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European geopolitics: from paper tiger to screaming kitty?

Germany could be a key player

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Summary

- While large in size, the EU is lacking teeth when it comes to geopolitics
- But the EU is waking up to a new reality. The swift response to the pandemic could indicate a change of heart
- Germany would be a natural leader of the bloc, but lacks military force and a willingness to invest in it. A cooperation with France on this point could be a solution
- We expect the EU to continue to prioritize internal issues before taking a more assertive geopolitical position however

A paper tiger

People often compare the European Union to a paper tiger¹. The bloc, after the US the biggest economy in the world, seems threatening based on size but is lacking teeth. Both to external as well as to internal threats. For example, when Russia illegally annexed the Crimea (breaking multiple international treaties), the EU strongly disapproved of a foreign nation breaching European borders and issued narrow economic sanctions against some of those involved. These limited sanctions did not impress Russia, and Russia controls the Crimea to this day.

The reasons why the EU response is often *too little too late* are both practical and ideological. First the *practical* issues. Before acting, there has to be consensus among 28 (now 27) sovereign states on the steps to be taken. The diversity in interests of member states (e.g. Poland is much more wary of illegal Russian expansion than France is) complicates the process of finding consensus, and consequently policy responses take considerable time to take effect. This diversity is amplified by the number of neighboring countries that Europe has (including sea borders). Second, *ideological*: the EU has often been accused of placing economic interests above others.

Germany is usually the key focus in these accusations. Although the EU leadership role rotates every six months, its size and economic importance often imply that EU foreign diplomacy issues end up on Germany's plate. With its large economic dependence on China, Germany seems unwilling to alienate this important trading partner, and thus refuses to take a standpoint on, for example, the trade of sensitive goods and/or capital flows more generally².

Despite its somewhat shaky track record, the European Union's economic response to the Covid-19 crisis has surprised many in a positive way. Germany has played a decisive and leading role here. Moreover, it seems that the Germans have also had a change of heart when it comes to foreign affairs. The poisoned Aleksey Navalny was moved to Berlin to be treated in Germany and chancellor Merkel openly called for justice for Navalny, demanding an explanation from Russia.

A year ago it would have been unlikely that the EU and Germany would have responded this way. But the question is: do the swift actions of the EU and the U-turn in Germany signal a permanent break in the trend? We will explore this below.

¹ For an in-depth, strategic global view on geopolitics, please see: [World in 2030: Fragments of the Imagination](#)

² Although it seems that Germany [has picked a side](#) with respect to Huawei.

Is this time different?

To answer this question we first need to take a closer look at the (change in) stance and actual policy. Specifically, we need to make a distinction between the following areas:

- **Internal stance:** The relation between internal members or alliances in terms of:
 - Economic and financial integration
 - EU cooperation on security and foreign policy vs. national sovereignty on these matters
- **External stance:** How the EU acts and deals with external partners
 - How to deal with trade partners with distinctly different ideologies or rule of law, particularly China and Russia; is the EU becoming more vocal and how does that show?
 - Its role within multilateral institutions and its cooperation with alliances

Usually in the backseat...

The EU has, since its inception, often taken a backseat in international matters, to a large extent because the European Parliament's prerogative was limited. However, Parliament's powers have gradually increased and it now [exercises influence over most aspects of EU affairs](#) (i.e. laws that apply to the whole union). That being said, its legislative powers have mostly concentrated on things like the EU internal market, consumer and environmental protection, agriculture and regional development, whereas Parliament still has only limited legislative powers in the areas of, for example, taxation, health services, education and, notably, **foreign policy**. Externally its focus has therefore mostly been on international agreements covering trade (such as, for example, CETA) and regulation of the financial sector.

Against this backdrop, Europe has leaned heavily on its Transatlantic Alliance, preferring to act as a *mediator* or broker in international conflict, rather than picking a side. Examples are its aim for diplomatic solutions in the Middle East and its stance vis-à-vis Iran and Turkey. This is not only to avoid external confrontation but arguably also to keep internal tensions in check.

