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A European path to higher economic growth

By Sander Tordoir, Aslak Berg, Elisabetta Cornago and Zach Meyers



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The European economy grew at around 2 to 3 per cent a year throughout the 1990s and early 2000s. But growth has never fully recovered from the 2008 financial crisis. While Europe continues to rank highly on broader measures of wellbeing, its meagre growth has fallen well behind that of the US. Europe also faces considerable economic headwinds. China is ramping up exports of goods such as cars and machinery, threatening a pillar of the European economy. Europe also lags behind China and the US in technology creation and diffusion, just as a potential artificial intelligence (AI) revolution might unlock new productivity gains. European policy-makers are making trade conditional on other policy aims, like combatting climate change, trying to make supply chains in important goods less dependent on China, while Donald Trump is forcing the EU into a trade war. These perils could further undermine European economic growth.

In November 2024, at its annual Ditchley economics conference, the CER gathered leading politicians, officials, academics, journalists and thinkers to discuss the causes of Europe's slow economic growth and what the continent should do about them. These are the main conclusions:

- ★ Domestic demand as a share of GDP in the EU declined sharply after the 2008 sovereign debt crisis and has not recovered since. As a result, the EU's economy has grown reliant on external demand - a structural vulnerability in an era of resurgent protectionism, especially as the US and China are less open to EU imports.
- ★ China has recently engineered the largest shift in net exports in recent history, squeezing European industry. Growth in US demand has provided a key offset for European exports but President Trump is sceptical of trade and is signalling the US is not as open to European imports as it used to be.
- ★ If Europe cannot generate domestic demand, it cannot grow its economy. Stoking domestic demand can also yield productivity gains, as shown by the US, which has run large budget deficits to create a high-demand, high-pressure economy. Faster-growing economies with markets with no slack in resource allocation, translating into low unemployment, encourage investment that helps the economy adapt to new technologies such as artificial intelligence. Ample demand also maximises the use of human capital, which is particularly important for a continent with a shrinking workforce.
- ★ But a 'hot' economy is no panacea: it creates risks of higher inflation - a key reason why Trump defeated Harris. Furthermore, many European countries already lack the budget space to boost demand. Running the European economy at the speed limit - neither so slow as to waste potential, nor so fast as to create inflation - thus remains the elusive ideal.
- ★ Voters are more sensitive to price increases than to more intangible boons like productivity growth, so politicians might aim for a low-volatility, low-growth environment. Similarly, politicians tend to pursue structural reforms only during economic slumps when there is maximum pressure to do so, even though capital and labour redeploy more swiftly when markets are liberalised in periods of high demand.
- ★ Domestic demand cannot fully replace exports as a growth driver in the EU, given the significant fiscal adjustment required by the EU's fiscal rules by 2031, influenced by rising pension and care costs.

- ★ To dial down transatlantic tensions, the EU has a few offers it could make to the Trump administration, which cares about bilateral trade balances. It could buy more US liquefied natural gas and military kit and reduce its €60 billion trade surplus in pharmaceuticals with the US by cracking down on the offshore profits of US pharmaceutical companies. At the same time, to stand up to Washington's bullying, the EU could (threaten to) retaliate against US services exports to Europe.
- ★ Europe needs to be clear-eyed that it remains very dependent on imported inputs – ranging from digital services to foundational AI models, from cloud infrastructure to critical raw materials. The bloc suffers from slow adoption of digital technologies, fragmented regulation, and underinvestment in R&D – especially in comparison to the US, where larger firms, deeper capital markets, and more risk-tolerant investors support faster diffusion and innovation.
- ★ To close the gap, the EU needs a more integrated tech strategy that prioritises cloud infrastructure and AI alike; reforms capital markets to unlock private investment; and addresses structural barriers that limit firm size, and regulatory overreach that stifles innovation. Even then, the EU is now far behind in many 'winner-takes-all' markets and can probably only carve out a few niches where it can lead globally.
- ★ Where the EU does have a lead over the US is in clean technologies, because it has taxed pollution and provided support for greening economies. The EU's clean tech industry, however, is under pressure from China's state-led competition. Political pushback and a lack of affordable green alternatives for households and firms may constrain the expansion of the EU's carbon pricing schemes to other sectors of the economy.
- ★ To respond, the EU could adopt sector-specific support for clean tech – prioritising areas of strategic importance or potential technological leadership – paired with greater EU-level funding, better coordination, and a shift toward a more risk-tolerant, portfolio-based approach to industrial investment.
- ★ Finally, Europe's open economy, and fragmentation of economic security tools across member-states, makes it more vulnerable than the US or China to economic coercion. Economists mostly agree that economic security is at odds with efficiency and could harm European economic growth. Focusing on diversification of supply, rather than self-sufficiency, would help minimise conflicts between the two aims.
- ★ Over time, there is a chance the EU and US could join forces to counteract China's overcapacities – for example, to diversify production of critical pharmaceutical ingredients and their chemical precursors where China is currently the sole supplier. But for the time being, any such co-ordination faces dim prospects, given the rupture in the transatlantic alliance.

