U.S.-China Economic and Security Review Commission

Hearing on "Key Economic Strategies for Leveling the U.S.-China Playing Field: Trade, Investment, and Technology"

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Thank you to the Commission for the invitation to speak with you on European economic relations with China. I am joining you today from my office in Berlin. I currently serve as the chief executive officer of the Atlantik-Brücke, or "Atlantic Bridge," a professional network founded over 70 years ago to bind the German Federal Republic into the West. For context, we are a non-partisan, cross-sectoral and membership-based organization. Our core activities are financed solely by membership dues and private donation. I myself have served as an economist at the Central Intelligence Agency, as an advisor on Europe in the Treasury Department's Office of Terrorism and Financial Intelligence, and from 2017-2019 I was detailed as a Director to the National Security Council staff, where I handled European foreign policy and economic affairs. I subsequently founded the Economic Statecraft Initiative at the Atlantic Council, where I remain affiliated, prior to my move to Germany. In my current position, I work with German and European leadership across industry, finance, politics, journalism, and academia. Adapting—and even revolutionizing—the Continent's approach to competitiveness—often code for China—is a predominant topic among our ranks.

This would not have been the case five years ago. When I first arrived at the White House in 2017, European counterparts were surprised to hear my assessment that the U.S. would place China high on the transatlantic economic agenda. Remember, it was new to Washington as well, as hard as that might be to believe considering the current nature of our national discourse. The pace of policy changes on China have evolved on both sides of the Atlantic in parallel, and at lighting speed within the course of our joint economic history. If I compare the divergent risk assessment between the US and many European capitals regarding Russia prior to Putin's renewed war against Ukraine in 2022, the shared US and European reality regarding China is an entirely different paradigm. During this testimony, I will provide an overview of the policy trajectory at the EU level and in key European capitals; describe where there is strategic alignment but how practical divergence based on economic exposure, institutional differences and capacity restraints will affect policy outcomes; and conclude with recommendations for US policymakers.

The Difference a Decade Makes

The EU economies, collectively, are export-dependent, relying on global consumption to buoy growth and support generous social services. Boosting domestic demand and investment, as a component of balance of payments is a long-term concern in Europe, and certainly a talking point for generations of US Treasury officials. It is important to compare this to the consumption-reliant economy in the United States before beginning a conversation on Europe and China. Prior to the eurozone crisis in 2012, markets were found closer to home within the

European single market. However, when several economies fell into sovereign debt or banking crisis and put into question the validity of the euro itself, debt relief and cash injections from the IMF and EU institutions were a key part of the solution; China was the other part. Those watching shifts in trade and financial flows at the time calculated how fast economic growth would need to expand among the BRICS nations, as we called them, to absorb the sudden excess capacity of European goods and capital stock. India and Brazil grew steadily, but minimally—it was the expansive growth trajectory in China that stabilized markets for European—and especially German—exporters. The formula of revenue generated as gross national income combined with relative wage restraint at home ensured that, unlike in the United States, low barriers to trade with China did not markedly affect employment levels in heavy industry. And in other parts of Europe, Chinese investment came as a reprieve because Troika programs mandated the privatization of state-owned enterprises, critical infrastructure, and public services.[1][2][3]

That was ten years ago. The portrayal in media outlets or international policy circles of European governments or industry as naïve to the risks of China's distortionary behavior, is painting with a broad brush. Last Spring, the European Commission published its economic security strategy, outlining risks including non-market behavior, broadscale subsidization, forced joint ventures, and intellectual property theft.[4] China is labeled as partner, competitor, and rival. The most novel and most heavily debated element of the strategy is a so-called "anti-coercion instrument"[5] that allows European authorities to react asymmetrically to coercive behavior by a third party, responding potentially to such events as a Russian import ban on European agricultural products,[6] a Chinese embargo of Lithuania,[7] or even unilateral tariffs by the United States.[8] For those Americans consulting with the Commission during its drafting period, it was clear that European counterparts were establishing an equivalent to the US Section 301 authority.

