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ECONOMIC INTEGRATION DURING AN AGE OF GEOPOLITICAL INSTABILITY

The EU's search for strategic autonomy

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SUMMARY

As the Covid-19 pandemic and the subsequent Russian invasion of Ukraine have fundamentally altered the dynamics of economic integration, and the rivalry between the US and China increasingly points towards a tectonic shift from the multilateral rules-based trading system, strategic autonomy has taken centre stage in EU policy discourse as a potential redress to the risks stemming from this shift. But what is it? And what does it actually imply?

The EU's pursuit of strategic autonomy fundamentally requires reducing reliance on other nations. Plunging headlong into a flurry of protectionist policies, however, will not ensure economic security, nor future prosperity. On the contrary, it will contribute to a global trading system that is even more fragmented, in clear contrast to long-standing EU strategic goals. Crucially, strategic autonomy implies maintaining global partnerships and striking a fine balance between openness and security of supply.

There is a combination of policy options – with different degrees of government intrusion in the economy – and policy trade-offs that can be pursued. Diversifying the supplies of products, services, and investments should be the first solution pursued to reduce dependencies. For strategic sectors where diversification may not be sufficient nor possible, public intervention should be considered.

This task raises two questions for the EU and national governments. First, what is strategic? The answer will define the scope of the policy intervention. Second, how do we deal with the chosen policy intervention's monetary and redistribution costs?

As this CEPS Explainer highlights, to really answer these questions, the objective and the scope of strategic autonomy should be much better defined and its costs and benefits carefully assessed.



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The EU has always strenuously promoted economic integration with the rest of the world – it served as a tool to create economic, political and cultural linkages with other countries. In a peaceful world governed by a rules-based system, this strategy made Europe not only one of the most important global trading powers but also one of the world’s most prosperous regions.

The Covid-19 pandemic and the subsequent Russian invasion of Ukraine have fundamentally altered the dynamics of openness and economic integration, and foreshadowed a long-term uphill struggle to preserve the EU’s prosperity. These disruptive events have underscored the need for the EU to enhance its resilience and ability to effectively safeguard its strategic interests. Already in 2020, alongside the Green Deal, the von der Leyen Commission proposed an EU industrial strategy that would support the EU’s ‘geopolitical’ role through strategic autonomy.

Since then, strategic autonomy is in vogue. A decade after its first official mention in an [EU document](#), a burgeoning literature discusses its origins, definition and the associated trade-offs. Yet, this literature yielded different interpretations of the notion. What is clear is that the discussion around strategic autonomy marks a remarkable shift in narrative, one in which trade ‘integration’ is superseded by geopolitical ‘vulnerability’.

As the EU is gearing up to respond to challenges that could signal a tectonic shift from the multilateral rules-based trading system that has been the hallmark of the post-World War II era, it can ill afford to be vague about its objectives. Recent policies put forth by key global powers signal a preponderance of geopolitical rather than economic considerations. But plunging headlong into a flurry of potentially ill-conceived and protectionist policies will not ensure economic security, nor future prosperity. At this stage, the EU would greatly benefit from more clarity on what its drive to achieve strategic autonomy should in practice translate into.

WHAT IS STRATEGIC AUTONOMY?

It’s not easy to achieve such clarity. An [overview](#) of the substantial body of literature on the definition of open strategic autonomy (OSA) reveals just how elusive the concept is. Rather than a merely hypothetical and conceptual problem, this vagueness has tangible policy consequences. Which policy areas are strategic and should take precedence over others? What would constitute an ‘optimal’ degree of autonomy? Which external factors warrant a move towards more (economic) security?

