

Responsible Coexistence with Autocracies in Foreign Economic Policy Making

Discussion Paper on Shaping Global Economic Relations with *Systemically Challenging Counterparts*

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- The BDI underscores its commitment to companies' global social responsibility. The issue at hand is the coexistence of different systems that while competing also have to cooperate with each other. Global challenges such as climate and environmental protection or poverty reduction require cooperation - also between different political and social systems.
- German economic operators are constantly in dialogue with foreign business and political stakeholders; as a matter of course this includes states that challenge our values. Countries such as China and Russia account for a significant share of German foreign trade and are important destinations and sources of foreign direct investment.
- German industry must be allowed to act according to its own values and to name deficits where they arise. However, companies must also be able to compromise on a day-to-day basis in order to create prosperity as well as opportunities for development and advancement at home and abroad. Even though the primacy of politics applies in international relations, companies play an important role when it comes to shaping third country relations - and must therefore position themselves and act upon political issues.
- German companies assume a share of political responsibility and advocate European values and universally recognized standards worldwide. The better the European Union (EU) is able to position itself globally with its value system and economic model, the more successful its ideas will be internationally. That is why it is important that the EU, along with partners, successfully positions itself anew as a value-based community.
- The well-founded necessity of imposing economic restraints on oneself in the form of high standards can only be justified if one's own influence is not permanently diminished and indispensable levels of competitiveness are subjugated to short-sighted cost-benefit analyses. This requires Europe to always gauge its standing and competitiveness. Hence, economic sanctions must always be considered and evaluated on a case-by-case basis. Possible retaliatory measures and the particularity of other side's potential response must always be taken into account. Trade controls should only be introduced if there is a clearly defined exit strategy.

- It is states drawing red lines for political reasons or to protect the environment as well as human rights. However, this does not release companies from their obligation to identify red lines for their own global engagement. German industry advocates a concept of *responsible coexistence* and proposes guidelines for policymakers and companies.

Executive Summary

With this discussion paper, the BDI contributes to the debate of social responsibility in economic relations with autocratic countries. The core mission for our companies is to do business successfully and innovatively and, with that, to secure the livelihoods and prosperity of our societies. At the same time, industry is supremely invested in sustainably preserving the natural resources of our planet and strengthening the rule of law as the basis of our success.

This discussion paper aims to define guidelines for companies as well as policymakers. At the same time, it calls for measures that significantly enhance companies' efficacy and capacity to improve performance. One fundamental issue for companies operating in foreign markets is how to deal with autocratic and paternalistic systems. China and Russia, for example, account for relevant shares of German foreign trade, but are equally important destinations and sources of foreign direct investment. German industry is also constantly in dialogue with foreign business and political stakeholders, of course also in countries that challenge our domestic values. In so doing, German industry must be allowed to act according to its own values and to name deficits where they arise. But companies must also be able to compromise on a day-to-day basis in order to create prosperity as well as opportunities for development and advancement at home and abroad.

The sober assessment is that "change through trade" has reached its limits. The expectation that global economic interdependence would automatically facilitate the spread and development of market economies and democratic structures has not come to pass. Despite this, we insist: the better the EU is able to position itself globally with its value system and economic model, the more successful its ideas will be internationally. On the other hand, the weaker the EU and the value-based community of liberal democracies act politically and socially as a whole, the stronger the effect of competing influences. This is another reason why it is now important for the EU to successfully position itself anew as a value-based community together with partners such as the United States, Canada, Japan, South Korea, Australia, New Zealand, the United Kingdom and others. Our continent should set a positive example. Transatlantic solidarity and increased development cooperation in Europe's neighboring regions are of fundamental importance in this context.

Leading by example, democratic market economies must promote their way of life by being as open and transparent as possible while naturally complying with the rule of law and international treaties. In dealing with autocratic states, we advocate a concept of *responsible coexistence* in external economic relations and make the case for a cooperation with clear boundaries. In our view such an approach is linked to the realization that different social systems will coexist and compete with each other for the foreseeable future. In light of the global ecological and economic challenges, therefore, cooperation is an imperative necessity. This applies in particular to areas like climate protection, the preservation of biodiversity, global protection against diseases and the digitalization of all areas of life.

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Naming the Challenge

A result of a series of (economic) crises since the new millennium, confidence in the preeminence of the liberal democratic and economic order as guaranteeing prosperity, equal opportunity and the preservation of the environment has been in significant decline. The assumption that this way of life represents the "end of history" (Francis Fukuyama 1989) and that democracy is the most just and efficient form of government is increasingly and globally being called into question. This decline has accelerated not least by four years of Donald Trump's administration in the United States and electoral successes of populist politicians in many democracies around the world, including in Europe. In Russia, Vladimir Putin tries any means to exploit weaknesses in the European Union and the United States. In turn, Putin stage-manages his country as a paternalistic counterweight to an "over-liberalized" EU. In Europe's neighborhood, there has been no success in preventing or ending wars and civil strife. Nor has the EU provided adequate support for existing movements for reform and democratic change in their central demands for economic prosperity and participation, for example in North Africa. There is no credible common European foreign and economic policy in Africa and the Middle East.