Brussels Bubble versus Capital Pride

A China economic strategy for the US and its closest partners asks its drafters to draw the line between actions we take to protect our national security, and those that we take to secure our economic interests. Within such phrases as "economic security is national security," or National Security Advisor Jake Sullivan's "small yard, high fence" the United States has established a good deal of intellectual malleability within the universe of government strategy and public messaging. Some cases will be clear-cut: removing Huawei hardware from telecommunications systems is a matter of data security and counterintelligence, not to the advantage of US providers; raising tariffs on Chinese electric vehicles, on the other hand, is not a national security matter but a response to unfair, distortionary trade practices, whereby government subsidy has forced China to dump vehicles at artificially low prices into the international market. But most cases in the modern economy are not clear cut—the line

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1 https://www.ft.com/content/53b7a268-44a6-11e4-ab0c-00144feabdc0
2 https://rhg.com/research/tipping-point-germany-and-china-in-an-era-of-zero-sum-competition/
3 https://www.bruegel.org/sites/default/files/wp-content/uploads/imported/publications/20140219ATT79633EN_01.pdf
4 https://ec.europa.eu/commission/presscorner/detail/en/IP_23_3358
5 https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:L_202302675
6 https://www.europarl.europa.eu/RegData/etudes/BRIE/2016/581971/EPRS_BRI(2016)581971_EN.pdf
7 https://www.politico.eu/article/european-union-china-world-trade-organization-dispute-lithuania/
8 https://www.bbc.com/news/business-67758395

between competitiveness in future technologies and intelligence or military application has grown increasingly muddled. Weeks before the release of the Administration's latest 301 findings,[9] the Commerce Department issued an inquiry on the same vehicles, not concerning the price, but the transfer of sensitive user data to China.[10] The same Chinese export—and two different justifications for prohibiting access to the US market. In Europe, the line between trade policy and national security is not academic, it is a legal one.

I highlight this distinction at a crucial moment in US economic history to remind officials how to calibrate overtures to European counterparts and also understand their actions. The Lisbon Treaty, the foundational agreement of the modern European Union, delegates trade authority to the technocratic European Commission but member states maintain sovereignty over national security. When the European Union takes a foreign policy decision, including on sanctions, it requires unanimity in the European Council—a body representing all member governments. The most prescient example of this national security prerogative is investment screening. As a result of the US 2018 CFIUS reform (FIRRMA) and a string of Chinese acquisitions of infrastructure and sensitive technologies, Brussels mandated that member states each implement a screening mechanism. To date, all member states, plus the UK and the rest of the European Economic Area, have screening mechanisms, at least on paper. Prior to the 2019 regulation, only four in the EU did, and they were hardly ever used. Italy, for example, has now invoked its "golden rule" on multiple occasions over the past several years.[11] The UK, long reticent to shake its relationship with Beijing due to historic ties to the financial center of Hong Kong and after the shock of Brexit, has taken landmark decisions to block Chinese acquisition of key industry.

Brussels, however, does not have jurisdiction over individual cases, although member states have the option of referring to the European Commission for advice, and European authorities may intermediate if others are implicated. This balancing act reflects an attempt by European officials to navigate the interdisciplinary challenges of economic statecraft within their given legal parameters. Export controls face a similar predicament. Countries may decide to implement unilaterally if EU consensus cannot be reached, and they often do so, but aside from niche technologies from specific firms (think of ASML), or specific arms shipments, the reality of the EU customs union makes trade substitution almost automatic and the flow of prohibited goods impossible to trace unless firms are willing to share proprietary data. Periodic initiatives to decide foreign policy issues by qualified majority are stymied by small states, whose power relative to big players like Germany and France is the right to that very veto.[12][13] On legal grounds, the concept of "economic security is national security" will remain a divided and legally complicated concept in Europe. Although US policymakers often balk at its perennial attempts to reignite a strategic autonomy debate, France is the EU country with the strongest intelligence service, a centralized decision-making process, the most robust understanding of economic statecraft and a well-trained technocracy.

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[9] https://ustr.gov/about-us/policy-offices/press-office/press-releases/2024/may/us-trade-representative-katherine-tai-take-further-action-china-tariffs-after-releasing-statutory
[10] https://www.commerce.gov/news/press-releases/2024/02/citing-national-security-concerns-biden-harris-administration-announces
[11] https://www.whitecase.com/insight-our-thinking/foreign-direct-investment-reviews-2023-italy
[12] https://www.auswaertiges-amt.de/en/newsroom/news/-/2595304
[13] https://www.swp-berlin.org/10.18449/2022C61/

Trade policies, however, are another matter. The "geopolitical" Commission[14] under Ursula von der Leyen is poised to exercise its supranational mandate to address Chinese non-market behavior. Just as the US will counter unfair state subsidy of electric vehicles and solar panels, the EU is preparing similar mechanisms to prevent Chinese exports from flooding markets and extinguishing local producers. The more Chinese internal market dynamics force products onto the market at the expense of European firms, the more the EU will be ready to use its trade authorities in suit. The rhetoric will focus on "leveling the playing field" to maintain intellectual distance from Washington and signal that the EU is reinforcing global trade rules, not engaging in protectionism against the spirit of those rules.[15] The US should allow Brussels that distance. There are also nascent efforts to build up supply chain resilience with third parties such as Japan. While one arm of the Brussels machine is actively "friendshoring," its other ideological workstream seeks to expand markets as far as possible. EU maintains a trade agreement with Vietnam and continues the uphill climb on an arrangement with MERCOSUR.

