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GEOECONOMIC BALANCING, GEOECONOMIC BANDWAGONING OR GEOECONOMIC HEDGING? GERMAN-CHINESE RELATIONS 2008-2020

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Abstract: *Despite the rising geoeconomic competition between the USA and China, no suggestions are offered in the contemporary literature as to what geoeconomic strategy middle powers can use towards the great powers in the face of the currently emerging bipolar world structure. In this paper, three ideal-typical models of geoeconomic strategies for middle powers are developed with the help of terminology borrowed from strategic studies: the concepts of balancing, bandwagoning and hedging lead to the concepts of geoeconomic balancing, geoeconomic bandwagoning and geoeconomic hedging. Further, the behaviour of Germany towards China is tested, and it is argued that Germany has chosen geoeconomic hedging as its strategy towards China. By simultaneously promoting and restricting economic relations with China, Germany seeks to protect its commercial interests in China and at the same time strengthen its partnership with the USA and EU members to avoid falling into the Chinese sphere of influence.*

Keywords: Geoeconomics, Germany, China, Geoeconomic balancing, Geoeconomic bandwagoning, Geoeconomic hedging.

Introduction

Faced with the end of the Cold War, Edward Luttwak suggested in a 1990 essay that “methods of commerce” are “displacing military methods”. Luttwak proposed the term geoeconomics to capture this “admixture of the logic of conflict with the methods of commerce” (Luttwak, 1990). Geoeconomics, in the Luttwak tradition, has been an answer to the realist school’s overemphasis of the role of military power (Scholvin and Wigell, 2018). A useful

definition of geoeconomics was offered by Mikael Wigell: “the geostrategic use of economic power” (Wigell, 2016, p. 147). Also, the definition proposed by Robert Blackwill and Jennifer Harris (2017, p. 20) emphasises the means – which are economic – and not the ends (which can be economic, political and strategic).

Geoeconomic competition has a long history (Baracuhy, 2019). In the post-Cold War era China is widely seen as a champion of geoeconomics (Grosse, 2014). Also, Germany has developed geoeconomic strategies towards all of its most important partners: the USA, Russia, China and other EU members (Kundnani, 2011; Kappel, 2014; Szabo, 2015).

Starting in the late 1970s, the goal of the USA’s policy towards China was to integrate China into the liberal world order. Also Germany’s strategic goal was to influence reforms in China and integrate it into the liberal world order by means of economic integration. Germany’s approach towards China, known as “change through trade”, was reminiscent of the strategy of the FRG in the 1970s towards the USSR (Kundnani and Parello-Plesner, 2012, p. 4; Schröder 2006, p. 141; Westerwelle 2012; Westerwelle 2013). Germany was convinced that integrating China into the global economic system would have the effect that “China’s authoritarian politics would morph into a free, open, and more democratic system through ever-tightening economic ties.” (Barkin, 2020, p. 2). Trade relations were not thought of as potential leverage by German elites. They believed that trade had transformative power in and of itself (Kundnani, 2014, p. 78). But this policy failed. China did not turn into a democracy, the territorial disputes between China and its neighbours have intensified, and the liberal economies of the Western democracies face growing competition from Chinese-style state capitalism (Fuest, 2019).

China and the USA find themselves in the Thucydides Trap, “a deadly pattern of structural stress that results when a rising power challenges a ruling one” (Allison, 2017; for an opposite view see: Ng, 2020). Unlike in previous centuries, competition among great powers today is mostly economic. Contrary to the expectations of liberals, a high level of economic exchange has not eliminated clashes in US-Chinese relations. As Dale C. Copeland (1996) argues, high economic interdependence can be “either peace-inducing or war-inducing”.

US-China trade and technological competition highlights the change that has taken place in the international order, from a Neoliberal Order to a Geoeconomic Order. This transformation is rooted in a shift in emphasis, from absolute gains to relative gains. The USA’s support for

free trade is waning, and its support for protectionism rising. With the convergence of economic power between the USA and China, the US's economic interdependence with China, previously seen in terms of absolute gains, is now seen in terms of relative losses and strategic vulnerability for the USA (Roberts, Moraes and Ferguson, 2019).

The potential US-Chinese "new Cold War" poses a challenge for middle powers, understood as "states that are weaker than the great powers in the system but significantly stronger than the minor powers and small states" (Holbraad, 1984, p. 4). It is forcing them to develop their own coherent geoeconomic strategies. Although in the contemporary literature the use of different geoeconomic instruments is discussed (Blackwill and Harris, 2017, pp. 49-92; Scholvin and Wigell, 2018) and strategies for regional powers towards their region are analysed (Wigell, 2016), no suggestions are offered on what geoeconomic strategy middle powers can use towards the great powers in the face of the currently emerging bipolar world structure. Faced with this research gap, this paper has two goals.

Firstly, it develops three ideal-typical models of geoeconomic strategies for middle powers with the help of terminology borrowed from strategic studies: the concepts of balancing, bandwagoning and hedging will lead to the concepts of geoeconomic balancing, geoeconomic bandwagoning and geoeconomic hedging.

