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64
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The European Economic Strategy after the EU and US Elections

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This document summarises the main discussions at the seminar "The European Economic Strategy after the EU and US Elections", *held on March 24, 2025, at CIDOB headquarters with academics and experts from the public and private sectors. This seminar aimed to analyse where the EU stands in the global strategic competition and the role it can play in geo-economic terms. With a forward-looking perspective, it examined the main challenges and steps forward in the EU's Economic Security Strategy. The event was part of CIDOB's Foreign Policy Dialogues, a programme organised with the support of the Ministry of Foreign Affairs, European Union and Cooperation.*

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Politics now drives the international economy. Interest in geopolitics and geo-economics is growing as national security considerations replace the consensus on free markets and globalisation. In 2023, nearly 3,000 trade restricting measures were put in place, almost triple the number in 2019, and the world today faces increasing protectionism, sanctions and economic warfare driven by the new US administration. De-globalisation isn't inherently negative – globalisation had its costs – and it aims to mitigate excessive dependencies. But it will be disruptive and challenging, particularly for the EU.

The EU combined the economy and politics in June 2023 with the launch of its economic security strategy. The aim is to maintain multilateral collaboration while ensuring autonomous action when necessary. In the aftermath of the pandemic and the Russian invasion of Ukraine, traditional alliances such as the Euro-Atlantic partnership are under scrutiny, compelling the EU to reassess its strategic dependencies, energy security and position within global value chains. In an environment of global rivalry and strategic competition, the challenge the EU's economic strategy faces is threefold: to enhance its competitiveness, to de-risk from China and to respond to the US assault on the international order. The EU needs an economic model that accommodates technological changes, addresses security risks and supports multilateralism. This includes boosting competitiveness, fortifying the industrial base in semiconductors, biotechnology, clean air, energy and supply chains, and forming strategic alliances while enhancing economic and trade diplomacy.

The EU's competitiveness challenge

There is a consensus in the EU on the need to increase productivity growth in the face of adverse demographics and a widening gap with the US. The Draghi report, the Letta report and several EU and think tank memos coincide in recommending *(i)* a reduction in and reform of regulation; *(ii)* single market reforms including services, labour mobility, capital markets and banking union; *(iii)* higher public investment for the green and digital transitions, cross-border infrastructure and grids; *(iv)* greater exploitation of EU-level efficiency gains as a result of enhanced coordination of investment and policies, and an EU budget focused on European public goods, for instance, on defence or the energy transition; *(v)* a greater role for EU-level industrial and innovation policy; and *(vi)* the reform of EU decision-making to improve speed and efficiency by reducing the veto power of individual member states.

This agenda is not new except for the focus on industrial policy, which has come to the fore due to strategic competition among the US, China and the EU. However, there is no agreement on using industrial policy due to its trade implications. Draghi, for example, proposes significant state subsidies to decarbonise energy-intensive industries, aiming to keep them in Europe. The challenge lies in the fact that these subsidies often protect existing incumbents and can be biased, promoting "clean tech" according to a predefined list. This strategy involves picking winning companies and technologies rather than adopting a technologically neutral approach to subsidies. Alternatively, the EU could adopt a "mission-oriented" approach, providing discretionary but accountable subsidies at the EU level. However, due to resource constraints, the European Commission (EC) has endorsed Draghi's vision "on a shoestring". It advocates coordination, a new state aid framework and financial incentives to foster national investments, though this stance may challenge the integrity of the EU's level playing field.

Secondly, most industrial policies are discriminatory in nature, involving some sort of state aid, and as such, countries typically cannot implement them without coming into conflict with EU competition laws or World Trade Organization (WTO) regulations. According to WTO rules, developing countries can adopt certain policies to protect fledging industries, but developed countries cannot. The EU has two options. On the one hand, it may follow Draghi's recommendations, as those advocating for establishing local content requirements place trade policy at the service of industrial policy and contradict international norms. Alternatively, the EU could adhere to rules-based trade, which benefits Europe economically and politically, particularly in the eyes of the Global South. Playing by the rules could offer a significant strategic opportunity, as 80% of the population resides in the Global South.

Finally, governments remain accountable to their populations, particularly on fiscal and defence issues, which affects the EC's coordination efforts. It limits delegation, coordination, harmonisation, fiscal sharing and other strategies aimed at optimising EU competitiveness. But coordination between countries and regions will be essential to leverage economies of scale and address capital market fragmentation. Ideally, industrial policies should be allocated according to regional production capacities and comparative advantages. This approach would involve selecting specific sectors such as hydrogen, electric vehicles (EVs) and semiconductors for particular regions in order to optimise European resilience, though it may impact sovereignty.