Instead of providing a definition of the concept, the debate on strategic autonomy [has focused on what it is not](#). What emerges is that the term should not be understood as a reference to autarchy, protectionism, or unilateralism. Neither is it confined to defence and security policy or building resilience or self-reliance. Instead, it should be understood



as a means to promote EU interests and values. On its end, the [European Commission](#) [defines](#) open strategic autonomy as ‘*the EU’s ability to make its own choices and shape the world around it through leadership and engagement, reflecting its strategic interests and values.*’

The EU is not alone in its quest for reducing reliance on other countries. All major powers have implemented similar policies, advocating different reasons and using different narratives, but with ultimately a similar effect. While in the US, ‘America First’ became the major slogan under the Trump administration and defined a new yardstick for an inward-looking America, the US had already shown earlier signs of withdrawal from its role of benevolent hegemon. The Inflation Reduction Act (IRA) is the most recent example¹ of a shift towards putting domestic objectives first and then resorting to substantial market intervention to promote them, even at a cost to its global partners.

Similarly, in 2015, China put forward the ‘[dual circulation strategy](#)²’, which embedded the idea of China becoming a self-sufficient nation. This was accompanied by the launch of China’s industrial policy masterplan ‘made in China 2025’. Since the 1980s, for certain strategic raw materials, China [has crafted plans](#) involving state-sponsored domestic and foreign investments. More recently, China’s attitude towards Western economies has

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become much more assertive and, in some cases, even openly contentious in the direction of a new global leader disconnected from Western powers. The ‘[Make in India](#)’ initiative, launched in 2014, was a step in a similar direction.

The EU has (thus far) steered clear of openly promoting domestic production. The principles of trade openness and market competition remain at the heart of the EU project and guide its decisions inside and outside. However, a growing number of measures and initiatives have been designed to defend EU interests and respond to unfair practices.

¹ See also [The Atlantic Declaration](#) in the framework of UK-US cooperation.

² The dual circulation strategy is a two-pillar approach aiming to spur domestic demand (‘internal circulation’) and, at the same time, at supplying export markets (‘international circulation’). So, on the one hand, the country seeks to improve its ability to participate in global trade, finance, and technology, and on the other to strengthen domestic consumption, production and technological capabilities to promote self-reliance.



IN THE NAME OF STRATEGIC AUTONOMY

Within this global context and considering the EU's longstanding performance anxiety *vis-à-vis* global competitors, the European Commission's newfound zeal for OSA-related policies is hardly surprising.

The Covid-19 pandemic, the invasion of Ukraine and the growing awareness of risks associated with trade linkages have all acted as catalysts for new measures. The pandemic uncovered Europe's dependencies on global supply chains in key strategic sectors as well as access to critical raw materials. This in turn shifted the OSA discussion from its initial focus on foreign policy and defence to economic and industrial policy.

Within a couple of years, the EU proposed or adopted several legislative initiatives, investment programmes, and strategic partnerships with the aim to respond to new risks and contribute to strategic autonomy. Examples are the framework regulation on [investment screening](#), the [regulation on foreign subsidies](#), and the EU [instrument on protection](#) from economic coercion from third countries (but this latter proposal is yet to be adopted). These have been complemented by initiatives linked to strategic value chains that aim to improve the resilience of the EU's economy, such as the proposed [European Chips Act](#) (which has the ambition to double Europe's share of global microchip production by 2030).

More generally, given the centrality of industrial strategy to the strategic autonomy agenda, the three proposals constituting the [Green Deal Industry Plan](#), namely the Net-Zero Industry Act, the Critical Raw Materials Act and the revised state aid framework, are all expected to improve strategic autonomy with a combination of regulatory and fiscal measures.

The latest instalment of OSA policies, the '[Economic Security Strategy](#)', was unveiled earlier this month. This 'helps to define the strategy that should guide the common assessment of risk'. It also proposes a new measure to address security risks resulting from outbound investments.

A TALE OF TRADE-OFFS

Accompanying the political discussion on strategic autonomy, the (economic) policy and academic debate has emphasised the trade-offs associated with OSA.

ECONOMIC EFFICIENCY VERSUS ECONOMIC SECURITY

At the centre of the debate lies the trade-off between economic efficiency and security of supply.

