Germany's Economic Myths Debunked: Rethinking State-Business Ties for Economic Security

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Rethinking State-Business Ties for Economic Security

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German economic policy has been in flux since the supply chain shocks of the pandemic and the Russian invasion of Ukraine. Partners in Europe are keen for reassurance that they can rely on Germany in a geopolitical crisis, even when its commercial interests are at stake. Germany is aware of this but has been guarded about its intentions and has merely signalled what it thinks partners want to hear. This runs counter to Germany's reputation as a supporter of constructive business ties, an open and secure EU, global multilateral bodies, and its steadiness and reliability as a partner.

- **Europe's economic security depends on German reassurance – from both its private and public institutions. The German state and its largest businesses, after years of growing mutual distrust, must therefore be self-disciplined for the sake of allies and partners and put their relationship on solid footing. The new German China strategy might prove to be a small step in the right direction.**

- **German actors should tone down the rhetoric about turning the EU into a geoeconomic superpower to rival the US and China. While nurturing and developing Europe's geoeconomic stance, Germany should help strengthen the G7 as a multilateral venue that ensures economic security efforts between the EU and US are embedded in open market relations.**

- **The potential for constructive joint action between business and government is probably greatest in the EU's neighborhood, in the Western Balkans and Eastern Europe. If German business and government work together to bring production and investment to these fragile regions, it would send a positive signal to both allies and rivals – not least by showing that the EU is a vector of security and openness.**

GERMAN POLICY UNCERTAINTIES FUEL INSECURITY IN EUROPE

When Lithuania greenlighted a *Taiwanese* Representative Office in Vilnius in November 2021, the People's Republic of China (PRC) took umbrage. To China, the semantic deviation – other European capitals have hosted *Taipei* Representative Offices – signalled an enhancement of diplomatic relations between Lithuania and Taiwan. In response, the PRC not only covertly restricted Lithuanian exports to China, it pressured German manufacturers with business ties to China to cease operations in Lithuania. The incident quickly became a test of solidarity for the incoming government of Chancellor Olaf Scholz with Germany's small EU partner – and a litmus test for European economic security.

In response, Germany sent its foreign minister and high-level officials from the economics ministry to reassure Vilnius. It also backed the European Commission in taking action at the World Trade Organisation (WTO), and it supported the new EU Anti-Coercion Instrument (ACI) to bolster a collective EU response in future such cases. This came amid rhetoric about Germany's geopolitical awakening and readiness to change. But speak with Lithuanian experts today and their unease is palpable. Although grateful for the support, especially for sending more German troops to the former Soviet republic after Russia's invasion of Ukraine, they are not really reassured.

Germany deployed troops as part of NATO's enhanced Forward Presence and subsequently announced it would permanently station a brigade of 4,000 in Lithuania. But that, along with the uptick in German business investment since the confrontation with Beijing began, has not settled nerves. Instead, such developments visibly underline Lithuania's heavy dependence on Germany for both military and economic security. Local experts say they do not always understand what motivates Germany's engagement with China now or in the future, or the depth of its European solidarity should Beijing again put coercive pressure on an EU capital.

Such doubts and questions are a good bellwether for the effectiveness of German reassurance policy in the area of economic security. Based on discussions with officials and experts that we held for a project with the US-based Center for International Private Enterprise, much remains to be done. Not only do different parts of the German government say different things, their efforts to straighten out the messaging often lead to even greater unclarity. The chancellor remains taciturn on how Germany would respond in a crisis for fear of antagonizing governments like Beijing, while the foreign minister over-reassures smaller EU states to show Germany knows how its business dependencies affect its neighbors.

What worries partners is their suspicion that the German state's close ties to big business will hold sway when core commercial interests are at stake. In the absence of clear messaging from Berlin, countries like Lithuania are tempted to probe Germany with loyalty tests of their own. Baltic politicians provocatively demanded that Germany decouple its economy from China and send a clear sign of loyalty to the US in its rivalry with the PRC. Germans, determined to focus on de-risking rather than decoupling, say that Baltic states like Lithuania can decouple only because they have little trade with the PRC. They talk, too, of "moral hazard" – the danger that Germany cannot give Vilnius unconditional backing because this will only encourage small states to pick fights with the PRC as they try to impress a hawkish US.

THE HALLMARKS OF THE GERMAN BUSINESS MODEL

Two years after that trade spat, messages from Berlin remain mixed. Foreign Minister Annalena Baerbock continues to paint Germany as a geoeconomic player that robustly uses its market power to Europe's geostrategic advantage, while Scholz is more reticent and does not seem to mind how outside observers interpret relations between his government and business. These clashing messages are reflected in strategy documents that are closely read abroad by its closest partners.

