

**A report from the Swedish National China Centre**

# **The limits of economic coercion**

## **Why China's red-line diplomacy is failing in Lithuania and the wider European Union**

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### **Summary**

- Throughout 2021, China has applied significant economic pressure on Lithuania in reaction to the Lithuanian government's Taiwan-friendly policies. These efforts are unlikely to reverse any decisions in Vilnius. Thus far, the government has continued its trajectory towards a more critical stance on China, there has been international support and efforts have been made to reduce exposure to further pressure. In Sweden, the only European Union (EU) member state that has been subject to economic coercion on a comparable scale, the government has also maintained its positions.
- It is unlikely that China has actively sought confrontation with Lithuania to send a signal to other European countries. Beijing has already made the point that challenging it will have consequences, including through its actions in Sweden. Instead, Lithuania's policy shift has put China on the back foot by presenting it with a dilemma. Beijing needs to maintain the credibility of its red lines on Taiwan in order to discourage others from following Lithuania's lead, but any coercion it uses to achieve this objective may inspire further criticism across the continent.
- Few of China's public attempts at economic coercion have been effective in recent years. In fact, the more Beijing is pushed to use overt coercion to maintain the credibility of its red lines, the less effective such measures are likely to become. China's actions have triggered efforts to reduce exposure to coercion and demonstrated that even smaller countries can resist pressure. Beijing's blunt methods suggest that its foreign policy in Europe may not be as sophisticated or targeted as is sometimes suggested. Grandstanding on predetermined positions appears to take priority over long-term foreign policy outcomes.

- A key aim of the EU's new anti-coercion instrument (ACI) is to deter China from taking future coercive actions by warning of the possible imposition of reciprocal measures. However, Beijing's foreign policy trajectory suggests that there is a significant risk that deterrence will be unsuccessful. A deterrence approach would also fail to address an important reason why member states acquiesce to China's coercion – fear of the economic consequences. Such concerns could be alleviated if the ACI shifted its focus from countermeasures to measures that absorb the effects of coercion. Neutralising China's actions while maintaining the policies that triggered a reaction from Beijing, as Lithuania has done, is as much a show of strength as the option of imposing countermeasures.

## Five key moments in Lithuania–China relations

### DECEMBER 2020. A new centre-right government takes office in Lithuania, following elections in October

The parties of the new ruling coalition agree to conduct a “values-based foreign policy” and to “defend those fighting for freedom around the world, from Belarus to Taiwan”. The announcement draws praise from Taiwan while China’s embassy says that it does not appreciate the “disturbance by other factors” to China-Lithuania relations. Gabrielius Landsbergis, the grandson of independence movement leader Vytautas Landsbergis, is appointed foreign minister.<sup>1</sup>

### MAY 2021. Lithuania leaves 17+1

Foreign Minister Landsbergis announces that Lithuania will leave 17+1, a forum for cooperation between China and the Central and Eastern European states. He argues that it is “high time” to move away from the “divisive” format and pursue a more unified 27+1 approach to China. Lithuania’s ambassador in Beijing later suggests that one of the reasons behind the move is that expectations of improved access to the Chinese market have not materialised. China’s mission to the EU reacts by emphasising the mutual benefits of the mechanism. An article in the state-run tabloid *Global Times* suggests that Lithuania leaving the 17+1 format is not a big problem and that others will not follow its lead.<sup>2</sup>

### JULY 2021. A Taiwanese representative office in Vilnius

The Lithuanian foreign ministry announces that a “Taiwanese representative office” will open in Vilnius and that a Lithuanian trade office is to be established in Taipei. Taiwan’s foreign minister later clarifies that the representative office will be the first to go by the name of “Taiwan” in Europe. The Chinese foreign ministry reacts by stating its firm opposition to official exchanges with Taiwan. Three weeks later, China’s foreign ministry issues a statement saying that the decision to establish a representative office under the name of Taiwan “brazenly violates the spirit of the communiqué on the establishment of diplomatic relations between China and Lithuania”. The statement notes that Lithuania has disregarded China’s repeated representations and warnings of “potential consequences”. It also states that Beijing will recall its ambassador and demands that Vilnius do the same. Shortly after, Lithuanian businesses start to report obstacles to acquiring new licenses for food exports to China.<sup>3</sup>