In November 2024, the CER held its annual economics conference at Ditchley Park on how Europe could reclaim some economic dynamism in a fraught geopolitical environment. The conference, organised with the support of the EU Delegation to the UK and the Observatory Group, has a unique role in European economic policy discussions. The CER brings together 40-45 politicians, officials, academics, journalists and think-tankers working on economic policy issues – all of whom are listed at the end of this report.

The debate was organised around five central questions. These included inquiries into whether a high-demand economy can drive productivity growth; whether Europe is too reliant on external demand in an era of protectionism; whether Europe will miss the next AI-led technological

revolution; how to devise a better EU industrial policy; and ways in which Europe might reconcile economic security with growth. This paper reflects the main takeaways from each of these debates and draws key lessons for Europe's policies.

Session 1: Can a 'hot' economy drive productivity growth?

The US post-pandemic recovery in GDP has left Europe in the dust (at least until the recent Trump-induced trade turmoil). Output per hour worked has also increased more quickly in the US than in Europe. What explains the gap in economic growth and, more worryingly, productivity? The European economy, which relies on imported energy, was heavily burdened by Russia's war in Ukraine. But energy prices have by and large normalised, while the European economy continues to languish. The monetary policies of the Federal Reserve and the European Central Bank have been remarkably similar. But the US has run larger budget deficits than the EU and provided post-Covid stimulus support, largely in the form of (more liquid) cash transfers instead of the furlough schemes and long-term investment and reforms used in Europe. It has also raised green subsidies more than European countries. In future recessions, should European countries continue to seek to keep workers attached to firms through bigger automatic stabilisers or should it encourage workers to switch jobs by prioritising income support? Does running a 'hot' economy facilitate reallocation from less to more productive sectors? If it does, should the EU raise the ECB inflation target to, say, 3 per cent, and allow governments to run large budget deficits even if growth is slow? Would a permanent EU recovery fund that keeps investment spending structurally higher provide a better answer? Or should the EU speculate that the US' fiscal sugar high will wear off eventually, and the European economy will catch up on its own?

Testing the speed limit of the European economy

European economic growth has fallen behind that of the US and so has productivity. In the wake of the pandemic, the US implemented a much greater fiscal stimulus than Europe, which helped propel the US economy. One question looming over Europe is whether it can catch up and induce innovation by creating a similar high-pressure, high-demand – or 'hot' – economy.

The European economy, which in some countries has repeatedly suffered from high unemployment coupled with underinvestment, has stayed 'below the speed limit' for many years, even if unemployment is now generally low. This leaves policymakers, especially in the low-deficit and low-debt countries of the Union, with ample fiscal space to respond to crises. But Europe may have wasted opportunities for growth and hindered its ability to increase its potential speed limit in the long run. For example, persistent unemployment undermines firms' incentives to invest in labour productivity. Some experts, however, disagree and think structural factors such as regulation, aging and fragmented capital markets are the cause of the EU's low potential growth limit, not a lack of demand pull.

Participants also discussed the wider dangers of running above the speed limit, such as overheating the economy in an already inflationary environment or crowding out private investment due to fiscal largesse. The US may be an example of the risks of excess stimulus stoking inflation. Inflation harmed the Biden administration's popularity and facilitated the re-election of Donald Trump. Others pointed to the fact that inflation levels after the pandemic have been largely similar across the developed world. The pandemic supply chain disruptions and the 2022-2023 surge in global energy prices may have driven the bulk of the price increases on both sides of the Atlantic, calling into question whether the

US had in fact surpassed the potential of its economy with large fiscal injections.