Secondly, it analyses Germany's reaction towards China's geoeconomic strategy in the period 2008-2020. Confronted with intensifying US-Chinese economic competition, and heavily dependent on both great powers, Germany became more reactive, trying to find a response to China's geoeconomic strategy. I argue that Germany is unsure about the future global balance of power and has chosen geoeconomic hedging as its strategy towards China. By simultaneously promoting and restricting economic relations with China, Germany seeks to protect its commercial interests in China and at the same time strengthen its partnership with the USA and EU members to avoid falling into the Chinese sphere of influence.

The paper consists of four sections. In section 1, I discuss the instruments great powers use in their geoeconomic strategies. In section 2, I develop the concepts of geoeconomic balancing, geoeconomic bandwagoning and geoeconomic hedging. In section 3, I discuss Germany's geoeconomic strategy towards the initiatives taken by China in the period 2008-2020, and in section 4, I analyse Germany's attempts to rebalance towards the USA.

1. Instruments of great powers in geoeconomics competition

Contrary to the expectations of some scholars, the rise of economic interdependence has not led to the abolition of power politics. The great powers are still trying to develop an asymmetric interdependence with middle powers. Deploying stick-and-carrot policies, they try to guarantee themselves disproportionate leverage by creating an “economic hierarchy” (Lake, 2009, pp. 56-57). To discuss the geoeconomic strategies of middle powers, we first have to classify the geoeconomic instruments states (great powers included) use. These can be divided into six groups.

The first and most important group is the economic potential of a state. Through their economic policies, states try to create wealth in the long term. The GDP is a basic index measuring the performance of a state (Gelb, 2010). Today, the USA and China are the biggest economies by far, and together create over 1/3 of global GDP. But GDP is not the only indicator; other important ones include: a balanced economic structure, an industrial base, the capacity to create credit, a disciplined labour force, efficient production methods, an active trade policy supporting exports, and energy and food security, while the most important factor for long-term economic strength is a country’s ability to create innovation. Well-established, state-of-the-art research centres are of crucial importance, and sectors such as telecommunications, computer science, health care and aerospace should be given top priority in economic policies. If middle powers understand the connection between being innovative and power, they can also join together to challenge much more powerful competitors, with EU members being a good example of this. Proper economic management and international cooperation may elevate the power of relatively small countries (Grosse, 2014).

The second group of instruments are trade, investments and currency policies. Under the World Trade Organization (WTO) rules, governments have a limited ability to introduce protective measures for their local market, but this does not mean they are powerless. The same applies to the control of investment flows and financial flows. The contemporary discussion in the USA (as well as in Japan and Taiwan) about “decoupling” from China shows that states are increasingly refusing to go along with the liberal argument of steadily increasing market integration. The demand for access to the market of a great power has been an important

instrument in the hands of that state's government. That access cannot be taken for granted. After 1945, granting access to the US market was an important instrument used by successive US administrations in building alliances (Kwan, 2020). A frequently used method is exerting formal and informal influence over companies (Bremmer, 2009). Geoeconomic strategy is rarely targeted towards the whole economy of a state. More likely, a certain economic sector that is strategic for a given country is targeted (Wigell and Vihma, 2016). Developing economic relations creates interdependencies that are rarely symmetrical. In fact, relations between great powers and middle powers are by nature asymmetrical, and make middle powers vulnerable. The consequence is "vulnerability interdependence defined as a situation where the targeted state has more to lose than the state that utilizes economic tools, if their economic ties were to be restricted" (Kim, 2019, p. 156).

But the use of trade, investments or finance is more complicated than the use of armies. Governments must cooperate with enterprises whose interests do not always fully coincide with those of the state (Luttwak, 1990).

The third group of instruments includes the creation of international initiatives, programmes, regimes and institutions. This is the most effective instrument with which a great power can build up a favourable geoeconomic environment, because it has long-term consequences. The institutions can be regional, multilateral or even universal. For decades, the best-known example of such a geoeconomic initiative was the Marshall Plan started up by the USA in 1948. The USA also backed the creation of a post-WWII world order by creating the International Monetary Fund (IMF), the World Bank Group and GATT (later the WTO). These institutions integrated the West economically during the early years of the Cold War, and expanded over time, ensuring the USA's primacy in the global economy. As US-Chinese geoeconomic competition intensified in the early 2010s, the USA promoted the Transatlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership (TPP) - two geoeconomic projects designed to strengthen ties between the USA and Europe and between the USA and the Asia-Pacific region, respectively (Blackwill and Harris, 2017, pp. 152-257). But due to changes in US foreign policy, the USA withdrew from both proposals, undermining trust in US leadership and America's ability to counterbalance China. China is also creating its own institutions. It brought the Asian Infrastructure Investment Bank (AIIB) to life, and formed the

