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Article

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Intereconomics

Suggested Citation: Tagliapietra, Simone; Trasi, Cecilia (2024) : How Should Europe Think About Economic Security?, Intereconomics, ISSN 1613-964X, Sciendo, Warsaw, Vol. 59, Iss. 2, pp. 88-91, <https://doi.org/10.2478/ie-2024-0019>

This Version is available at:

<https://hdl.handle.net/10419/297704>

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How Should Europe Think About Economic Security?

In the context of evolving geopolitical dynamics and economic challenges facing Europe, the emphasis on economic security within the European Union's policy agenda is increasingly pertinent. The array of crises, from the COVID-19 pandemic's lasting effects to geopolitical tensions arising from the Russia-Ukraine conflict, highlights the necessity for the next Commission to place economic security as a foundational element of its strategic focus. This approach is critical not just for protecting the Union's economic interests against external shocks but also for promoting internal market resilience and sustainability.

Economic security has become a leitmotiv of Europe's economic policy discourse, prompted by multiple crises, spanning from the COVID-19 pandemic to the Russia-Ukraine war, the ensuing energy crisis, and mounting tensions between the US and China. These events have spurred discussions on the integration of a renewed quest for geopolitical resilience into Europe's well-established model of open trade and comparative advantage.

Last spring, French President Macron advocated for a new doctrine of "European economic security" (Kauffmann, 2023; Wright, 2023) focused on ensuring competitiveness, revitalising industrial policies and promoting reciprocity with trading partners. Shortly thereafter, Germany disclosed its very first National Security Strategy, which recognised how unilateral dependencies in economic relations can develop into security risks (Federal Foreign Office, 2023). In June 2023, the European Commission unveiled its European Economic Security Strategy (European Commission, 2023). The strategy identifies four prominent risks that endanger economic stability: the vulnerability of supply chains, the threats to physical and cyber security of critical infrastructure, the potential leakage of technology and the weaponisation of economic dependencies or coercion.

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Open Access funding provided by ZBW – Leibniz Information Centre for Economics.

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In early 2024, the European Commission adopted a package of five initiatives in trade, investment and research policies aimed at safeguarding and promoting domestic technology and industry (European Commission, 2024). These initiatives adopt a flexible approach to supporting innovative research, a common approach on export controls, and the screening of outbound investments. However, this package primarily consists of non-binding legislation; many of these ideas are currently in the form of opinions and recommendations, the implementation of which hinges on the preferences of EU member states as they are responsible for their own decisions on investments and export controls.

It is crucial to avoid the emergence of a fragmented landscape of control measures, especially as the current geopolitical landscape and the race for new technologies necessitate enhanced coordination, effectiveness and efficiency in the EU's existing regulatory framework and practices. Amid the growing importance of this issue, a fundamental question arises: what does "economic security" truly entail? Remarkably, the definition of economic security remains elusive and lends itself to different interpretations. Determining the criteria under which a nation can assert economic security is as complex as identifying the strategies needed to attain it.

In this piece, our objective is not to provide an ultimate and rigid definition of economic security. Instead, we aim to set the stage for a broader discussion by highlighting the nuances often overlooked in this ongoing debate.

Economic security: A historical excursus

The concept of economic security is born in political economy and international relations theories. With his seminal work on the relationship between foreign trade and national power, Hirschman (1945) pointed out that economic security means building robust economic systems able to withstand external pressures and adapt to change through diversification and flexibility.

The concept of economic security developed further in response to events like the oil shocks of the 1970s and the fall of the Soviet Union in 1991. The oil shocks emphasised the risks of economic dependencies, and asserting economic security meant protecting a nation's economic interests from external threats and ensuring stability within its borders. Approaching the collapse

of the Soviet Union, economic security evolved into a multifaceted idea encompassing the protection of a nation's social and economic fabric, regulation of social cohesion, and cultivation of a stable international economic environment (Sperling and Kirchner, 1998). In fact, since the 1980s, economic and financial instruments have become essential diplomatic tools, with economic interdependence gaining significance in shaping security considerations (Baldwin, 1985; Gilpin, 1992).