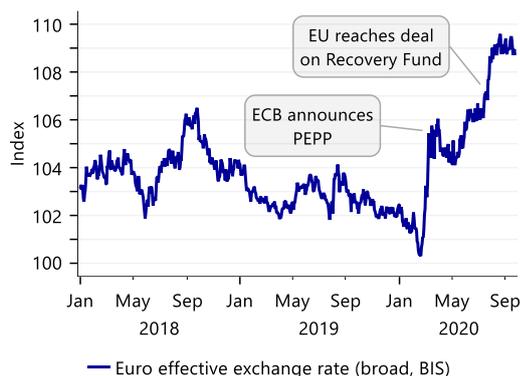
More broadly, the EU has promoted and defended multi-lateral institutions. And whilst it has defended and protected its internal market tooth and nail (agriculture in particular), when it comes to external trade and finance, it has championed globalization and free-trade. External defense (of its borders for example), on the other hand, has been left to the Member States, who remain sovereign.

... but waking up to a new reality

The EU's *soft-power*, in the form of promoting and defending its 'social market economy' and by offering a 'democratic beacon of stability' in the world - while still relatively strong - has clearly been dealt a few blows since the 2008-'09 Global Financial Crisis. In particular its internal squabbles following the 2010-'12 sovereign debt crisis and the 2015-'16 refugee crisis have tarnished its image. The general public's opinion of the EU has often swung with the general state of the economy (see figure 2), occasionally also dented by non-economic events. Although this does serve as a reminder that 'Europe' is often seen as the bogeyman (as unfair as that might be), the recent EU policy response to Covid-19 (see the next section) may help nuance that view.

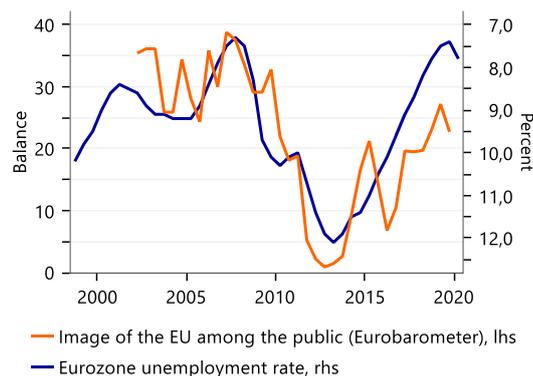
Moreover, with geopolitical tensions rising, the growing assertiveness of China and a more complicated relationship with the US under the Trump administration, there is growing acknowledgement in the EU and its member states that its position in the world is fragile and that something needs to be done about that. *Brexit* not only acted as a wake-up call, the EU's handling of the discussions with Britain has also demonstrated that it can keep its ranks closed if and when required. Meanwhile, the Covid-19 crisis has once again exposed the internal and external fault lines, leading to renewed calls for internal solidarity (and a realization that countries need each other most in these exceptional circumstances) but also for a more assertive external orientation.

Figure 1: Positive marks by the market reflected in a strong trade-weighted exchange rate



Source: Macrobond

Figure 2: Public opinion (net positive balance) on EU has improved since the 2015-'16 refugee crisis



Source: Macrobond

Tangible evidence?

It begins with waking up, but what are the tangible changes so far that portend a more activist approach in future? And what role is there for the member states?

Surely on the (internal) front

Let's first zoom in on the most visible and 'easy' part: **a notable change in the economic and financial response of European policy makers to the Covid-19 crisis**. To be sure, this was always going to be less contentious than the response to the sovereign debt crisis due to the external nature of the threat. But that does not necessarily alter the conclusion. Financial markets have given the EU positive marks (although we shouldn't overlook the role of the ECB), as the political polarization, chaotic virus response and indecisiveness over a new economic support package in the US has weighed on the dollar. In August, the trade-weighted Euro exchange rate reached an 11-year high.