Government Capacity and Corporate Culture

Governments tend to design policies that fit within their own bureaucratic ecology—that is, not only reflecting the priorities they set but their resources on hand. There is no European capital that possesses the personnel strength of the US government—even scaled for the size of their respective economies. Steering foreign policy through economic instruments has been a fixture of Washington decisionmaking since 9/11, with ever increasing frequency. Alongside this evolution the government apparatus has grown, and firms have developed a culture of compliance and enforcement. Entire industries have emerged to assist the private sector, and firms hire readily from the ranks of US government officials seeking to expand their professional horizons. Think tanks, also stocked with former government officials (witness the panels called for today's hearing) generate new ideas with knowledge of government and feed those back into the system. These individuals often return to public service with tactical experience in implementation or academic work.

European capitals do not have these revolving doors, or only in rare cases, and these are often heavily scrutinized for signs of corruption. Given the interdisciplinary nature of 21st century challenges, the firewalls are starting to crack. Firms are spending an increasing amount of time analyzing supply chains and export control exposure, but European governments cannot expect the private sector to have the capacity for anything akin to the Commerce Department's Foreign Direct Product Rule, which US firms employing former officials also claim is nearly impossible to get right.[16][17] Several member states recently vetoed the EU's newest proposal for a Supply Chain Security Act,[18] which is lamentable given some of the Xinjiang cases recently. Industry lobbying is not to be discounted, but the central claim that the burden on firms would be unmanageable is not bluster. Implicitly, many European governments have traditionally relied on the United States to tell them where something has gone awry. Fulfilling that role remains in our national interest, but it is encouraging to see European governments shift from following the direction of their closest ally when asked, and often begrudgingly, to generating

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[14] https://ip-quarterly.com/en/how-european-commission-became-geopolitical-player
[15] https://www.ft.com/content/cdc0d397-1a20-4b57-b5b9-5de57bf0c87b
[16] https://www.atlanticcouncil.org/blogs/econographics/foreign-direct-product-rule-is-russia-the-next-huawei/
[17] https://kse.ua/wp-content/uploads/2024/01/Challenges-of-Export-Controls-Enforcement.pdf
[18] https://www.politico.eu/article/supply-chain-european-union-rules-lobbying-france-germany-italy-belgium/

home-grown supply chain resilience and compliance. China and the dislocations of the pandemic have caused that shift.

Caught in the Middle or a Competitiveness Gap?

European capitals will often portray their economies as caught in a dilemma between the United States and China.[19][20] In my view, this is partly justified. American companies are voicing similar concerns and [21][22] the "one world, two systems"[23] phenomenon will burden supply chains, regulatory commitments and financing for Western multinationals and SMEs alike, regardless of where they are headquartered. Most member states would gladly forgo difficult choices that will create economic losers (such as through industrial policy, by, conversely, picking winners) or cede further negotiating authority to Brussels to make a run at superpower status. This is not a permanent stall-out. Europe acts decisively when it needs to: the eurozone crises gave rise to centralized banking supervision, the pandemic spurred the first issuance of joint debt, and it is likely that the downstream effects of "being caught in the middle" will pull the trigger on a new wave of integration. Given the massive financing needs for innovation, energy transformation, and defense, fractured capital markets remain the most strategic shortcoming in European strategic architecture.[24][25] A much anticipated study published in April by one of Europe's wise men, former Italian Prime Minster and political scientist Enrico Letta, argues that further integration of European financial and industrial instruments (and elimination of red tape) will boost fortunes when up against structural advantages in the United States, China, and a string of fast growing global economies.[26]

It is in US national interest that European markets strengthen and consolidate, not only for investor classes looking for new horizons, but as a component of US China strategy. Closing the competitiveness gap will bolster European economies in critical technologies that fall within the "small yard," helping to establish Western standards as global standard. A sustainable energy transition and modernization of defense industries will require new rounds of government incentive but will ultimately rely on private capital as their backbone.[27][28] The shock of Russia's aggression on Ukraine has unleashed levels of defense spending not seen since the early 1990s, but the "guns vs. butter" tradeoff is a tougher tightrope for governments whose borrowing capacity is much stricter than in the United States. A robust investment climate will help shield European economies from Chinese coercion and shake renewal out of stubborn industrial structures tailor-made for the circumstances of the millennial era.