Between the 1980s and the 1990s, in an historical context in which many conceived nations almost as corporations engaged in a global competition to gain market share, fears emerged in Europe about its lack of competitiveness in electronics and other technologies compared to the US and Japan (Pinder, 1984; Cable, 1995). These fears sparked an economic security debate that is strikingly like the one ongoing today.

As a result, from the early 2000s to this day, the most conventional approach to achieve economic security has focused on supply diversification to avoid overreliance on external suppliers of technology, raw materials, food and energy. In practice, concerns over “security of supply” address first, the potential disruptions in imported supplies caused by factors such as war or foreign sanctions, or accidents that significantly affect a national economy or specific industries; second, the unfavourable trade conditions due to supplier monopolies or cartels.

It is important to underline that placing undue emphasis on the security dimension might lead policymakers to fixate on the geopolitical facet of economic security, potentially yielding unintended consequences. Focusing efforts on countering declining competitiveness by actively promoting so-called strategic industries (Tyson, 1992) may result in wasteful expenditures aimed solely at enhancing competitiveness at the expense of addressing underlying structural challenges (Krugman, 1994) that would still leave economies vulnerable to shocks as a result. In fact, threats to economic security arise not only through the antagonistic actions of other countries, but also through external and domestic shocks.

Economic security and resilience

This perspective has recently led to a growing interest in cultivating “economic resilience”. In fact, this interpretation of economic security really points to the need to enhance economic *resilience* by minimising risks and vulnerabilities against various types of shocks, whether external or domestic.

The concept of economic resilience took centre stage in Europe, particularly during the financial and sovereign debt crisis. The weaknesses within national economic structures were laid bare: labour market rigidities, restricted competition in product markets, hindrances to new business entry, complexities in daily operations for existing businesses and the quality of government services (e.g. rule of law and corruption-ridden environments) were all factors that tended to impede higher shock absorption capacities (Sondermann, 2018).

However, defining what constitutes economic resilience is as challenging as pinning down the concept of economic security as there is no universally agreed-upon definition of it. A short digression on its meaning might be useful here.

The term first emerged in the study of ecology when Holling (1973) referred to resilience as a system's ability to persist through change and disturbance while maintaining relationships between variables. The term was also used in economics, and most notably in regional economics. Pendall et al. (2010) defined economic resilience as the ability of an economic system to return to a previous state while adapting to external shocks, or in other words, the ability to rebound (Brunnermeier, 2021).

While closely related, economic resilience should be distinguished from the concepts of “exposure”, the degree to which a system is subjected to a crisis or shock, and “sensitivity”, the degree to which a crisis or shock actually impacts the system and its functions (Mumby et al., 2014). A low degree of sensitivity is called “robustness” which implies that a system has a strong ability to resist shocks (Anderies et al., 2013). In fact, while it is efficient to combine low sensitivity and resilience when designing systems (that is, to include safety buffers), too much robustness is undesirable as a system can become too rigid and thus forfeits the capability to change and improve its structure (Brunnermeier, 2021). In the spirit of never letting a good crisis go to waste, a muscular shock can be an opportunity for transformation of structures that can lead to a more favourable (or a less favourable) growth model than before in what is called a “hysteresis effect” (Martin, 2012).

Policymakers then should aim to strike a balance between sensitivity and resilience. The right mix of policies can foster economic resilience to allow an economy to not only withstand shocks, but successfully adapt. Notably, studies by Briguglio et al. (2006) and Briguglio (2016) reveal that even economically vulnerable small states can promote growth and competitiveness through

well-designed economic policies that foster macroeconomic stability through fiscal sustainability, low inflation and close-to-natural unemployment rates, accompanied by external balance evident in international current account positions and external debt levels. Incidentally, this would improve competitiveness as well (Briguglio and Vella, 2019).

Resuming the threads of the discussion: How should Europe think about economic security?

