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The EU in Rough Seas

The EU is in a difficult economic situation, beset by external and internal threats. The global economic order that was based on the idea of the economic superiority of free trade has collapsed. Added to this are internal threats posed by the rise of right-wing populists, who seek to weaken, if not abolish, the EU. In times of such great distress, it is important to focus on the essentials. The EU's primary goals at present should be to ward off external threats and weaken internal ones. Overall, the EU's resilience in a turbulent global economy should be strengthened. Three areas should be at the forefront: infrastructure, innovation and crisis resilience.

The EU is in a difficult economic situation. The global economic order, which was based on the implicit agreement that free trade was economically superior, has collapsed. This threatens to dry up a major source of prosperity for EU countries. Added to this are the military threats from Russia.

Even if the reality of trade policy has by no means always and everywhere corresponded to the ideal of free trade, the emerging new global trade order is damaging to the EU. It is not only China, with its restricted access to its domestic market, that has made only a limited contribution to market openness in the past. The EU itself, with its import restrictions, particularly on agricultural products, has also fallen short of the ideal. Among the member states, Germany in particular contributed to current account imbalances at the beginning of the century through its real devaluation strategies based on wage restraint.

The widespread positive connotation of current account surpluses as proof of superior competitiveness was particularly problematic. Ultimately, it forced deficit countries to make painful adjustments in order to avoid sinking into excessive foreign debt in the long term. What is fatal, though, is that such a view contradicts the theoretical insight that foreign trade is a source of mutual benefits. Instead, it falsely degrades it to a zero-sum game with winners and losers.

With the rise of right-wing populist governments, this idea has now spread globally. It guides the actions of the US

government under President Trump, aiming to turn its highly deficit current account into a surplus. The imposition of tariffs, exploiting the power of a large global single market, is intended to bring this about. Similarly, China is using its power over supply restrictions for strategic products, such as rare earths, to secure the same for its own economy. In other words, the two largest global economies are closing off their markets and at the same time exerting their power in global trade.

This is putting the EU in serious economic distress. Its most important export markets are becoming less accessible. Its technological lag in digitalisation is having a more profound economic impact, as both US and Chinese companies are pushing into the European market with greater power. On top of all this, a climate crisis looms, the damage from which also threatens to increasingly burden the European economy.

These are only the external threats. There are also internal ones. Right-wing populism is also finding resonance in EU member states. This is linked to a wide variety of economic policy strategies that give absolute priority to national goals over deepening European commonalities. Right-wing populist factions in the EU Parliament are already trying to implement this politically. This harbours further dangers. During this time of great external distress, the EU is in danger of becoming incapable of action due to internal quarrels.

Setting clear priorities

In times of such great distress, it is important to focus on the essentials. The EU's primary goals at present should be to ward off external threats and weaken internal ones. Overall, the EU's resilience in a turbulent global economy should be strengthened. Three areas should be at the forefront: infrastructure, innovation and crisis resilience (Draghi, 2024).

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The first two topics can also be described as offensive resilience strategies, as they directly increase the efficiency of the EU economy, making it more resilient and powerful. The resilience strategies mentioned in the third area of focus are defensive in nature, as they ward off threats from power games but at the same time make the EU's economy less efficient. Infrastructure refers to Europe-wide infrastructure, i.e. European public goods. It is about energy, mobility and intra-European trade.

It is obvious that some member states cannot or do not want to participate in these projects. Therefore, this path can only be pursued in an EU with differentiated speeds. The supranational formats already in use in many areas should be applied to economic policy.

The prerequisite is that at least the economically strongest states, Germany and France, agree. This would make the economic appeal of such an approach strong enough to encourage more and more EU members to participate in these programmes over time. As these are public goods, free-riding effects can never be completely ruled out. However, they should be accepted in order to broaden support for such an approach.

The second major task is the promotion of innovation. The EU's technological lag behind the US and China relates primarily to digitalisation (Draghi, 2024) and – in the case of the US in particular – to the application of artificial intelligence. The challenge now is not only to produce our own fundamental research, which is achievable given the good conditions for basic research, but the bigger hurdle for the EU is to make these results economically viable through industrial scaling. Appropriate strategies should be developed and programmes set up for this purpose.

The third area of great relevance, given the external threats, is crisis resilience. So far, the EU economies' ability to hold their own in trade wars involving disrupted supply chains and blackmail has been far too weak. The EU is currently unable to defend itself in terms of trade policy. However, global trade has become an area of conflict. The EU is still stuck in a model of economically determined global division of labour that has been rendered obsolete for the foreseeable future by the new power-oriented trade policy of the US and China's corresponding counter-reactions. In the current environment, an efficient global division of labour looks different than it did in times of largely rule-based free trade.