New Development Bank together with other BRICS countries. In 2013, China proposed the Belt and Road Initiative (BRI). Immediately, comparisons with the Marshall Plan were made. The popular view is that these geoeconomic projects should enable China to achieve “economic domination” and change “economic interdependence into a hierarchical relationship”, making “China’s trade partners dependent on Beijing” and allowing “China to write the rules of the game” (Grosse, 2014, pp. 48-49). Middle powers face a dilemma over whether to participate in the initiatives of great powers, for they can also create institutions of their own, and frequently do so, with the most notable examples being the EU, ASEAN and Mercosur, which are regional, or issue-specific organizations such as OPEC. An important aspect of the creation of institutions is the popular misperception that geoeconomic strategy is a form of protectionism. It is not. States can build liberal economic system or subsystems, as long as they benefit from them; examples are the post-WWII order created by the USA, and the regional order in Europe dominated by Germany (Kundnani, 2019).

The fourth group of activities is technological standard setting and technological dominance. A state’s position in international relations is heavily dependent on its ability to generate new technologies. The contemporary US-China technology race is similar to the Anglo-German quest for dominance in radio telegraphy in the late 19th and early 20th centuries (Brunnermeier, Doshi and James, 2018). To achieve technological dominance, great powers invest heavily in basic scientific research and try to develop technologies crucial for the future. Technological superiority creates a strategic advantage. Today, such competition revolves around AI (Lee, 2018), 5G telecommunications technology, and the future of the internet. The Chinese government has already initiated a discussion at the UN to reinvent the internet (Gross and Murgia, 2020).

The development of new technological standards is convergent with the development of international programmes and institutions, as the case of the BRI and its digital corridor suggests. But a strong innovation sector can also be a strength of middle powers, as the examples of Sweden and Finland show (Sanger and McCabe, 2020).

The fifth group of geoeconomic instruments is official development aid (ODA). Great powers direct ODA towards developing countries, and wealthy middle powers also frequently provide ODA. ODA is a useful foreign policy instrument (Blackwill and Harris, 2017, pp. 68-

74). The rise of emerging powers as donors in the 21st century increased the diversity of ODA instruments to include both foreign aid in accordance with OECD rules and more commercially oriented financial flows.

The sixth group of instruments consists of economic ideas. Explicitly or implicitly, states promote their economic models. In the 19th century, the British laissez-faire economic system served as a model for many countries, which followed the British example, and joined the gold standard as well. But Germany, the main challenger, partially refused to go along with the British example, with protectionism and cartels playing a much bigger role in the development of its economy (Brunnermeier, Doshi and James, 2018). During the Cold War, US capitalism faced off against Soviet communism. And today, the free market economy has been challenged by state capitalism. This inter-system competition differs from competition between free-market economies. Although competition between free-market economies is still taking place, most attention is currently concentrated on intensifying competition between free-market economies and state-capitalist countries. This calls into question the superiority of a mixture of economic liberalism and political democracy over a centrally managed authoritarian state. The crucial question is whether the free-market economies can outperform China's state capitalism economy in science, technology, economic efficiency and economic dynamism. Can China remould the international economic order in its favour? And finally, what is the future of Western values such as individual freedom, the rule of law, etc.? (Fuest, 2019).

2. Towards geoeconomic balancing, geoeconomic bandwagoning and geoeconomic hedging

The balance of power is one of the most important concepts in international relations theory. Kenneth Waltz (1979) predicts that actors will balance against a stronger state, because the power difference presents a security threat to the weaker actors. But Stephen Walt (1987, pp. 21-28) modifies this argument, suggesting that states do not balance against power *per se*, but only against power that they perceive as a threat. Walt defines balancing as “allying with others against the prevailing threat” (Walt, 1987, p. 17). Balancing may be achieved in two ways. Firstly, it can be an internal balancing, which means an increase in military spending and the transformation of economic strength into military power. Or it can be external balancing,

which means one or more external partners banding together against a superior state that presents a threat (Walt, 1987, p. 18).

Bandwagoning theory states that a middle power may accept a subordinate role, taking cover under a great power's umbrella (Walt, 1987, p. 33). Bandwagoning is traditionally seen as the opposite of balancing. As Waltz (1979, p. 126) indicates, it is a strategy of cooperating with a dominant power. Walt defines bandwagoning as an "alignment with the source of danger" (Walt, 1987, p. 17). It is an "accommodation to the pressure (either latent or manifest)" (1987, p. 55). According to Walt, when faced with two great powers, a middle power should ally with the less threatening one, while simultaneously enjoying reasonably good relations with the more threatening one. The idea of bandwagoning as a defensive strategy has been challenged by Randall Schweller (1994, p. 74). He argues that bandwagoning is driven by the prospect of political and economic gain.