The China challenge

When Xi Jinping came to power in 2013, he made national security central to the Communist Party of China's reform agenda. China's concept of national security is very broad, covering areas such as trade, financial risk, cybersecurity and demographics. The country has an unparalleled capacity to mobilise resources, using state-owned companies (SOEs) and controls on capital and foreign direct investment (FDI) while prioritising security over growth, without the need for public consent. An example of this mobilisation capacity is the shift of 30m jobs to new high-tech sectors. On the other hand, China has been accused of economic coercion, cyberattacks, technology and security breaches, and weakening supply chain resilience.

The scope and opacity of this change have prompted responses from the EU and the US. In the EU, initiatives like the European Chips Act, Green Industry Act, Critical Raw Materials Act, the Global Gateway and the revival of trade talks could be interpreted as a reaction to China's policies and success. Since 2019, the EU has defined China as a partner, competitor and systemic rival, noting both opportunities and risks. Since 2023, the EU's main goal has been to build economic security through de-risking. China's support for Russia hardened Europe's stance. In the context of digital competition, the EU introduced tariffs on Chinese EVs to balance restriction and openness. The EU was focusing on increasing the level playing field within the single market, with the EC reactivating old tools like anti-dumping measures while keeping its market accessible. This strategy differed from the approach taken by the US, focused on forcing companies to choose between markets and luring Chinese investments.

Yet China not only presents risks; it also presents opportunities and satisfies necessities. China is at the technological forefront in green industry, in some areas of digital tech and close to the forefront in biotech. Collaboration, therefore, is desirable. Rather than decoupling from China, it may be more effective to identify and prioritise risks. Despite structural challenges, engaging with China could help the EU to address the US challenge. Following Donald Trump's re-election, the EU has moved towards a more functional rather than confrontational relationship with China. Trump's re-election has been viewed positively by part of the Chinese elite. Europeans are concerned about a potential agreement between the US and China that may exclude the EU. This occurred in 2020 with the signing of phase one of the US-China trade agreement, prompting

> "The EU's new approach to industrial policy contradicts international trade rules and erodes the EU's position in the eyes of the Global South"

a few months later a comprehensive agreement on investment (CAI) between the European Commission and China, which had been in the pipeline for seven years. However, this agreement was not ratified by the European Parliament in 2021 due to Chinese countersanctions to EU human rights sanctions.

Despite stagnating consumption in China, Xi Jinping is now less inclined to compromise with the EU. Prioritising economic security over growth, China has diversified trade with the Global South and invested in innovation and green technologies, resulting in industrial overcapacity and an export boom. In this context, China's has toughened its response to the EU, including implementing export controls on critical minerals.

For its part, the EC has been quick to show its readiness to leverage the EU internal market by proposing conditionality in public procurements and state aid within its Clean Industry Plan, as well as local content requirements in the automotive action plan. Coordination at the EU level is necessary since FDI screening is managed at the national level, and China has shifted from brownfield investment to greenfield investment. Ideally, the EU will aim to secure technological transfers, facilitate European investment access in China and establish a political agreement to prevent the weaponisation of critical mineral supply chains, reciprocally allowing access to European markets.

There is still a short window of opportunity as the Chinese still need access to the EU single market, but rapprochement between the EU and China faces challenges. The Chinese commerce minister has instructed companies not to transfer technology, and EU member states have mixed views on China. The EU remains stuck, diplomatically speaking, with reciprocal sanctions blocking investment deals, and China's cooperation may decrease in the future as a potential US-China deal could favour US interests over European ones.

The US challenge

Trump's return to the US presidency has had a negative impact on the EU with tariff wars, pressure to increase defence spending, withdrawal from international commitments like the Paris Agreement, pressure to relax regulation including ESG and a favouring of Xi and Putin's view of the global order as spheres of influence. However, it also has its upsides like a regulatory reform race instead of a subsidies race, which isn't zero-sum. Europe's fiscal policy has become expansionary, and increased defence spending can boost growth and R&D (the multiplier effect is around 0.6). In this context, Europe has a strategic opportunity to be the world's only remaining economic superpower that is willing to play by rules.

On the subject of trade war, countries respond differently because they have different trade structures and dependencies (not just economic ones) in relation to the US. This explains why Mexico and Latin American countries are more willing to accept economic coercion and why the EU, more intertwined with the US than China, will struggle to retaliate. The European Union has a trade surplus in goods and a trade deficit in services with respect to the United States. Overall, the EU's total surplus amounts to 90bn euros, representing just 6% of their trade. However, the new US administration only looks at the trade balance in goods and has imposed blanket tariffs on the EU and the rest of the world. Given this, how should the EU respond to the US challenge?