Covid-19 and Russia's weaponisation of the EU's energy dependency have raised fundamental questions about the factors that should define the structure of the supply value chain and the supply of energy (and other raw materials).

Long supply chains, particularly if scattered across several regions, make it difficult for individual firms to keep their dependencies in check, as downstream actors often have [little control over upstream production steps](#). The [logic of strategic autonomy implies](#) that making decisions based purely on the economic merits of investments, outsourcing or trade could leave the EU vulnerable to a few unreliable partners who could use this as leverage (the 'weaponisation' of trade) to achieve political goals at the expense of the EU's interests. In the context of increasing geopolitical rivalry and the steady erosion of

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the multilateral rules-based trading system, diversifying and securing critical parts of the supply chain therefore become vital objectives – or so the argument goes.

Consequently, there has been a growing debate in the EU on [reshoring](#), near-shoring and friend-shoring. The terms refer to the

process of relocating the manufacturing activities and production sites back from third countries to the EU, or to a geographically close or a 'like-minded' country. While reshoring can help reduce the vulnerability of critical supply chains, it inherently carries an economic cost. In a rules-based trading system, decisions by economic operators to offshore parts of the production process can be assumed to be in line with the logic of comparative advantage building on local factors. Reshoring thus implies less optimal conditions, requiring not only significant investments in infrastructure, technology, and training but also results in higher operating costs.

These costs are likely to lead to higher prices for consumers and lower global competitiveness for re-shored industries. This, in turn, can also have a public cost. Reshoring may be appealing for businesses only if the government incentivises the process by handing out subsidies, tax breaks and other similar measures (this is happening in the US with the IRA). This could make some companies completely dependent on government support.

A similar setting applies in the context of a 'friend-shoring' strategy, whereby production is relocated to countries with shared values. Thus, in principle, the process should be driven by a better alignment with the principle of comparative advantages and would presumably lead to lower overall welfare losses, but at an implied cost.



..BUT IT IS MORE THAN THAT

The reality is that trade-offs are not only limited to economic inefficiency.

Reshoring production may entail bringing back severely polluting activities to the EU that are likely to be tied up with red tape and run against many Europeans' NIMBY tendencies. Taking the well-documented example of access to [critical raw materials](#) – indispensable for a successful digital and green transition – opening new mines is very likely to run into strong opposition from the public as well as bump up against existing environmental standards. At the same time, lengthy and costly permitting procedures, as well as a high regulatory burden, pose a formidable constraint that could discourage investment in such activities within the EU. The same argument applies in practice beyond raw materials.

Another important trade-off concerns the potential asymmetrical impacts of strategic autonomy policies across EU Member States. Western and northern EU countries host relatively larger – and internationally more competitive – companies, which are [better suited](#) to weather the ramifications of new regulation on, for example, access to foreign investments, technology or knowledge. Moreover, a subsidy race is likely to favour Member States with deeper fiscal pockets. Evidence emerging from the use of the Temporary State Aid Framework indicates that just two Member States (Germany and France) account for a [large majority of total aid](#), with the framework already likely [producing distortion in competition and negative effects on trade](#).

Finally, in the drive to become less dependent and more autonomous, there lies the inevitable risk that the EU, by reducing its global linkages, [loses its own leverage over others](#). This clearly contradicts its ambitions to '[act as a truly global player](#)'.