Running the European economy at the speed limit remains the elusive ideal: neither so slow as to waste potential, nor so fast as to create inflation. Faster-growing economies encourage investment, helping the economy adapt to new technologies such as artificial intelligence. Ample demand for labour also maximises the use of human capital, which is particularly important for a continent in demographic decline and needing to maximise the potential of a shrinking workforce. Increased demand for investment and labour also helps to increase the supply of both – an example of this is the US labour market, where increased demand expanded the size of the workforce, either by luring the inactive population into work or through higher immigration rates.

The political economy of high-demand economies

There was also a rich debate on the political economy of hot versus cold economies. Employers have more bargaining power over employees when there is slack in the labour market. Likewise, given voter sensitivity to tangible price increases over more intangible boons like productivity growth, politicians might prefer a low-volatility environment with low inflation instead of pursuing a high-pressure economy with strong demand growth and (a bit) more (risk of) inflation.

It is unclear whether running the economy at the speed limit facilitates structural reform or not. On one hand, if the economy is growing faster, there is more government revenue available to pay for the adjustment costs from structural reforms. For example, governments could smooth the short-term pain that voters suffer as a result of reforms that make pension systems more sustainable in the long term. Capital and labour also redeploy much more easily

and quickly when market liberalisations are undertaken in periods of high demand, rather than when they are sitting idle. But structural reforms always create political resistance: governments are unlikely to pursue them unless circumstances require it – in other words, during slumps, when reforms are less quick to pay dividends.

Looking ahead, Europe should tread carefully: fiscal space in many European economies is in any case limited and smaller than in the US, which enjoys structurally higher demand

for its debt thanks to the central role of the US dollar in the global financial system – although President Trump's erratic policies are recently triggering market jitters and the US' exorbitant privilege may be waning. Europe could instead rely on a combination of targeted fiscal measures and a more growth-friendly monetary policy, for example lifting the ECB's inflation target marginally. But opinions diverge on whether a policy mix with higher reliance on monetary policy can be as effective as using fiscal policy to accelerate growth-enhancing public investments.

Session 2: Is Europe too reliant on external demand in an age of protectionism?

The EU economy is exposed to the turn against free trade by key trading partners. The share of extra-EU foreign trade currently stands at around 40 per cent of GDP, more than that of the US. In recent years, US consumer demand has been a prime driver of global economic growth, while European demand has stagnated – which has resulted in the EU running large trade surpluses. Unlike in the US, much European economic discussion has focused on 'competitiveness' instead of driving economic growth through boosting domestic demand. European macroeconomic policy has also tended to be tighter than in the US. With China continuing to suppress domestic consumption and the US becoming less willing to import European goods, can Europe find new export markets? Or should European countries forget competitiveness and embrace increased domestic consumption and investment, and, if so, how?

Global demand will not save Europe this time

The EU is a trade-oriented economy, with extra-EU trade accounting for around 40 per cent of its GDP. The bloc also exports more than it imports, and runs a persistent trade surplus, indicating a structural reliance on external demand. That reliance has now become a profound vulnerability: protectionism is resurgent across the globe, and the US and China are becoming less open to European imports.

China's exports are growing at an annual rate of 12 per cent, while imports are increasing by just 2 per cent – the past few quarters have marked the largest increase in net exports in recent history. At the same time, its investment rate is declining as the property bubble deflates. The IMF has been recommending that China embarks on a significant fiscal consolidation, which would further weaken domestic demand. Growth in the US has provided a key outlet for European exports. But President Trump is sceptical of trade and is signalling the US is not as open to European imports as it used to be. Instead, the Trump administration is now imposing sweeping tariffs, limiting global exports to the US – a market that has long served as a key source of final demand. The rest of the world, from India to Saudi Arabia, is unlikely to provide large enough alternative sources of demand.

Germany, the EU's biggest export-led economy, is the canary in the coal mine. Warnings about the decline of German industry have surfaced before – during the 1970s oil crisis and after the early 2000s dotcom bubble burst – but the current challenges are more acute due to high energy prices and intensifying competition from China. Industrial production has been falling since 2018, and Germany's export engine has lost momentum, with exports shrinking

relative to global output. Crucially, exports also no longer translate into stronger domestic investment.

