

Memo on an
**‘Economic
Article 5’**

to counter authoritarian
coercion



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of Democracies

**By Anders Fogh Rasmussen and
Ivo Daalder**

With project direction by Jonas
Parello-Plesner and Brian Hanson

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To the leaders of the free world,

Increasingly, authoritarian countries are using economic coercion against democracies. In recent years, China's economic coercion of Lithuania and Australia stands out as a prominent example. Russia uses economic levers to achieve geopolitical aims, notably by weaponizing its natural resources. The aim of such coercion is to bend the will of democratic countries. This is a test for the free world.

In response, we propose an Economic Article 5 among democracies to counter authoritarian coercion.

Our proposal is inspired by NATO's Article 5, which states that a military attack on one ally is considered an attack on all. The aim is to produce the same deterrence and solidarity in the economic realm among democracies that NATO produces in the security realm.

How would such an economic mechanism work? One solution: an international grouping, or "alliance of democracies," could come together and agree on such a framework, possibly through the Summit for Democracy that US President Joe Biden is convening. Other configurations are possible, as discussed below.

Once enacted, a democracy subjected to economic coercion by an autocracy could invoke the Economic Article 5 to secure unified support from fellow democracies. In effect, this would act first as a deterrent, second as a retaliatory coercive step, and finally as a longer-term proactive element.

The deterrence would be immediate. Autocracies would face the unified economic strength of the democratic world, a grouping of economies representing well over 60 percent of the world's economic power. Indeed, the symbolism of such solidarity would be a potent deterrent. Bullies respond to strength and exploit weakness. The possibility of a coordinated response would make them think twice before acting. This is the overall goal of the instrument: preventing economic coercion from happening.

Secondly, the joint response must have bite if deterrence fails. It would move beyond statements of support to proportional, retaliatory measures. Not only governments but also individual companies have been subjected to authoritarian coercion; acquiescence has often been the result. Yet the extraordinary private-sector withdrawal from Russia in response to the invasion of Ukraine shows the increased willingness of businesses to stand up. Regardless, as mitigating steps, lines of credit and alternative (democratic) supply lines should be included in an Economic Article 5 to help businesses adapt their supply chains if necessary.

Finally, such an Economic Article 5 is a longer-term opportunity to strengthen trade bonds among democracies. The longer-term response to authoritarian economic coercion could be a move toward a common market of democracies, which could include supply lines for sensitive and critical infrastructure among members of such an alliance of democracies. That would also lead to long-term inoculation from authoritarian economic coercion.

In conclusion, the democratic world needs a way of dealing with authoritarian actors from a position of strength—economic strength it inherently possesses. It's time to tell the bullies that if they poke one of us in the eye, we'll all poke back.

An Economic Article 5: Definitions and Q&A

The short memo above—for once a genuine one-pager—naturally raises many further practical questions on how to establish such an Economic Article 5. In the following pages, we attempt to answer such questions posed to us during an internal workshop.

We include sidebars on recent cases of authoritarian economic coercion against Lithuania and Australia and explore how an Economic Article 5 could have made a difference.

Do we need to first establish an alliance of democracies before we establish an Article 5?

There are two principal ways to move toward an Economic Article 5.

One route is to build on existing organizations to strengthen ad hoc cooperation. The Group of Seven (G7) could be one such venue. Since 2014 and the expulsion of Russia, the G7 has provided responses to international events from the world's leading democracies, including jointly announced sanctions. More recently, in 2021 the G7 reached consensus positions on unfair trade practices and market-distorting action, statements aimed implicitly at China.¹ Moreover, under the British presidency of the G7, important work on supply chain resilience was also undertaken. As a next step, the G7 could become the clearinghouse for an Economic Article 5 response and involve other democracies in the process.

Similarly, the European Commission has proposed a so-called anti-coercion instrument that aims to address economic coercion against member states. When enacted, that legislation could serve as the legal framework for other countries to associate themselves with the anti-coercion tool. It could be implemented in the G7 framework and more broadly among the democratic members of the OECD. Such an approach would be similar to EU sanctions policy, which allows non-EU members to coordinate their sanctions with those of the European Union. In that vein, the EU could be a legal cornerstone for a broader effort.