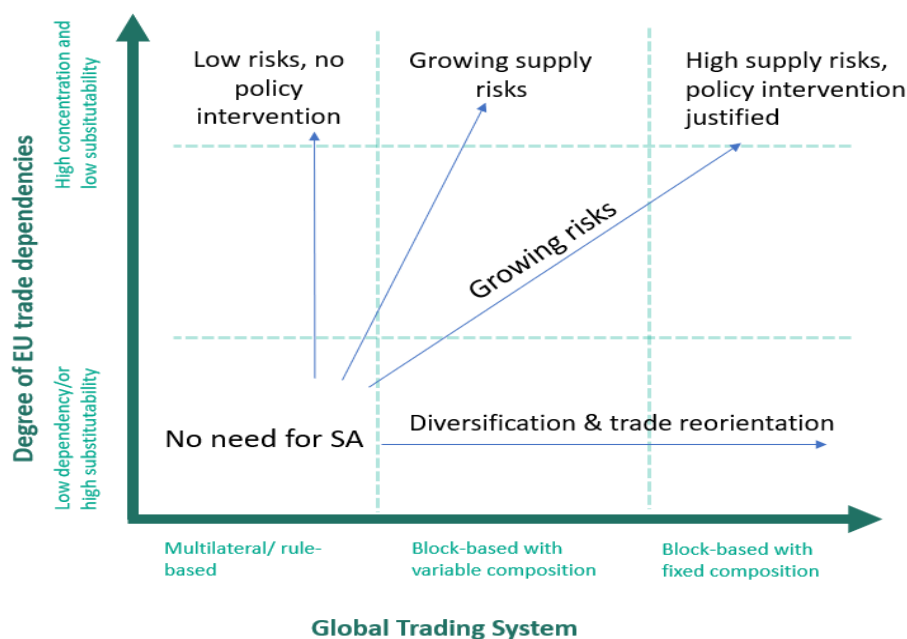
IS THERE A COMPASS TO GUIDE STRATEGIC AUTONOMY CHOICES?

In view of these trade-offs, the careful balancing of OSA policies is clearly essential for future EU policies. The EU has acknowledged the importance of maintaining, and even fostering, its longstanding partnerships and cooperation with allies and partners, especially the US. Nonetheless, there is little doubt that the uncertain US political landscape is not going unnoticed. The EU increasingly seeks to decrease its reliance on other partners for its security and prosperity. While this is the essence of open strategic autonomy, what does this mean in practice?

From an economic standpoint, the question boils down to how to identify the degree of openness (something in between full openness and self-sufficiency) that allows access to the largest set of international opportunities and satisfies geopolitical considerations, i.e. that it's compatible with an assertive defence of the EU's key interests and its protection against unfair practices (above all the weaponisation of trade).

One way to operationalise this idea is to dissect the problem along two dimensions – the degree (and the nature) of existing (and emerging) trade dependencies and the evolution of the geopolitical space that determines the global trade system (see figure below).

Figure 1. How to operationalise the concept of strategic autonomy



Source: Authors' own elaboration.

The trade dependency dimension (vertical axis in the figure) goes well beyond large volumes of imports³. In addition to the extent to which EU countries import a certain good or a product, one should consider whether such imports are concentrated in a few or just a single supplier (at country level) and the extent to which production could take place in the EU (the potential substitutability of imports). In principle, the combination of high relative import demand-dependency, high concentration and low substitutability is a good recipe for dependency, but not necessarily for policy intervention (see vertical arrow in the Figure above).

But the type of product also matters. Not all dependencies should be of concern for the purpose of achieving strategic autonomy – only high dependency on products belonging to sectors which can be qualified as being strategically important. These are sectors (industries) for which the loss of access to certain products or materials could result in debilitating effects on security, economic security, development (including the achievement of the green and digital transformation), public health and/or safety, or any combination of the above. Whether the country from which the EU imports can be

³ While trade dependency mostly refers to imports, exports also matter. As a very open economy, the EU is a central part of many global value chains and hence highly exposed to foreign demand. Therefore, both import and export (trade) dependencies should be considered.

considered unreliable or could be tempted to weaponise its dependency is a key consideration for any assessment.

Mapping sectors (possibly products) that are strategically important to the EU is a crucial first consideration for the trade dependency dimension. A lot of work has already been done on this. Until now the mainstream approach has focused on mapping (significant) dependencies in sensitive EU industrial ecosystems⁴ to identify [possible vulnerabilities](#)⁵.