Germany's new National Security Strategy, in which Scholz is known to have had a strong hand, briefly acknowledges that "in an open economy, state and private stakeholders must assume responsibility for security." This typically cautious statement offers no prescription for how the German state will steer business in the current geoeconomic environment. The government's China strategy, in which Baerbock's Greens were influential, is more outspoken. It argues that "systemic rivalry has in recent years increasingly come to the fore" and more vigorously underscores that the German government expects businesses to identify and mitigate major geopolitical risks when pursuing China-related trade and investments. The strategy was hence praised for its clarity in laying out the need for action, but criticized for its ambiguity on how to proceed.

So what is German policy? Expert voices are split into those who want to reassure European partners by giving them the messages they wish to hear, and those who are quieter and understand the complexity of the traditional German economic model but do not see how to change it.

In reality, the German state has comparatively limited capabilities in (say) trade and supply-chain intelligence

Speak with German foreign policy experts, and they tend to side with Baerbock and the critics of Scholz's tight-lipped approach. They repeat the mantra that the German government bears responsibility for Europe's slow and painful response to Russia's invasion after it "sold its energy needs to Russia, production needs to China, and security needs to the US." Their narrative suggests that the government has significant influence over business decisions and thus the scope to fix things – a mischaracterization of the role of government in the economy. In reality, the German state has comparatively limited capabilities in (say) trade and supply-chain intelligence, partly because trade is an exclusive competence of the European Union and partly because the German state struggles to attract the best minds from key sectors like tech or energy due to wage competition from the private sector.

Economic experts and businesses offer an alternative picture – debunking the notion that the state uses its influence to cynically promote German business interests, or naively permits business to use the government as a tool of commerce. They argue that the German government's model for managing geopolitical business risk is quite different than its critics suppose. Far from collusive, it is a hands-off, *mediated* relationship to business that works through institutions such as an open and inclusive EU, international organizations like the WTO, and a web of German chambers of commerce with relations to German ministries and embassies. Its weakness is not collusion but the way it has permitted the government to abdicate its political responsibility, for instance when the government asserted that the Nordstream gas pipeline project with Russia was a purely commercial matter.

They concede that this model is outdated in an era where national security concerns increasingly outweigh the pursuit of economic efficiency. The model has traditionally been of great benefit to partners precisely because it is not a vehicle for state interests. The goal of this model has historically been to create regulatory environments in which German business can have a positive effect, less through a grand idea of "change through trade" ("Wandel durch Handel") – the notion that trade induces political liberalism – than through the small-scale transfer of standards, with German businesses boosting local property rights, accountancy standards, and environmental protections where they invest. This has allowed German business to thrive in emerging markets – in the global swing states Berlin now needs to buy into multilateral rules. Precisely because German businesses are not seen as the long arm of a European state, these post-colonial countries have welcomed them.

SENDING CREDIBLE SIGNALS TO EUROPE'S PARTNERS

The traditional German model remains largely intact: German businesses make investment decisions independently of government concerns – and often move at a quicker pace than regulators. This holds potential strengths. But a growing focus of expectations on lawmakers and the government's inability to explain where it is headed are serious deficits – not just for European partners like Lithuania. There is a risk that the mix of forceful rhetoric about German and EU geoeconomics and taciturnity on key issues will, in the eyes of some global swing states, merely make authoritarian state-market models such as China's seem more reliable and attractive: at least China's state interests are nakedly transparent. For all the warnings about Chinese debt-trap diplomacy, these countries may see investment from the PRC as a safer bet; in their view, Europe – and Germany – should increasingly embody double standards.

In our interviews with policymakers and experts in Germany, we found that the trade and business communities have at least one thing in common. They are acutely aware of the need to send credible signals to European partners. Debates about the future of state-market relations in a hyper-globalized, yet highly confrontational, geoeconomic order are probably more profound in Berlin than in almost any other EU capital.

German economic security policy in is in flux. This is inevitably confusing for neighbors and partners as well as swing states that would like to get on board. Other export-driven European economies that have traditionally followed the German line are also grappling with new realities, and they need Germany to be honest about the strengths and weaknesses of its model. Many here feel that Germany is being pushed in unfair directions, held to impossible loyalty tests such as whether it will decouple from China. It does no good to tell partners and allies what Germany thinks they want to hear if this does not match reality.

Often behind the curve in European discussions on military security, Germany is de facto a leading voice and driving actor in Europe's economic security. But it can only live up to this role if state and business recognize that now is not the time to indulge in squabbles. Three vectors emerged as we brought these various parties together – German officials and politicians, business leaders and their new cohort of geopolitical risk officers, along with experts and foreign officials – and asked them to build upon what they saw as Germany's traditional strengths.