Europe's quest to increase domestic demand

In this environment, if Europe cannot generate domestic demand, it cannot grow its economy. Domestic demand as a share of GDP in the EU declined sharply after the 2008 sovereign debt crisis and has not recovered since. Within the euro area, Germany's domestic demand ratio was higher than France's in the early 1970s, but the positions reversed over time. The divergence stems primarily from different fiscal approaches: Germany pursued sustained fiscal austerity, while France maintained a more stimulative budget policy.

Europe could generate some additional domestic demand, especially as Germany loosens its fiscal straitjacket. The necessary outlays are relatively clear too, in broad strokes. Europe has a strategic opportunity to rebuild its defence capital stock, modernise railways, power grids and other public infrastructure, and expand renewable energy capacity. Mobilising the continent's considerable private savings to deepen its capital stock would also provide a much-needed boost to demand and investment at a time of structural economic challenges. Overall, the EU's reliance on exports reflects an imbalance between savings and investment, not a lack of competitiveness, and creates a strategic vulnerability in a world where dependencies can be weaponised.

But embracing Draghi's plan to save the European economy – by bringing those savings 'home' – is easier said than done. Domestic demand cannot fully replace exports as a growth driver in the EU. To contain public debt, the EU fiscal rules require most European countries to either tax more or spend

less by 2031 to offset the rising costs of long-term care and pensions associated with ageing populations. Sustained low interest rates can support investment, but only if fiscal tightening does not negate monetary easing. The EU also depends on trade due to its lack of critical natural resources and energy. There are concerns that it may be self-defeating for Europe if industrial strategy takes precedence over trade policy. The situation for the resource-rich US is different.

In terms of trade strategy, the EU has a few offers it could make to the Trump administration, which cares about bilateral trade balances. It could buy more US liquefied natural gas and military kit, provided that the bloc is not concerned about increasing its dependency on the US for its defence. The EU also runs a €60 billion trade surplus in pharmaceuticals with the US – an amount roughly equivalent to the offshore profits of US pharmaceutical

companies. These tax practices and the way US pharma multinationals use them artificially inflates the EU's trade balance with the US – a distortion Ireland and the EU could in principle address. But Brussels should also stand up to American bullying. Europe could for example focus its leverage on taxing the profits of US companies operating in Europe rather than on goods trade, where it faces disadvantages given its dependence on the deep American consumer market.

Both the EU and the US are worried about China squeezing their manufacturing capacity by exporting its own overproduction. So over time, there is a chance Brussels and Washington could join forces to counteract China's export-led growth model. Any such coordination faces diminished prospects for now, however, given the global and transatlantic trade war.

Session 3: Can European economies take advantage of the next technological revolution?

Faced with a shrinking workforce and political opposition to extending working hours, the EU will increasingly have to use technology to raise output. Artificial intelligence offers significant potential to increase productivity, particularly in the services sector, which has not enjoyed the productivity growth seen in manufacturing as a result of automation. But Europe's track record of exploiting the ICT sector is poor. While the US enjoyed a productivity boost which economists commonly attributed to the ICT boom, Europe missed out. European firms have been slower to take up technologies like cloud computing than their US equivalents. Technology is diffused through European firms more slowly than in the US. What more can policy-makers do to ensure the European economy exploits emerging technologies? Is EU-wide regulation of technology a help or a hindrance in these efforts? And should Europeans be worried that the continent plays an ever-decreasing role in the development of ICT-related frontier technologies?

The bleak view

Europe is very dependent on imported inputs. This concerns everything from digital services to foundational AI models, and from cloud infrastructure to critical raw materials used, among other fields, in tech manufacturing. Ultimately, dependency on imported digital technology translates to a lack of digital and technological sovereignty, which is problematic for Europe on multiple levels: from an economic perspective, but also because of risks to democracy and security. The discussion focused on pinning down the reason for this dependency and lack of homegrown tech innovation, broadly quantifying its impact, and identifying solutions to address it – while taking into account a generally low propensity for risk-taking, both among investors and policy-makers.

So why does Europe lag behind the US both in the development and adoption of digital technologies? Small firm size, lack of private R&D investment due to shallow capital markets, and fragmented regulation are prime candidates as explanations.

In the EU, tech regulation tends to have an 'ex ante' approach, frequently pre-empting innovation, as opposed to a more light-touch, 'ex post' approach in the US. Further, digital

policy in Europe is very fragmented: currently the policy 'hype' focuses on AI, whereas equal attention should be given to cloud infrastructure, for example. The EU needs a more integrated tech policy strategy to drive investment.

