

# Dealing with Europe's economic (in-)security

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## Abstract

Economic security is going to occupy an increasingly important role in global politics. While the EU should aim to avoid a fragmentation of the global economy and support multilateralism, it needs to prepare for protectionism, a global subsidy race and weaponisation of interdependencies. First, the EU must take geopolitical risks seriously and use stress tests and a data-driven approach to identify vulnerabilities. We propose creating a European Economic Security Committee to advance coordination between national security and European economic policymaking. Second, the EU must increase its resilience to better withstand economic coercion and be less affected by shocks. Resilience cannot be increased by protectionism but by keeping markets open and concluding trade agreements. Industrial policy has some role to play, but the EU should apply the 'narrow yard' principle in industrial policy and enhance cooperation to reduce the risks and costs of a global subsidy race. Third, economic security will require investments in European public goods such as R&D for defence, decarbonisation, technology and the reconstruction of Ukraine, which will be cheaper to procure at EU level. Strengthening the international role of the euro would add to Europe's economic security and financial power.

## 1 | EUROPE'S PROBLEM WITH THE RISE OF GEOECONOMICS

'In today's global politics, if you are not sitting at the table, you are probably part of the menu'. This phrase is increasingly common around the corridors of the European Commission in Brussels. It corresponds with the idea that the European Union (EU), sometimes characterised as an herbivorous power that performs well in a cooperative, rules-based world, needs to adapt to an international reality characterised by great power competition. Otherwise, it risks being devoured by carnivorous powers willing to use hard power and economic coercion, break multilateral rules and weaponise interdependence.

Increasing economic security and acquiring strategic autonomy are two crucial components of the EU's new Economic Statecraft. Both terms are broad and elusive, and the latter has received more attention than the former in recent years. In fact, the concepts of geopolitical

Europe and strategic autonomy have been ubiquitous in both statements by European leaders and EU official documents. Ursula Von Der Leyen, the President of the European Commission, highlighted in 2019 the need for a 'Geopolitical Commission' to respond to the challenges of a more unstable international environment; Charles Michel, the President of the European Council, made the case for European Strategic Autonomy in 2020 (Michel, 2020), and the 2021 EU Trade Policy Strategy (European Commission, 2021a, 2021b) coined the term 'Open Strategic Autonomy' to emphasise the need to make trade openness compatible with autonomy.

While the term has remained vague and has allowed actors to project their hopes and fears into it (Tamma, 2020), there is an emerging consensus around the idea that strategic autonomy refers to the ability of Europeans to live as much as possible by their own laws and defend their interests without foreign interference. But since the EU's DNA is cooperative in

The authors presented key results of their research to the informal meeting of EU Finance Ministers at Santiago de Compostela, Spain, September 2023.

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nature and law, it needs to promote and defend its interests with partners when it can and act alone only if it is strictly necessary, in keeping with the principle: 'Multilateral if you can, unilateral if you must'.<sup>1</sup>

Academic journals have dedicated special issues and papers to EU trade policy and strategic autonomy (Global Policy, 2023; Meunier & Nicolaidis, 2019; Schmitz & Seidl, 2023), and different scholars have recently identified strategic autonomy with the return of 'fortress Europe' (Lavery, 2023), and argued that the new European industrial policy is an essential tool of the strategic autonomy agenda (Wigger, 2023).

However, economic security has received less attention in both policy and academic debates. This is not exclusive to Europe. The relationship between economics and security has traditionally been neglected in scholarship (Mastanduno, 1998). The term is often used to describe the ability of economies to weather risks and shocks, withstand economic pressure and coercion, manage strategic dependencies, protect critical infrastructure, deter cyber-attacks and disinformation and maintain and strengthen economic leverage and/or technological edge.

But while the United States and China have made successful efforts in the last decade to address the economic aspects of national security, the EU has, so far, paid limited attention to the issue (Xiaotong, 2023). Recent developments, however, have forced the EU to think deeper about economic security and its relationship with strategic autonomy. COVID-19 exposed risks of disruptions to supply chains, and Russia's invasion of Ukraine has put hard security risks at the top of EU policymakers' agenda and shown that energy dependence can be weaponised. Rising trade tensions, the increasing use of subsidies and economic coercion have forced the EU to prepare for disruptions to multilateralism, recalibrate its relations with other great powers and revise its dependencies on non-EU jurisdictions.