The EU will only be able to hold its own in this conflict-oriented environment if it leverages the strengths of its internal market. Only if the EU is perceived by both the US and China as an independent and powerful global agent

will it have a chance to represent its interests effectively in world markets in the future. This requires far-reaching measures on both the demand and supply sides.

Infrastructure in Europe

The EU's internal market is still incomplete. Regulatory differences, such as in the banking sector, which governments continue to uphold out of narrow national interests, still hamper trade and thus leave potential for prosperity untapped. The same applies to many public goods on a European scale. Two areas in particular stand out here: energy supply and mobility. Both are essential for competitiveness and for a successful climate policy.

Low energy costs are a cost advantage of considerable importance, as the costs of energy consumption not only directly influence the purchasing power of private households; since energy costs are reflected more or less in all products, they also have an indirect influence on the entire price structure. Above all, they are of considerable importance for production costs in global competition. Put together, this has a significant impact on employment and thus on the economic situation.

The energy system is also of great importance for climate policy. Whether the EU's climate targets are achieved depends to a large extent on whether energy production can be made largely emission-free. The most efficient way to achieve this is to establish EU-wide networks of emission-free energy sources. These include both centralised and decentralised storage capacities and reserve capacities to bridge periods of low wind and low sunlight. All of this can be done much more cost-effectively on a European scale than at national level. This is partly due to the diversification of risk in terms of weather and climate. Secondly, it allows the specific advantages of different locations to benefit the EU as a whole. Thirdly, it allows companies from all member states to contribute their relative strengths or utilise those of others, thereby exploiting the advantages of a technological division of labour.

There are already numerous EU initiatives to promote cross-border energy. The TEN-E Regulation (Trans European Network for Energy), the Action Plan for Grids, the Connecting Europe Facility and the RepowerEU initiatives all have precisely this goal. But the list alone shows how fragmented these activities still are. This calls into question their coherence. Furthermore, they are far from being given the necessary priority in national energy debates. The recurring debates in Germany about why so much energy had to be imported during certain periods are a striking example of this. It shows that energy security is still predominantly viewed through a national lens rather

than a European one. Against the backdrop of global tensions, this is particularly unfortunate. With the extensive isolation from Russia, relatively expensive liquefied natural gas is being sourced from the United States and the Gulf states. Under the confrontational global circumstances, these supply chains threaten to create new dependencies and reinforce old ones. This is dangerous in the current global situation.

The second priority in the creation of a European infrastructure should be mobility. Here, too, there are already initiatives such as the TEN-T – the Trans-European Transport Network. However, this is limited to a few main corridors, where progress is also quite slow. In view of the changed global situation, acceleration is urgently needed, particularly with regard to rail transport. Mobility that is as unrestricted as possible strengthens the internal market as a whole and thus opens up additional productivity potential.

The climate policy dimension should not be forgotten in this context. If transport is increasingly shifted to rail, this will reduce Europe's carbon footprint.

In order to achieve all this, it is necessary to rapidly dismantle the regulatory provisions that divide the member states. It is equally urgent to quickly provide the necessary financial resources. Since this is a classic case of investment expenditure, it makes perfect sense to take on at least some debt for this purpose.

Innovation in Europe

One of the major weaknesses of the European economy is its inability to exploit innovations commercially (Draghi, 2024). Many ideas remain unused or migrate outside the EU for this purpose, particularly to the US or China. As a result, the EU is stuck exporting medium-level technologies (Fuest et al., 2024). This would be acceptable as part of a rule-based world trade order within the framework of a functioning global division of labour. However, in the global trade wars that are now breaking out, in which economic power positions are crucial, it significantly weakens the EU's position. In an economy that is relatively poor in sought-after raw materials, the creation of new technological opportunities that establish at least a temporary monopoly position in important markets is one of the key sources of economic power. This could be a decisive advantage, especially in a global order based primarily on market power and less on rules.

Europe's weakness in innovation is not so much a lack of ideas. Rather, it lies in a lack of ability to quickly scale up economically viable ideas to the industrial level. This requires a

large amount of capital, which is clearly not being provided, or at least not sufficiently, by the European capital markets. It is unclear whether this is due to a more pronounced risk aversion or inadequate regulation of venture capital. Neither of these factors is likely to change in the short term.

There is another option, which is practised primarily by China: the EU could provide equity capital to emerging and innovative companies for a limited period of time. There are already a number of EU initiatives in this area. For example, innovative companies are supported under the New European Innovation Agenda. Yet these programmes are strikingly fragmented, which is likely to hamper the effective use of funds through a coherent strategy. As part of this agenda, the European Investment Fund (EIF) is to provide equity capital to enable companies to make investments that will significantly expand their production. For 2024, the EIF's annual report allocates approximately €7 billion (EIF, 2025) for this purpose. Even assuming that this sum will be leveraged with private capital, it is nowhere near enough for the EU to compete with the US or China. An increase in these funds is therefore urgently needed.

