostly those who are less educated and indeed more likely to be replaced by robots – toward less optimism, less tolerance, and a less favorable view of globalization etc. Cf. Peterson Institute, *The interconnected economy: the effects of globalization on US economic disparity*, 2021. Brookings, *Automation and the radicalization of America*, 2021.

PUBLIC OPINION UND FREE TRADE OVERALL, DO YOU THINK INTERNATIONAL TRADE IS GOOD OR BAD FOR ...



Source: Chicago Council on Foreign Affairs

potential to undermine the Biden administration’s foreign policy and strategy. If these surveys are to be believed, American public opinion is currently neither isolationist nor necessarily protectionist. No wonder that Biden’s foreign policy has not encountered any significant domestic obstacles in the past 15 months.

Important partisan differences do nevertheless exist. A 2021 Pew Research poll¹¹⁰ shows that 85 percent of respondents who identify themselves as Republicans or as leaning toward the Republican party consider “protecting American jobs” to be the top foreign policy priority, as compared with 67 percent of respondents who lean toward the Democratic Party or see themselves as Democrats. Maintaining a military advantage over “all other countries” was a top priority in the eyes of 68 percent of Republicans but only 30 percent of Democrats, while “improving relationships with allies” was seen as a priority issue by only 44 percent of Republicans as compared with 63 percent of Democrats.

Similarly, “getting other countries to assume more of the costs of maintaining world order” was a top priority for 57 percent of Republicans and only 30

percent of Democrats. Finally, as for “limiting the power and influence of China,” the split was 63 percent Republican versus 36 percent Democrats.

So, while there are partisan differences regarding the prioritization of foreign policy goals, neither Republican nor Democratic voters are isolationist or hold views that are categorically at odds with Biden’s strategy. It is therefore not surprising that partisan differences have not visibly constrained Biden’s foreign policy, nor does this result create significant incentives for Republican or Democratic legislators to oppose a China-focused US foreign policy, or indeed an alliance-oriented policy.

For what it’s worth, there is also little daylight between Republicans and Democrats with respect to Russia: 50 percent of Republicans and 49 percent of Democrats see Russia as a competitor, and 39 percent of Republicans and 40 percent of Democrats view it as an enemy. (This was before Russia’s invasion of Ukraine.) Similarly, half of Republicans and Democrats consider Russia to be an immediate threat.¹¹¹ However, while 36 percent of Republicans

110 Pew Research, 2018.

111 Office of the United States Trade Representative, USTR Releases 2022 President’s Trade Policy Agenda and 2021 Annual Report, March 1, 2022: <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2022/march/ustr-releases-2022-presidents-trade-policy-agenda-and-2021-annual-report> (last accessed: November 1, 2022)

PARTISAN DIVIDES IN FOREIGN POLICY PRIORITIES

(% WHO SAY SHOULD BE GIVEN TOP PRIORITY AS A LONG-TERM FOREIGN POLICY GOAL)

Importance		Democrats	Republicans	Total
1	Protecting the jobs of American workers	67	85	75
2	Taking measures to protect the US from terrorist attacks	60	81	71
5	Improving relationships with our allies	63	44	55
6	Limiting the power and influence of China	36	63	48
7	Dealing with global climate change	70	14	44
8	Getting other countries to assume more of the costs of maintaining world order	30	57	42
9	Limiting the power and the influence of Russia	50	30	42
13	Reducing illegal immigration into the US	16	64	38
17	Reducing US military commitments overseas	29	29	29
19	Reducing legal immigration into the US	29	35	20

Source: Pew Research

and 33 percent of Democrats see it as minor threat, many more Republicans see it as a major threat (Rep 72 percent versus Dem 26 percent).¹¹² Since Russia’s invasion of Ukraine, US public opinion has also been supportive of the Biden administration’s Ukraine policy, including sending American troops to bolster NATO defenses.¹¹³ Again, Republicans tend to be even more hawkish. This explains why Congress, including its Republican members, is quite united in confronting Russia. This was demonstrated by the quick and bipartisan approval of Ukraine aid, despite some parts of the populist right remaining critical of Biden’s Russian policy.¹¹⁴ Republican opposition to Ukraine aid remains largely confined to the fringes of the Republican party.¹¹⁵

Naturally, public opinion rarely drives US foreign policy, let alone longer-term strategy, even if it does occasionally constrain the choices available to a president. This typically only happens with issues where public opinion can threaten to impose tangible political and electoral costs if foreign policy deviates too far from popular preferences. Trade is such

an issue. While public opinion is far from unambiguously opposed to free trade, subsequent US administrations have become less supportive of free trade, in part because of electoral considerations related to swing states. This helps explain Biden’s reluctance to flank US security strategy with an appropriate, alliance-focused trade policy.

Despite domestic hyper-polarization, Biden has benefited from a relatively broad bipartisan consensus in Congress in terms of confronting China and Russia as well as the preservation and revitalization of traditional alliances. For example, in spite of noise in the MAGA world, Sweden and Finland’s NATO accession passed the Senate 95 to 1, and the CHIPS Act passed by 86 to 11 (but by a narrower margin in the House), pointing to continued solid bipartisan support.¹¹⁶ If anything, Congress has pushed hawkish China legislation (e.g. CHIPS and Science Act, Countering China Economic Coercion Act).¹¹⁷ Other bipartisan proposals include *The Restoring Essential Security and Energy Holdings Onshore for Rare Earths Act* (requiring the creation of a strategic rare

112 Pew Research, Republicans and Democrats alike view Russia more as a competitor than an enemy of the US, January 26, 2022.

113 Brookings, The American’s people message to President Biden about Ukraine, April 1, 2022, <https://www.brookings.edu/blog/fixgov/2022/04/01/the-american-peoples-message-to-president-biden-about-ukraine-get-tougher-but-dont-risk-war-with-russia> (last accessed: October 21, 2022)

114 Politico, McConnell’s \$1.5B phone call: how congress supercharged its Ukraine aid deal, March 11, 2022.

115 Politico, Inside McConnell’s bid to quash GOP ‘isolationists,’ May 20, 2022.

116 Politico Playbook, August 4, 2022.

117 For example, the *Chinese Military and Surveillance Company Sanction Act of 2021* which prohibits US resident from investing in selected companies linked to Chinese military and/ or surveillance technologies. Or the *Protecting Americans from Corporate Human Right Abusers Act* which sanctions Chinese companies that contribute to human rights abuses. My favorite proposal semantically is called (no joke!) *Crippling Unhinged Russian Belligerence and Chinese Involvement in Putin’s Schemes Act*.

earths stockpile by 2025) as well as the *Taiwan Invasion Prevention Act* (authorizing the president to use force to defend Taiwan). Finally, even where Congress is at its most influential in terms of foreign policy and strategy, namely regarding the funding of defense spending, bipartisan consensus reigns.

The Biden administration did encounter pushback with respect to individual policies. The Afghanistan pull-out came in for criticism, but to little practical avail. Some Republicans (and some Democrats) were highly critical of the Biden administration's initial decision to waive sanctions against *Nord Stream 2*. Other than blocking or slow-walking the State Department, senators could do little to thwart the decision. Anecdotally, when the Senate in 2021 tried to force the administration to impose harsher sanctions on Russia and take action against *Nord Stream 2*, it was congressional gridlock that actually helped preserve the president's relative autonomy in terms of foreign policy.¹¹⁸ Similarly, the Senate's failure to agree on Russia sanctions just before the Ukraine war provided the president with increased leeway to impose measures on the basis of existing legislation.¹¹⁹

In brief, US foreign policy under Biden, in both words and deeds, suggests that systemic competition with China is the major driver and focus of US strategy. To date, resource availability has not been a limiting factor, while domestic politics constraints have only applied to specific foreign policy areas (e.g., trade). However, despite bipartisan support for a hawkish China policy, domestic politics has put constraints on a geopolitically oriented foreign trade policy as well as on parts of Biden's domestic strengthening agenda. This is why the Biden administration's various trade initiatives, such as the *Indo-Pacific Economic Framework* or the *EU-US Trade and Technology Council* focus on such issues as digital trade, supply chains, technology, infrastructure, and the environment rather than on market access, for only the latter requires congressional approval.¹²⁰ There has been no domestic political pushback to Biden's alliance re-engagement strategy, including the settlements of bilateral transatlantic disputes and the coordination of trade, investment, and technology policies with US allies, including Europe and Germany.

HORIZON SCANNING AND WILD CARDS

The focus on structural drivers and concomitant trends is necessary to generate medium-term scenarios. But it is not well-suited to anticipating potentially critical turning points. So-called 'wild cards', such as 9/11, the end of the Cold War, and maybe to a lesser extent Pearl Harbor, have the potential to lead to dramatic shift in US foreign policy and related scenarios.