Many states try to escape the dichotomy between balancing vs bandwagoning strategies. It was out of this dilemma that the concept of hedging emerged. Goh defines hedging as "a set of strategies aimed at avoiding being in a situation in which states cannot decide upon more straightforward alternatives such as balancing, bandwagoning, or neutrality" (Goh, 2005, p. viii). He sees hedging as a strategic choice of a middle power that helps it maximize profit under conditions of competition among the great powers. Cheng-Chwee Kuik defines hedging more thoroughly as "a behaviour in which an actor tries to mitigate risks by pursuing multiple policy options, which would produce mutually counteracting effects, under the situation of high uncertainty and high stakes". It is a "multiple-component strategy between the two ends of the balancing-bandwagoning spectrum" (Kuik, 2008, pp. 164-165). Denny Roy sees hedging as "keeping open more than one strategic option against the possibility of a future security threat." (Roy, 2005, p. 306). Le Hong Hiep (2013) indicates that a diversity of tools allows a state to move between balancing and bandwagoning depending on the international situation and its bilateral relations. In the case of an external threat, a state can easily move further towards balancing or bandwagoning. A useful definition was offered by John Hemmings (2013), who wrote: "hedging means a state spreads its risk by pursuing two opposite policies towards another state".

The reason many states choose hedging is that balancing or bandwagoning operate primarily when a state is under a significant external threat or crisis. Hedging is a more useful strategy under normal conditions. For middle powers, balancing and bandwagoning can entail a danger of being dragged into a conflict between great powers, where picking the wrong side can mean being in an unfavourable position in the future and losing out on possible gains (Lim and Cooper, 2015).

While traditionally, balancing, bandwagoning and hedging mainly involve political and military means, middle powers can employ the strategies of geoeconomic balancing, geoeconomic bandwagoning and geoeconomic hedging in the current “Age of Geoeconomics” (Hsiung, 2009). Opposition to incorporating non-security elements into the hedging concept (Lim and Cooper, 2015) does not stand up to reality, because economics is at the heart of great power competition in the 21st century. Economics and politics are interrelated. The issue of who will have primacy in the future world will be decided by the economic balance of power (Hsiung, 2009).

Geoeconomic balancing is a strategy that should strengthen a middle power’s position against a great power that is seen as a source of danger. It can be achieved by internal balancing, meaning a state’s strengthening of its own economy, or by external balancing. External balancing consists in limiting economic cooperation in strategic sectors (energy, infrastructure, high technology) with a great power that is seen as a source of danger. A middle power allies itself economically with another great power or other middle powers, thereby strengthening its international position by reducing its economic dependence on, or even disconnecting from, the economy of the great power it sees as a potential threat.

A middle power can choose a strategy of geoeconomic bandwagoning with a great power. This means accepting the geoeconomic strategy, as well as the individual initiatives and demands of the great power, which is seen as a source of danger, in the hope of mitigating the threat through economic interdependence. It also means occupying a subordinate position and leaving the country at the mercy of the great power. If the hegemon proves to be benevolent, this strategy may offer an environment conducive to development, and the potential for adopting a different strategy at some point in the future.

Geoeconomic hedging is the right strategy for a middle power trying to develop “strategic autonomy” (Hsiung, 2009, p. 115) by simultaneously developing and restricting economic exchanges with competing great powers. It is more open to economic relations with a great power it identifies as less dangerous, and applies more restrictions in relation to a great power it is more afraid of. Restrictions apply primarily to economic exchanges in strategic areas of the economy. But no sector of the economy should fall into dependence on a great power seen as a source of danger. By choosing geoeconomic hedging, a middle power strives to keep all strategic options open. The development of economic relations should not lead to economic dependencies that might restrict the state’s freedom to act. Geoeconomic hedging is especially suitable when there is uncertainty about the future balance of power. It may provoke clashes with one great power or another, but it does not close any options. When the stakes and uncertainty are high, states tend to hedge. They can do so for as long as neither of the competing great powers forces them to choose whether they are “with us or against us”.

Geoeconomic bandwagoning, balancing or hedging should not be confused with trade exchange. The almost universal membership in WTO makes trade less dependent on political preferences. The contemporary situation is different than that of the Cold War, when the United States and the Soviet Union built their economic systems independently from each other. Any identification of which strategy a middle power applies should be comprehensive, and should be based on the middle power’s behaviour towards the six groups of instruments used by the great power.

3. Germany’s geoeconomic strategy towards China: 2008-2020

Germany has been classified as a middle power. It has the fourth-largest economy in the world, but it is dependent on US-led international institutions and US security guarantees (Otte and Grewe, 2000; Baring 2003). The German economy is competitive and has been export-oriented. In 2018, German industrial production was the fourth-largest in the world, worth \$821.8 billion. For decades, Germany has been among the top three exporters in the world, and its export dependence increased significantly between 1998 and 2018 - from 26.41% to 47.42% of GDP. The consequence of this export success is a current account balance surplus. Germany has run a budget surplus since 2012 while reducing public debt. This excellent performance

would not be possible without the supply-side structural reforms introduced by the second government of Chancellor Schröder (Agenda 2010) and a steady rise in R&D spending, which went from 2.212% of GDP in 1998 to 3.035% in 2017, one of the highest levels in the world (World Bank, 2020a). Although Germany lost competitiveness in the electronics and biotechnology sectors in the 1980s and 1990s, the excellent performance of its automotive, aerospace, chemical and electrotechnical industries and engineering has long been seen as a solid foundation of German economic power (Rode, 2007). But that success has been increasingly seen as a poisoned chalice. It allowed German industry to take its eye off the ball as technological progress accelerated. As the German foreign minister Heiko Maas admits, in the technological race Germany has fallen not only behind the USA, but also behind China (Maas, 2019a).