Amid the evolving global landscape, Europe must recognise that economic security is intertwined with economic resilience. Framing economic security purely as an economic facet of “national security” might inadvertently weaken Europe’s resilience against other types of threats, such as exogenous or domestic shocks. Take autarky as an extreme example – it might serve against foreign threats but is an inadequate overall security strategy. At the same time, conceiving economic security solely as resilience against domestic shocks overlooks the strategic dimensions of security, wherein threats might indeed arise from other countries, as the consequences of Russia’s war in Ukraine illustrate. Understanding this game-theoretic dimension can aid in reducing such threats.

Therefore, we need to think about both sides together. Going forward, it would be wise to draw upon valuable lessons from historical developments that have shaped economic systems to distill some useful principles.

First, it is crucial to recognise that economic security thrives on international integration, rather than isolation. Collaborative actions during past oil shocks exemplify this principle, where coordinated efforts of importing nations via the International Energy Agency (IEA) minimised supply disruptions, thereby safeguarding national economic security (Cable, 1995). The IEA’s coordinated efforts ensured that member nations had access to energy resources during times of scarcity. This access helped stabilise domestic energy prices, preventing inflationary spikes and ensuring that industries could continue their operations. Then, the concerted response helped build a sense of resilience, fostering confidence among businesses and consumers alike, and bolstering economic stability. In other words, in times of crisis, it is better to go together than to go it alone.

Second, blindly supporting declining industries to regain lost competitiveness might result in being inefficient and do little to strengthen economic security. In the 1980s, the fear over the loss of competitiveness in the automotive sector led the US to impose voluntary

export restrictions on Japan to limit car exports. However, the restrictions only safeguarded a maximum of 1,500 new jobs for domestic autoworkers and resulted in an increase in the price of new Japanese cars of over US \$1,114 per car, transferring approximately US \$2 billion from consumers to producers and dealers, and creating efficiency costs of US \$166.4 million (Bryan and Humpage, 1984). On the other side of the Atlantic, restricting Japanese car exports to the European Community until 1999 favoured competitive automakers, particularly in Germany, but had no impact on the overall decline of British car production (Ferguson, 2023). In other words, it is better to embrace transformation rather than resist it.

Finally, it is imperative to include in debates on economic security and resilience a thorough evaluation of the effectiveness of current economic systems. In the aftermath of the 2008 financial crisis, the Baltic countries experienced a more severe economic downturn compared to southern European nations, yet they managed a quicker recovery. By 2019, the GDP per capita in the Baltic countries had surpassed their 2008 levels. Conversely, all four southern eurozone members were still below their pre-crisis peaks. Several factors contributed to the Baltic countries’ relative success compared to their southern counterparts. These include external adjustments, a low public debt-to-GDP ratio that served as a fiscal cushion, and a high degree of microeconomic flexibility, which facilitated sectoral reallocations and adaptations (Darvas, 2019).

Indeed, the capacity to rebound effectively from a crisis is significantly bolstered when a nation possesses flexible institutions, coupled with robust economic governance frameworks (Sondermann et al., 2019). Their flexibility allows for quick responses to emerging challenges, as they can swiftly adjust policies, regulations and procedures to address the unique demands of a crisis. As a matter of fact, flexible institutions could provide targeted stimulus measures, implement regulatory changes and support vulnerable populations, all of which were essential for mitigating the impact of the crises brought on by the COVID-19 pandemic or the Russian invasion of Ukraine. In other words: in a storm, it is better to bend with the wind rather than stand still.

In light of global challenges, including pandemics and geopolitical tensions, it is essential for the next Commission to integrate economic security into its agenda. The recent disruptions to global supply chains have highlighted the need for economies to mitigate vulnerabilities to external shocks. Additionally, the digital transformation, while beneficial for growth and innovation,

introduces cybersecurity risks that could compromise economic stability. The impacts of climate change on the European economy further necessitate a policy approach that combines economic stability with environmental sustainability. Therefore, the next Commission should focus on policies that increase the EU's self-reliance in critical sectors, support sustainable technology innovation and enhance digital infrastructure security. By addressing economic security in its policy framework, it is worthwhile to observe three key principles distilled in this contribution: the cultivation of economic security and resilience by prioritising global engagement rather than adopting protectionist measures. They need to embrace transformation rather than resist it and foster adaptable economic systems to ensure that they can stand their ground when the next shock hits.

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