Europe also suffers from low corporate investment in R&D: the leading private R&D investor in Europe is still the automotive sector, whereas in the US it is now the tech sector. A lack of capital, due to fragmented and insufficiently deep European capital markets, is holding investment in tech back, too. This is a well-known problem that has repercussions for investment as a whole, well beyond the tech sector.

Firm and market size

EU firms tend to be smaller in size than their American counterparts. Small and medium-sized enterprises struggle with tech adoption, and generally do not invest as much in intangible assets, including in human capital. This is a roadblock both to the emergence of 'big tech' players and to the adoption of tech in the general economy. Does this require a change in the European approach to competition policy, allowing firms to achieve scale and fixing problems ex post, if need be? There was disagreement about this, as some believed competition policy should not be portrayed

as the main scapegoat for all problems in European competitiveness.

Some were cautiously optimistic that Europe could still find some niches to lead in tech development, focusing for example on issues that were perceived as more important on this side of the pond – such as privacy-enhancing technologies – instead of trying to duplicate existing technologies, such as AI large-language models, which would come at a high cost and dubious benefit.

Others questioned whether it mattered for the EU to lead in tech innovation, or whether it should focus on reaping

productivity gains from tech adoption. But the track record for adopting innovative technologies in Europe was not very encouraging, as shown by the fact that the productivity gains from the IT revolution in the '90s were smaller than in the US – pointing again to the low uptake of IT practices among SMEs.

At the same time, low adoption seemed to be a problem going beyond SMEs: some promising European innovations, such as digital government practices, digital health journals, or even the ECB's idea of a digital currency, seem to percolate through the economy only in a limited way.

Session 4: Europe's single market and green industrial policy: An unhappy marriage?

Europe's efforts to lead the green revolution have been challenged by Chinese and US subsidies. The continent has already seen its solar panel industry ruined by China. Now, it also faces the growing use of subsidies by the US, and threats covering sectors such as electric vehicles where Europe had hoped to become a big exporter. Yet, despite hopes that the Covid recovery funds would signal the start of a truly European industrial policy, the idea of a 'European sovereignty fund' has gone nowhere. The EU has instead relaxed restrictions on national subsidies, risking undermining the level playing field within Europe. Should the EU follow the US and China in supporting domestic production of strategically important green goods – or should it instead enjoy cheaper imports subsidised by US and Chinese taxpayers? If an EU industrial policy is essential, how can policy-makers ensure it promotes green innovation rather than merely protecting incumbents? And does the creation of European champions have a role to play in green industrial policy, or does traditional EU competition policy offer a better path to ensuring European firms are globally competitive?

The European Union has long pursued the green industrial transition with a largely stick-based approach, centred on regulation and carbon pricing to steer markets and producers towards carbon neutrality. European policy-makers have not always been clear-eyed about the trade-offs involved. There has been an illusion of a 'triple dividend', in which the Union can green its economy, maintain tight budgets, and boost innovation and competitiveness. The reality is the higher demand for clean tech could also be met by Chinese supply. And the EU's competitors have not been sitting idle: China's bubble of industrial overcapacity does not yet show signs of bursting, and in the US trade protectionism may replace the Inflation Reduction Act as a threat to EU industry. The EU needs its own industrial policy to avoid the threat to the single market posed by the assertive policies of others.

Europeans should not be too pessimistic about their achievements, however, nor blindly copy the American or Chinese models. Compared to the US, EU member-states have provided more funds for greening their economies, even if it often did not come in the form of industry-specific tax credits or subsidies. The green transition is now under political pressure. But the Commission made more progress on advancing the green than the digital transition between 2019 and 2024, even if specific challenges remain: a slow buildout of grid interconnectors to link up member-states' electricity markets, a car industry under severe pressure from China's electric vehicles, and base industries like chemicals

or steel moving out of Europe. It is also not only about money: policy and planning certainty are far more important in unlocking private clean tech investment than financial incentives from governments.

The EU could benefit from a targeted industrial strategy, using different tools for different sectors, including in clean tech – a framework which Mario Draghi's landmark report usefully outlined. In a nutshell, Draghi urged the EU to distinguish between sectors where it has lost its ability to compete and in which it should exploit Chinese imports, like solar panels; employment-rich sectors like cars; strategically important industries like steel; and infant industries where the EU can defend and expand emerging technological leads, like electrolyzers to make hydrogen. But the approach taken by the EU falls short of this useful Draghi blueprint.