Meanwhile, the relationship between strategic autonomy and economic security remains unclear. Some consider economic security to be a part of strategic autonomy since the strategic autonomy concept initially included military autonomy and economic security is clearly part of national security. Others emphasise that economic security only partially overlaps with the earlier strategic autonomy debate, as hard security questions such as limiting the spread of dual-use technology or ensuring effective sanctions were not part of the discussions associated with strategic autonomy. Overall, it seems clear that increasing economic security will enhance strategic autonomy in Europe, but the term is certainly new enough to have warranted new policy strategies by the European Institutions.

As a result, in June 2023, the EU published its Economic Security Strategy (European Commission and High Representative for Foreign and Security

Policy, 2023), which focuses on promoting competitiveness, protecting citizens and forging partnerships. The strategy tries to bring coherence to a number of initiatives and policies of economic statecraft adopted in the last years, such as economic/trade and FDI tools to level the playing field and respond to external actions (Investment screening mechanism, Anti-Subsidy Regulation, Carbon Border Adjustment Mechanism (CBAM), Anti-Coercion Instrument, etc.) and initiatives to promote economic resilience and foster industrial capacity, particularly in the green and tech sectors (Chips Act, Green Deal/Fit for 55.). Finally, the EU has fashioned the term de-risking to emphasise the need to reduce vulnerabilities associated with economic interdependence while maintaining an open global economy.

Despite these initiatives, the EU remains relatively badly prepared for a world of geopolitical rivalry and great power competition. This is the case for several reasons. The EU is institutionally set up for a rules-based world. While trade, single market, competition, investment and financial policies are largely EU competences, foreign policy and hard security questions reside largely in the hands of Member States. Therefore, defining geopolitical priorities and translating them into economic policies is institutionally difficult for the EU. This stands in contrast to the United States, China and other powers where there is no conflict of competences, where being a political union facilitates a strategic vision and where there is more experience in Economic Statecraft (Leonard et al., 2019; Zuleeg, 2023). Moreover, EU treaties foresee openness to international trade, investment and finance (for instance, Art 63 TFEU (European Union, 2007), prohibits restrictions on the movement of capital and payments between EU and third countries), and do not contemplate a breakdown of multilateralism and the rules-based liberal order. Finally, the EU economy and its growth model could be more jeopardised by deglobalisation and decoupling from China than other regions.

In addition, there is no agreement on the aims, the means, the priorities and the path towards economic security in the political and economic circles around Europe. Two broad approaches can be contrasted (Lavery, 2023). One, more associated with the position of Commissioner Vestager and the small, liberal and export-oriented open economies of northern Europe, argues that geopolitical disruptions can be dealt with should they arise in the future, emphasising the need to preserve openness and multilateral rules. The opposing view, represented by Commissioner Breton and the traditional 'French/Fortress Europe' view, argues that the EU needs to massively change course and adapt to the new reality of great power competition, prioritising domestic investments, industrial policies and reducing trade with countries that are not 'like-minded'. In our view, both views are mistaken. The

former underappreciates the economic and political cost of a major geopolitical confrontation. Geopolitical risks are real and facing them unprepared would entail major costs. The latter is naïve on the feasibility and affordability of relocating supply chains: Subsidies cannot change long-term comparative advantages and can easily become prohibitively expensive. Moreover, the costs of a fragmentation of the global economy into rival blocs are usually not well understood by politicians and citizens.

The recent EU initiatives on economic security are an attempt to take a middle ground within these two positions. Yet, choices along the dimensions ‘protectionism-openness’ and ‘centralisation–decentralisation’ of funding are not clear and may even be unjustified.