1. Put old tensions between business and government into perspective. Our interviews revealed a legacy of strained relations between the state and business in Germany. Business representatives accused lawmakers of having denigrated them by playing the anti-business card, only to come crawling back in a crisis – whether big banks, tech and pharma, asylum reception firms or the armaments industry. Lawmakers, for their part, criticized businesses for damaging Germany's global standing through selfish behavior, such as BASF's assertion that "de-risking" would mean investing more, not less, in China and its decision to move production from Germany. Both sides acknowledged, however, that their reputations are now entwined whether they like it or not. They could not indulge in old dogma about "state interference." Surprisingly, business representatives suggested that they did want clear signals and messages from government on foreign investment risks. Also of surprise, they argued for limits on government subsidies in the current geoeconomic environment. Subsidies, although generally welcome, should not come at the expense of the EU's cohesion and should not be used to cushion German consumers from an increasingly brutal outside world. This is because businesses want consumers and voters to reward them for making geopolitically responsible decisions such as divesting from China or investing in the EU. German consumers must thus see that their choices – the apps they use, the hidden costs of cheap energy – have geopolitical implications. Lawmakers responded that business must be constructive when regulators seek to amend key geoeconomic instruments, such as those related to investment screenings. And they conceded that if the state's role in economic security should be limited to core state functions, then that means all core functions expected of a state, including the military sphere. Ultimately, the German government's readiness to play a role in NATO and protect Ukraine will make Ukraine a safer investment for German business.

2. Anchor European economic security even more in the G7. Some business representatives suggested that Germany was ill-served by the one-sided attempt to reassure European partners by painting the EU as a geoeconomic player to rival the PRC and the US. They argued that the EU has neither the economic strength, the political will nor the right tools to wield credibility in this three-way battle. While praising the EU for deepening its geoeconomic toolbox in recent years, they noted that its strategic direction remains unclear. The new European Economic Security Strategy was seen as emblematic of this: a framework with devils in the detail that now need resolving by divided member states. One theme was that Germany would be well-served by anchoring the EU economic security agenda rather more in the G7, which includes Germany's closest transatlantic allies and an important Asian partner. Europe – and Germany – should come to the table with a strong common understanding of European interests and instruments, as the US, Japan and others will certainly promote their own versions of an economic security agenda. Importantly, the G7 remains a legitimate global caucus, likely to win over states for a cooperative agenda. Furthermore, the G7 has a ready format, the B7, to coordinate state-business relations. And it offers scope to pool trade intelligence, which can be tricky at the national level because of wage competition with the private sector. Participants pointed out that the G7 is mentioned only briefly as an "important avenue" in the European Commission's economic security strategy, with no in-depth details of the potential it holds for cooperation. Admittedly, some business interviewees saw the G7 as a distraction to building a coherent EU position. Moreover, representatives of partner states like the Netherlands complained that Germany was already too focused on the G7, one reason Berlin has resorted to unilateral domestic protections while other EU members are exposed. But those from Central Europe and Baltic states argued that the drive for "EU autonomy" will always be directed as much toward the US as toward China and Russia, and so G7 talks are a good corrective even if smaller EU member states are not at the table.

Europe – and Germany – should come to the table with a strong common understanding of European interests and instruments

3. Take friend-shoring seriously to bolster Europe's economic security. Regarding geoeconomic competition, most German participants still saw the main source of Europe's economic security as its sheer economic power and scale. This allows it to leverage access to European markets and consumers and "unilaterally regulate globalization" or bring countries into line with the EU's broader security interests. But representatives from the Western Balkans and Eastern Europe saw dangers in this perspective. They warned that the EU was creating new hurdles by increasing intra-EU subsidies and deepening its geoeconomic rulebook and toolbox even as it paid lip service to their accession to the EU. The EU too often demanded these vulnerable neighbors wean themselves off foreign investments or follow EU sanctions policies without offering much in the way of compensation, support or market access. They fear they are becoming a battleground in the geoeconomic competition between West and East, due to their proximity to the EU and because the EU often disregards their heavy dependence on it. The remedy is friend-shoring – a concept that both German business and government seem to treat with scepticism. Intensifying trade relations has not automatically spread liberal standards, so now the Germans prefer to rely on conditionality. Nevertheless, German businesses can have a huge impact in smaller, poorer economies in the way they spread property or environmental standards when they set up in a country. They thus made a case for openness and inter-dependence rather than leveraging economic power and scale. Balkan and Eastern European businesses suggested that if German standards are clearly spelled out – not in a complex law like the German *Lieferkettengesetz (supply chain law)* – they would voluntarily accept them if it would attract German investment. German business and government should also be more vocal about the upsides of good business practices when engaging with European neighbors. This would balance the often overly defensive and inward-looking German debate on these matters. Such hands-off ways of achieving further market and supply chain integration are key to binding European neighbors closer to the EU's joint market – and should help bolster the ambitions of Berlin and others to strengthen German and European economic security.

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