### AUGUST 2021 Lithuanian defence ministry discovers censorship capabilities in Chinese smartphones

Lithuania’s National Cybersecurity Centre releases a detailed study on the security of smartphones supporting 5G technology produced by Chinese manufacturers Huawei, Xiaomi and OnePlus. It finds that one Xiaomi model has built-in censorship capabilities that could be switched on remotely, and identifies security flaws in a Huawei model. Xiaomi and Huawei deny the allegations. Lithuania had previously signed a memorandum of understanding with the United States on 5G security and introduced legislation that prohibits “unreliable” telecommunications manufacturers and suppliers.<sup>4</sup>

### SEPTEMBER 2021. Foreign Minister Landsbergis meets US Secretary of State

During a visit to by Landsbergis to Washington, DC, Secretary of State Antony J. Blinken expresses “ironclad” US support for Lithuania “in the face of attempted coercion from the People’s Republic of China”. The two ministers also discuss “efforts to assist Lithuania build supply chain resiliency and expand bilateral economic cooperation”.<sup>5</sup>

## **China's economic coercion against Lithuania**

Sino-Lithuanian relations have seen a sharp deterioration in the past year. Throughout 2020 and 2021, Vilnius has made several policy decisions that have sparked negative reactions in Beijing. Lithuania has called for Taiwan to be included as an observer at the World Health Assembly, the decision-making body of the World Health Organisation (WHO), and signed a joint statement criticising China for its handling of a WHO study on the origins of the COVID-19 pandemic. In addition, its parliament has adopted a resolution condemning China's "Uyghur genocide in Xinjiang", it has left the 17+1 platform for cooperation between China and the Central and Eastern European states, and it has accused Chinese smartphone manufacturers of building censorship capabilities into their phones.<sup>6</sup>

What triggered China's most forceful response, however, was Lithuania's decision to allow the opening of a representative office under the name of Taiwan instead of Taipei, the usual title for such offices. In response, Beijing recalled its ambassador and demanded that the Lithuanian government do the same, and implemented a set of informal economic sanctions. These include:

- **Restrictions on Lithuanian exports to China.** The main sectors targeted appear to be agriculture and timber. It has been reported that processes for export permits have been halted, credit limits for Lithuanian companies have been cut, and the prices of certain products have been increased.<sup>7</sup>
- **Restricting Lithuanian imports from China.** Access to raw materials, glass and electronic components has been affected. Chinese businesses have blamed delayed deliveries on domestic power cuts.<sup>8</sup>
- **Pressure on international companies.** Thermo Fisher Scientific, a biotechnology business with a significant presence in Lithuania, was reportedly informed that its business in China would be at risk if the government in Vilnius did not alter its positions, and a Lithuanian telecommunications firm had its Hong Kong bank accounts closed.<sup>9</sup>

There have also been reports that China has halted cargo train traffic to Lithuania.<sup>10</sup> However, this does not appear to be the case and there are even signs that the volume of Chinese rail freight passing through Lithuania has increased.<sup>11</sup>

This type of economic statecraft emanating from Beijing is not new. Other countries have been subject to similar, sometimes more extensive, measures in recent years: Australia, following its request for an inquiry into the origins of the COVID-19 virus; Canada, following the arrest of Huawei Chief Financial Officer Meng Wanzhou; and South Korea, following its decision to install a US missile defence system (Terminal High Altitude Area Defense, THAAD). In the European Union, however, only Sweden has been subject to economic pressure on a comparable scale. For the past three years, China has adopted a number of coercive actions against Sweden, including travel warnings to restrict tourism, cancelled business delegations and talks, as well as pressure on specific companies, most recently in response to the decision to exclude Huawei and ZTE from certain parts of Sweden's 5G telecommunications network.

This is not to say that EU member states are less likely to be subject to Beijing's economic pressure. On the contrary, a study of China's coercion from 2010 to 2020 found that Europe was the region most commonly targeted with such measures.<sup>12</sup> Taken together, this suggests that the frequency of attempts at coercion against European countries is high but that the magnitude may be smaller compared to countries in China's vicinity or close US allies such as Australia and Canada.