This paper re-examines choices taken and argues that European Economic Security needs to focus more on (1) how to deal with hard economic security risks and prepare for high-risk events; (2) how to maintain openness and competition by increasing resilience and building international partnerships; (3) how to address institutional weaknesses and finance European public goods that will increase the EU's economic security. We thus develop a new proposal that would achieve greater economic security at a lower cost.

While the EU should aim to avoid a fragmentation of the global economy into rival blocs and support multilateral institutions, it needs to prepare and deal with protectionism, fragmented value chains, a global subsidy race and weaponisation of interdependencies. Economic security risks can be best addressed by deepening European integration, including the single market and the Economic and Monetary Union (EMU), maintaining openness and narrowly defined interventions. We develop these proposals in the next pages.

## 2 | PREPARING FOR HIGH-RISK EVENTS AND DEALING WITH HARD ECONOMIC SECURITY RISKS

Risk tolerance is lower for hard economic security risks than for simple economic vulnerabilities. Hard economic security risks can generate rapid and high economic and societal risks, for example in the context of a cyber-attack. The risk of a recession is different from the risk that investments lead to the loss of control on sensitive data because (telecommunication) networks are foreign-owned. Foreign ownership in such critical infrastructure can entail major security vulnerabilities. For instance, whether the EU has a solar industry is not a particularly hard security question. Hard economic security is thus about R&D critical for dual military use, critical infrastructure, cyber security and resilience to hybrid attacks (Demertzis & Wolff, 2020). High-end technology of military and commercial use is particularly subject to US-China

rivalry. The United States is using export controls as well as outbound investment screening in certain national security technologies, particularly semiconductors, quantum information technologies and artificial intelligence (Department of the Treasury, 2023; White House, 2023a) to limit their spread. The rules focus only on China (plus Hong Kong and Macao) and investments in a narrow set of technologies are prohibited while in a somewhat larger set, reporting requirements are established (Chorzempa, 2023). China, in turn, has focused on building its own semiconductor industry in a quest for self-reliance at least since 2014 with its dual circulation strategy and made-in-China 2025 strategy published in 2015. Yet, up to today, self-reliance has not been achieved (García-Herrero & Weil, 2022).

A narrow definition of high-end dual-use technology may be the right compromise between preserving security interests while avoiding large economic costs. The US proposal on outbound investment control can fairly be assessed as being in the ‘small yard, high fence’ spirit of de-risking rather than decoupling (Sullivan, 2023). It aims to preserve leadership and choke points in a narrow set of technologies. A wider definition of what constitutes security-relevant technology risks would not only undermine trade and commerce massively but may also be very hard to manage due to additional bureaucratic burden. Government intervention should thus focus on narrowly defined hard security risks.

The EU's approach to build a high-tech cluster for semiconductors with the Chips Act is in principle welcome to strengthen the EU's economic security. Subsidies have been substantial, and one can debate their size and the specific cases. Yet, trying to reduce dependency on the highly concentrated production of high-end chips in Taiwan is a step towards increasing economic security.

A further hard security question is sanctions policy. Sanctions are effective ways of limiting economic activity and technological development. The EU has imposed substantive sanctions on Russia. At the same time, it needs to be prepared for sanctions against the EU or individual Member States.

The EU's inbound investment screening mechanism needs rigorous implementation to safeguard hard security interests in critical infrastructure. From a macroeconomic point of view, investment stocks of China in the EU are small while EU investments in China are bigger but still small.<sup>2</sup> Yet, information on Chinese investments in the EU single market remains scattered. More coordination is needed to monitor the security concerns of these investments. Moreover, a debate on enlarging criteria for the rejection of investments based on the lack of reciprocity appears appropriate to increase the EU's leverage.

International coordination of security-related outbound investment and export controls is important for

their effectiveness. G7 countries agreed in Hiroshima in May 2023 on their basic approach to economic security and are contemplating measures (Isaac, 2023; Ministry of Foreign Affairs of Japan, 2023). Nevertheless, the EU and G7 members will need to define their stance on the precise US measures on technology. While there may be scope for some divergences in measures, divergent actions undermine their effectiveness. It is therefore not impossible that the United States will push for alignment of measures and even require all companies that are listed on US stock exchanges or even all those active in the United States to fully comply with measures, including by resorting to secondary sanctions. If the scope of US export control and outbound investment screening were to substantially increase, the EU would need to define a strategy to defend its interest.<sup>3</sup> Firms need to be prepared for extreme scenarios in which the United States forces them to leave China. The more limited US controls currently discussed, however, appear in line with EU interests.