The other option for a full-fledged Economic Article 5 alliance of democracies would require the establishment of a stand-alone organization. As outlined in 2004 in a proposal to consider alternatives to address the incapacity of the United Nations to prevent military conflict and other limitations,² such an alliance of like-minded democratic states could be a powerful bloc to deter and thwart coercive actions. More recently, the Alliance of Democracies Foundation, in cooperation with the Atlantic Council, published a report³ on how to establish such an alliance, and we refer to its in-depth treatment of the topic in terms of membership, term limits, and other intricacies involved in establishing an international organization.

The Summit for Democracy, initiated by President Joe Biden, could be the launchpad for creating such an alliance. In December 2021, more than 100 democracies participated in the virtual summit, kicking off a yearlong effort to strengthen democratic renewal. In that effort, an economic instrument could be an initial concrete step for joint action. It could hold additional broad appeal for a larger grouping of democracies if it also brought economic benefits. Accordingly, the elements of a democratic common market and democratic supply chains would be important and appealing components in establishing an Economic Article 5.

What's the inspiration from NATO's Article 5?

NATO's Article 5 served as the inspiration for an Economic Article 5 in only some respects. For example, the Economic Article 5 shares the fundamental one-for-all approach enshrined in NATO's Article 5. When NATO invokes Article 5, it is in a defensive posture. If one NATO member state is attacked, all other member states will come to its assistance. Similarly, the Economic Article 5 would, when agreed upon and invoked, also trigger defensive measures—but purely in the economic realm.

Ideally, an Economic Article 5 would also share NATO's strong element of deterrence because of its promise of mutual assistance. NATO's Article 5 has only been invoked once, following the September 11 attacks on the United States. The fundamental goal is not to create a widely used tool. Quite the opposite: as with NATO's Article 5, the aim is deterrence. However, the threat must be credible. There must also be concrete points of action and a willingness to follow through on them if needed.

The Economic Article 5 differs fundamentally in that NATO is a military alliance with Article 5 as its defensive cornerstone. In most cases, a military attack on a country can be clearly defined. In contrast, economic coercion can be camouflaged. Consequently, it is challenging to operationalize such a concept. However, this should not discourage attempts to do so. Several countries have experienced unusual and harsh inspections or blockages of their products by Chinese custom authorities—for example, in 2008 China found “quality and safety problems” with EU-based food exports following official meetings with the Dalai Lama.⁴

How can we define ‘authoritarian economic coercion’?

As defined in the European Commission's proposed legislation, “economic coercion” refers to a situation in which one country seeks to pressure another into making a particular policy choice by applying—or threatening to apply—measures affecting trade or investment.⁵

Authoritarian economic coercion is more varied and not as clear-cut as military aggression. Still, if we break authoritarian economic coercion down into its components, we are looking at actions undertaken by autocracies, meaning countries ranked “not free” in international rankings such as Freedom House. In practice, China and Russia carry out the bulk of economic coercion against democracies, with China in the lead in terms of sophistication.

In recent decades, China has enacted various elements of economic coercion against governments that welcomed the Dalai Lama, the Tibetan spiritual leader and Nobel laureate, who China perceives to be a “separatist.” In each case, China tried to exact its policy goal—namely, that the leadership of the country in question would refrain from accepting such visits in the future. Fascinatingly, China professes noninterference as a foreign-policy principle but still seeks to affect actions and visits taking place inside democratic countries.

When the private Norwegian Nobel Committee awarded the Nobel Peace Prize to Chinese dissident and writer Liu Xiaobo in 2010, China blocked Norwegian products, such as salmon, from entering its market. China did not reverse the ban until it received a written declaration from the Norwegian government, which it perceived as an apology. In this sense, authoritarian economic coercion is employed not for trade purposes but to ensure a political goal of compliance with the Chinese Communist Party's priorities.

What are the thresholds for action?