Nor is China's coercion against EU member states limited to the past few years. Historically, the Dalai Lama has been a prominent trigger for Beijing, which has threatened European governments that meet the Tibetan leader with both economic and political consequences.<sup>13</sup> In 2008, China responded to then President of France Nicolas Sarkozy's meeting with the Dalai Lama by postponing business deals and restricting visits by Chinese trade delegations to France. Other examples where leaders met the Dalai Lama and were subsequently subjected to coercion include Germany's Angela Merkel in 2007, Danish Prime Minister Lars Løkke Rasmussen in 2009, and British Prime Minister David Cameron and Lithuanian President Dalia Grybauskaitė in 2013.<sup>14</sup> A 2013 global study suggests that countries where leaders meet with the Dalai Lama experience a drop in trade with China for an average of two years.<sup>15</sup>

Although China's methods are not new, both the frequency and the magnitude of such measures appear to have increased in recent years. A recent study showed a sharp increase in the number of recorded cases of Chinese coercion since 2018.<sup>16</sup> Meanwhile, the extensive measures implemented against countries such as Australia, Canada, South Korea, Sweden and Lithuania suggest that the amount of pressure Beijing is willing to apply has also increased. In the Swedish case, for instance, the two companies most directly targeted by coercion, Ericsson and H&M, have both reported significant loss of market share in China.<sup>17</sup> A further indication of China's growing willingness to employ economic measures is its use of sanctions in the form of restrictions on travel and on "doing business with China" against European entities and individuals in March 2021.<sup>18</sup>

## **The effects of China's actions**

Are China's actions likely to reverse Lithuania's policy shift? Thus far, there has been no public sign of this. The Taiwanese Representative Office opened in Vilnius on 18 November and Foreign Minister Landsbergis has said that his country will not back down.<sup>19</sup> Moreover, six Memorandums of Understanding were signed on issues such as semiconductors and financial technologies during a visit by a Taiwanese delegation in October.<sup>20</sup> In September, the Lithuanian defence minister recommended that the public "not buy new Chinese phones, and to get rid of those already purchased as fast as reasonably possible", following the report on built-in censorship capabilities.<sup>21</sup>

China's actions have sparked expressions of solidarity from parliamentarians and governments across Europe.<sup>22</sup> The EU has stated that Lithuania opening a Taiwanese representative office in Vilnius is in line with the EU's One China policy, and European Commission Executive Vice-President Margrethe Vestager stated in October that "Lithuania and all member states [that] find themselves coerced for taking decisions that China finds offensive need support and our

solidarity. The EU will continue to push back at these attempts and adopt appropriate tools, such as the anti-coercion instrument currently under preparation".<sup>23</sup>

China's coercion has also triggered efforts to reduce Lithuania's exposure to further pressure. In September, Foreign Minister Landsbergis visited Washington, DC, where Secretary of State Blinken expressed strong support for Lithuania and discussed US assistance with building supply chain resilience and expanding bilateral economic cooperation.<sup>24</sup> The Lithuanian Foreign Ministry has also said that it is helping companies "find new export and import markets and to address other problems caused by China's unlawful and undeclared, and so far publicly denied actions against Lithuanian businesses".<sup>25</sup> Meanwhile, Lithuania has been elected to the UN Human Rights Council and the North Atlantic Treaty Organisation (NATO) has agreed that the 2023 NATO summit will be held in Lithuania.<sup>26</sup>

The episode has played into the wider trend of growing criticism of China within the EU. The image of one of the smaller EU member states being bullied by China due to its efforts to deepen relations with a democratic country in Asia has drawn attention from observers. It may also have served to put a spotlight on the Taiwan issue among European leaders, some of whom have shown signs of shifting their perceptions. Taiwan's foreign minister, Joseph Wu, recently visited Czechia, Slovakia and Belgium on a European tour. During Wu's visit to Prague, he met with the Czech Parliament and five Memorandums of Understanding were signed, including on cybersecurity and green technology.<sup>27</sup> Wu also met with Members of the European Parliament (MEPs), and apparently also EU officials in Brussels, although his stay there was less publicised than in Czechia and Slovakia.<sup>28</sup>

In November, when an official delegation from the European Parliament visited Taiwan, a French MEP told President Tsai Ing-wen that "Europe is standing with you".<sup>29</sup> There has also been speculation that Lithuania's decision to leave the 17+1 could inspire other states to do the same. One local expert has suggested that Estonia might follow suit or at least minimise its engagement in the constellation, which would leave Latvia to decide whether it wants to be the only Baltic state still in the format.<sup>30</sup>

In short, China's coercion attempts have not only proved insufficient to bring about a policy reversal in Lithuania, but also appear to be triggering efforts to reduce the exposure to future pressure while inspiring further criticism from other countries.