Fully Europeanizing the outbound and inbound investment screening and export control mechanisms would help protect the single market from differentiated national applications based on different security considerations and strengthen European power. Yet, it would require a shared understanding of security risks. We therefore propose to form a 'European economic security committee' that would ensure better coordination on national security considerations with EU economic policies. It would assess economic security and foreign policy risks and propose feasible strategies to address them, for instance, regarding third-country equipment in the telecom infrastructure or investments in European ports. Better coordination and information sharing between national security representatives and economic policymakers would help to overcome the dearth of security knowledge in EU institutions.<sup>4</sup> Even in a scenario of full centralisation of investment screening, a joint committee would still be required to ensure adequate information flow on security risks. Short of fully centralising security policy at the EU level, which seems unlikely, such a committee would be needed. Even at the national level, more coordination across different parts of the government would be desirable.

### 3 | INCREASING RESILIENCE AND BUILDING PARTNERSHIPS

The EU needs to continue defending the rules-based international order. The EU's and the world's prosperity depend on global trade in goods, services and data. Protectionism, ill-guided subsidy races and even worse a fragmentation of the global economy into blocks would entail substantial costs (according to the IMF (2023) international trade restrictions could reduce global economic output by as much as 7 per cent over

the long term, or about \$7.4 trillion in today's dollars). Many countries of the so-called 'Global South' are also worried by trade deglobalisation, look for flexible partnerships and would like to avoid being drawn exclusively either to the United States or to China. Moreover, they look at EU to find a way to sustain multilateral trade openness and even reform the WTO.

Yet, the risk of a security-related fragmentation of the global economy is real. The EU should prepare for such worst-case events. For that, a change in mindset is needed. While the EU needs to continue defending a multilateral order and seek strategic partners to sustain it, it must prepare for a world in which interdependence will be increasingly weaponised, other powers will exercise economic coercion and geopolitical uncertainty will continue.

Stress tests can be useful instruments to prepare for worst-case scenarios. How would the EU respond if a major geopolitical confrontation in the Indo-Pacific were to lead to a total fragmentation of global trading system? How would the EU deal with a strategic shift of the United States towards decoupling, with extraterritorial measures against firms? What to do whether China restricted exports of all critical raw materials beyond the recently reported restriction on Gallium? Such stress tests can obviously not address all vulnerabilities, but they can help establish European routines for communication channels permitting more rapid reactions. Moreover, some key vulnerabilities can become more obvious and could be addressed early on.

Two approaches to increase the EU's resilience are widely discussed and first steps are implemented. (1) Reorganisation of global trade patterns and increasing the attractiveness of the domestic market, (2) industrial policy and trade-defence instruments.

Trade and investment policy can play an important role in strengthening the resilience of the EU economy. Global economic fragmentation would be extremely costly (IMF, 2023) and reshoring would be a very costly way of attempting to increase resilience (Felbermayr et al., 2022; Fuest et al., 2022) and would also create new risks. Instead of trying to force re-shoring of production or even trying to fragment global trade based on ideological blocks, the EU should prioritise trade agreements with third countries in combination with investments from a more focused Global Gateway. Such agreements and investments create opportunities for diversification and would render the EU economy more resilient (Dadush, 2023). Concluding ambitious trade agreements would also set the EU apart from the United States, where concluding trade agreements is now politically rejected.