In the past two decades, particularly China has become a systemic rival to liberal societies, not only economically but also politically. China's party state capitalism and hybrid economy has proven to be extremely adaptable. Even if the often-used narrative of China's unstoppable success overlooks inherent structural weaknesses that have not yet been solved by the Chinese Communist Party, the Chinese model is increasingly challenging democratic market economies economically and technologically. China establishes itself as a role model to other countries in its development. In addition, China's hegemonic advances are gaining momentum through the *Belt and Road Initiative* (BRI). Disguised as development policy, BRI created economic dependencies in the target regions and in some cases has reached out far into the European region. We welcome the fact that the recent G7 summit in Great Britain has set clear counter accents here.

In its internationally widely received China policy paper, the BDI noted as early as January 2019 a systemic competition between our model of a liberal, open and social market economy and China's party-state-capitalism. The paper called for a broad public discussion including political stakeholders, as well as society and business in Germany and Europe. This discussion is now well under way. U.S. President Joe Biden rightly speaks of a "turning point" in view of the "systemic competition with China" and addressed America's democratic partners in Europe, Asia and other parts of the world: "Democracy doesn't happen by accident. We have to defend it, fight for it, strengthen it, renew it. "

German industry stands on a firm foundation of values and is, at the same time, confronted with rigorous and considerable demands and expectations from various social interest groups exerting pressure on companies. In addition, economic sanctions are increasingly being discussed and levied by the EU and other regions. Internationally active companies are required to shoulder the burden enforcing political interests. Companies will carry their share of responsibility as they have no intention of evading the mounting pressure to act put on the international system.

Economic Relations in the Age of Coexistence

The BDI advocates an open and unbiased dialogue on the question of where influence by economic means as well as demands towards other countries are justified – and where they reach their limits. While universal human rights are non-negotiable and international commitments are binding, not every labor, environmental or social standard that deviates from the European standard should put a question mark to economic cooperation in general.

At its core, *responsible coexistence* attempts to balance diverging goals: First, democracy and the rule of law are the foundations from which we will help to shape the international order. Second, economic strength as a prerequisite for social security and prosperity is essential for any functioning society. Third, it is a fact that companies must generate profits in order to retain long-term competitiveness.

In our view, sustainable economic success is closely linked to the rule of law, environmental protection and preservation, and to a significant level of social participation afforded to as many people as possible. Large investment companies and other players are imposing ever stricter requirements for good corporate governance and linking investments to ever more detailed sustainability criteria. Companies are an important part of all societies and bear an important responsibility for their functioning. As one of the foremost umbrella organizations representing German business interests, we expressly acknowledge this. Despite the primacy of politics in international relations, globally active companies play an important role in shaping third country relations. Therefore, they must also take a stand on political issues. With this discussion paper, we want to advance and deepen the debate on these issues in Germany and the EU and provide guidance for companies as well as policymakers.

German companies operating in international markets assume a share of political responsibility and stand up for European values and universally recognized standards worldwide.

In contrast to the Cold War, it is much more difficult for companies today to position themselves politically, even or especially when they have made far-reaching voluntary commitments to their social responsibility. In a globalized world, systemic rivalry is taking place simultaneously on various fronts and, under certain circumstances, in changing coalitions.

In a world of globalized value networks and reciprocal technology transfer, sanctions or market access restrictions can quickly create far-reaching externalities. While these might deliver the targeted results, trade control measures could also negatively influence a country's competitiveness and in turn provoke market access restrictions. We reject concepts that call for the far-reaching "decoupling" of social, economic, technological and communicative ties.

Moreover, global challenges such as climate change, the protection of biodiversity or the fight against pandemics can only be overcome if there is a consensus across different systems on the implementation of measures and the best technologies are used worldwide. Policy instruments that exclude certain groups of investors or restrict technological cooperation must therefore be carefully scrutinized before they are deployed. Consequences such as limited growth opportunities or reduced innovation capacity must be considered, as must possible countermeasures and countersanctions.

Therefore, what is meant well might not necessarily be well executed in the end. The well-founded necessity of imposing economic restraints on oneself in the form of high standards can only be justified if one's own influence is not permanently diminished and indispensable levels of competitiveness are subjugated to short-sighted cost-benefit analyses. What is more, the early development and setting of future-oriented standards by policymakers can only create competitive first-mover advantages if these

standards become globally adopted or recognized in a meaningful way. This tension between foregoing a risk and benefiting from new opportunities must be observed and considered by policymakers.

The discussion in Germany and the EU on strengthening regulations with regards to due diligence in supply chains is emblematic of this tension. Only through joint efforts can politics and business effectively implement human rights due diligence in global supply chains and make substantial contributions to better enforcing human rights, the rule of law, and transparency. We advocate solutions, in which the onus does not lie mostly with German industry, but that are built to create a level playing field. Legal regulations must establish resilient and viable behavioral standards and focus on targeted efficacy.