Another major economic-financial crisis, for example, might further weaken the United States, strengthen isolationist forces, or embolden China. Similarly, should China be engulfed in domestic political turmoil or a destabilizing financial crisis and subsequent economic stagnation, its ability and willingness to compete with the United States might diminish. Yet such a development could also lead to a more aggressive foreign policy. Or, less likely, harmony and cooperation might suddenly break out between Washington and Beijing. Or domestic political destabilization in the United States or democratization in China might lead to significant changes in US or Chinese foreign policies.

One of the most obvious 'wild cards' (at least in the sense of high impact events) or 'known unknowns', is the 2024 presidential election. Biden's favorability ratings are very low, and Trump remains popular among Republicans and has a fair chance of winning the Republican nomination. In a scenario where Donald Trump (or a Republican America First candidate) wins in 2024, US foreign policy may yet again become much more unpredictable, volatile, unilateral, and potentially systemically destabilizing.

It is difficult to see how US policy during a second Trump term would not radically break with Biden's alliance-oriented foreign policy. In terms of our three original scenarios, a Trump 2.0 policy might move US strategy down the path of the realist scenario in an accelerated way. It might even lead the United States to pursue a more isolationist-protectionist strategy. Neither would be good news for Germany and Europe.

118 Politico, Congress frets over 'missed opportunity' on Russia's Ukraine aggression, November 7, 2021.

119 Politico, Why Congress' sanctions push cooled eve as Russia aggression didn't, February 18, 2022. The failure to pass new legislation was not reflective of a bipartisan disagreement over the need to confront Russia, but rather over the most effective means of doing so.

120 White House, Readout of President Biden's participation in the East Asia Summit, October 27, 2021, <https://www.whitehouse.gov/briefing-room/statements-releases/2021/10/27/readout-of-president-bidens-participation-in-the-east-asia-summit> (last accessed: October 21, 2022).

RECOMMENDATIONS

German and European Options

This section lays out the vulnerabilities and risks that arise for German interests¹²¹ from a *realist scenario*, where the United States remains focused on China, rather than from an *isolationist-protectionist scenario*, where it retreats to the Western hemisphere, militarily and economically. We will outline German vulnerabilities and interests in view of prospective US and Chinese policies and describe current national and EU-level efforts to address these vulnerabilities. Finally, high-level policy recommendations for specific policy areas will be sketched out.

3.1 GERMAN INTERESTS, VULNERABILITIES AND MITIGATION OPTIONS

Germany shares many of America's strategic goals, including the preservation of the territorial status quo in Europe and East Asia and the creation of an economic level playing field vis-à-vis China. It also has an interest in maintaining technological leadership and national security.¹²² Due to Germany's significant dependence on foreign trade and investment, a broader securitization and weaponization of economic interdependence¹²³ and a broader politicization of international economic relations are nevertheless not in its interests, absent outright military conflict.

Germany needs to take seriously the possibility of less cooperative US foreign economic and security policies – whether in the context of a return to

MAGA-style unilateralism or in the event of America's increasing willingness to weaponize economic relations in the context of US-Chinese geopolitical competition. But Germany should be at least equally if not more concerned about its significant economic vulnerability vis-à-vis China. As the war in Ukraine demonstrated, economic overreliance can be very costly, particularly in case of a near-complete breakdown of economic relations. China's failure to condemn Russian attempts to change the territorial status quo in Europe has given Germany (and Europe) good diplomatic reasons to adopt an even more cautious, skeptical attitude toward China,¹²⁴ while Russian aggression has increased Germany's dependence on the United States.

Germany has an interest in opposing any changes to the territorial status quo in Asia (and Europe), even though it may not want to be seen as aligning itself with the United States more firmly than necessary for fear of Chinese geo-economic retaliation. The challenge for German decisionmakers will therefore be how best to support US policies aimed at preserving geopolitical stability while avoiding a broader politicization of economic relations with China so as not to invite Chinese retaliation. Berlin needs to avoid Washington's ill will in case Germany is seen as insufficiently supportive of hawkish American China policies. Washington (and especially Congress) is unlikely to allow Germany to play the role of a so-called 'third-party spoiler'¹²⁵ as this would risk undermining the effectiveness of broader US policies vis-à-vis China.

As US-Chinese competition intensifies, the United States is likely to resort to greater export and investment controls as well as secondary sanctions, indirectly pressuring Germany to follow suit. If Germany does align itself with US policies, however, it risks provoking – at the very least selective but nevertheless costly – Chinese economic retaliation in the form of trade and investment restrictions, regulatory discrimination, trade sanctions, and other retaliatory measures. Washington might even seek to leverage Germany's continued security

121 German interests' are here defined in terms of security and economic prosperity rather than derived from the views expressed by German policymakers, though the two arguably largely coincide.

122 Germany has tightened FDI legislation and lent support to a variety of EU-level initiatives, including trade defense measures, anti-coercion instruments, and an FDI screening mechanism at European level.

123 Markus Jaeger, Great Power Competition and the Securitization and Weaponization of International Economic Relations, German Council on Foreign Relations (forthcoming).

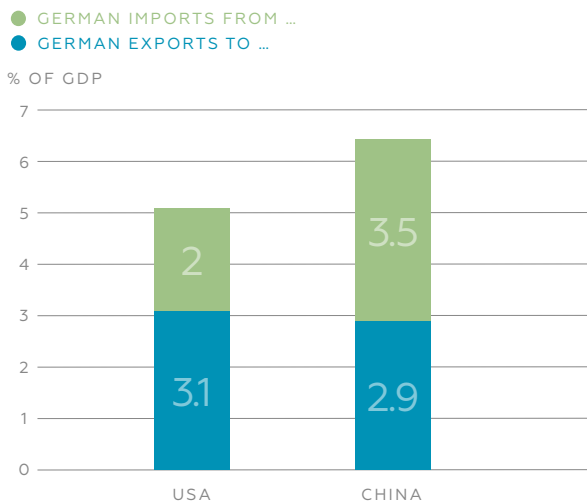
124 Financial Times, EU ministers advised to take a tougher line on China, October 17, 2022.

125 Bryan Early, Sleeping with your friends' enemies, *International Studies Quarterly*, 53(1), 2009.

dependence on the United States to win support from Berlin.¹²⁶

Germany and Europe should therefore urgently act to mitigate their most critical security and economic vulnerabilities. This will require strategic planning, intra-EU coordination, additional resources, and efficient implementation of policies. The German government and the EU should conduct cost-benefit assessments of individual policies in the context of a broader strategy aimed at economic and military security.

GERMAN BILATERAL TRADE DEPENDENCE 2020



Source: International Monetary Fund

Even if such policies fail to eliminate respective vulnerabilities completely, they will go some way in terms of limiting them. Any progress in this area would provide German and Europe with greater policy flexibility and autonomy and limit the costs of being caught in the US-China rivalry. In principle, Berlin and Brussels should consider addressing vulnerabilities vis-à-vis the United States and China as well as relevant third parties. In practice, they will need to be judicious and selective. To limit common vulnerabilities vis-à-vis third parties, Germany and Europe will also have to decide where and

to what extent to cooperate with others, including America. Unlike in the protectionist-isolationist scenario, Germany has greater incentives to reduce its vulnerability vis-à-vis China than vis-à-vis the United States because of the security externalities of intra-alliance economic cooperation.

Addressing structural vulnerabilities will take time. In the meantime, Germany should consider pursuing a multi-track approach, consisting of offering Washington conditional support in pursuit of narrow, well-defined objectives (e.g., concerning supply chain security). At the same time, it should explore reducing critical security, economic, financial, and technological vulnerabilities with respect to both the United States and China – *wherever this is deemed effective from a risk-reward point of view*. Diversifying risks is going to be generally the economically less costly option, compared to self-sufficiency.¹²⁷ But much depends on what level of residual vulnerability Germany is comfortable with or which level of resilience Germany seeks in any particular policy area.

3.2 SECURITY POLICY

Vulnerability: Germany is highly dependent for its security on NATO and especially American commitments under Article 5 of the NATO treaty. Considering the likely shift of US strategic focus and resources to Asia, Germany will find it increasingly difficult to ‘free ride’ on the security provided by the United States. Whether or not Washington resorts to *linkage politics*, tying the extent of its security commitments to German support for a hawkish China strategy, fewer US resources mean that Germany will need to strengthen its military capabilities to enhance European military capabilities and deterrence.

German interests: Germany has a fundamental interest in preserving (1) the conventional military balance and (2) a credible nuclear deterrence vis-à-vis Russia. Furthermore, it has an interest in supporting (3) an effective and autonomous European capacity able to intervene in Europe’s periphery in view of a declining American willingness to do so; and in in

126 Michael Mastanduno, Trade as a strategic weapon, *International Organization* 42 (1), 1988; Michael Mastanduno, The United States defiant: export controls in the postwar era, *Daedalus*, 120(4), 1991. Henry Farrell and Abraham Newman, How global economic networks shape state coercion, *International Security*, 44(1), 2019; Daniel Drezner et al., The uses and abuses of weaponized interdependence (Washington DC, 2021); Robert Keohane and Joseph Nye, Power and interdependence (1977); for a more recent iteration, Joseph Nye, Power and interdependence with China, *Washington Quarterly*, 43(1), 2020.