Trade and investments have been a cornerstone of German–Chinese relations for decades. Germany developed intensive relations with China, underpinning them with a political rapprochement expressed in the signing of an agreement on Strategic partnership in global responsibility in 2004 and elevating their cooperation to the level of a Comprehensive strategic partnership in 2014. Intensive intergovernmental consultations were developed, and the perception of Germany’s “pivot to China” was strengthened by the German ambassador to Beijing, Michael Schaefer, who said in 2012: “I don't think there is such a thing as the West any more” (see: Kundnani, 2015, p. 115). But Germany has no clear vision of what should make its relations with China strategic. Apart from trade, the two countries’ relations lack substance due to differences in numerous policy fields (Heiduk, 2015). Germany and China have seen each other as partners between whom there exists an economic “symbiosis”. Germany used to supply investment and high value consumer goods, and China mass consumer goods. The German trade deficit with China was never a central topic of economic and political discussion. Two reasons for this may be indicated: on the one hand, Germany has had an overall positive trade balance as well as a current account surplus. On the other hand, its deficit towards China was relatively modest. German exports were growing continually, and their structure was favourable for Germany, too. German decision-makers and politicians believed that China’s growing wealth would create further demand for German goods (Kundnani and Parello-Plesner, 2012).

In the early 21st century, China became one of Germany's top economic partners, though access to the Chinese market for foreign goods and services remained limited. By 2018 7.07% of German exports were sent to China, and 9.8% of German imports came from China (World Bank, 2020b). On the other hand, China sent only 3.14% of its exports to Germany in 2018 (World Bank, 2020c). German exports to China radically accelerated after the start of the 2008 economic crisis. The Chinese government launched an anti-crisis package for the Chinese economy that resulted in rapidly growing imports, including from Germany (Kundnani and Parello-Plesner, 2012).

The development of trade relations has been supplemented by increasing German investments in China. At the end of 2017, German direct investments in China amounted to more than 80 billion euros (Deutsche Bundesbank, 2019, p. 23). That same year, Chinese direct investments in Germany were worth only 5.1 billion euros (p. 63).

German exports to China and German investments in China are concentrated in a few economic sectors. The automobile companies are the most dependent on China. In 2018, the biggest German automaker, Volkswagen, earned 39.9% of its revenue in China, while among companies listed on the DAX index, semiconductor producer Infineon, carmakers Daimler and BMW, and the chemical company Covestro all earned more than 20% of their revenue in China. On average, DAX-listed companies earned 15% of their revenues in China in the same year. The German "big business" faces the problem of a concentration risk (Heide et al, 2019). Although, as a whole, the German economy is less dependent on the Chinese market than its flagship companies; the problem of vulnerability persists (Barkin, 2019).

The problem is intensified by China's refusal to adopt the principle of reciprocity or symmetry in its trade and investment policies, and by its strong support for local enterprises. An unequal playing field for local and foreign companies is causing growing opposition among the German authorities. In December 2016, Ambassador Michael Claus indicated that it was difficult for German officials to encourage German companies to invest in China because they feared they would be nothing more than "useful instruments" supplying technology that could later be discarded (see: Ankenbrand, 2016). Despite Chinese demands, the EU did not grant China market economy status. This was partially a consequence of Germany's ambiguous position. Chancellor Merkel was ready to accept Chinese demands, but opposition from the

Ministry of Economy and industrial associations, which were worried about growing imports from China, stopped her from taking that step (Huang, 2019, pp. 205-208).

The German companies' fears of losing their technological advantage have been exacerbated by a series of acquisitions in recent years in which Chinese companies have bought up their German competitors. For a long time, German politicians invited Chinese companies to invest in Germany, but that has changed. The turning point was the takeover of the German robot producer KUKA in 2016. In response to the Chinese companies' expansion in the German high-tech sector (Jungbluth, 2018), German regulations on foreign investments were tightened, and some takeovers of German companies were blocked (Huang, 2019, pp. 202-204). Although the new regulations applied to all foreign investors, the discussion in the Bundestag shows that companies from China were the main target. Alexander Ulrich, a member of the house critical of the new regulations, dubbed them "Lex China" (2019, p. 11539).