In accordance with the definition of economic coercion put forth in the memo, the Economic Article 5 would be invoked when a democratic country is pressured by an authoritarian state to make particular policy choices or concessions. We cannot anticipate every possible scenario, but previous cases of authoritarian economic coercion provide a foundation for identifying triggers. The blocking of exports or imports, as seen in the cases of Australia and Lithuania, is a clear trigger (for more, see “Economic coercion of Lithuania” and “Coercive actions against Australia”). However, other de facto blockages that are less obvious, such as unusual and harsh inspections of specific goods, would also enable the invocation of the Economic Article 5.

The nature of the response would be determined in consultation with the entire alliance of democracies. In line with the EU’s proposal for an anti-coercion instrument, the response should follow a principle of proportionality. Thus, countermeasures should not exceed the level of coercion they seek to end.

This may require the Economic Article 5 to be drafted as a document of political principles and commitments to other democracies and shared economic values, rather than as hard and fast rules that attempt to anticipate each scenario. The key is to establish the principle of collective response, with triggers for action leading to consultation if deterrence is ineffective, akin to NATO’s Article 4 mechanism.

Is such an Economic Article 5 compliant with international law and World Trade Organization rules?

The short answer is yes. In its proposal for an anti-coercion law, the European Commission deems an Economic Article 5 to be consistent with international law.

Nevertheless, in practice, at the World Trade Organization (WTO), authoritarian governments could challenge the use of such an anti-coercion instrument as being at odds with a core tenet of the organization: nonpreferential treatment.

But the WTO is already at a crossroads. Lengthy dispute-settlement proceedings, an absence of interim relief for plaintiffs in WTO cases, and costly resolutions that disregard prior offenses have all contributed to the diminishing role of the WTO in recent decades.⁶ The organization’s failure to include binding countermeasures against economic coercion adds to the weakness of the WTO as cases of targeted economic coercion by authoritarian states continue to emerge.

Nevertheless, the EU’s proposal for an anti-coercion instrument deems it possible to implement countermeasures in compliance with international law. The EU posits that member states “remain responsible for and are able to act in the defence of their rights under international law. This includes their right to counteract international economic coercion. . . .”⁷ The reasoning is rooted in the limited remit of international trade law: using or threatening to use trade measures to pressure democracies on political issues is arguably beyond its scope.⁸ But such coercive trade action violates the independence and sovereignty of states by intervening in domestic political matters. Hence, economic coercion goes beyond trade law and infringes on obligations rooted in general international law. Consequently, the European Commission posits that countermeasures can legitimately be implemented by the injured state individually or in cooperation with other affected parties, which, in the case of the EU, is the entire union.

ECONOMIC COERCION OF LITHUANIA

Lithuania has been exposed to significant economic pressure from China since summer 2021, with Chinese coercive actions reaching unprecedented levels later that fall. On November 18, 2021, Lithuania allowed Taiwan to open a Taiwanese Representative Office in Vilnius, Lithuania. Letting the office represent “Taiwan,” rather than “Chinese Taipei,” was perceived by China as an acknowledgment of Taiwan’s national sovereignty, conflicting with China’s territorial claim to Taiwan. As retaliation, China weaponized its economy to put pressure on Lithuania.

The economic coercion by China has had an impact on Lithuanian exports to China, as well as on Chinese exports to Lithuania. In addition, multinationals from other EU member states continue to be pressured by China to sever ties with Lithuania and exclude inputs from Lithuania in their supply chains.

Lithuania envisaged that coercive actions could be taken by China but had not anticipated such scope and size. Lithuanian exports to China, amounting to 0.7 percent of total exports, were effectively blocked. More damagingly, China also applied export restrictions for goods destined for Lithuania, which made up 3.7 percent of total Lithuanian imports.⁹ The import restriction meant a blocking of goods already paid for by Lithuanian industry, as well as blocked access to raw materials and goods central to the production and upgrading of final goods intended for export to other countries. In addition, Lithuanian companies continue to experience difficulties in switching to alternative

suppliers and getting loans from foreign banks to ease cash shortages, given that any connection to Lithuania risks exclusion from the Chinese market.