127 Markus Jaeger, The Logic (and Grammar) of US Grand Strategy, German Council on Foreign Relations, 2021: <https://dgap.org/en/research/publications/logic-and-grammar-us-grand-strategy> (last accessed: October 16, 2022).

SECURITY DEPENDENCE

	Population (million, 2021)	GDP (USD trillion, PPP, 2021)	Per capita income (USD, PPP, 2021)	Defense expenditure (% of GDP, 2020)	Defense expenditure (USD billion, 2020)*
USA	333	22.7	68,000	3.4*	732
Germany	83	4.7	57,000	1.4	49
UK	67	3.2	47,000	2.2	50
France	67	3.2	49,000	2.1	49
Italy	59	2.6	43,000	1.6	27
Big-Euro-4	276	13.7	49,1	2	175
China	1,412	26.7	19,000	1.7	261
Russia	146	4.3	29,500	4.3	65

*Measured in terms of purchasing power, Russian defense spending is far higher than suggested by nominal spending levels.

Source: International Monetary, Stockholm International Peace Research Institute

building (4) a greater capacity to secure its sea lines of communication as the United States transfers naval assets to Asia.

American policies: The United States has reaffirmed its commitment to European security following the Russian invasion of Ukraine. But if China continues its ascendancy, America will have little choice but to direct greater resources and attention to Asia and effectively force Germany and Europe to step up. While the United States does not wish to see Russia extend its influence in Europe, let alone destabilize the continent, Washington also has an interest in reducing its defense commitments by getting European countries, and especially Germany as Europe's largest economy, to accept greater responsibility for their own defense. This may over time lead to an outright reduction of US conventional forces in Europe. The implicit US nuclear guarantee, including nuclear sharing, will be less affected by a reduction of America's military forward presence, given its relative cost-effectiveness. (It is worth noting however that the Biden administration did toy with, but then abandoned, the idea of weakening traditional 'extended deterrence' by switching to a 'no-first strike posture'.)¹²⁸ And a substantial drawdown of America's forward presence in Europe might yet negatively af-

fect the credibility of the US nuclear guarantee by removing the so-called 'trip wire,' that is, the deployment of a military force inferior to an adversary for purposes of strategic deterrence.

Current policies at national and EU levels: Long before the Ukraine war, Germany, like all other NATO members, had committed to increasing its defense outlays to two percent of GDP, though that figure was never reached. The war led Germany to renew its promises to spend more on defense and in particular force modernization, including a EUR 100 billion investment fund. A myriad of initiatives was also launched at EU level over the past decades to enhance Europe's military capabilities and autonomy. In 1999, the Amsterdam Treaty laid the foundation for a Common Security and Defense Policy (CSDP). In the context of the Permanent Structured Cooperation (PESCO), which was established in 2017 as a legal framework for joint capabilities projects, some 60-odd projects have been launched. The recently approved EU Strategic Compass foresees setting up a rapid intervention force of 5,000 soldiers, strengthening maritime cooperation, and focusing on military dimension of new technologies such as AI and cyber. Outside the frameworks of NATO and the EU, European

¹²⁸ Financial Times, Biden steers away from big change to US nuclear weapons policy, March 25, 2022.

countries also created the European Intervention Initiative to help develop a common strategic culture to facilitate joint missions.

This has created a rather Byzantine system where it is often unclear how the different initiatives relate and how they can be coordinated effectively (see Box). While many earlier attempts to strengthen European security have not been particularly successful, the renewal of such efforts reflects a broader recognition that Germany and Europe need to cooperate more closely and take on greater responsibility for their own security. Yet none of the current initiatives will come even close to offsetting a significant reduction of US security commitments to Europe in the foreseeable future.

Policy recommendations: In the short to medium term, Germany should seek to maintain NATO cohesion and ensure that the United States remains strongly committed to NATO. At the same time, Germany must pursue a forceful forward-looking defense strategy on the assumption of a weakening US commitment. Germany and its European allies must devise policies and invest in European capabilities in order to maintain credible deterrence, particularly vis-à-vis Russia. Strategically, priority needs to be given to the effective and credible conventional and nuclear deterrence of Russia. Germany should also devise a plan B in the less likely event that the

United States withdraws its nuclear guarantee and terminates nuclear sharing (in the isolationist-protectionist scenario). Independently, Germany should therefore explore the feasibility of a Franco-German nuclear sharing agreement as a hedge in case of a precipitous withdrawal of the US nuclear guarantee. Most importantly, Germany must hash out a viable strategy supported by the major European countries on how to proceed and how to streamline various defense-related initiatives. Germany as the economically largest country needs to take leadership, ideally jointly with France and other like-minded EU countries, to enhance European defense. If EU defense cooperation proves challenging, Germany should consider working more closely with a core group of European partners. Greater European defense capabilities and autonomy do not need to be detrimental to NATO cooperation.

Institutional reform: At the national level, defense and foreign policy planning should be more tightly coordinated. The creation of a National Security Council charged with coordinating defense, foreign, and related policies would help make German policies more coherent. At the European level, an institutional framework needs to be created that helps coordinate the various defense-related initiatives into a coherent and sensible whole, much more so than what is currently attempted under PESCO and other initiatives.

DEFENSE COOPERATION FRAMEWORKS

Regime	Membership & History	Mission & Purpose
North Atlantic Treaty Organization (NATO)	28 European and 2 North American members, established in 1949	Collective security, various cooperation arrangements (incl. with EU)
Common Security and Defense Policy (CSDP)	27 EU members; since 1999/ 2009	Collective self-defense; no permanent military command structure
Permanent Structured Cooperation (PESCO); part of CSDP	25 out of 27 EU members pursue structural integration/ enhanced cooperation, established in 2017	Streamlining and cooperation on development of weapons systems etc.
European Intervention Initiative (EI2)	13 members, established in 2018	Outside NATO and EU; enhance ability to work together in joint missions as part of EU, NATO, UN etc.

Source: Author's compilation

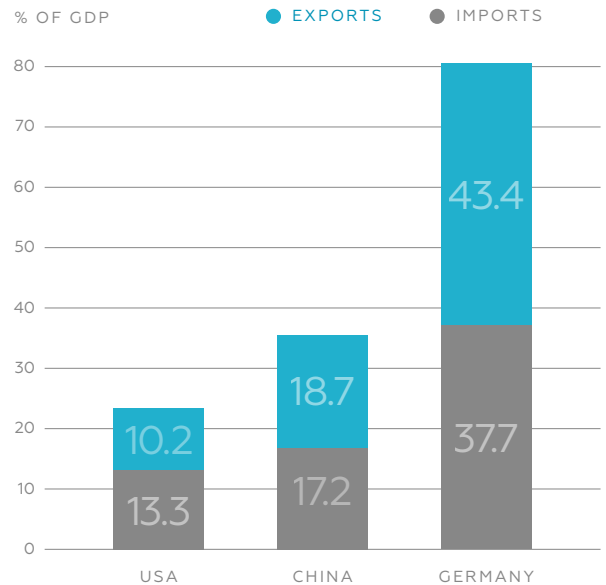
3.3 TRADE POLICY

Vulnerability: Germany's economic prosperity is highly dependent on international trade. Germany is more dependent on trade with both the United States and China than other large EU members. Hence trade-related vulnerabilities remain of greater concern to Germany than to most other EU members. Germany is also far more dependent on the US and Chinese markets than vice versa. This asymmetric vulnerability is further exacerbated by extensive local sales of German subsidiaries in both the United States and China. As a consequence, Germany is very vulnerable to unfriendly measures limiting German exports or the operations of the affiliates of German companies.

Germany is highly dependent on both exports and critical imports, such as energy, rare earths, or semiconductors. On the import side, this makes Germany susceptible to other countries' export controls and secondary sanctions. The inability to procure a particular item can wreak economic havoc regardless of its import volume. (German energy dependence on Russia is a case in point.) Taking the EU as a single entity, more than half of critical imports originate from China, while only three percent originate from the United States, according to the EU Commission.¹²⁹ Sectors vary by their dependence on critical imports.¹³⁰ And of course, quantitative dependence says little about how difficult or costly it may be to replace critical items, nor how economically costly lack of access to them would be.

German interests: Germany has a major stake in the stability and predictability of the multilateral trade regime based on reciprocity and non-discrimination. A general politicization of international trade in the guise of increased tariff and non-tariff barriers as well as export controls would harm German interests. True, two thirds of German trade is with other EU member states. But exports to China and the United States are economically important. Germany therefore has an interest in minimizing trade frictions. At the same time, Germany also has an interest in preserving (or creating) a level playing field vis-à-vis China in terms of market access and other trade-related issues, such as competition, state-owned enterprises, intellectual property rights, subsidies, and

VARYING DEGREES OF TRADE DEPENDENCE



Source: International Monetary Fund

so on. Crucially, Germany and Europe need to improve their ability to manage their trade dependence, particularly their dependence on critical imports.