The EU **temporarily eased its – normally stringent – fiscal framework** (the Stability and Growth Pact) including a relaxation of state-aid rules, in order to allow member states to respond to the economic challenges caused by the spread of the virus and the ensuing restrictions on activity. A special role was reserved for Germany, who led by example and ditched their usual fiscal restraint. Questions about the German debt brake (or *schwarze Null*) already emerged in 2019 due to disappointing economic growth momentum and falling support for the strict policy among the social democrat coalition partner SPD and opposition parties. That discussion likely served as a springboard for the Covid-19-induced 'need for speed' in March.

However, it arguably was the **quick agreement on the next EU budget and particularly the €750bn NextGenerationEU recovery fund** in July that cemented the idea that Europe *can* get its act together (although the ratification process may still face some hurdles). This decision came on top of earlier agreements, such as the SURE fund to support member states. This result, we would emphasize, is no small feat and Germany played a decisive role here once again.

What is also notable, but certainly 'less visible' is the **changing role of the Commission and the EU in shaping structural economic policy**. As a general observation, it appears that the Commission is gradually shifting away from a rather dogmatic and theoretical 'neoliberal' view of the world – which has been a key driver of competition, flexible markets (does anyone remember 'Lisbon?') and trade policy in the past decades – towards a more 'hands-on' or practical approach to nowadays challenges. This is demonstrated by its focus on the digital society, climate change and the energy transition, where the EU has been working on a comprehensive vision of the

future as well as actual policies to achieve its goals. The [European Fund for Strategic Investments](#), which already built on its predecessor of the *Juncker Plan* and under which some €400bn worth of investments were made through EU-provided guarantees, is now being seamlessly morphed into the broader *InvestEU* programme. The initial focus on digital and physical infrastructure is being broadened as well as deepened: sustainable infrastructure, research, innovation and digitization, small and medium businesses; and social investment and skills. InvestEU is expected to mobilize at least €650 billion in additional investment between 2021 and 2027.³

Looking for a 'game-changer'?

In her [State of the Union](#) speech, Von der Leyen argued that the EU should become more vocal on the issue of human rights abuses: *"So we must always call out human rights abuses whenever and wherever they occur – be it on Hong Kong or with the Uyghurs. But what holds us back? Why are even simple statements on EU values delayed, watered down or held hostage for other motives? When Member States say Europe is too slow, I say to them be courageous and finally move to qualified majority voting – at least on human rights and sanctions implementation. This House has called many times for a **European Magnitsky Act** – and I can announce that we will now come forward with a proposal."*

Common foreign and security policy are currently considered as 'sensitive' thus requiring unanimity. Clearly, **introducing qualified majority voting in this area could be a game changer** as it would allow the EU to respond more quickly and forcefully to a fast-moving external environment. That said, small member states may oppose as such a system benefits bigger member states⁴. Moreover, we should bear in mind that its international prerogatives remain limited to begin with.

More generally, though, it does appear that the EU are slowly but surely taking on a more assertive stance vis-à-vis Russia and China. And even the US is no longer sacred. The EU have played an important role in recent years with sanctions on Russia following its annexation of Crimea, although that policy has not delivered any tangible results other than reduced trade, as we pointed out in the introduction. Meanwhile, there has been speculation that Germany would [pull the plug](#) on the Nord Stream 2 project following the poisoning of Alexei Navalny. But so far, the German Chancellor has been quite consistent in her view that the (European) response should be decoupled from economic issues.

To an extent this goes to the heart of the matter: **the (un)willingness of Germany/Europe to sustain (financial or other) pain in order to achieve certain objectives on other fronts, such as foreign policy.**

³ In her [State of the Union](#) address, EC President Ursula von der Leyen emphasized that *"the European Green Deal is our blueprint to make that transformation. At the heart of it is our mission to become the first climate-neutral continent by 2050"*, adding the proposal for a Carbon Border Adjustment Mechanism. To emphasize the green nature of the EU plans, she said that 37% of NextGenerationEU will be spent directly on the European Green Deal objectives and that 30% of NextGenerationEU's 750 billion euro is to be raised through green bonds. On digitisation, the emphasis of the investment plans should focus on the digital infrastructure, the use of data (AI) and protection of data, including the development of GaiaX – a European cloud; 20% of NextGenerationEU will be invested in digital.