The third group of instruments is the creation of international programmes, regimes and institutions, and launching international initiatives. China abandoned its "low profile policy" in November 2012, under the new leadership of President Xi Jinping. Germany's response to the Chinese geoeconomic initiatives has been mixed. Germany joined the AIIB, becoming its fourth-largest shareholder. It did so against the expectations of the United States, which sees the AIIB as an instrument for advancing China's global presence. The German government justified its AIIB accession with the argument that participation by Germany (and other European countries) would make it possible to turn the AIIB into a true international financial institution, weakening its "Chinese characteristic". Germany presents itself as satisfied with its role in the AIIB and with the AIIB's policy (Stanzel, 2017).

When President Xi Jinping proposed the BRI in 2013, the initial reaction from Germany was positive. The Siemens CEO, Joe Kaeser, even called it "the new WTO" (Barkin, 2019). But, after a more thorough analysis of the implications of the proposal, the tone became more critical. Causes for concern were seen in the impact of the BRI on the transparency of public procurement, a level playing field for business, and European labour, environmental and social standards. Also, the impact of Chinese investments and credits on the solvency of African and Asian countries became a hot topic, and the term "debt-trap" started to circulate.

Germany has not signed a bilateral agreement with China about participation in the BRI and is pushing for an EU-Chinese agreement regulating relations between those two partners overall, not only concerning the BRI. Germany is interested in signing an EU-China Comprehensive Agreement on Investment (CAI). It has also criticised Italy for joining the BRI, and the Central European countries for cooperating with China within the 17+1 format (Stanzel, 2019). Among German elites, there is a growing feeling that China prefers state-to-state relations over relations with the EU as a whole, and that a united EU is the only instrument in German hands to have balanced relations with China - and the USA as well. German politicians understood that, while China is developing its global vision, Germany and the West lack one (Gabriel, 2018).

The fourth group of instruments applied by great powers is related to standard setting. In this area, the balance of power between China and Germany has dramatically changed in the analysed period. For years, Germany supplied technologies to China, but technological progress has turned the tables, as highlighted by the 5G telecommunication technology offered by the Chinese company Huawei. Germany now finds itself in the position of a country that is technologically inferior to China. In the last two decades, Germany's share in creating world-class innovations has declined in comparison with China, Japan and South Korea (Bertelsmann Stiftung, 2020). To further accelerate their economic progress, Chinese companies invest abroad. FDI should help China achieve its "China 2025" plan. Between 2014 and 2017, 64% of Chinese M&A transactions with a share of at least 10% in German companies were related to the key industries listed in the "China 2025" plan. China is set to achieve "Economic Superpower" status by 2049 (Jungbluth, 2018). There is much division in Germany over how to deal with Huawei. The USA put pressure on Germany to ban Huawei from the German network. Yet in December 2019 the Chinese ambassador to Germany, Wu Ken, said that the exclusion of Huawei would not be ignored and there would be consequences for Germany, suggesting that German car producers could become a target. Despite the security risks, in February 2020 the German government decided to allow Huawei to participate in the development of the German 5G network, although Huawei, like all companies, will have to meet new security standards (Sanger and McCabe, 2020).

In Germany, uncertainty about the country's "digital sovereignty" is growing (Maas, 2019b). The increasing US-Chinese technological conflict has caught Germany in the middle between two economic giants on which it is dependent. As Angela Merkel summarized the German situation: "The odds look pretty bad for us" (2019).

The fifth group of instruments used by great powers to bind middle powers is ODA. Relations between China and Germany are a very specific instance of great power-middle power relations. It was the middle power, Germany, that for years supplied today's great power, China, with ODA, worth almost 10 billion euros since 1979. German ODA was designed to support the export of German technology and standards to China, as well as to gain political influence. With China's economic success, that traditional development aid stopped in October 2009, and since then new forms of development cooperation have been created (Huang, 2019, pp. 177-179).

The sixth group of geoeconomic instruments are ideas, understood mostly as the promotion of a state's own economic system, whereas the last element of geoeconomic power is ideological primacy. In Germany, there was a view that the social market economy could be an inspiration for Chinese reformers. But China's economic success convinced the Chinese leadership that state capitalism with Chinese characteristics is superior to other forms of capitalism. In Germany, the growing worry about Chinese dominance in the ideological sphere was first expressed in a paper published by the Federation of German Industries (BDI), which called China both a "partner" and a "systemic competitor" (BDI, 2019, p. 2). This argument was repeated by chancellor Merkel. She called China simultaneously a "strategic partner" and "strategic competitor", against whom Germany is in "systemic competition" (Merkel, 2019, p. 10482). Merkel's statement was a clear signal that the "change through trade" strategy had failed. Norbert Röttgen, the chairman of the Committee on Foreign Affairs of the Bundestag, argues that Germany should cooperate with China, but should not subject itself to China and it should fight for its own values and interests (Röttgen, 2020, 20425). That is why, in its guidelines to the policy towards the Indo-Pacific region in 2020, the German government encouraged "shoulder-to-shoulder" cooperation in the region with democratic countries sharing the same values (Bundesregierung, 2020).