## **Why are China's public coercion attempts not working?**

Looking at trade and investment volumes, it is less surprising that China's economic coercion aimed at Lithuania has been unsuccessful. The country consistently ranks at the very bottom among EU member states when it comes to trade reliance on China.<sup>31</sup> However, coercion has also been unsuccessful in countries that rely more heavily on trade with China, such as Sweden. Here, Beijing's actions have met with heavy criticism and failed to reverse policies such as the exclusion of Huawei and ZTE from certain parts of the 5G telecommunications infrastructure.<sup>32</sup> Similar reactions to China's coercion attempts on the 5G issue have been seen in Germany, France and the United Kingdom, each of which has a comparatively high level of trade reliance

on China.<sup>33</sup> In the Netherlands, China imposed trade restrictions in response to a renaming of the Dutch office in Taiwan, but this has not led to a reversal of the name change.<sup>34</sup>

When these events are compared to the coercion attempts in connection with the Tibet question around a decade ago, China's methods appear to have become less effective over time.<sup>35</sup> For example, Beijing cancelled high-level meetings with Angela Merkel after she met with the Dalai Lama in 2007, after which she toned down her criticism of human rights in China.<sup>36</sup> Merkel does not appear to have publicly met with the leader since then. In 2009, when Denmark's Prime Minister Lars Løkke Rasmussens met the Tibetan leader, Denmark later succumbed to pressure from China by issuing a statement that it was "fully aware of the importance and sensitivity of Tibet-related issues".<sup>37</sup> Similarly, China responded to Sarkozy's meeting with the Dalai Lama in 2008 by postponing business deals and restricting trade delegation visits to France. France later reiterated its support for Chinese territorial integrity. Cameron found himself in a similar situation in 2013, and a year later the British foreign minister reassured Beijing that the British prime minister would not meet the Dalai Lama again.<sup>38</sup> So, what has changed in the past decade that might have made China's public coercion attempts in the EU less effective?

One reason that China's past coercion attempts succeeded in persuading political leaders not to meet the Dalai Lama was that the issue was of much greater significance to Beijing than to the targeted European governments.<sup>39</sup> This balance of interest on the issues of the day may have shifted in recent years as concerns over events in Hong Kong and Xinjiang, as well as China's policy on Taiwan, have mounted across Europe. Public opinion on China has also taken a sharp downturn, while public scrutiny and pressure on governments to stand firm on issues deemed sensitive by Beijing also appear to have increased.<sup>40</sup>

In this context, the more China needs to follow through on its threats and use economic coercion, the less effective such measures might become. As the Lithuanian case illustrates, coercion can trigger efforts to reduce exposure to future pressure through a diversification of economic ties. In addition, the resilience of targeted states such as Lithuania and Sweden could inspire further criticism from other countries if they come to see that the economic costs have been bearable even for smaller states. An Australian researcher recently concluded that the costs of China's trade restrictions against Australia were "far lower than many have assumed".<sup>41</sup>

## **What is China then trying to achieve?**

China's apparent lack of success with coercion attempts in recent years begs the question of what Beijing's objectives really are. A recurring hypothesis is that the main goal is not to reverse the policies of the targeted countries, but to send a signal to others. This explanation was recently offered by a senior EU diplomat. Quoting a well-known Chinese proverb, he argued that Beijing was "killing the chicken to scare the monkeys".<sup>42</sup>

However, the point that opposing China will have "consequences" has already been made to Europeans. Beijing has driven home the message through frequent and forceful protests as well as coercion in response to decisions on issues ranging from the Dalai Lama to Hong Kong and 5G telecommunications networks. There should be no doubt among European



policymakers that challenging China on sensitive issues will lead to a reaction in Beijing. In this context, there would appear to be little added value in Beijing actively seeking confrontation with Lithuania.