⁴ Qualified Majority Voting is already the most widely used voting method in the European Council for non-sensitive topics. It requires that 55% of the member states votes in favour and that any proposal is supported by member states representing at least 65% of the total EU population. A blocking minority must include at least four Council members representing more than 35% of the EU population: <https://www.consilium.europa.eu/en/council-eu/voting-system/qualified-majority/>

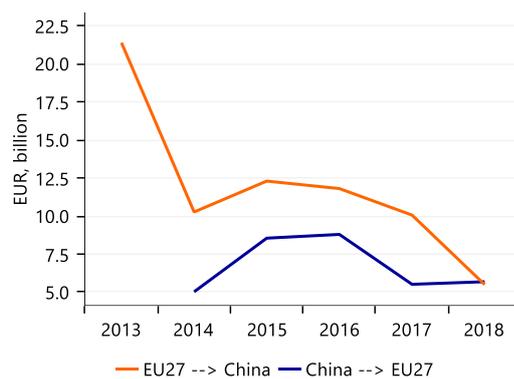
Special case China

China is, we would argue, somewhat of a special case, largely because the international relations between China and the EU have been mostly driven by trade and investments. However, in recent years the awareness among member states and the EU has grown that other issues, such as security, level playing field and protection of strategic industries are much broader and a growing cause for concern. The EU has started to realize that China, dubbed a *systematic rival* in an EC report last year, would fare best by a stable but indecisive Europe.

This certainly makes it worth mentioning that in the 14-September EU-China [summit](#), there was no tangible success to be reported and that the tone of the press release by EU President Michel, EC President Von der Leyen and Chancellor Merkel was very much one of 'China should do more' on opening up its markets and sustainable development⁵. And neither did the EU shy away from expressing its concerns over Hong Kong, human rights and tensions in the South China Sea. In short, this press release could well have been written up in Washington!

In recent years, several member states have taken on a 'China-friendly' stance. Italy was the first big European member state to sign up to China's Belt and Road Initiative. Key pieces of infrastructure such as the Greek port of [Piraeus](#) and terminals in several Spanish ports have been sold to Chinese counterparties. But also in German, Dutch and Belgian ports, Chinese companies gained a foothold.

Figure 3: FDI flows: modest and dwindling...



Source: Macrobond, Eurostat

At the same time, critical voices have grown louder. This has led, for example, to increasing scrutiny of takeovers and of the role of telecom providers such as Huawei. According to Merics, a think tank on EU-China relations, in an [interesting paper](#), the EU's 5G security review is "[...] unparalleled in terms of processes and could provide a blueprint for future similar exercises." The paper notes that "[...] The EU has adopted new assessment methods for China's dumping practices in 2016 that averted China gaining inappropriate 'Market Economy Status' (MES), and it has introduced an EU wide

investment screening mechanism to come into force in late 2020, also prompted by the PRC's 'Made in China 2025' industrial policy. It is in the process of rolling out its own connectivity strategy and bolstering industrial and innovation capacity and competition and procurement policy.

Clearly, investment activity by Chinese counterparties in Europe has dwindled in the last couple of years (from low levels to begin with, Figure 3) and investment by European counterparties in China has slowed down even more sharply. **Still, and despite the changes highlighted above, the overall stance of Europe has been uncoordinated, incoherent and uncertain so far.**

Germany could play a leading role but lacks military power

As Europe's biggest economy and largest country by population, Germany is often viewed as the leading country within the bloc, being a key driver of change in Europe – often in cooperation with France. The departure of the UK and the significance of the UK as a military force (although both parties have vowed to keep close relations on foreign policy) has only raised the stakes. It therefore seems natural for Germany to also take the lead in a more proactive foreign policy that the EU might adapt. And with its backing of the EU recovery fund, Germany has shown that it is

⁵ A few days later, China announced its new policy aim of becoming carbon-neutral in 2060.

willing to take the lead regarding internal European affairs. But is Germany also willing to take the lead in *external* affairs?