Among other initiatives, Lithuania has increased trade and investment with Taiwan. Taiwan has set up both a \$200 million investment fund to boost trade and a \$1 billion credit program for joint projects, as well as importing Lithuanian goods, especially food products.¹⁰ Both the EU and the United States have also offered their support. The United States has signed a \$600 million export credit agreement in support of Lithuania,¹¹ and the European Commission has likewise approved €130 million in financial support, granting companies affected by China’s trade restrictions access to loans of up to €5 million.¹²

Beijing has also pressured large multinationals to exclude Lithuanian components. When Lithuanian components or products exported to China via other countries are included, the share of Lithuanian exports to China increases to 3.2 percent of total exports. Consequently, China’s attempt to direct trade away from Lithuania becomes a threat to the entire EU single market and thousands of jobs. As a result, Lithuanian companies took steps to diversify and found new export markets for their goods, building positive dynamics for future Lithuanian trade outside of China.

In January 2022, the EU initiated a World Trade Organization (WTO) dispute against China, claiming that China’s trade practices are discriminatory and illegal.¹³ G7 members supported the EU on this, demonstrating an embryonic democratic front. But WTO procedures are lengthy, and no settlement has yet been reached.

An Economic Article 5 sounds useful in principle, but would meaningful action prove difficult given that democracies have varying interests, including on economic issues?

Action could prove difficult, but the alternative is worse. This is what happens when autocracies use economic coercion and democracies negotiate on their own. With both China and Russia, it makes the response weaker, and for smaller countries and individual businesses, the response can often end up being compliance with the autocratic demands.

Is there enough solidarity among democracies to stand up economically for each other?

Such solidarity does not currently exist, but we expect it to emerge as countries increasingly embrace the need to protect fundamental freedoms. So far, an Article 5 approach has not been applied by democracies jointly, with solidarity confined to statements of support. It must be acknowledged that democracies are not just partners but also economic competitors; thus, it cannot be taken as given that countries will be willing to incur economic costs on behalf of one another, especially when there is a potential economic gain from taking over trade lines from the injured state. However, if we compare this with sanctions policy, some of the same concerns define a country's willingness to agree to a mutual retaliatory reply. If one country suffers from authoritarian economic coercion, another may ask how much it will also hurt their country and its companies. Such a scenario plays out inside the European Union and its 27 member states when sanctions are negotiated. Russia's war in Ukraine shows both the impact that sanctions can have and their limits, as seen in the debate on imposing sanctions on Russian oil and gas. On the positive side, autocratic Russia's war against Ukraine has made governments, businesses, and voters in democracies painfully aware that fundamental freedoms need to be protected. In business, there seems to be a focus on defending values as a new bottom line.

Does an Economic Article 5 accelerate global decoupling?

We are already witnessing signs of decoupling and bifurcation: China's persistent economic coercion and Russia's war on Ukraine are key accelerators of this. Therefore, the real question is how to keep trade open among democracies. We propose an alliance of democracies with the Economic Article 5 as a step toward a democratic common market. It is possible that this mechanism will further accelerate an inevitable economic decoupling from China and Russia—the countries that have abused the open, rules-based trading system and undermined global free trade from within.

However, this decoupling risk can be managed by confining the Economic Article 5 to a response to coercion, not a vehicle for economic protectionism. Further collective effort can be focused on critical sectors such as raw materials. Diversification of supply lines is another method to maintain a global trading system while lessening monopolies in autocracies, including those on raw materials.

The proposal for an Economic Article 5 does not permanently close the door for trade with states that currently pose a threat to the free-market order. A future recoupling is possible and desired—to the extent that trade principles of states such as China adhere to free-market principles.

What about democratic countries that do not want to join or that fence-sit?

Concerns may be raised as to whether democracies such as Brazil, India, Indonesia, and South Africa will want to be associated with an Economic Article 5. If those countries' reactions to Russia's invasion of Ukraine—that is, mostly seeking positions of nonalignment and not forcefully condemning the action—are any indication, the outcome looks somber. Therefore, attention must be given to enticing such fence-sitting democracies.