Guidelines for German companies operating internationally

The following principles are intended to serve as a framework for orientation regarding the worldwide foreign involvement of those economic operators represented by the member associations of the BDI. These principles are no substitute for differentiated discussions about red lines in the involvement of German industry abroad. Political red lines are necessary – as is actively addressing tensions between the legal iniquities in individual countries and the entrepreneurial involvement there. Overall, the guidelines charter a way for acquiring and securing a license to operate under politically challenging conditions, particularly in countries governed by autocratic regimes.

1. The BDI and its members are part of the open, pluralistic civil society in Germany and the EU. We view ourselves as a pillar of liberal democracy. The business activities of German companies abroad must be committed to the value principles that apply in the EU.
2. We are committed to human and workers' rights as set out in the United Nations Universal Declaration of Human Rights, the ILO Core Labor Standards and the EU Convention on Human Rights. Our companies take measures to exclude their involvement in child labor and forced labor at home and abroad.
3. We are staunch advocates of the benefits the social market economy provides for society, employees, consumers and companies; social responsibility is part of our companies' DNA.
4. We are committed to the United Nation's 17 Sustainable Development Goals (SDGs) and to the Paris Climate Agreement. We are continuously working toward the goal of climate neutrality.
5. We oppose corruption and bribery. We ensure transparency and integrity in our companies and in our relationships with public-sector clients, customers and suppliers.
6. We are committed to the rules-based international order and support the modernization of the World Trade Organization (WTO). We are convinced that open borders for trade and services worldwide contribute to sustainable growth.
7. We support policies that achieve inclusive growth and reduce the gap between rich and poor within and across our societies.

Guidelines for German and European Foreign Economic Policy: The Business Perspective

European companies that are to operate successfully internationally and, beyond that, hold their own in the systemic competition with state-owned enterprises from authoritarian countries need strong political backing. Concretely, this means:

1. Companies operate in highly competitive markets and depend on a level playing field. Their role in advancing social progress through liberal values and environmental standards will be increasingly successful, the more political efforts ensure the functioning and maintenance of international organizations and the global regimes of standards they support.
2. Political interventions in economic relations must have a firm legal basis. The new EU mechanism for sanctioning human rights violations points in the right direction. There is a legally robust link between the act and the sanction. Persons responsible are subject to entry bans, asset freezes and other individual measures.
3. Sanctions must always be a tactical tool within a comprehensive foreign and security policy strategy. Mutual isolation should be avoided. Economic sanctions must always be weighed up on a case-by-case basis: We cannot defend democratic values any better if we considerably weaken ourselves (economically) or call into question the very principles of market economic exchange and the rule of law. Possible retaliatory measures and individual retaliatory measures must always be taken into account.
4. Restrictive measures should only be introduced if there is a clearly defined exit strategy and the conditions for the withdrawal of these measures have been established in advance. Milestones for a gradual withdrawal of sanctions should also be established in order to incentivize behavioral change. Unintended political developments in the target countries should be taken into account. Generally, exceptions to sanctions must be possible, especially for ongoing contracts.
5. In all measures, policymakers must be clear-eyed about potentially – or apparently – conflicting objectives; this includes social, environmental, and climate externalities. Breaking off economic contacts can also lead to increased costs, reduced opportunities for exerting influence, or medium to long term externalities.
6. The implementation of legal standards must be a high priority for the EU's internal market. The creation of the EU's Rule of Law Regulation as part of the Multiannual Financial Framework is an important approach. A recognized and assertive "EU compliance department" is needed in this regard.
7. German companies are valued partners in developing and emerging countries because of their high standards and their personnel's level of training. German investments contribute to sustainable economic development. German and European development cooperation must also be consistent with democratic goals and must not undermine standards demanded of European companies.
8. The EU must become more sovereign in its foreign and economic policy, even where the United States might be concerned. Extraterritorial U.S. sanctions against European companies demonstrate the EU's limited ability to act. The EU must develop instruments against foreign

influence, for example in the form of a functioning blocking statute or an anti-coercion instrument. The BDI recently presented a catalog of proposals and demands to strengthen the EU in its quest for a global level playing field and has proposed a comprehensive plan for introducing an EU anti-coercion-instrument.

9. One crucial step is to strengthen the Euro relative to other currencies. In the long term this would provide Europe with more weight in the international payments system and global financial markets. Here, the introduction of a digital euro can have a reinforcing effect.
10. To increasingly locate strategically important industries and technologies in Europe with public support and EU special projects (IPCEIs) is an appropriate response to the challenges Europe will face in the coming decades.
11. For Europe to act strategically and swiftly when facing geopolitically challenging autocracies, EU foreign policy making should rely on majority decisions.
12. Instead of individual European sanctions regimes, an approach coordinated with like-minded partners around the globe is necessary. The current revitalization of transatlantic cooperation and the new ambitions of the G7 are steps in the right direction.

Imprint

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