4. Germany revives the transatlantic-partnership

In the face of Germany's growing vulnerability towards China, the German government is pursuing the goal of strengthening the EU and the transatlantic partnership, underlining the role of the "community of values" shared by Europe and the USA (Altmaier, 2019, p. 16252).

In the early 21st century, the USA began negotiating the TTIP with the EU. Despite some scepticism among the public and NGOs, the German government supported the TTIP for three reasons. Firstly, it would deliver economic growth and new jobs. Secondly, it would revive the transatlantic partnership. And thirdly, it would have the potential to define global standards for trade and investments. The TTIP was seen by the government in Berlin as a strategic project strengthening economic ties in the Euro-Atlantic region and reducing the relative importance of the fast-growing emerging markets (Sparding, 2014).

But the TTIP failed, and disputes started to pile up in US-German relations. The four most important of these are: the German trade surplus, Germany's position towards Huawei, the German-Russian energy partnership, and the low level of German defence spending. The US administration sees the German trade surplus as a threat to US national security, while the German government tries to calm the US administration's fear in order to reduce the danger of American sanctions against the German automobile industry. Further, German politicians attempt to convince the US administration that, under the new regulations, the German telecommunication networks will be safe, even with Chinese equipment. The long-standing dispute over German-Russian gas cooperation ended with the outbreak of the military conflict between Russia and Ukraine in 2022, as the German government declared a shift away from Russian gas supplies by 2024. Also, the pledge of an additional 100 bn euros in military spending, a stated rise of up to 2 per cent of GDP in 2024, and the decision to purchase F-35 jet fighters as a consequence of the Russian-Ukrainian conflict, have symbolic value for reducing the tensions between the United States and Germany (Merkel, 2019; Pfeifer, 2022; Arnold, 2022).

The ability to come up with ground-breaking innovations is a central area of German security, and the backwardness of the German industry in the high-tech sector is a primary geoeconomic weakness of the country. In 2019, during the Munich Security Conference, Heiko

Maas argued that the EU should transform its geoeconomic capabilities into geo-political power. He pushed for a transatlantic trade partnership that could evolve into the core of a transatlantic agenda towards the rising powers, including towards an “increasingly overpowered China” (Maas, 2019a). He and chancellor Merkel repeated the call for a united Europe investing in technologies of the future during the debate on the German Presidency of the Council of the EU 2020 (Maas, 2020; Merkel, 2020a). In her speech to the European Parliament, Merkel also argued that strategic relations between the EU and China “are characterized by close trade links but equally by very different approaches to social policy, particularly respect for human rights and the rule of law”. These differences are playing an increasingly important role for Germany in its relations with China, bringing Germany closer to the USA (Merkel, 2020b).

The USA wants to prevent the expansion of the Chinese 5G telecommunication equipment around the world because of security concerns, and is using a mixed bag of tactics to discourage other countries from using Huawei 5G equipment: threatening to cut them off from information sharing and intelligence cooperation, trying to cut Huawei off from American-made technology. But the USA has no alternative technology to offer. The main competitors to Huawei come from Sweden (Ericsson) and Finland (Nokia), but they are struggling with a cost disadvantage. Given the support provided by China to Huawei and the huge Chinese market on the one hand, and EU-US discord over support for European producers on the other, the future does not look bright for them. The US’s strategy towards 5G is still being formulated, so Germany’s position may change over time. Chancellor Merkel feared Chinese retaliation towards German companies, but her heads of intelligence and some politicians within the CDU/CSU shared the assessment of their American partners (Sanger and McCabe, 2020).

Many German business people felt uneasiness over the future of their companies in China. As a study by the Allensbach Institute from 2019 shows, if faced with a choice between the USA and China, half of German economic elites would be in favour of cooperation with the USA, one third with China, with the rest undecided. This contrasts with the view expressed in the same study, where two thirds of respondents were of the opinion that, in the long term, China will overtake the USA as the No.1 global power (Göbel, 2019).

Conclusions

The international system is in a state of decay. Geoeconomic competition between China and the USA is on the rise. The two great powers are competing against each other for world primacy, especially in the high-tech sectors and trade. Middle powers such as Germany are unsure of what the future balance of power will be like, and have to develop geoeconomic strategies that somehow respond to those of the great powers. This paper aims to fill this research gap by developing the concepts of geoeconomic balancing, geoeconomic bandwagoning and geoeconomic hedging.

Germany's response to China's geoeconomic strategy was analysed. Germany is simultaneously developing and restricting economic exchanges with China, taking contradictory steps. Cooperative and competitive elements in the German strategy towards China intertwine. Faced with uncertainty about the future balance of power between China and the USA, German governments have developed a strategy of geoeconomic hedging towards China, which involves measures that mutually counteract each other and are deliberately contradictory. Because the integration of China into the liberal world order failed, Germany intends to keep its cooperation with China as alive as possible, with the goal of continuing to reap economic and political benefits from that cooperation, but without weakening Germany's belonging to the "West". The behaviour of Germany towards the six groups of geoeconomic instruments used by China defines its strategy.