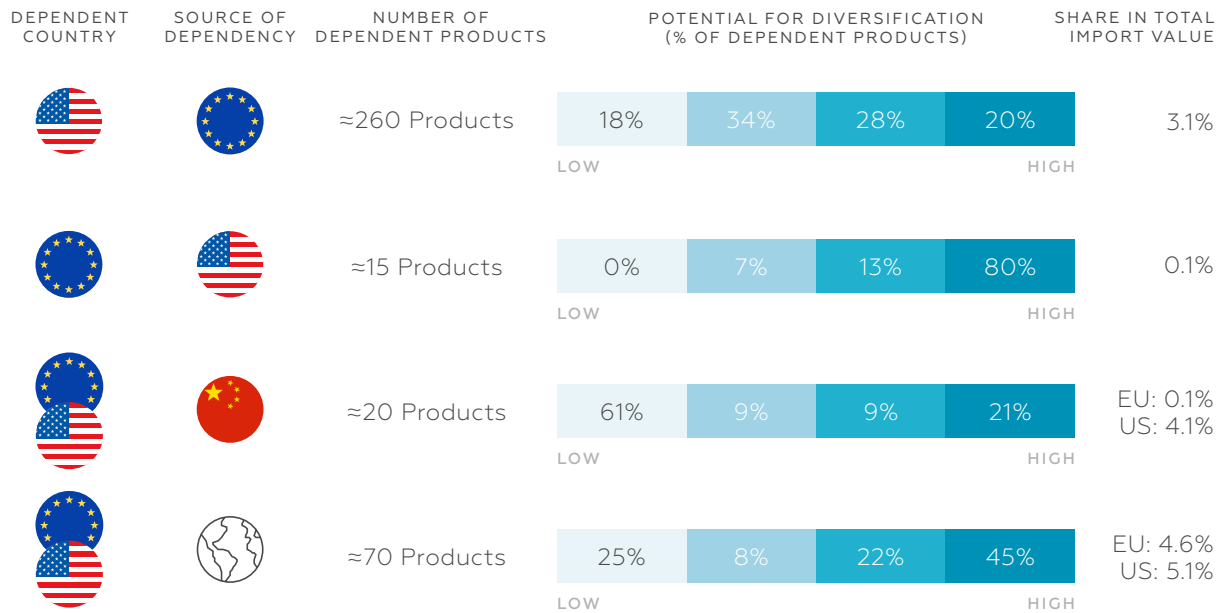
American and Chinese policies: US-Chinese rivalry and the concomitant weaponization of economic interdependence represents a significant risk to German economic interests. Neither the United States nor China will shy away from disregarding international trade rules, as the US 'trade war' against China and Chinese sanctions against Australia, Japan, South Korea, and Lithuania demonstrate. In addition to imposing tariffs, both countries have resorted to export controls concerning technology and essential commodities.

Thanks to its lesser degree of bilateral trade dependence and greater control of strategic goods, including technology, the United States can employ trade as a coercive instrument more easily. It can threaten to impose significant costs on the sanctions target as well as on third parties which might act as 'spoilors.' As US-Chinese economic and

129 European Commission, Strategic Dependencies and Capacities, Commission Staff Working Document, 2021, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=SWD:2021:352:FIN> (last accessed: October 21, 2022). The EU has identified nearly 140 imports goods (out of 5,000) where one foreign supplier is dominant, one quarter of which are considered difficult to substitute.

130 European Commission, Critical Raw Materials, 2022. European Commission, Action Plan on Critical Raw Materials, Factsheet, September 3, 2021.

DEPENDENCE ON CRITICAL IMPORTS



Source: European Commission

technological competition heats up, Washington will expand the definition of dual-use goods and ‘emerging and foundational’ technologies and restrict the access of Chinese companies to America’s domestic market. This may force third countries such as Germany to abide by US export control policies. As a result, German trade and investment with its second-largest economic partner, China, could be at risk. And if China then made good on its threat to retaliate, if only selectively, against companies and countries that go along with US sanctions, Germany could incur significant losses and might even be forced to choose between its two most important international trade partners.

Current policies at national and European levels: To counter the threat of economic and trade-related coercion, the EU has proposed a so-called ‘trade defense’ policy and an ‘anti-coercion’ instrument to deter other countries from coercing the EU or any of its members. The current proposal seeks to deter hostile trade measures by threatening retaliation through the imposition of tariffs and quotas

and the restriction of intellectual property rights protections. Ultimately, offending countries could even be locked out from the EU financial markets. To enhance this instrument’s credibility and effectiveness, EU member states will need to delegate the use of the new instrument to the European Commission.¹³¹

The EU is also seeking to address import dependence through enhanced supply chain security, import diversification, and additional global trade deals.¹³² In terms of energy security, for example, the EU is pushing for ‘mandatory strategy stocks and storage’, greater diversification and greater interconnectedness of intra-EU energy infrastructure (to make energy more fungible). It has proposed leveraging the EU’s market power by forming a buyers’ cartel to engage in voluntary joint purchases of energy and other critical materials, not least to prevent a bidding war in an emergency.¹³³ The European Commission has also announced its intention to propose plans to lower regulatory barriers to the mining and production of critical raw materials needed for

131 Markus Jaeger, Designing a Geo-Economic Policy for Europe, German Council on Foreign Relations, 2022: <https://dgap.org/en/research/publications/designing-geo-economic-policy-europe> (last accessed: October 16, 2022).

132 Financial Times, Australia backs rare earth mine to reduce China’s supply dominance, February 2, 2022. Financial Times, EU must act faster to agree more global deals, says trade chief, July 23, 2022.

133 Financial Times, EU energy proposals to focus on gas storage, March 22, 2022.

green technology.¹³⁴ Efforts in other areas include the European Raw Materials Alliance, which is meant to coordinate private-sector-led efforts to reduce vulnerabilities related to the EU's dependence on critical imports.¹³⁵ In some areas, the EU has also proposed policies aimed at increasing self-sufficiency, particularly with respect to technology (see below). Finally, the EU has also committed to coordinating its policies with the United States in the context of the EU-US Trade and Technology Council.¹³⁶

Policy recommendations: The EU should continue expanding its trade defense and anti-coercion policies, including the introduction of an anti-coercion instrument.¹³⁷ This requires a well-calibrated policy and the recognition that geo-economic deterrence can and does fail, which may then lead to greater escalation. To best manage this challenge, it is crucial to delegate retaliatory policies to the European Commission and even make them quasi-automatic. Only then will it be possible to prevent third parties from pursuing a 'divide and rule' policy vis-à-vis the EU. Trade defense and anti-coercion policies also need to be designed very carefully so that they cannot be hijacked by protectionist interests or lead to an inadvertent escalation of trade conflict. This should be of particular concern for Germany as a very trade-dependent country.

Mitigating trade-related dependencies requires export and especially import diversification. Where feasible and desirable from a cost/vulnerability point of view, imports should be diversified to mitigate dependencies. Supply chain security measures may also include reshoring and stockpiling, but only in areas where the EU is critically dependent on imports and where there is a reasonable chance that these policies will successfully mitigate vulnerabilities. These policies should be coordinated among EU members on a voluntary but ultimately binding basis. Where critical import-related vulnerabilities cannot be mitigated sufficiently at the EU level, national governments may seek to provide financial and regulatory support to create domestically sourced substitutes. Greater economic costs may be the price to

pay for lessened vulnerability. A careful cost-benefit calculation will, however, be required in each case.

In terms of cooperation, the EU and Germany should explore 'friend-shoring' or 'allied-shoring' to limit supply chain vulnerabilities. Various EU-US fora and councils provide a platform, including the EU-US Trade and Technology Council and the EU-US Energy Council. Ideally, attempts to foster cooperation should seek to leverage the existence of common vulnerabilities. A complex network of symmetric dependencies will also make it more difficult for either side to 'defect' and exploit bilateral dependencies.

Institutional reform: At the national level, Germany should create a National Economic Security Council,¹³⁸ to monitor, identify, and assess present and future trade-related vulnerabilities in terms of exports (loss of market access) and critical imports (loss of supplies). In consultation with the private sector, the council should also coordinate information sharing and transparency to identify existing and emerging economy-wide vulnerabilities as well as to propose initiatives to address them.

Ideally, similar but more formal and binding efforts should take place at the EU level. (The economic weight of the EU can be leveraged on both the export and import side.) This would help avert disruption and sustain cooperation in case of an emergency and make it possible to avoid intra-European bidding wars for critical imports. Intra-EU coordination is highly desirable, in fact necessary, when it comes to mitigating national-level trade vulnerabilities.

3.4 INNOVATION CAPACITY AND INDUSTRIAL POLICY

Vulnerability: Europe's innovation capacity and ability to keep up and compete with the United States and China, economically and militarily, appears limited.¹³⁹ A consistent failure to innovate in critical and emerging technologies is a source of present and future security and economic dependencies.