> "There is still a short window of opportunity for rapprochement between China and the UE, as the Chinese still need access to the EU single market".

One option would be to take no action, in a similar manner to the appeasement strategy employed by the United Kingdom. Another option involves retaliation, ideally focusing on *(i)* goods that are easily replaceable; *(ii)* products for which the US does not have a dominant global production position (for instance, insulin); *(iii)* final goods rather than intermediates to avoid negatively impacting one's own economy; and *(iv)* goods produced in politically sensitive constituencies in the US where tariffs may be recognised as harmful by voters. Additionally, efforts should be made to reduce economic dependencies on the US and improve overall economic security. An obvious candidate for retaliatory tariffs would be US services, but it has drawbacks. Intellectual property, R&D and consulting services are key imports for the EU; they are also intermediate products and taxing them would harm the EU economy.

Alternatively, the EU could increase investment in research and development in services to reduce dependency and catch up with the US technologically and economically. The EU's current focus on manufacturing, including substantial investments in mid-level technologies and specific targets for manufacturing output, should shift towards fostering high-tech services. It is crucial for the EU to avoid an obsessive pursuit of matching the US in every aspect, as this would be too costly and potentially unfeasible. Investment should aim not at replicating existing technologies (e.g. cloud computing) but rather at pioneering the next generation of advancements that will supersede them.

The US challenge brings new dilemmas to the European economic security strategy presented in 2023. In that strategy, the EU recognised it cannot achieve economic security on its own and made the G7 (like-minded partners) the cornerstone of its economic security. The first dilemma is whether to de-risk or not to de-risk from the US, since it is very costly and there is no time as the tariffs are already upon us. It will be difficult to diversify away from the US in the short term, except in very specific areas, but companies will move to new markets and de-risking will happen eventually if tariffs and uncertainty remain in place. The second dilemma is how to make economic security affordable. Economic security has a military and national security component that involves investing more in defence and technology to reduce EU dependency on the US, but this comes at a high cost.

The third dilemma is whether the EU should speed up de-risking from third countries, particularly for semiconductors. The European Chips Act aims to double production capacity to 20% of the global market by 2030. However, European central planning faces challenges as companies like Intel are moving away from manufacturing in the EU, potentially leaving the continent with a 13% share. In the event of a Taiwan Strait crisis, could the EU rely on the US for semiconductors? Possible strategies include providing more incentives and subsidies for FDI, adopting Japan's approach to focus on new semiconductor generations, or stockpiling like China.

The fourth dilemma concerns the scope of economic security. The EU has decided to narrow its definition by excluding the financial system. However, the US is opposing ESG regulation and may potentially use the payment system as a tool for coercion. The US is also advocating for cryptocurrencies to be more broadly accepted in the EU, despite the financial risks involved. Finally, the fifth dilemma concerns how suboptimal policies affect productivity and growth. Expanding economic security raises costs, so it could be more beneficial to de-risk only from more specific and likely threats such as pandemics, a conflict with Russia or a Taiwan Strait crisis.

Envisioning disruptive scenarios

Trade wars can lead to economic conflicts involving financial and monetary aspects. Preparing for disruptive scenarios is challenging, as impacts would vary significantly according to the situation, but it is possible to envisage the United States using its financial influence in its economic strategies. For example, the US may impose secondary sanctions and utilise its control over international payments. It could also withdraw from the IMF and impact the global financial system, although it is generally believed that such action might lead to a financial crisis, capital controls and a weakening of the international standing of the US dollar. The economic and financial implications also illustrate why the proposal from Stephen Miran, chair of the Council of Economic Advisers to the White House, known as the Mar-a-Lago accord, will not be presented. Miran has advocated for all countries except the US appreciating their currencies to improve US export competitiveness and converting their holdings of US Treasuries into 100-year bonds. But this proposal will be rejected as it could lead to forced restructurings and bankruptcies.

This US administration wants to enjoy the "the exorbitant privilege" of having a global reserve currency without paying any costs. The US trade deficit stems from overconsumption funded through international financial flows. Addressing this issue would require tight fiscal policies, which no US government appears willing to implement. What is not unlikely at all is a real crash in the dollar. There is a possibility of a significant decline in the value of the dollar. The independence of the Fed has been repeatedly questioned, and if there is a loss of confidence in the currency, investors may choose to divest from it. It is notable how Japan, South Korea and China have been quietly selling US bonds.

"US tariffs and the assault on the international order defies the European economic security strategy, which is based on cooperation with the G7 and like-minded partners".