Ratifying the Mercosur agreement rapidly would be particularly beneficial. In fact, the EU has a ready-negotiated agreement with the Mercosur, which would give access to more than 260 million consumers, including by lowering tariffs substantially and increase the EU's



regulatory cloud. It would create the second biggest free trade zone including 770 million people, providing ample opportunities for diversification. Moreover, it would provide access to important critical raw materials (Grimm et al., 2023a, 2023b). To conclude the agreement, the EU need to accepts Mercosur as an equal partner, become less demanding and be ready to open its market. The EU should also conclude additional trade agreements in Asia, including with India, ASEAN countries, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) or the Regional Comprehensive Economic Partnership (RCEP). Without a trade agreement, EU firms will be put at a disadvantage relative to firms serving the Asian market from China, given that China is a member of RCEP. This could in turn increase rather than decrease dependency on China.

A stronger and more integrated EU market will also provide incentives to diversification away from geopolitically more risky jurisdictions. The EU should strengthen its own single market by reducing regulatory barriers, enhancing convergence and reducing bureaucracy. The Delors program has never been more pressing. EU internal competition and global competition will drive innovation.

Some specific supply chain risks require public policy intervention. In principle, firms need to be responsible for the resilience of their supply chains. However, since externalities exist in the form of systemic vulnerabilities as well as moral hazard of firms hoping for public bail-outs, there is a role for government intervention. Just like systemic risks in the financial system, systemic risks can also exist in supply chains. Empirical, data-driven work should identify which supply chains are at such systemic risk that individual firms cannot properly account for (Arjona et al., 2023). Public policy intervention should focus on those risks. A priori, there is no reason to single out specific industries since vulnerabilities can arise in many areas. Within this framework, it needs to be understood that black-swan-type event like COVID cannot be foreseen.<sup>5</sup> Overall, the EU should avoid mechanical quotas for domestic production. It should use stress tests and data to identify specific vulnerabilities rather than rely on sectors such as health, and it should incentivise diversification in the EU and global markets.

Industrial policy, protectionism, neo-mercantilist policy and domestic demand suppression have created significant distortions to global markets and costs to the EU economy (Steinberg, 2023). Aggressive state subsidies and predatory pricing in the green sector can be characterised as uncooperative and trigger uncooperative responses, with the risk of engaging, a full subsidy race would emerge (Juhász et al., 2023). In the trade relationship between the EU and China, Chinese policies have created distortions and shifts in trade patterns.<sup>6</sup> High domestic savings and financial repression

continue to create large current account surpluses. It is important the EU insists on fair trade and reciprocity in market access and builds pressure points to achieve this objective.

Public subsidies to boost domestic industries have become an important policy tool to respond to the uncooperative game (EIU, 2023). Yet, subsidies have the potential to create large costs. They can create distortions and lead to a global subsidy race wasting taxpayers' money. The US Inflation Reduction Act (IRA) (Campbell & Gritz, 2023) is a major subsidy scheme. There is a risk that it could create resentment, especially in poor countries, and may even slow down the green transition and productivity growth (Posen, 2023). In the EU, an important risk of nationally funded industrial policy is that the relaxation of the EU's state aid rules leads to a fragmentation of the single market as countries with deeper pockets subsidise more substantially. EU-level joint financing of European public goods would address this concern (Draghi, 2023).

To avoid a worsening of the situation, the EU could use anti-dumping measures in WTO spirit. That would send a strong signal to global partners on the value of multilateral institutions and the need for a global playing field. Moreover, industrial policy can be an element of the public policy intervention to increase resilience if properly designed. To be successful, research shows that industrial policy should focus subsidies on R&D, human capital and new technologies. It should aim to foster change and subsidise newly emerging technologies to minimise the risk of being captured by large incumbents. Fostering change, rather than preserving or even re-gaining industrial structures, for which the EU has little comparative advantage, needs to be the core approach.

Precisely defining why a certain subsidy would increase security is essential to avoid arbitrariness. Narrowing industrial policy to the 'small yard' would go a long way to minimise harmful global distortions. Policymakers thus need to approach resilience understanding that economic agents react to geopolitical shocks. Instead of using mechanical production goals, stress testing needs to dynamically consider specific security risks.