While valuable, this approach has limitations. Sensitive ecosystems are very broad (their original purpose was of course not to serve the concept of strategic autonomy) and the actual identification of the relevant products is determined by the degree of dependency, not by how strategic they are. If the 'strategic' connotation needs to reflect geopolitical considerations, as we argue above, this needs to reflect political priorities.

But accurate foresight is notoriously difficult because the definition of 'strategic' sectors and products continuously evolves over time, but also because the risks and their perceived magnitudes hinge to an extent on the nature of (future) shocks. The example of the Covid-19 pandemic (e.g. masks, respiratory equipment, vaccines) is a case in point.

Nonetheless, it is critical that the list of strategically important sectors and products be forward-looking. To date, this is still missing in the EU. The notable exception is the JRC's [impressive study](#) forecasting the evolution of demand until 2050 in 15 key technologies. In the US, the [Atlantic Council](#) identified a clear list of five sectors to monitor for the purpose of friend- or re-shoring. A similar list, reflecting the EU's resource endowment and its economic structure, would help to focus efforts but not necessarily lead to the automatic cutting of commercial ties.

The second dimension of the problem (horizontal axis in the figure above) is the state of the global trading system. There is a growing concern that current trade tensions between the US and China could lead to increased geopolitical rivalry and in turn to a bipolar configuration led by these two economies and their respective allies. This could start as blocs with variable compositions and substantial trade openness. But if tensions escalate, the blocs could ossify into having a defined composition and favour – or even only permit – intra-bloc trade (see the sliding scale of the horizontal axis). Thus, the more we move away from a multilateral trade system based on rules and towards a system dominated by power, the higher the risks the EU is exposed to (see the arrows up and to the right of the figure).

⁴ The concept of an industrial ecosystem was introduced by the European Commission in 2020, when it presented the New Industrial Strategy. The strategy is framed around 14 different ecosystems which represent around 90 % of the business value added in the EU. Of the 14 industrial ecosystems, six are labelled as sensitive. They include digital, electronics, renewable energy and energy intensive industries, health and aerospace and defence.

⁵ See also Alcidi et al. (2023) *forthcoming*.



Together with the US, China plays a key role in defining the world's geopolitical space. It must be acknowledged that China occupies a crucial position in global trade, supply chains and investment partnerships. Any attempt to decouple or diminish economic ties with China will lead to major challenges for EU policymakers and companies. Furthermore, an EU decoupling from China would inevitably contribute to a more divided world, which is the very outcome that the EU wants to avoid at all costs.

SO, WHAT ARE THE OPTIONS FOR THE EU?

Going forward, first the EU should attempt to remain as open as possible. It should not be forgotten that the EU is made up of trading nations, and measures impairing trade would not only harm the EU's growth model, they would also weaken one of the key tools that defines its global actorness. As the EU's relative economic weight declines, driven by the emergence of other economic powers (like India and some African countries), economic relationships are likely to remain crucial for defining who the key global actors are in a politically more fragmented world.

Second, the diversification of supplies, encompassing products, services, and investments, should be the first solution to reduce dependencies. In practice, this may happen quite naturally as companies reassess risks (for instance in global value chains) and choose to relocate (part of the) production and to explore other suppliers. This option should be in line with the fundamental principles of market-based economies and companies' own risk assessments, hence leading to limited market disruption and distortions.

There are sectors – the strategic ones – where risks may be growing and diversification may not be sufficient nor possible, however. In such cases, (limited) public intervention should be considered. Crucially, government intervention (subsidies, taxation, regulations), which should aim to deliver a public good – i.e. the security of strategic supplies – will certainly entail monetary costs and, most likely, lead to a cascade of redistribution effects (across companies, EU Member States and citizens).

Thus, going forward, it is vital that both the benefits and costs of seeking strategic autonomy should be carefully assessed and acknowledged, the result of an informed policy choice and not a kneejerk reaction to unexpected or unwelcome events.

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