First, the structure of the green transition matters. Carbon pricing, which raises the price of fossil-fuel intensive products, is challenging because many households lack the money to purchase low-carbon items such as electric vehicles or heat pumps. Energy costs cannot be increased without providing affordable alternatives - otherwise, pricing mechanisms will fail. Because the EU has failed to do so, there is now a real risk that increases in carbon pricing will not take place. Political clamour for more free allocations under the emissions trading scheme (ETS) may escalate, the second emissions trade scheme covering buildings and road

transport could be delayed, and even the EU's carbon border adjustment mechanism (CBAM) may be undermined. Such a trajectory risks choking the EU's policy strategy for the green transition, even as support for greening industry is increased.

Second, the EU has largely set targets without backing them up with appropriate enforcement tools or financial envelopes. In 2023, the EU attempted to create a framework for EU green industrial policy by adopting the Net Zero Industry Act (NZIA). The NZIA identified a series of 'net-zero technologies', from solar photovoltaic to battery technologies, as well as heat pumps, geothermal, electrolyzers and carbon capture and storage (CCS) technologies. But the NZIA has two main weaknesses. First, it imposes a blanket target of 40 per cent deployment across very diverse industries. Second, it was not accompanied by additional programmes, nor did it refinance existing programmes with extra funds to meet such deployment goals. For these reasons, it has so far remained a target-setting exercise. The clean industrial deal, the NZIA successor, will hopefully not fall prey to these pitfalls.

Third, as part of its new, active industrial policy, the EU should change its approach to risk. The EU has time and again selected a narrow list of sectors to prioritise. Supported by governments and national promotional banks, the EU could instead take equity positions and invest in a wider set of technologies following a 'portfolio' approach – accepting some firms and technologies will not make it, but expecting that enough will pay off to offset the losers.

Fourth, European-level funding for green industry is still entirely missing, and EU coordination of national policies has been suboptimal. One opportunity to address this would be in the negotiations on the EU's 2028-2034 budget, which could include discussions on funding green industrial policy. These negotiations should also build on lessons from the EU's post-pandemic recovery fund. For instance, when allowing member-states to repurpose funds from the recovery fund to address the energy crisis in 2022, the Commission was not

sufficiently pushy in directing them to invest in grids and interconnectors instead of LNG terminals. There was also a governance gap, as no European-level forum existed to coordinate green industrial policy.

Still, given the progress the EU has made, rolling back the green policy architecture would undermine the chances of the bloc reaching the 2050 net zero target. Rolling back ETS and CBAM would also create massive uncertainty, throttling clean tech investment – which could be even more self-defeating as the US pulls back from the clean tech race under Trump.

The greening of monetary policy has largely faded from the agenda. The ECB faces both physical climate risks on its balance sheet and transition risks. While it has been proactive considering climate risks in the context of banking supervision, it has remained a policy-taker in monetary policy. There was a heated debate, for example, on whether targeted long-term refinancing operations (TLTROs) should be used to lower financing costs for renewables relative to brown investments. But the debate stalled, in part because it raised fundamental questions about the division of responsibilities between governments and central banks—who should bear the risk and provide the additional financing?

Overall, with climate change threatening natural resources globally—through water shortages, biodiversity loss, and extreme weather—Europe's future comparative advantage may lie in resource efficiency: achieving more with fewer resources. Focusing on innovation that increases reuse and recycling of raw materials and components and thereby reduces import dependency will bolster both economic security and strategic autonomy. The green transition is clearly costly and requires massive investments. But it should not only be framed as a burden. As renewables become cheaper and more widely available, the EU can offset some of its natural disadvantages: its lack of fossil fuel resources will no longer be as decisive.

Session 5: How can Europe reconcile economic security with higher growth?

The line between national security and economic interests is becoming increasingly blurred. Under Biden, the US adopted a policy of 'a small yard with a high fence', imposing high barriers to the export to China of a limited number of critical goods and technologies. Washington has, however, been steadily expanding the size of the yard, entangling European firms, including some of its technological leaders. Trump is likely to do even more to force Europeans to help contain China, with the threat of tariffs on European exports if they do not co-operate. European leaders fret about China's bellicose actions and surging exports, but many also continue to regard the country as an important trading partner, and fear taking US-style action against China would undermine Europe's economy. The European toolbox to pursue economic security – from critical minerals agreements and export controls to FDI screening – also remains unpredictable and in many cases untested or fragmented along national lines.