Energy security and the transition to a green economy matter for economic security. In a context of structurally higher energy prices after phasing out significant amounts of Russian gas imports, energy security has become more dependent on US and Qatari Liquid Natural Gas (LNG) exports. In the short- to medium term, more diversification of LNG production seems necessary. European industry has impressively adjusted to the price shock by substituting the most energy-intensive parts of production while maintaining core underlying industrial structures. Yet in the medium term, some industrial structures may be difficult to sustain if energy prices remain permanently higher.

Subsidies cannot permanently work against such comparative disadvantages and should therefore be avoided or limited in time.<sup>7</sup> On the contrary, the deployment of large amounts of renewable capacities may well bring energy prices substantially down, thereby creating new comparative advantages in the medium to long term.<sup>8</sup> More broadly, the EU's Net-Zero Industry Act and Critical Raw Materials Act should focus more strongly on diversification and following comparative advantages as some raw materials and production of green technologies will simply be too costly and inefficiently produced in Europe (Kleimann et al., 2023; Tagliapietra et al., 2023).

More cooperation with the United States, G7 and countries from the 'Global South' on industrial policy, standards and supply chains would reduce frictions and costs. EU policymakers need to collaborate with third countries on their subsidy policy to counter protectionism and reassure that the EU remains committed to free trade. The agreement between the Commission President and the US President (White House, 2023b) to launch a clean energy incentives dialogue and cooperation in the framework of the transatlantic trade and technology council are welcome steps.<sup>9</sup> G7 members do not need seven independently de-risked supply chains (e.g., for gallium), so cooperation would be important. Even more importantly, the EU should make a strong effort to advance cooperation with countries of the 'Global South'. It should reassure its continued commitment to openness and prevent negative counter-reactions to the limited subsidies undertaken. In doing so, it should charter a course independent of that of the United States. The EU's global gateway initiative should be strategically used to advance industrial and energy cooperation, among others. Overall, cooperation can help minimise the costs of the global subsidy race.

## 4 | ADDRESSING INSTITUTIONAL AND SYSTEMIC EUROPEAN WEAKNESSES

The new geopolitical realities have highlighted the need for European public goods in the fields of R&D, defence, security, innovation, energy, sustainability and technology. Moreover, long-debated institutional and systemic EU reforms would also strengthen economic security. Some of the traditional scepticism towards deeper economic, monetary and financial integration is changing considering the new geopolitical reality. This opens an opportunity for ambitious reforms (Draghi, 2023), and even to combine the needed reform of the Stability and Growth Pact with progress towards a Fiscal Union. We see two areas as crucial: EU joint financing and the use of the euro as a geoeconomic tool. Both require reforms in the EMU.

First, the EU should equip itself with joint public resources to address economic security risks. Joint spending on R&D in defence would advance innovation and help build an integrated European defence market. The US experience with DARPA shows that such investments have the potential to be applied to civilian uses and increase economic growth and productivity. In addition, joint resources are also warranted to re-build Ukraine. The ongoing support and the reconstruction of Ukraine will require substantial fiscal resources and can be considered an investment into the EU's future security and economy. For both, a joint European debt instrument would be the right way forward. Not only do both constitute truly European public goods, but both constitute investments that will generate EU economic growth.

To avoid a fragmented single market, industrial policy for decarbonisation, green technology, and energy security should be jointly funded from a dedicated part of the EU budget. The experience of the Next Generation EU Funds, which provide financing for strategic investments in exchange for reforms agreed between Member States and the European Commission provides a promising way forward. Focusing on European public goods is central while it is also of utmost importance to avoid misuse of European Funds (ECA, 2022). Finally, resisting economic coercion or rejecting foreign investments on grounds of European security may entail substantial costs for individual EU Member States. Joint EU resources can be used to compensate for specific losses, thereby enabling more coherent joint foreign policy positions.

