Summary

Europe in the Era of Geoeconomics

Rebalancing Trade, Boosting Innovation

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Europe in the Era of Geoeconomics: Rebalancing Trade, Boosting Innovation is a government advisory document prepared on behalf of the full Netherlands Scientific Council for Government Policy (Wetenschappelijke Raad voor het Regeringsbeleid, WRR).

WRR-Report 115 was prepared and written by:
Ab Klink (Council Member and Chair of the Project Group),
Maarten Lindeboom (Council Member),
Josta de Hoog (Project Coordinator),
Bart Stellinga (Research Fellow),
Haroon Sheikh (Research Fellow).

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THE NETHERLANDS SCIENTIFIC COUNCIL FOR GOVERNMENT POLICY

This publication is an English summary of WRR Report 115 *Strategisch handelen: Beleid voor een geopolitieke economie.* For substantiation of the conclusions and recommendations presented here, the reader is referred to the comprehensive analysis of policy and the scientific literature found in WRR Report 115.

The Council presented the report *Strategisch handelen: Beleid voor een geopolitieke economie* to the Dutch government on 27 August 2026.
The report can be downloaded for free at wrr.nl.

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The Netherlands Scientific Council for Government Policy
Buitenhof 34
P.O. Box 20004
2500 EA The Hague
070-356 46 00
info@wrr.nl
wrr.nl

Summary

We live in an era of geoeconomics – we are witnessing a geopoliticisation of economic relations. Where mutual economic dependencies were previously seen mainly in a positive light, they are now more often deployed for geopolitical leverage. The European Union is particularly vulnerable in this situation. Europe is dependent on the US and China in many key areas, but there are fewer vital dependencies the other way around. While the urgency of this issue is widely felt, Europe's dependencies are not actually diminishing. This is the result of two underlying dynamics: (1) the global innovation race and (2) growing imbalances in international trade.

The global innovation race

A global innovation race is underway, which is seeing not only companies compete with each other, but also countries and their innovation systems. This is especially the case for critical technologies that are of vital importance to society, such as in the fields of digital services and energy. For many of these technologies, the economies of scale are immense due to high R&D costs, high start-up costs and the required knowledge and skills. This means that once a lead has been established, it is not easy for others to catch up. Companies and countries therefore have a strong interest in reaching and remaining at the forefront.

For a long time, the US was the clear frontrunner in technology, but it has since been overtaken by China in several areas. Both countries have robust innovation systems, with many differences of course, but they also share a number of key features. Firstly, there is the combination of direction and orchestrated competition, whereby the government continually challenges companies to innovate. Secondly, there is a focus on the entire value chain – from suppliers to end markets – and the surrounding ecosystem. This includes raw materials, energy and infrastructure. Finally, these countries can be highly strategic vis-à-vis foreign companies.

Growing imbalances in international trade

We are also confronted with major imbalances in international trade. The US runs a huge trade deficit, while China has a massive surplus in goods exports. This enormous surplus is no coincidence; it is the result of an economic strategy that relies heavily on exports. There are three underlying factors that help explain the surplus:

- Low domestic demand: This is partly due to low wages and partly due to the fact that households save a relatively large share of their incomes, given limited public provisions for healthcare and pensions.
- High state subsidies: The OECD estimates that Chinese companies receive on average three to eight times more industrial subsidies than companies in OECD countries. The organisation itself describes this as a conservative figure. These state subsidies account for a large share of the growth in global market share of Chinese companies.
- The undervalued yuan: China's currency – the yuan – is estimated to be undervalued by between 12% and more than 30%, which gives the country a significant competitive advantage. The exchange rate is actively managed by the Chinese central bank and major state-owned banks.

Consequently, a great deal of Europe's industrial sector has come under pressure, with studies showing that Chinese companies offer products that are more than 30% cheaper than European products. This makes it almost impossible for European companies to compete with Chinese ones, with economic dependencies likely to increase even further as a result.

The challenge for Europe

Europe is faced with a major challenge. The two largest economies in the world – the US and China – are increasingly deploying economic dependencies as an instrument of geopolitical power. Europe is vulnerable owing to the vital dependencies it has on these two countries. Although our awareness of the situation is growing, our dependencies are not decreasing; if anything, they are growing even further. Consequently, a robust response is required.