Conceptualising economic security

For its overall security, the EU needs adequate defence, including autonomy in its defence decisions. Economic security – essentially, certainty that critical raw materials and

manufactured goods will always be available – underpins the EU's defence industrial capability and thus its ability to defend itself. European defence industry does not currently produce enough for the continent's needs, making the EU dependent on imports. Such dependencies may limit

Europeans' decision-making autonomy in a crisis, when suppliers may restrict or cut off supplies. The issue is not only weapons and munitions, but the increasing number of dual-use goods, such as semiconductors or drones, that have both civil and military applications. It is difficult to isolate defence and civilian supply chains from each other, or to be sure that imported items will be available when needed.

Economic security can also mean mitigating the risks of 'supply shocks': here, Europe's focus has been on its import dependencies, particularly for strategic goods like energy and critical raw materials. There is debate among economists about how manageable these risks may be. Some consider the number of sensitive goods for which the EU is nearly wholly dependent on one trading partner to be relatively small. Others consider the costs of this type of de-risking to be significant, and note that sectors that pose vulnerabilities can be difficult to identify until there is a crisis. For example, many goods like basic pharmaceutical ingredients are not high-value, but restricted supplies would pose a risk of great social or economic harm.

A broader definition of economic security includes tackling trading relationships which Europe's partners may try to weaponise. This implicates not only the EU's imports but also its exports and its investment relationships. This is a much larger problem for Europe than for the US and China, given the EU's open and trade-intensive economy. The EU's new Anti-Coercion Instrument is its most powerful weapon here, and one which is primarily designed to deter foreign coercion rather than to be used. It provides a menu of options ranging from trade policy tools (such as tariffs and restrictions on trade in services), to restrictions on access to foreign direct investment and public procurement. But European leaders will need unity to make the instrument's use a credible threat.

Under President Biden, however, the US took an even broader view of economic security. According to Biden, ensuring sufficient levels of domestic employment was a necessary condition to prevent the US from sliding into populism. This concept of economic security implied that not only goods were 'strategic', but the structure of the US economy as a whole.

Economic security and economic growth

Economists mostly agree that, at least in the short term, economic security is at odds with efficiency and therefore could harm European economic growth – with broader interpretations of 'economic security' having greater impacts on growth. For example, Europe will need to make investments in basic defence materiel like ammunition, which will not increase productivity. Europe could, however, make such spending more efficient by creating an integrated EU-wide defence market. Focusing on diversification of supply, rather than self-sufficiency, would also help minimise

conflicts between economic security and economic growth. 'Buy European' programmes involve significant inefficiencies. Markets can respond to crises quickly if there are incentives to diversify sources of supply.

In theory, investing in strategic 'infant industries' could boost both Europe's economic growth and its economic security. However, in practice, such industrial policy tends to be unproductive, heavily influenced by corporate lobbying, and supports incumbents rather than innovators. Industrial policy ought to focus on broad sectors rather than on specific technologies or outcomes.

One area in which security and economic growth could align is in energy. Energy costs in the US are projected to rise, whereas those in the EU should fall with more investment in expanding the grid and promoting renewables. The EU still faces about 10-15 years where energy-intensive industries will suffer a significant competitive disadvantage, however.

Transatlantic co-operation under Trump

Some aspects of Trump's approach to economic security are not yet clear – in particular, whether he will take a transactional approach to China or seek to constrain the country's growth and technological development. Trump's team does, however, appear likely to prioritise protecting the US manufacturing and employment base, perhaps even more than Biden did. And tariffs are clearly an increasingly important part of US economic policy.

To act more strategically, the EU needs a more centralised approach to economic security. Europe will not take the same approach to economic security as the US, but both jurisdictions need a better understanding of each other's priorities. Better dialogue could reduce surprises: much of Europe's concern about the US Inflation Reduction Act could have been mitigated had the Biden administration kept European leaders better informed about the law's progress.

The US and the EU should also work together: for example, to diversify production of critical pharmaceutical ingredients and their chemical precursors, for which China is currently the sole supplier. Similarly, the EU and US could do deals with developing countries that have critical raw materials to help them develop their resources and move up the supply chain, while giving the EU and US new guaranteed sources of supply.

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