Second, the EU also needs to use more strategically its financial and monetary power as a geoeconomic tool. It should prioritise completing the EMU and integrating its financial system. Not only would fiscal and financial integration benefit the functioning of the euro area and enhance growth, but such integration would also strengthen the EU's geoeconomic power. The importance of monetary power has been highlighted in the international political economy literature, which focuses less on growth and efficiency and more on power structures, dependencies, coercion and the importance of relative gains (Cohen, 2015; Strange, 2015). Monetary power generally refers to the ability of a country to influence and shape international outcomes through its control and influence of international monetary arrangements, monetary and exchange rate policies, currency politics, and financial and payment systems (Andrews, 2006). Financial and monetary power can facilitate economic and political autonomy, increase political leverage, reduce financing costs and even be a tool for economic coercion if the country that issues the currency is willing to use it (Kirshner, 1995). It can do so by increasing isolation and resilience from external monetary shocks, defecting the burden

of macroeconomic adjustment on other countries or facilitating (and even circumventing) the application of financial sanctions (McDowell, 2023). It is thus a key tool of economic security and statecraft. But one that the EU has been reluctant to use so far.

To use monetary power, the EU must be willing to accept and utilise the political nature of money and promote the euro as an international currency with both technical and political measures. Important decisions would need to be taken to overcome the current limits of the EU's financial and monetary system (ECB, 2023). Besides completing the banking union with a common insurance deposit scheme and deepening the Capital Markets Union to mobilise private financial resources for investment, the EU should create a permanent safe asset and commit to limited but permanent common debt issuances to finance the above-mentioned selected European public goods that enhance productivity and security. This, in turn, would further strengthen EMU. Financing growth-enhancing European public goods with EU debt would also facilitate implementing relatively tight fiscal rules at the national level.

Creating deeper, wider, flexible and more permanent markets for joint European debt will probably reduce financing costs in Europe.<sup>10</sup> As financing decisions can be increasingly taken in the EU financial system, also the growth of the EU technology ecosystem could increase as the funding bottlenecks for European start-ups can be addressed. Deeper capital markets would also increase the use of the euro as a reserve currency. Over time, larger amounts of EU-issued debt in international markets and foreign central bank reserves will increase the EU political leverage. That would open the discussion as to how to use that power in the realm of economic sanctions, euro swaps with specific countries and financial infrastructure/SWIFT. As the euro grows stronger, it would also become easier to ensure euro denomination of invoicing of trade, including certain commodities such as hydrogen. Overall, a stronger financial system will provide numerous geoeconomic benefits ranging from more effective sanction policy to better funding of cutting-edge technology firms.

## 5 | CONCLUSIONS: TOWARDS A EUROPEAN STRATEGY OF ECONOMIC STATECRAFT

In the context of great power competition, economic security is going to occupy an increasingly important role in the global political economy. The EU is neither comfortable with the weaponisation of interdependence nor is it institutionally designed for a less cooperative and more threatening world. Yet, it cannot afford to just continue its old model hoping that a rules-based world will prevail. On the contrary, it would be a severe mistake to turn away from global integration and engage in mechanical

reshoring with quotas for domestic production and massive subsidies to achieve that. The economic costs of such a wide-yard approach would be prohibitive. This paper argues that economic security is an important element of open strategic autonomy and proposes an EU intervention relying on more trade rather than reshoring, data- and stress-test-driven identification of hard security risks to be addressed with suitable instruments, including industrial policy, and deeper economic and financial integration to increase the EU's leverage.

The new geoeconomic context provides an opportunity to deepen economic integration and to address the political and institutional weaknesses that the EU has been dragging along for many years. External threats change the trade-offs and incentives faced by Member States, making it more evident that the response to the new situation must focus on a series of European public goods without which the EU will find it difficult to sustain its economic security and deepen its strategic autonomy. From a macroeconomic perspective, the new geopolitical age may well mean more negative supply shocks, creating difficult trade-offs for European fiscal and monetary decision-makers. Forging a European strategy of economic statecraft requires better tools to identify risks and the shared willingness to use economic, monetary and financial power.