¹³⁴ Financial Times, EU digs for more lithium, cobalt and graphite in green energy push, August 16, 2022

¹³⁵ European Raw Materials Alliance.

¹³⁶ White House, Fact sheet: United States and European Commission announce task force to reduce Europe's dependence on Russian fossil fuels, March 25, 2022, <https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/25/fact-sheet-united-states-and-european-commission-announce-task-force-to-reduce-europes-dependence-on-russian-fossil-fuels/> (last accessed: October 21, 2022).

¹³⁷ Markus Jaeger, Defense and Deterrence Against Geo-Economic Coercion, German Council on Foreign Relations, 2022: <https://dgap.org/en/research/publications/defense-and-deterrence-against-geo-economic-coercion> (last accessed: October 16, 2022).

¹³⁸ Japan has created a Ministry of Economic Security and South Korea has just upgraded its Economic Security Taskforce within the Foreign Ministry.

¹³⁹ For what it's worth: "Of the world's 142 listed firms worth over \$100bn, 43 were set up from scratch in the past half-century, 27 in America, and 10 in China. Only one was in Europe: SAP, a German software group founded in 1972." The Economist, Europe is now a corporate also-ran, June 5, 2021.

Technological dependence on rapidly innovating countries such as the United States and China, particularly in the context of US-Chinese technological decoupling, represents an even greater vulnerability, as Germany and Europe may be forced to pick a side.¹⁴⁰

German interests: To maintain industrial and economic leadership, innovation particularly with respect to critical technologies is crucial. While Germany and Europe cannot be leaders in all areas, they do have a major interest in being a leader in some strategic technological sectors and thus reduce the risk of becoming susceptible to the politically motivated exploitation of technological asymmetric interdependence. To the extent that others rely on European technology, risks become more manageable.

American and Chinese policies: Due to its economic and military importance, technology is a key determinant of US-Chinese economic and security competition. Crucial difficult-to-substitute technologies provide America with an important source of leverage, while creating an important source of vulnerability for countries that depend on US technology. America can restrict access to many critical technologies through export controls, including the so-called foreign direct product rule that also restricts exports by third parties to sanctioned entities.

Not surprisingly, China has accelerated efforts to wean itself off critical dependencies through a whole-of-government effort. To that end, it is moving toward 'dual circulation' (that is, improving innovation capacity and reducing independence while remaining open to outside world) and implementing its Made in China 2025 policy. At the same time, China can be expected to increasingly use its own technology as a lever vis-à-vis third countries.

Meanwhile, the United States is also dusting off industrial policy by providing increased financial support not just to remedy technological vulnerabil-

ities, but to 'win' the race in emerging technologies. Both the United States and China are investing significant amounts of money in the development of advanced and emerging technologies. They also provide extensive support in a variety of ways, including industrial policy, defense spending, subsidies, government ownership, preferential tax policies, and, in the case of China, through below-market rate financing, forced joint ventures and technology transfer, and so on.¹⁴¹

Export control policies and technological decoupling between the United States and China will affect third parties that are unable to compete in advanced technologies. Washington will be especially keen to prevent technological leakage via allies and other third parties. China will similarly guard critical technology from third parties. This will effectively translate into global technological decoupling.

Current efforts at national and EU levels: The German Economics Ministry in 2019 rolled out an industrial policy (Germany 2030).¹⁴² There is also a Franco-German manifesto for a European policy, and the European Commission is warming to the idea of an EU industrial policy. In terms of scale and funding, however, these proposals and policies pale in comparison to US and Chinese efforts.¹⁴³

The EU has launched policies aimed at 'technological sovereignty' in the broader context of *European Strategic Autonomy*. The proposed *European Chips Act*, for example, is to provide extensive public funding for next generation microchips. Other EU initiatives are underway, such as the development of a satellite internet system to compete with US systems.¹⁴⁴ There is also a Franco-German plan to fund four 5G projects¹⁴⁵ and other initiatives ranging from microelectronics to cloud computing.¹⁴⁶ The Commission is using its market power to mitigate its dependence on US technology and tech companies through market regulation in the guise of the *Digital Markets Act*. Finally, the EU is exploring cooperation with

140 For example, under the US Cloud Act, the US government can requisition European data held by US companies. (And Amazon, Microsoft and Google accounts for 70 percent of European market compared to Deutsche Telekom's two percent.)

141 Financial Times, Emmanuel Macron unveils EUR 30bn plan to boost tech industries, October 12, 2021.

142 Federal Ministry of Economics, Industrial Strategy 2030, 2019, <https://www.bmwk.de/Redaktion/EN/Publikationen/Industry/industrial-strategy-2030.html> (last accessed: October 21, 2022).

143 European Commission, A new industrial strategy for Europe, 2020, https://ec.europa.eu/commission/presscorner/detail/en/ip_20_416, (last accessed: October 21, 2022). German Federal Ministry for Economics and Energy, A Franco-German Manifesto for a European industrial policy fit for the 21st century, February 19, 2019, <https://www.bmwk.de/Redaktion/DE/Downloads/F/franco-german-manifesto-for-a-european-industrial-policy.pdf?3Fblob%3DpublicationFile%26v%3D2> (last accessed: October 21, 2022).

144 Financial Times, EU takes on SpaceX and Amazon with its own satellite internet system, February 15, 2022.

145 Financial Times, China, US and Europe vie to set 5G standards, February 6, 2022.

146 Politico, Inside Gaia-X: how chaos and infighting are killing Europe's grade cloud project, October 26, 2021.

TECHNOLOGICAL COMPETITIVENESS FOUR QUADRANTS OF NATIONAL AI STRATEGY IMPLEMENTATION



Source: Brookings, Winners and losers in the fulfilment of national artificial intelligence aspirations, October 21, 2021.

the United States through various transatlantic fora, such as the EU-US Trade and Technological Council.

Policy recommendations: Germany and the EU should identify the most critical present and likely future technological dependencies and assess their importance in terms of economic vulnerability and political exploitability. Rather than taking a haphazard approach to mitigating dependencies, they need to prioritize areas of critical – present and future – vulnerability and assess the cost-effectiveness and likely success of mitigation efforts. They should consider prioritizing areas where Europe has comparative advantages, for it cannot expect to compete successfully in all areas. Policies will also need to be well-targeted to enhance efficiency and avoid waste. The challenge is in the design of policies, given the difficulty involved in picking winners and avoiding rent-seeking.¹⁴⁷

To compete, Germany and Europe need to provide significantly greater financial resources and allocate them intelligently and efficiently in view of US and Chinese efforts. In addition to providing selective public financial support, it is crucial that Germany and EU countries adopt regulations conducive to innovation and the exploitation of economies of scale.¹⁴⁸ Ideally, such policies would be designed by an independent commission to minimize rent-seeking and enhance the chances of success.

Transatlantic cooperation also offers an opportunity to coordinate policies to mitigate shared vulnerabilities and address future vulnerabilities. In American eyes, Germany is an attractive partner thanks to its very good scientific infrastructure and extensive industrial capabilities. Moreover, it is less risky to share technology within alliances given se-

147 Peterson Institute, Scoring 50 years of US industrial policy, 1970-2020, Briefing 5, 2021

148 Brookings, How the US can dominate the race to national AI supremacy, February 3, 2022, <https://www.brookings.edu/blog/techtank/2022/02/03/how-the-u-s-can-dominate-in-the-race-to-national-ai-supremacy> (last accessed: October 21, 2022).

curity externalities, making ‘friend-shoring’ research and development a viable proposition.¹⁴⁹ Joint exploitation of new technologies can also help avoid the creation of excess productive capacities that could cause global oversupply and even trade tensions. In contrast, a policy that seeks to ring-fence domestic markets through discriminatory measures may fuel transatlantic conflict.

Ultimately, self-sufficiency in critical technologies would be too costly, assuming it is possible at all. Cooperation would help limit costs, avoid wasteful competition, and lay the basis for a symmetric dependence that limits concerns about bilateral exploitability. In other words, a cooperative innovation and technology policy needs to constantly assess the economic costs and benefits of, and related geopolitical risks associated with, such policies.