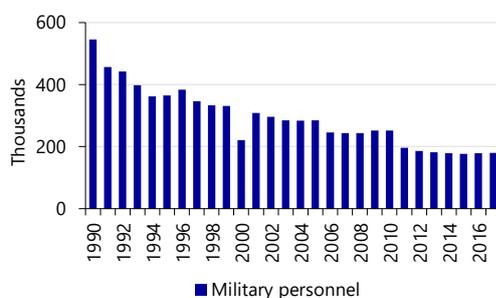
We argue that Germany alone cannot take the lead in external affairs. A proactive geopolitical strategy has to be backed by military strength, but the overall state of the Bundeswehr, Germany's armed forces, [is dismal](#). This can be explained from two facts. First, the *Treaty on the final settlement with respect to Germany*, which was a part of the reunification of Germany, puts a limit to the size and the capabilities of the Bundeswehr. Most important, Germany was forced to reduce its armed force to less than 370.000 personnel. Admittedly, the current size of the Bundeswehr is much smaller, but this treaty started three decades of dwindling personnel numbers (figure 4).

Second, and most important, Germany is traumatized by the guilt of having started two world wars. With its national history and its new anti-war identity, extra defense spending has little support from the electorate. Under pressure from president Trump, Chancellor Merkel has vowed to increase defense spending from 1.2% to 1.5% of GDP, [but a mere 15% of voters supported this](#). Re-energizing the Bundeswehr will be a tough nut to crack. With the abolition of conscription in 2011, it will be hard to find extra personnel in a pacifist country on a voluntary base (figure 5).

One could say that German citizens rather export cars than ideology. We therefore deem it unlikely that Germany will take a leading role on the military front any time soon.

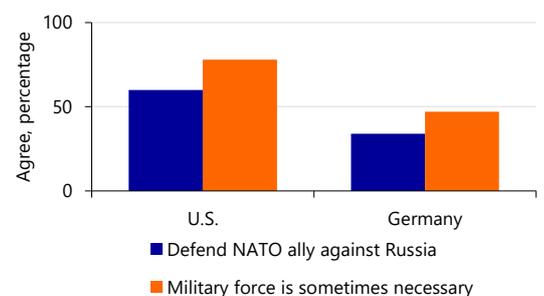
With Germany as the 'natural' leader of the EU, but without the military force to back up a proactive foreign policy, other countries with a larger army, such as France, could step in to complement Germany in this matter. This would be the first step towards a further integration of European armies, enabling the EU to act swifter and with greater determination in international affairs. But this is easier said than done. Is France willing to put its people's lives on the line for the greater good of Europe? Are other countries willing to chip in there as well? **We would argue steps on this front are likely to be slow and piecemeal in the foreseeable future.**

Figure 4: The Bundeswehr's numbers have dwindled



Source: Worldbank

Figure 5: Germans are less likely to support military interventions



Source: Pew Research Center

European Union's own funds

But perhaps intensified cooperation in the area of intelligence can be achieved, whilst EU external border defense can be supported by EU funding. Next to relieving indebted and hard hit countries from some of the pressure on their national finances, the newly created Recovery Fund also **aims to raise own funds through taxes on plastics, a revised ETS scheme and a digital services tax**. The extra incoming funds could be used to increase the annual budget, enhancing the ability of the EU to adequately and swiftly address external issues. Extra funds could also be used to mitigate some of the side effects of a more assertive foreign policy, such as compensating member states for damage from import tariffs in the U.S. or China.

But more important than the extra spending capacity, the ability of the EU to raise funds is a step towards a further financial integration of the EU.. By moving some of the national sovereignty in the area of taxation to the European level, the EU is signaling a further centralization of policy making.

This decline in sovereignty is a topic of hot debate, but the piling up of external threats and rapidly changing geopolitical environment may ultimately shift the balance in this discussion.

Why a sceptic view is to be advised?

Although the changes are palpable and the ambitions are rising (as per Von der Leyen's speech), it is really hard to see the EU/Europe pack a punch on the foreign policy front. Germany is likely to remain cautious in taking up the leadership and a big ramp-up in military spending in Germany and/or the EU at large does not seem to be on the cards. Relying solely on France does not seem to be a realistic option either.