## ACKNOWLEDGEMENTS

The authors would like to thank, without implicating, Lorenzo Bini Smaghi, Carlos Cuerpo, Maria Demertzis, Enrique Feás, Gabriel Felbermayr, Alicia García-Herrero, Alexandra Gritz, Jörg Kukies, Muriel Lacoue-Labarthe, Aliénor Margérit, Emmanuel Moulin, Wolfgang Niedermark, Jean Pisani-Ferry, André Sapir, Petra Sigmund, Ole Spillner, Jan Stöckmann, Heiko Thoms, Shahin Vallée, Assen Vassilev, Achim Wambach, Sabine Weyand, Eva Wimmer, Jörg Wuttke and Jeromin Zettelmeyer for open exchanges on the topic. They would also like to thank an anonymous reviewer for the useful and constructive comments.

## CONFLICT OF INTEREST STATEMENT

No conflict of interest. Federico Steinberg obtained financing for this research from Ministerio de Universidades de España, Plan de Recuperación, Transformación y Resiliencia and Universidad Autónoma de Madrid, Grant CA5/RSUE/2022–00064.

## DATA AVAILABILITY STATEMENT

Data sharing is not applicable to this article as no new data were created or analyzed in this study.

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## ENDNOTES

- <sup>1</sup> There is an on-going discussion in the EU about the meaning of Strategic Autonomy. The concept originated in the defense sphere and was first mentioned in official documents in 2013. It was later extended to the field of foreign policy with the 2016 EU Global Strategy and then entered the economic field in 2021, re-branded 'Open Strategic Autonomy'. See Tocci (2021) for a discussion of its meaning and evolution.
- <sup>2</sup> According to Eurostat, the inward FDI stock of China in the EU amounts to €69,9 bn in 2021, that of the EU in China to €233,6 bn. For comparison: FDI stocks of the EU in the US amount to €2512,9 bn.
- <sup>3</sup> In the case of the Dutch limits to TSMC lithography machine exports, important negotiations took place to ensure that business interests were safeguarded, and Dutch exports would not simply be replaced by exports of other advanced economies.
- <sup>4</sup> Our proposal for a security committee would thus go well beyond the proposal made by the Commission in its communication on the economic security strategy as well as Germany's recently published China strategy. For an earlier proposal, see also Spillner and Wolff (2023).
- <sup>5</sup> The production of masks or ventilators is area which prior to a black-swan-type event like COVID, no one would have identified as potentially becoming an issue. The solution to this type of problem cannot be to produce everything domestically, but rather to ensure an open economy with multiple producers in different regions. During COVID, maintaining global supply chains for vaccine production was critical for speedy production of life-saving vaccine (see, e.g., European Commission, 2021a, 2021b).
- <sup>6</sup> For example, according to the IMF in Q1, 2023, EU exports to China amounted to €56,9 bn while China's exports to the EU reached €116,2 bn. In 2022, China exported €533,8 bn while the EU only €227,6 bn.
- <sup>7</sup> For example, trying to produce large-scale solar panels in Europe may be economically inefficient, given the higher energy and labor costs. At the same time, forced labor and coal-fired power plants should not be accepted in the supply chain for solar panels, a real concern when it comes to solar panels from China.
- <sup>8</sup> The German auction for offshore wind energy with 7GW volume brought a record €12.6bn volume in revenues which will be invested to 90% in reducing the network costs, thereby reducing energy prices. (German Federal Network Agency, 'Ergebnisse der Offshore-Ausschreibungen aus dem dynamischen Gebotsverfahren [Results of the offshore tenders from the dynamic bidding process]', Press release (12 July 2023). Available from (accessed on 15 August 2023).
- <sup>9</sup> The rightly move the EU's position closer to that of the United States, rather than China and it is important that they deliver concrete results. See, for example, Schmucker et al. (2023). Technical standardisation is an important area for geopolitical cooperation. See Rühligh (2023).
- <sup>10</sup> Interest rates on Next Gen EU and ESM bonds are still higher than those of some member states because financial actors find those markets insufficiently illiquid, perceive those bonds as temporary and have problems using them as collateral (Bonfanti & Garicano, 2022).

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**How to cite this article:** Steinberg, F. & Wolff, G. (2023) Dealing with Europe's economic (in-) security. *Global Policy*, 00, 1–10. Available from: <https://doi.org/10.1111/1758-5899.13303>

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