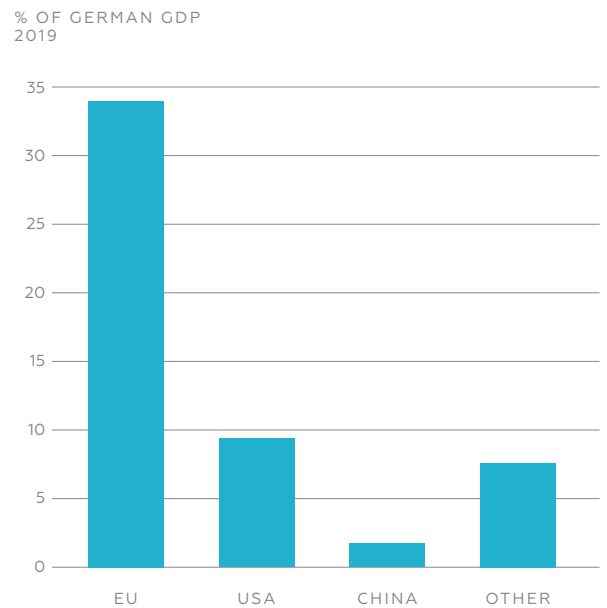
Institutional reform: Germany should create a National Technology and Innovation Advisory Council to provide guidance on trends in emerging technologies and their likely economic impact. This Council should help the government formulate appropriate policies. Industrial and technology policy should not be subject to knee-jerk reactions to the most recent experience of supply bottlenecks but based on a well thought-out, longer-term strategy that addresses strategic vulnerabilities. The Council should also advise the government on institutional mechanisms and ways to allocate financial resources as well as on flanking policies to be put in place.

3.5 FOREIGN DIRECT INVESTMENT POLICY¹⁵⁰

Vulnerability: While outward FDI is predominantly directed toward other EU countries, Germany also has sizeable holdings in the United States and China. Large FDI stocks are vulnerable to asset freezes, expropriation, and regulatory discrimination. In value terms, Germany’s FDI in China is much smaller than in the United States. To assess related economic vulnerabilities, it is helpful to classify FDI in terms of seeking access to resources (commodities), efficiency (cheap labor), assets (technology), or markets. Resource- and asset-seeking FDI is related to import vulnerabilities, while market-seeking is indirectly linked to export-related vulnerabilities. Extensive holdings may make German companies and the Ger-

man economy vulnerable to ‘unfriendly’ measures taken by the host country. Germany is also relatively more vulnerable than the United States and China, as its FDI in the United States and China is significantly greater than American and Chinese FDI in Germany.

GERMAN OUTWARD FDI CONCENTRATED IN EU



Source: Bundesbank

German interests: Economically, Germany has an interest in maintaining and expanding access to both the US and Chinese economy in terms of foreign direct investment. While the US market is fairly open to German investment, China is much more restrictive. In case of FDI being weaponized, Germany needs to ensure that its financial and economic vulnerabilities remain systemically manageable. It has an interest in limiting its trade- and financial dependence on any one market.

American and Chinese policies: Washington will increasingly restrict Chinese FDI. To that end, it will significantly broaden the definition of national security-related restrictions. This will affect not just the technology and infrastructure sector but all sectors deemed important to national security, such as health, media, etc. The US government has a

149 Edward Mansfield and Rachel Bronson, *Alliances, preferential trade agreements and international trade agreements*, *American Political Science Review* 91, 1997.

150 US-China Economic and Security Review Commission, *Unfinished business: export control and foreign investment reforms, 202*, <https://www.uscc.gov/research/unfinished-business-export-control-and-foreign-investment-reforms> (last accessed: October 21, 2022).

broad array of statutory tools to intervene and restrict access.¹⁵¹ FDI restrictions may indirectly affect German economic interests if, for example, a German company has close ties with China. Washington is also toying with the idea of restricting outbound FDI as well as certain types of non-FDI, which might affect German companies with investments in the United States. China is far less open to FDI in general, with the government maintaining a large degree of discretion over inward FDI. Sectors deemed strategic are largely off-limits to foreign investors. China also has the tools to penalize foreign companies and has made use of them in the past. Crucially, US-Chinese decoupling would increase the risks to German companies operating in both the United States and China, as they may be forced to pick a side, particularly if they have investments in sectors important to national security.

Current policies at national and EU levels: At the national level, German FDI legislation was tightened several times with respect to national security, critical infrastructure, and technology in recent years. But Germany remains substantially more open to Chinese investment than vice versa. At the EU level, there are efforts underway to coordinate inward FDI screening policies. This is proving challenging, not least because national security (and related FDI restrictions) remains the prerogative of EU member states. So far, EU members coordinate their FDI screening policies largely on a voluntary basis. This also includes an initiative to restrict inward FDI in case of non-EU companies benefitting from government support, which effectively extends the EU competition regime with respect to subsidies, government procurement, and mergers and acquisitions. At the transatlantic level, the EU-US Trade and Technology Council similarly seeks to coordinate investment policies. EU attempts to codify European access to the Chinese market in the guise of a Comprehensive Agreement on Investment have been put on ice. (Not coincidentally, the agreement had come in for harsh criticism from the Biden administration, likely a harbinger of things to come.)

Policy recommendations: German FDI restrictions should be narrowly focused on national security and strategic technology. Germany and the EU should demand greater access to Chinese markets by insisting on reciprocity. Germany and the EU should use

their FDI policies to nudge China to liberalize inward FDI (*quid pro quo*). At the EU level, Germany should push for streamlined and coordinated FDI regulation and screening to enhance leverage vis-à-vis third countries. While non-sensitive sectors should be kept as open as possible, strict reciprocity in terms of US and Chinese market access policies should apply in 'strategic' sectors related to national security and technology. A common transatlantic approach, supported by the EU-US Trade and Technological Council, is desirable, but may be difficult to agree on, given that the United States will push for greater China-related restrictions than Europe.

Institutional reform: At the national level, Germany should enhance FDI screening and adapt its FDI regulation flexibly in view of concerns about national security or non-competitive market behavior. At the EU level, the voluntary FDI screening framework should be replaced by more binding coordination and implementation. The politicization of international economic relations in the context of US-Chinese rivalry requires a more flexible and strategic approach to inward FDI and needs to be flanked by a more coordinated policy at the EU level.

3.6 CURRENCY AND FINANCIAL POLICY

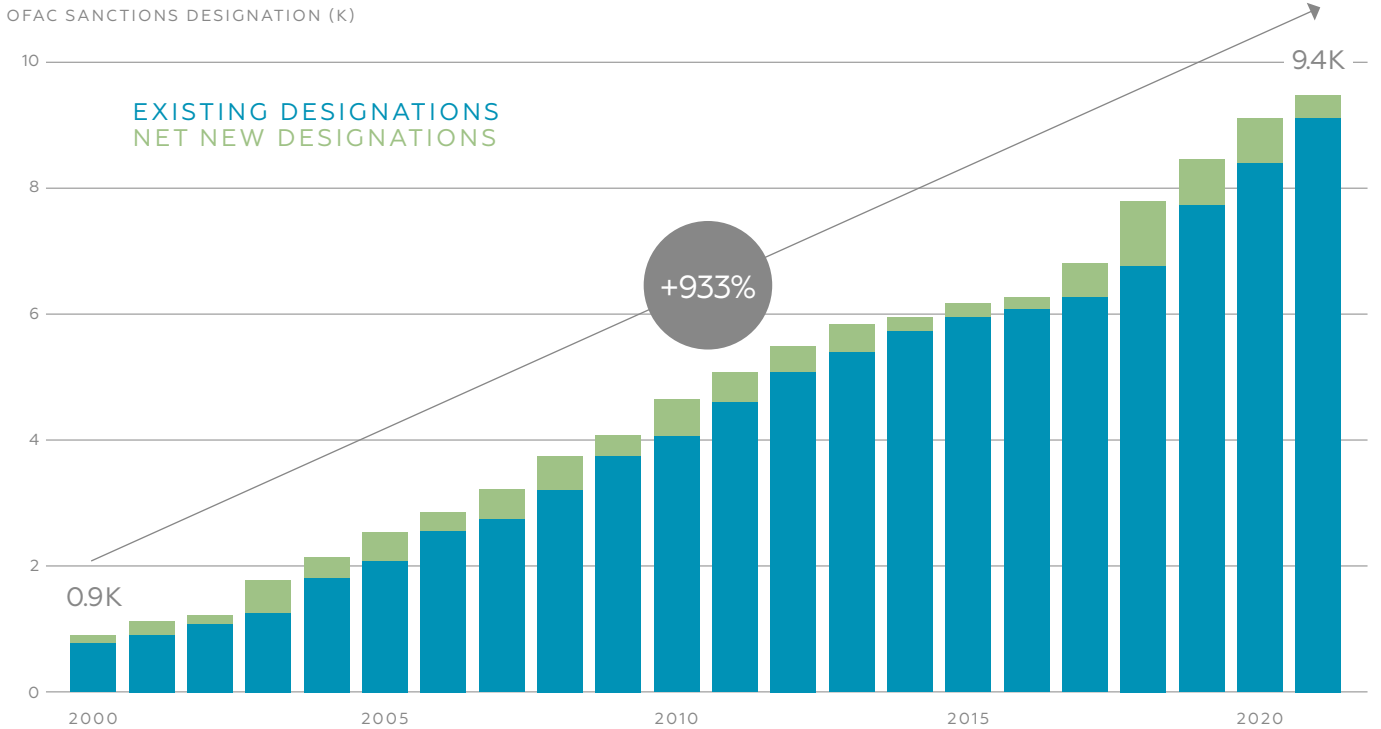
Vulnerability: Financial sanctions can be defined as the deliberate "withdrawal of customary financial relations."¹⁵² Currency sanctions are measures aimed at preventing a targeted party from using the sanctioning country's currency. It is important to distinguish between primary and secondary sanctions: Primary sanctions seek to exclude a targeted entity from taking part in an economic exchange. Secondary sanctions target third parties by threatening to punish them in case they transact with the primary target. The wide-spread use of the dollar and the large stock of foreign held US (dollar) assets provides the United States with significant leverage and constitutes a vulnerability for countries holding US assets and transacting in dollars. While European countries conduct much of their international business in euros, they continue to depend on the dollar.