This is all the more important given that speed is of the essence, particularly in digital technologies, as the fastest innovative providers can relatively easily establish monopolistic market positions. This gives EU companies and EU political authorities economic and political power, which they know how to exploit in a power-based global economic order. The US customs policy and China's supply restrictions are telling examples of this.

Crisis resilience in trade

A power-based global economic environment is forcing a departure from the previous world trade order, which was characterised, at least in theory, by economic competition. The EU must establish its own position of power in this new environment. It must develop economic and political resilience to the power claims of China and the US.

The above-mentioned development of a modern Europe-wide infrastructure and the move towards a significant increase in entrepreneurial innovation are essential offensive elements of such a response. As economic instruments, they are even more suitable than US tariffs and Chinese supply restrictions, as they do not damage the EU's own economy.

Nevertheless, this is not enough. The EU must also rethink its trade alliances and supply chains in order to offer less scope for power games by its competitors. Ultimately, power can only be countered by power.

An essential step towards building this is to conclude new trade alliances or strengthen existing ones. Much of this has already been tackled. In addition to the UK, Canada, Mexico and Japan are natural allies in this regard. Added to this are the countries of the global south, which are increasingly exposed to Chinese power claims. The EU can help them strengthen their position of power vis-à-vis China.

The EU will have no choice but to make a difficult decision. It will have to open its markets more, especially in the agricultural sector, to countries in the global south, particularly in Asia and southern Africa. Internal conflicts, especially with France, show that this is likely to be anything but easy. The influence of right-wing populist parties within the EU, which are fundamentally sceptical about open markets, will also come into play here. They will seize on this issue and promise to protect domestic agriculture from foreign competition, even if this is at the expense of all other exporters. However, without improved export opportunities to the EU, countries of the global south are unlikely to want to join an EU trade alliance.

In addition to these new alliances to secure new export markets as at least a partial replacement for the US and Chinese markets, supply chains must be better protected against power games played by the US and China, as well as possible other imitators.

There are two possible strategies: diversification and relocation. Diversification of suppliers and supplier countries should already be possible in the short to medium term. This strategy was already under discussion after the supply chain problems during and in the aftermath of the coronavirus crisis. However, as the supply problems with semiconductor chips in 2025 show, this path has not been taken by many companies, or only to an insufficient extent. The competitive pressure to find the cheapest offer was apparently stronger.

However, if this pressure is yielded to, the dependencies remain. This is primarily a problem for the companies affected, which suffer production losses in the event of a conflict. But entire economies are also affected when supply difficulties arise for strategically important goods such as semiconductors.

It therefore makes sense for the EU to set up a resilience fund as part of the InvestEU programme to drive diversification forward faster than before. To do this, however, time pressure would have to be created for companies. This can be done either by limiting the funding available for a limited period of time or by setting a fixed upper limit for the total amount. Then only the quickest companies will receive funding. This should be an incentive to act rapidly.

The relocation of production must inevitably be a longer-term project, as technological capabilities may first need to be acquired. Relocation is also already being promoted in the InvestEU programme. However, this should be expanded in order to increase incentives. Both strategies will make the production of certain goods more expensive. This resilience strategy will therefore make the European economy less efficient, but at the same time more secure. These are defensive strategies, after all.

A more powerful EU

At a time when global markets are increasingly dominated by power politics, the EU must also become more powerful. Otherwise, it will lose economic strength and prosperity. Contrary to the programmes of right-wing populist parties, it is therefore necessary to strengthen EU institutions, not weaken them.

But this costs money. So how should these measures be financed? There is a well-known way: all countries that want to participate in these programmes should contribute to the financing in accordance with their size. Since infrastructure and innovation are investments, borrowing for this purpose would not be economically problematic. The funds for the resilience programme, which does not promise any positive productivity effects, but only greater security, must be financed through tax revenue. Whether national governments agree to this approach is a question of their economic policy priorities.

In any case, the use of available financial resources should be focused and not fragmented across numerous programmes, as is currently the case. Needless to say, the allocation of funds must be much less bureaucratic than it has been to date. Instead of costly input controls, there should be resolute output controls.

If all this happens and the EU steps up its efforts to improve infrastructure, boost economic innovation and increase resilience, not only will the EU's longer-term development be more positive, but so will its short-term development. This is because all these measures directly strengthen internal demand in the EU. This is particularly important at a time when export markets are under threat. In this respect, the path to greater resilience outlined above is in itself a contribution to increasing it.

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