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[19] https://dgap.org/en/research/publications/dont-get-caught-middle
[20] https://www.cer.eu/publications/archive/policy-brief/2020/europe-us-and-china-love-hate-triangle
[21] https://www.amchamchina.org/press/amcham-china-statement-on-us-china-tariffs/
[22] https://www.uschamber.com/international/how-tariffs-are-hitting-small-business-and-why-congress-needs-to-renew-gsp
[23] https://www.atlanticcouncil.org/in-depth-research-reports/issue-brief/one-world-two-systems-takes-shape-during-the-pandemic/
[24] https://www.piie.com/blogs/realtime-economics/2024/europes-capital-markets-union-make-it-or-break-it
[25] https://www.deutsche-boerse.com/dbg-en/regulation/regulatory-topics/cmu
[26] https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf
[27] https://www.bloomberg.com/news/articles/2024-01-18/sewing-says-europe-needs-capital-market-union-to-lure-tech-firms?embedded-checkout=true
[28] https://table.media/en/europe/news-eur/deutsche-bank-ceo-without-a-capital-markets-union-the-green-deal-is-dead/

Even without the guiding hand of government incentives or compliance requirements, European firms, as a whole, are targeting a "China plus one"[29][30] approach to avoid supply chain bottlenecks, buffer Chinese internal market weaknesses, and insure against creative interpretations of rule of law or government crackdown. The clear test-case for this reorientation is Germany, the world's third largest economy, whose industrial workhorses remain existentially bound to Chinese demand. After several years pointing in the other direction, the US is emerging this year once again as Germany's largest trading partner,[31] and countless conversations I have held with both government and business representatives underscore the statistic. The German economy is diversifying, particularly among the small and medium enterprises that make up the core of the domestic economy and the "Made in Germany" moniker. But there is no way around the fact that China remains the second largest market for Germany's biggest players. Shifting away from a business model that buoyed the country's multinationals for over a decade cannot happen overnight, even as Chinese indigenous production and intellectual property theft steadily eat away at market share and profit, and with it, Germany's proudest source of national income. No one is unaware of this trend, but the path forward is all but clear. The government has responded with a mixed recipe: keep the China engine going for as long as possible, court US investments in strategic sectors—from Tesla to Intel to Amazon—and spur innovation and investment through subsidy and by cutting red tape. Although Germany is uniquely exposed to China and singled out as having the most to lose, its strategy still does largely align with that of its European neighbors.

Conclusions

US outreach will require a multi-pronged approach. Policymakers must embrace European institutions as the godfather of central rulemaking, but also each member state as its own universe of national interests and security identity. One of the biggest policy mistakes US officials make is to limit outreach to the European Commission and officials in London, Paris and Berlin. Foreign policy consensus in Europe is more hard-won than winning over the "Big Three," and it is precisely the smaller member states without as much market power that China will court to try and crack consensus-making on policy that it disfavors. Hungary, for instance, is eager to court Chinese investment and position itself as a repeated thorn in the side of the Commission, which it portrays as a half-malign "big brother of all things."

The operational realities of the transatlantic economy—shaped by electromobility, data flows, defense technology, and advanced manufacturing, will over time force consensus-making at the Trade and Technology Council (TTC). Although critics hankering for headlines have written off the convenings thus far as "concluding without results," the TTC represents a steady and often rocky march towards a new form of agreement, where interoperable regulation has taken the place of tariff schedules to regulate the cross-border movement of

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[29] https://www.spglobal.com/marketintelligence/en/mi/research-analysis/asean-china-plus-one-destination-current-situation-risk-outlook.html
[30] https://dgap.org/en/research/publications/managing-risks-eu-china-economic-relationship
[31] https://www.cnbc.com/2024/05/10/the-us-is-now-germanys-biggest-trading-partner-ahead-of-china.html#:~:text=Alliance%20%7C%20Getty%20Images-,After%20years%20of%20China%20being%20Germany's%20main%20trading%20partner%2C%20the,January%20and%20March%20of%202024.

value. Patience is warranted—we are just at the beginning of a global economic era that will require a form of governance a far cry away from WTO rules.

Tariffs, export controls and investment restrictions each bear their justifications, but will erect barriers to trade and raise prices for both producers and consumers at a time when industrial economies are battling a form of inflation that may prove more structural than transitory as government policies mature. Policymakers today argue that the 21st century economy and geopolitical realities require an adapted interpretation of economies of scale than the diktat of short-term profit maximalization. However, trade interventions and economic statecraft have proven to be fickle beasts that often do not deliver on their intended outcome. The "small yard" risks getting too large. As the United States barrels head-on into uncharted territory, it cannot only rely on its unparalleled market power. Unilateralism will almost certainly backfire and diminish the leverage we so readily employ in our image. Our partnership with Europe is the bedrock of our future success.