German interests: As a country that is highly dependent on the international economy, Germany

¹⁵¹ For a selection: Trade Expansion Act (1962), Trade Act (1974); Omnibus Foreign Trade and Competitiveness Act (1988); Trade Facilitation and Trade Enforcement Act (2015); Export Control Reform Act (2018); Foreign Investment Risk Review Modernization Act (2018); and especially International Emergency Economic Powers Act (1977).

¹⁵² Gary Hufbauer et al., *Economic sanctions reconsidered* (Washington 2009).

SANCTIONS USE HAS INCREASED OVER THE LAST 20 YEARS



Source: US Treasury

has a major interest in being able to use the dollar and acquire dollar assets. Germany (or more specifically German companies) therefore has an interest in avoiding primary and secondary currency and financial sanctions. In the context of US-Chinese conflict, it also has an interest in not becoming the target of Chinese counterretaliation in case Germany (or German companies) complies with US mandated secondary sanctions. Sanctions might force German companies to comply with US sanctions but in doing so invite Chinese retaliation.

American and Chinese policies: Over the coming years, the United States may be making increasing use of dollar sanctions to target Chinese entities. It may also target third parties more frequently in the guise of secondary dollar and financial sanctions. China can and probably will impose financial countersanctions targeting not just the sanctioning country, but also third countries that go along with US sanctions to try and deter them from such compliance.

In case of US sanctions and Chinese countersanctions, Germany, being highly dependent on trade

with both countries, would quickly suffer collateral damage. If the United States threaten to exclude a German company from its market in case it engages in business with a targeted Chinese entity, the German company risks losing access to a very important market. But if it does comply with US sanctions, it risks retaliation by China.

3.7 CURRENT EFFORTS AT NATIONAL AND EU LEVELS

In the mid-nineties, the EU enacted a so-called blocking statute to prohibit companies from complying with extra-territorial sanctions. The EU measure, however, did not prove effective. In 2021, the EU renewed its efforts and proposed an anti-coercion tool in the context of its trade defense policy. In principle, this tool is designed to deter third-party currency and financial sanctions by threatening retaliation, but much will depend on the decision-making procedures: If the mobilization of the anti-coercion tool requires unanimity, it risks becoming ineffective. A third party may simply target the 'weak-

EUROPEAN AND GERMAN STRATEGIC REPOSES WORSENING US-CHINESE RELATIONS – SELECTED ISSUES

	Selected Policies & Initiatives	Proposed Capacity-Enhancing Measures	Potential Costs
Security	<ul style="list-style-type: none"> NATO's new Strategic Concept Common Security and Defense Policy Strategic Compass Permanent Structured Cooperation European Intervention Initiative (enhancing ability for joint missions outside existing structures like NATO, EU) 	<ul style="list-style-type: none"> Prepare to offset reduction in US security commitments through greater investment in defense capabilities Strengthen intra-EU security cooperation (esp. conventional military capabilities, overseas intervention capacity and sea lane security; but also evaluate feasibility and credibility of French-German nuclear sharing agreement proposal) 	<ul style="list-style-type: none"> Increased spending on defense Costly and risky investment in emerging technologies and cutting-edge weapons systems European-level coordination 'costs'
Trade	<ul style="list-style-type: none"> Strengthen EU trade defense¹⁵⁶ Safeguard critical supply chains¹⁵⁷ Increased coordination of EU export controls on dual-use goods¹⁵⁸ 	<ul style="list-style-type: none"> Approve and strengthen EU anti-coercion and trade defense policy by leveraging EU market size Coordinate EU efforts to strengthen supply chains and ensure access to critical goods 	<ul style="list-style-type: none"> Securing supply chains is economically costly due to reduced efficiency
FDI	<ul style="list-style-type: none"> Tightening of German FDI screening with respect to national security Enhance EU's voluntary FDI screening mechanism¹⁵⁹ for non-EU companies Force non-EU companies to abide by the same competition rules as EU companies 	<ul style="list-style-type: none"> Push for greater EU-level coordination to strengthen EU bargaining position 	<ul style="list-style-type: none"> Lower FDI inflows and lower overseas FDI reduce efficiency of capital allocation and supply chains
Technology	<ul style="list-style-type: none"> Made in Germany 2030 industrial policy¹⁶⁰ Impose regulations and standards on non-EU tech companies¹⁶¹ 	<ul style="list-style-type: none"> Focus industrial policy on (1) sectors with a comparative advantage or (2) greatest exploitable vulnerability Create national-level federal innovation agencies to support selective development of critical and emerging technologies¹⁶² Mobilize national innovation policies and coordinate with EU partners 	<ul style="list-style-type: none"> Increased need for public and private investment in critical technologies
Currency & Financial Policy	<ul style="list-style-type: none"> Ad hoc coordination of EU sanction policies Advance banking and capital markets union 	<ul style="list-style-type: none"> Attach relatively strong automaticity to broad-spectrum economic anti-coercion policy by limiting veto power of individual member-states Complete (1) monetary, (2) banking, and (3) capital markets union to make euro and European capital markets coequal to the dollar 	<ul style="list-style-type: none"> Strengthening of deterrence increases escalation risk Completing monetary, banking, and capital markets union requires far-reaching, politically difficult intra-EU compromises regarding risk sharing

Source: Author's compilation

est link' among EU members to immobilize the tool. But if policy is delegated and made automatic, the EU risks being embroiled in geo-economic conflicts over relatively minor economic issues if deterrence fails.

Policy recommendations: The EU should strengthen its anti-coercion policy by making it more effective and credible. Credibility can be enhanced by delegating decisions with respect to deterrence and retaliation and by making it more automatic, which is not without risks, of course. Effectiveness requires the ability to impose real costs if Europe is hit by another country's currency and financial sanctions – either by retaliating in kind or by threatening to over-retaliate. In the wake of the Russian aggression against Ukraine, Brussels is pushing for an EU sanction agency.¹⁵³

Germany should support strengthening monetary union.¹⁵⁴ For the euro to become more prominent, the euro area needs to be able to issue 'risk-free' asset backed by the full faith and credit of the EU (or the euro area). While strengthening the banking union and advancing the capital markets union will help make the euro more attractive in terms of financial intermediation and investment opportunities, it is unlikely to prove sufficient to challenge the dollar.¹⁵⁵ International investors will need to be reassured that sovereign euro assets are safe and that there is a large and sufficiently liquid supply of them. This will require a common currency backed by a meaningful supra-national or federal fiscal union. A decentralized monetary union will not do. The more important the euro becomes relative to the dollar, the less vulnerable Europe will be to US currency and financial sanctions. Greater international use of the euro will mitigate European vulnerabilities to third-party currency sanctions. It will also provide it with greater deterrence and retaliation potential.

Institutional reform: Completing and strengthening monetary union will require a fundamental reform of euro area governance and critical decisions in terms of risk sharing. In terms of enhancing the euro area sanction and counter-sanction capacity, members would need to agree on a streamlined decision-making procedure, possibly based on majority voting instead of the current unanimity, and the creation of a sanctions (or countersanctions) office comparable to America's Office of Foreign Asset Control (OFAC). This is necessary in addition to the anti-coercion tool to prevent the euro area from becoming the target of a 'divide and rule' policy and to make currency and financial deterrence more effective and credible.

Final Thoughts

SEEK COOPERATION WHERE POSSIBLE, LIMIT VULNERABILITIES WHERE NECESSARY

Germany is at risk of sustaining collateral damage in the face of intensifying US-Chinese competition and conflict. China's ascendance and America's desire to preserve the status quo lock Beijing and Washington into a classic security dilemma. The United States sees China as a potential regional hegemon in Asia

153 Financial Times, Brussels pushes for tougher sanctions, enforcement via EU-wide body, July 3, 2022.

154 Markus Jaeger, Promoting the Euro - Countering secondary financial sanctions, German Council on Foreign Relations, 2022: <https://dgap.org/en/research/publications/promoting-euro-countering-secondary-sanctions> (last accessed: October 16, 2022).

155 IMF, A banking union for the euro area, 2013. IMF, A banking union for the euro area, 2013. IMF, Toward a fiscal union for the euro area, 2013. Johannes Becker and Clemens Fuest, Der Odysseus Komplex, Hanser (München 2017). IMF, A capital market union for Europe, 2019.