A more likely explanation is that Lithuania's actions have put China on the back foot by presenting it with a dilemma. Beijing needs to maintain the credibility of its red lines on Taiwan to discourage others from following Lithuania's lead. If it fails to react to being challenged, others may see this as an indication that such actions may go unnoticed. However, any coercion China uses to achieve its objective could trigger actions in solidarity with those targeted and inspire further criticism across the continent.

An additional indication that Beijing has been reactive rather than proactive is that when Lithuania announced that it was leaving 17+1, the Chinese mission to the EU did not have a prepared response ready. This is significant as the Lithuanian Parliament had told the executive months before that this was its desired outcome.<sup>43</sup>

China's reactive and blunt coercion attempts suggest that its foreign policy in Europe may not be as sophisticated or targeted as is sometimes suggested.<sup>44</sup> To Beijing, the priority seems to be to preserve the credibility of its red lines, even if this is counterproductive in the long term. It appears unmoved by the fact that it has not only failed to kill the chickens, but also attracted more angry monkeys through its attempts to do so. This follows known patterns of "wolf warrior" diplomacy, where grandstanding on a set of predetermined positions takes priority over long-term foreign policy outcomes.<sup>45</sup>

## **The EU's anti-coercion instrument: counteract or absorb?**

The European Commission is developing a legislative proposal to establish an "anti-coercion instrument" (ACI) by the end of 2021. Proponents hope that equipping the EU with the power to respond to economic coercion with countermeasures such as trade and investment restrictions will serve as a deterrent.<sup>46</sup> The results of this study identify two potential problems with this approach.

First, there is a significant risk that deterrence will be unsuccessful. Just like China's attempts to deter European governments from criticising it have failed, so could the EU's attempts to deter Beijing from what it perceives as defending its red lines. In fact, it seems unlikely that China under its uncompromising wolf warrior approach to diplomacy would refrain from coercive actions just to avoid the economic costs of European trade and investment restrictions.

If the ACI fails as a deterrent, the instrument could become part of a spiral of reaction and counterreaction where European economies would have to bear the costs not only of China's coercion, but also of the EU's own anti-coercion measures. Unless the EU is prepared to enter such a confrontation, establishing an instrument that puts a premium on "countermeasures" may not be the best option.

Second, when it comes to using the instrument, an approach that targets publicly known cases of coercion might fail to address the actions that pose the biggest threat to EU interests. This



study suggests that public coercion attempts tend to be unsuccessful and that the economic costs of such actions have thus far been manageable for most of the targeted states.

There may, however, be a large number of unknown coercion attempts, where China has warned of economic consequences but did not have to follow through on its warning as the targeted state agreed to the demands. As governments are typically less eager to share information about such acts of capitulation, it would not be surprising if most instances of successful coercion were unknown to the public and even the EU institutions. An ACI focused on countermeasures would do little to change this.

These two problems of deterrence and undisclosed coercion could be addressed by shifting the ACI's focus from countermeasures to actions that aim to absorb the effects of coercion. Under such a design, the ACI's main function would be to provide tailored support to targeted EU member states to prevent or offset any economic fallout. For example, in cases where supply chains are disrupted, it could help open connections to alternative partners and suppliers or provide financial aid for specific switching costs. It could also comprise a solidarity mechanism, whereby member states on a voluntary basis would agree to assist or to share some of the economic burden with the targeted country. These types of mechanisms would serve to reassure governments that support would be forthcoming if they were to disclose coercion attempts to which they might otherwise have acquiesced.

An ACI focused on absorption would also avoid the risk of a spiralling exchange of measures and countermeasures. The main goal should not be to economically deter China as the likelihood of failure is significant and it is unclear whether member states would be willing to bear the cost. A more realistic objective would be to make coercion attempts ineffective and maintain an independent – or autonomous – policy direction. Neutralising coercion while upholding the policies that triggered a reaction from Beijing, as Lithuania has done, is as much a show of strength as the option of imposing countermeasures.

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