The answer could be in the economic attractiveness of joining the democratic camp's response, including potential for greater trade access. Countries that join an alliance of democracies and sign on to the associated Economic Article 5 should get access to exclusive trade benefits, including a move toward a democratic common market and preferential treatment. This is key to winning over many countries that fence-sit between democracies and autocracies.

What are the implications for investments?

Private investors are occupied with certainty and returns. Potential retaliatory steps inherent in the Economic Article 5 could deter private investors in democracies from investing in autocracies. Decoupling may also accelerate as a result. However, decoupling by commercial interests is arguably already an ongoing process. Russia's invasion of Ukraine has emphasized the need for a diversified supply chain, and we see corporate diversification from China as companies realize that being overreliant on the Chinese market is not tenable. Therefore, firms are coming to terms with political values as part of a new bottom line.

As noted, focusing a democratic common market on critical sectors and strategic diversification may prevent complete private-sector decoupling. Through such a vehicle, investor confidence may be preserved because of the direct benefit of an alternative source of supply and the indirect benefit of constraining monopoly behavior by the incumbent supplier. Consequently, done correctly, this may be a way to avoid complete divestment.

How would the Economic Article 5 cover private business?

Generally, democracies favor free trade and private enterprise—in contrast to autocracies, where the state and business are enmeshed either in legal practice, as with China's state-owned enterprises, or de facto, as with Putin's oligarchic system in Russia.

Recent expansions of China's geo-economic tool kit underline the centrality of an Economic Article 5 for private business operations. The 2020 Export Control Law passed in China's National People's Congress expands the mechanisms available to set terms on foreign commercial transactions both inside and outside China.¹⁴ The law is legitimized based on concerns for national security and national interest. This ultimately affects firms, joint ventures, and other partnerships. Likewise, in January 2021, China increased its legal framework for controlling investment-related transactions. This grants the government the authority to review, block, and mitigate foreign investments, making the scope of its authority over investments even more pervasive.

Authoritarian economic coercion has often been applied to companies based in democracies. It constitutes a new front line. For example, the Chinese government exerted pressure on the hotel chain Marriott following the chain's publication of a questionnaire listing Taiwan as a separate entity; Daimler was pressured to apologize for a social-media post containing a quote from the Dalai Lama; and the National Basketball Association in the United States was subjected to coercive practices because of a manager's support for Hong Kong's democracy movement. Because of the continued allure of the vast Chinese market, the easiest solution for many businesses has been to acquiesce to the coercion.

The Economic Article 5 should offer some assistance to companies in such situations. It could include joint credit lines, for example, or assistance in the diversification of supply lines. Further, there could be a disclosure requirement for firms pressured by Chinese trade measures and firms that oppositely receive benefits and preferences.¹⁵ Increased oversight of firms subject to authoritarian trade measures is a tool that could help direct efforts to counter economic coercion and provide company-level support.

Shouldn't we just stop trading with authoritarian powers so we wouldn't need an Economic Article 5?

In theory, that would be an easy solution to authoritarian economic coercion. In practice, however, both Russia (to a smaller degree now, following the sanctions and private-sector withdrawal due to the war in Ukraine) and China (to a much larger degree) are intertwined in the global economy, making trade cessation more difficult.

But the Economic Article 5 should lead to broader cooperation among democracies, including on trade. It could be the point of departure for a democratic common market among members and for collaborative work to build the resilience of supply chains. That would also lessen the impact of authoritarian economic coercion.

For democracies in the developing world, joining an Economic Article 5 could be seen even more favorably if it included unique economic opportunities. That is why preferential free trade among participating countries should be a component of such a system. This would both promote free trade among democracies and signal to China and Russia that undermining free trade from within the global trading system does not pay off.