156 European Commission, Trade Defence, April 17, 2020: <https://ec.europa.eu/trade/policy/accessing-markets/trade-defence/> (last accessed: October 21, 2022). European Parliament, EU International Procurement instrument, 2021, <https://www.europarl.europa.eu/news/en/press-room/20220603IPR32143/international-public-procurement-instrument-securing-fairness-for-eu-firms> (last accessed: October 21, 2022).

157 European Commission, Strategic Dependencies and Capacities, Commission Staff Working Document, May 5, 2021, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=SWD:2021:352:FIN> (last accessed: October 21, 2022).

158 European Commission, Strengthened EU export controls kick in, September 9, 2021, https://ec.europa.eu/commission/presscorner/detail/en/ip_21_4601 (last accessed: October 21, 2022).

159 European Commission, Foreign Direct Investment EU Screening Framework. February 2019: https://trade.ec.europa.eu/doclib/docs/2019/february/tradoc_157683.pdf (last accessed: October 21, 2022).

160 Federal Ministry of Economic Affairs, Made in Germany: Industrial Strategy 2030, November 29, 2019: <https://www.bmwi.de/Redaktion/EN/Dossier/industrial-strategy-2030.html> (last accessed: October 21, 2022).

161 Financial Times, EU to outline tech standards to counter China influence, February 2, 2022.

162 European Commission, Digital Sovereignty, July 19, 2021, https://ec.europa.eu/commission/presscorner/detail/en/IP_22_729 (last accessed: October 21, 2022).

and as an emerging global systemic challenger.¹⁶³ China sees the United States as impeding its rise. Security competition is already well underway. So are geo-economic and geo-technological competition and conflict.

US-China relations are structurally geared toward deterioration. The Ukraine war notwithstanding, US-Chinese competition will limit the amount of resources Washington will be willing and able to commit to Europe. It will also negatively affect German economic interests, as it will lead Washington to increase the pressure on Germany – as China's most important European economic partner – and Europe to align itself with US geo-economic and geo-tech policies. This may happen in the form of direct diplomatic pressure or indirectly through secondary trade and financial measures. If Germany aligns itself with US policies, however, it risks provoking Chinese economic retaliation in the form of trade and investment restrictions as well as regulatory discrimination. Sino-US economic decoupling represents a major problem, given that the United States and China are Germany's two most important extra-EU economic partners.

Germany's continued security dependence on the United States also limits the extent to which it can afford to align itself with China economically. The war in Ukraine has, if anything, reinforced this dependence. In the context of US-Chinese rivalry, Washington would hardly be willing to underwrite German security to the extent that it does if Berlin were to align itself more closely with Beijing and undermine US geo-economic policies. Meanwhile, a position of relative neutrality or equidistance is not an option, either. Washington is not going to accept German economic neutrality in the context of intensifying US-Chinese geopolitical and geo-economic competition. For US strategy to be successful in the geo-economic and geo-tech realm, Washington needs Berlin to support US policies, lest Germany threaten to undermine US policies as a so-called 'third-party spoiler.' The more intense US-Chinese competition, the greater the US pressure on Europe and especially Germany to align with hawkish US geo-economic policies toward China.

Germany has good reasons of its own to offer conditional support to US policies vis-à-vis China. The Ukraine war has made these reasons undoubtedly more compelling. First, Germany and the EU have come to see China as both a systemic rival and economic competitor. Like America, Germany is also committed to maintaining the territorial status quo, and it is keen to level the economic playing field vis-à-vis China and maintain technological leadership. Second, even a completely realpolitik-oriented German policy would be well-advised to stay relatively close to the United States – and not just in view of recent events. Not only does Germany depend on the United States for its security, but the transatlantic partnership is also an important economic relationship, comprising not just trade and investment but also offering Germany access to advanced technology. Finally, in the longer-term, the United States looks 'great power competitive' despite China's impressive ascent. It stands a fair chance of maintaining its geo-strategic and geo-economic position in Asia and globally – not least thanks to its extensive alliance network.

Germany should therefore consider pursuing a multi-track approach. On the one hand, it should offer Washington conditional support to help establish an economic level playing field vis-à-vis China and preserve technological leadership as well as the territorial status quo in East Asia. On the other hand, Germany and Europe should minimize their critical economic vulnerabilities vis-à-vis third parties. This can best be done through diversification and, where necessary, increased self-sufficiency. Such a balanced policy would afford Berlin greater flexibility.

As part of the cooperative element of this strategy, Berlin should continue attempts to resolve important outstanding bilateral US-EU disputes and to deepen transatlantic economic cooperation. Major trade deals will be out of reach, given domestic political obstacles on both sides of the Atlantic. But more specific, issue-oriented cooperation is possible, including politically less onerous regulatory coordination, technological cooperation, and standard-setting (e.g., in the EU-US Trade and Technology Council¹⁶⁴ or the Trilateral Group).¹⁶⁵

¹⁶³ Systemic in the sense of challenging the dominant position of the United States in the international system, and systemic in the sense of China of challenging the norms and rules underpinning the present system, including the provision of international public goods.

¹⁶⁴ European Commission, EU-US Trade and Technology Council, 2021, https://ec.europa.eu/info/strategy/priorities-2019-2024/stronger-europe-world/eu-us-trade-and-technology-council_en (last accessed: October 21, 2022).

¹⁶⁵ European Commission, Trilateral Meeting of the Trade Ministers, 2020, https://trade.ec.europa.eu/doclib/docs/2020/january/tradoc_158567.pdf (last accessed: October 21, 2022).

Such cooperation and coordination should help both sides agree on a joint position seeking to level the playing field vis-à-vis China, enhance supply chain security, and preserve US and European technological leadership. And it should help create a relationship of mutual dependence between the United States and the EU/ Germany, which should make it more difficult and costly to exploit the other side's weaknesses.

Germany and the United States should be able to agree on a common position pertaining to emerging technologies and national security in view of their security implications and externalities in terms of economic competitiveness. National security is undoubtedly a more sensitive issue to the United States given intensifying US-Chinese security competition. But Germany also has an interest in preserving technological leadership. And Germany has a stake in the preservation of the status quo in Asia, and not just because of its interests in preserving and defending it in Europe.

Transatlantic disagreement might arise due to Germany's preference for narrowly restricting technological decoupling and limiting national security exemptions, while Washington is bound to push for more extensive restrictions. The United States is far less sensitive to Chinese geo-economic retaliation than Germany and will therefore be more willing to weaponize the existing economic and technological interdependence in pursuit of broader political and strategic objectives. This is precisely what Germany should seek to avoid and where it will be faced with increased US geo-economic pressure.

Hence the defensive part of the strategy should focus on accelerating efforts to make more manageable critical economic, financial, and technological vulnerabilities vis-à-vis both the United States and China by accelerating efforts to gain greater autonomy – but not necessarily autarky – and enhance the capacity to deter geo-economic measures. These efforts need to be intensified and accelerated, not least in view of the 2024 presidential elections and the risk of a return to a unilateral, America First, foreign policy.

Over the long term, reducing vulnerability in the security realm will require better defense capabilities to limit the dependence on US military power. While the Ukraine war will accelerate European

efforts to enhance capabilities, it has also made Germany more dependent on the United States as the ultimate security guarantor. Creating more autonomous capabilities for power projection and intervention and the protection of seaborne trade is highly desirable. Much enhanced military capabilities in Germany and Europe will also help preserve the conventional and nuclear military balance in Europe as well as a credible and effective nuclear deterrent.

Washington is currently pursuing a policy of internal and external balancing vis-à-vis Beijing (realist scenario). The Biden administration is wooing Germany by offering cooperation, and the Ukraine crisis has led the United States to reaffirm its commitment to the transatlantic partnership. But the 2024 elections may lead to renewed fissures and expose German and European vulnerabilities and dependencies. Independent of the outcome of the 2024 presidential elections and the Ukraine war, the structural deterioration of US-Chinese relations and the increasing US shift toward Asia will weigh on transatlantic relations. Germany and Europe should therefore accelerate and intensify their efforts to limit critical vulnerabilities. They need to prepare for a world where the United States will be less committed to Europe than it has been over the past three quarters of a century. Such an approach is perfectly compatible with a policy of conditional, smart transatlantic cooperation in view of common vulnerabilities and in pursuit of common interests.

Reducing critical vulnerabilities will afford Germany and Europe greater policy flexibility by making them less susceptible to geo-economic coercion, wherever it may come from. At the same time, Germany and Europe will gain a greater ability to deflect geo-political, geo-economic, geo-financial, and geo-technological pressure to pursue policies that are not in their interests. Fewer vulnerabilities and a more balanced relationship will also make it easier to maintain deep and extensive transatlantic cooperation. And should the United States ever move toward full-blown protectionism and isolationism, or China turn inward, or global cooperation break down completely as it did in the 1930s, Germany and the EU will already have done some of the preparatory work necessary to operate in a less cooperative, more conflictual, and more fragmented international system and economy.



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