Firstly, the dynamism of the Chinese economy was once seen as an opportunity but is increasingly seen a source of danger. Facing growing competition, Germany has improved the competitiveness of its national economy.

Secondly, in the early 21st century, German governments successfully encouraged local companies to trade and invest in China. But their success made the German economy dependent on the Chinese market without having any impact on Chinese politics and society. Simultaneously, the German market is less relevant for Chinese exporters. Faced with the failure of the "change through trade" strategy, the German government no longer encourages German companies to invest in China and has developed more mechanisms for scrutinising foreign investments flowing into Germany lest German companies should be sold off to their Chinese

rivals. It is also promoting more diverse economic relations with other countries in the Indo-Pacific region.

Thirdly, Germany was not prepared for China's refusal to fully accept the existing world order. China's new geoeconomic initiatives, and the rising competition between the USA and China have called the existing world order into question. German support for Chinese geoeconomic initiatives in the 21st century has been diminishing as China's power has grown. The accession of Germany to the AIIB was not followed by its accession to the BRI. Germany has not actively lobbied the European Commission to grant China market economic status. And now, German politicians are calling for a revival of the idea of a USA-EU geoeconomic partnership, based on common interests and common values, to preserve the position of the "West" in global politics. In the future, common values should play a bigger role in relations with countries of the Indo-Pacific region.

Fourthly, the current technological revolution is weakening Germany's position in the global economy. For the past century and a half, Germany was a world frontrunner in terms of technological progress and standard setting; today, it is falling behind the leaders, although in the last two decades it has raised R&D spending. Reviving the US-EU partnership could lead to a bundling up of R&D capacities in the Euro-Atlantic region, and to a strengthening of its position in the technological battle against China.

Fifthly, Germany stopped supporting China with ODA in 2009. Both countries initiated development cooperation instead.

Sixthly, Germany sees China as a "systemic competitor" and a social-economic threat. Unlike Germany's relations with China, differences between Germany and the USA are contained within the system supported by both countries. Because of its support for the liberal international system, the USA is Germany's preferred partner over China. But is the German geoeconomic hedging strategy successful? Germany has not overcome its backwardness in the high-tech sector. It is also losing its superiority in numerous other sectors of the economy; moreover, the complementary character of the German and Chinese economies, where Germany supplied high-value added investments and consumer goods in exchange for cheap consumer goods, is vanishing.

Further, Germany is in a situation known as “vulnerability interdependence” towards China. In consequence, it cannot allow itself to make an abrupt change in its policy towards China or to ban Huawei from participating in the development of the German 5G network. The leading German companies are especially dependent on the Chinese market, and their political influence in Germany offers China in this context an instrument with which to influence the German government. Germany’s dependence on China in trade and investments should be gradually limited. Already, some takeovers of German companies by Chinese rivals have been blocked.

Germany has successfully resisted China’s demands that it joins China’s geoeconomic initiatives, by striving for an EU-China CAI and suggesting a revival of the economic alliance between the EU and the USA. But no specific plan for an EU-USA geoeconomic partnership has even been presented. Despite its preference for a geoeconomic partnership with the USA, Germany is keeping all its strategic options open.

The plan to once again become a standard-setting country in new technologies and regain technological leadership is conspicuously absent. The subject of how to respond to the Chinese challenge in telecommunications technology is discussed on a daily basis, but an unambiguous strategy is deliberately avoided. The rise in R&D spending has not stopped the decline in Germany’s share in world-class innovations.

In the systemic competition, supporters of the free market such as Germany are on the defensive. State capitalism is enjoying growing support in many countries, and the BRI is helping this trend. In numerous emerging markets, China’s economic success is acting as an inspiration. The future will show whether a free market economy or state capitalism is more efficient.

As Henry Kissinger indicated some time ago, without its alliance with the USA, Europe would be “an appendage of Eurasia”. It would be at the mercy of China (Kissinger, 2018). German political elites took this suggestion seriously and would like to see the Europe-USA alliance strengthened once again. As Chancellor Merkel noted in January 2020, she is convinced that all Europeans “need to think very hard about how we position ourselves” (Merkel, 2020c) suggesting that a much more straightforward strategy towards China may be needed in the future. Germany wants to be part of the winning coalition but is increasingly unsure about

whether the “Chinese coalition” would be as favourable as the “US coalition” has been for the last seven decades.

With the end of the Merkel era in late 2021, a discussion began about change and continuity in German foreign policy. But then an external factor emerged: the military conflict in Ukraine that proved to be a “game changer”. The Russian operation against Ukraine has caused a revival of the West. Contrary to Ambassador Schaefer’s argument, the West still exists. The policy of sanctions against Russia shows that the West is capable of using its economic might for strategic purposes. Its policy against Russia suggests that, in the case of an intensive strategic competition between the West and China, the West is capable of reducing its economic exchange with China - and that reduction could be faster than might be expected.

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