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COERCIVE ACTIONS AGAINST AUSTRALIA

In recent decades, Australia and China have benefited from strong trade links and prolonged economic growth. But the relationship between the two countries has soured in recent years, with Australia critiquing China on issues from human rights abuses to the latter's changing behavior in the South China Sea. Then, in April 2020, Australia called for an inquiry to determine the origins of the COVID-19 pandemic. Following the raising of this concern, China has taken measures against a range of Australian products since May 2020, including an imposition of tariffs on barley, beef, coal, copper, wine, and other goods.

In response to these actions, Australia has initiated two World Trade Organization (WTO) dispute settlement proceedings regarding China's trade measures on barley and wine, still in litigation. The Australian government's response also included domestic efforts such as the creation of the Agri-Business Expansion Initiative, meant to help the agricultural economy diversify its export markets.¹⁶ This fund committed A\$85.9 million and was a direct result of the difficulty that Australian exporters have experienced since mid-2020 in shipping goods to China, Australia's largest agricultural export market. Finally, Australia has been active in opening alternative markets for its producers; bilateral trade agreements are currently being negotiated with the EU and India and have concluded with the United Kingdom.

Surprisingly, Australia's economic damage seems to have been halted by the ability of companies to find alternative export markets for their goods. Even though China represented 37 percent of Australian exports as of 2020, Australian companies have been able to find alternative trading partners. Take the example of coal: from 2018 to early 2020, total coal exports to China remained between roughly US\$2 billion and US\$3 billion but dropped almost to zero after restrictions were implemented.¹⁷ However, this was offset by early 2021 by a near doubling of coal exports to India, Japan, South Korea, and other countries, with the total value of Australian coal exports growing overall.

However, certain sectors (such as wine exports) have not fully recovered, while others (iron ore) remain vital to the Chinese economy because of unreliable alternative sourcing options for China.

How would an Economic Article 5 have helped in cases of economic coercion?

What if there had been an Economic Article 5 among democracies? How would it have helped Australia and Lithuania?

An Economic Article 5 could have helped both countries on three levels.

Initially, as a deterrent, the instrument may have successfully prevented China's coercive trade actions against Lithuania and Australia because of the potential for retaliatory countermeasures by a concerted grouping of democracies. Second, the Economic Article 5 would have ensured the option of joint retaliatory trade measures, prompting a much faster reply than going through WTO procedures, which in any case fail to cover the broader coercive elements of such actions. Third, assurance of credit lines and swift diversification of trade could have supported Australia and Lithuania in locating new markets, softening economic losses. In the longer term, the Economic Article 5 would have helped both countries find alternatives in a democratic common market.

Here is how this could play out: when China launches a pressure campaign against a state, the state would turn to the alliance of democracies to invoke the Economic Article 5. All alliance members would agree to support the injured state and condemn the actions of China. If China continued its coercive actions, all members would agree to strict countermeasures to be implemented immediately. China would respond by escalating its rhetoric and threatening to take coercive measures against all alliance members. However, faced with the prospect of serious economic harm, Beijing would withdraw its trade bans and gradually deescalate its threats. Thus, the Economic Article 5 would ensure a joint response and retaliatory trade measures, prompting China to cease economic coercion more quickly than through a WTO dispute settlement process.

Further, the unity of democracies standing up for the injured state would constrain the initial scope of the coercive actions. China would refrain from blacklisting the state's components in supply lines of its trading partners due to the profound counter-sanctions that such demands against multiple members of the alliance would entail. In addition to countermeasures, the Economic Article 5 would ensure that injured states have access to credit lines and swift diversification of trade. Therefore, the injured state would look to the alliance for alternative markets for its goods previously exported to China without the need for bilateral trade negotiations. As such, strong inter-alliance market support would soften the economic loss that the state would incur while subject to coercion, a loss that the WTO cannot relieve while dispute settlement proceedings are ongoing. ■

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Amalie Salomon Jankjær, Junior Analyst, Alliance of Democracies Foundation

Alexander Hitch, Research Associate, Chicago Council on Global Affairs

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Chicago Council on Global Affairs
Two Prudential Plaza
180 North Stetson Avenue
Suite 1400
Chicago, Illinois 60601



Alliance of Democracies

The Alliance of Democracies Foundation
Bredgade 71
1260 Copenhagen
Denmark