More likely, we would argue, is that the EU will concentrate on its 'domestic affairs', developing/nurturing its soft powers and that it will selectively pick its foreign battles (with a key emphasis on economic policy/sanctions etc.), whilst relying on its current alliances.

Indeed, to make the EU's ambitions work, Merics, a think tank on EU-China relations, [recommends](#) that the EU first strengthens its own resilience, promote competitive liberalism at home and abroad, and generating greater global influence by working together *"like-minded partners on matters regarding China."* Effective EU China policy, it says, *"will require swifter and more decisive leadership, and the emergence of ad-hoc coalitions able to advance and coordinate decisions quickly. This will require EU member states and EU institutions to have all relevant government and institutional players adopt and embrace a joint perspective on China which is rooted in a principles-first approach, centered on competition."*

It concludes that *"Europe needs to be prepared for all eventualities, including disruption, deterioration, and landslide change in the relations with China in the years ahead. Finding a response to these eventualities will require flexibility without compromising on European interests and principles."*

What conditions not fulfilled?

Broadly speaking we feel that a number of conditions are not yet fulfilled, thus informing a skeptical view regarding Europe's external stance; some of those conditions are easier to solve than others; summing up:

- **Sovereignty.** There is still an overwhelming lack of willingness to transfer sovereignty to the EU, although this may ultimately change under the influence of external threats; qualified majority voting on certain foreign-policy issues would be a first step in improving the EU's ability to respond quickly and forcefully to rapidly changing geopolitical conditions; another step would be a bigger role for EU funding and 'own funds'.
- **Military.** The EU cannot muster a rapid reaction force. A lack of (joint) military power combined with relatively strong 'soft powers' such as a big economy and level of technology and institutions set limits as to in which areas the EU can raise its assertiveness: these will often be confined to 'purely' economic issues. And even on that front, also when it comes to its role on international financial markets (reserve currency, common safe asset), the [EU plays second fiddle](#).
- **Allies.** The EU's heavy reliance on the Transatlantic Alliance, which is crumbling, implies that it will need to re-build its alliance and/or create new alliances; for example by topping up its role in NATO with a new EU alliance on foreign policy, security/defense. At this point, however, such a coordination is largely absent.

- **Leadership.** Germany may be taking on a bigger role on economic leadership, but it seems unlikely that it will broaden that role into other areas as forcefully. The German-Franco relationship could prove a way out; but it is also a wildcard.

Conclusion and implications

After many years of taking a backseat in international relations, Europe is waking up to the changing geopolitical environment. There are tangible changes also in the way it has been dealing with internal problems and economic challenges, such as Brexit and the spread of Covid-19. Germany has clearly taken on a decisive leadership role on this front.

The EU certainly has potential, if only because of its (economic) size. If it continues with financial integration it may – one day - play a role as a true reserve currency and provider of a safe assets. But at this stage the EU project is still very much a 'work in progress' and a group of nations with differing views of what the world should look like. This implies that in the coming years, at best, Europe will be able to maintain or modestly strengthen its soft (economic, cultural) powers. More EU funding, a sharper defined agenda for structural economic change and a more assertive stance vis-à-vis certain trade partners is likely to be the result.

However, the EU is unlikely to pack a punch on the foreign policy/defense front, as German leadership here is not self-evident and as other member states are unlikely and unwilling to fill that void. Modest steps such as qualified majority voting and a rebuild of existing alliances or establishment of new EU-led alliances could be part of a gradual process.

But things are moving slowly. And this, in effect, is the main problem for the EU. The world is [no longer dominated by neoliberal politics](#) and the EU needs to adapt (quickly). Although a Biden presidency could give the EU some extra time to adjust to this new world (and perhaps carve out a stronger position for itself), another Trump presidency will likely only speed up the drift away from multilateral neoliberalism.

Given that there is still a lot of work to be done before the EU can really take an assertive role, the EU is likely to remain fragile during this transition phase.

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