That is no easy task; in fact, it is a challenge at four different levels.

- At the level of assumptions: we need to look at the global economy through a different lens than the one we have used in recent decades. If we stick to the previously dominant liberal world view, we will fail to tackle the challenges that lie before us.
- At the level of institutions: we need institutions capable of greater direction and control, while remaining responsive to a changing environment.
- At the level of international cooperation: how do we choose our partners in this fragmenting world order and how do we deal with a multilateral trade order that is becoming less and less effective?
- At the level of instruments: we do not have the policy instruments needed to deal effectively with this situation – not at the international level, nor at the European or national level.

Key takeaways

Because the geopoliticisation of economic relations is an issue that challenges so many of our fundamental assumptions – both in our thinking and in our institutions – there is no immediately obvious answer. Our response will have to be developed step by step, in close cooperation with other countries. In the report's final chapter we discuss potential ways forward and the key considerations behind them. Four main messages emerge from this.

1. Industrial policy is important, but by itself not enough to tackle strategic dependencies. Formulate a strategy that addresses both trade imbalances and innovation.

In European policy debates, the global innovation race is often front of mind – and with good reason. However, focusing only on industrial policy and competitiveness in an effort to keep pace in the global innovation race, without addressing the dynamics of growing trade imbalances, has major shortcomings. Europe risks spending large sums of public money and jeopardising key European values and ambitions in areas such as privacy, working conditions and climate policy, without actually reducing its critical dependencies. Certainly, a strong industrial policy is crucial. China and the United States are advancing rapidly in technology, supported by powerful innovation systems. In today's increasingly geopolitical world, in which economic dependencies are more often deployed as instruments of geopolitical power, it is important to strengthen our position in critical technologies. The first key takeaway from this report is that both are needed: a response to trade imbalances and a commitment to a strong European innovation system.

2. Doing nothing also comes at a high price. Therefore, to address trade imbalances, all options need to be on the table, even if they are painful.

Large parts of the European industry are under pressure. In Germany, we have already seen this result in large-scale job losses. Under the current circumstances, doing nothing also comes at a high price. If we do not act, our dependencies will only worsen, and we will be hit hard economically. A strong response would also come at a price: government support will be needed, trading partners may retaliate and prices could rise. These drawbacks have, thus far, discouraged the EU and its Member States from formulating a robust response. But the costs must be weighed against the potential damage of geoeconomic coercion, trade shocks and long-term economic costs. All policy options must therefore be seriously considered, even if they are painful.

3. Europe is lagging behind when it comes to applying and scaling up technological innovations. Commit to a coherent European innovation system.

Limiting our high-risk dependencies requires a strong European innovation system. While China and the US have coherent innovation systems, the European system is still fragmented and lags behind in scaling up and bringing technological innovations to the market. We need a consistent policy across the different stages of the innovation cycle – from breakthrough innovations to market introduction. At the moment, the European Union and its Member States find themselves caught in a mutual constraint. Member States are limited in the scale they have, the financial support they can provide and the conditions they can impose. But the European Union is also limited in its budget and powers, which means that a fully fledged European industrial policy fails to get off the ground. It is critical that we break this deadlock.

4. The world as we knew it no longer exists. Dare to think outside existing frameworks.

Europe has benefited greatly from a world of free trade governed by international agreements. However, the pillars of this post-war multilateral trading order are crumbling. This changing reality is not something that we can afford to ignore. Now that the world has fundamentally changed, it is important to reconsider entrenched perspectives on trade policy, industrial policy, government intervention and competition. If we fail to do so, do too little or wait too long, we run significant risks. Only by daring to think beyond conventional approaches can we build a prosperous future for Europe.

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Economic relations are increasingly used as instruments of geopolitical power. We are living in an era of geoeconomics. The European Union is particularly vulnerable in this situation. While the urgency of this issue is increasingly recognized, Europe's dependencies are not diminishing. This has to do with two underlying dynamics: the global innovation race and growing imbalances in international trade.

In European policy debates, the global innovation race is often front of mind – and with good reason. A major effort is required to develop a truly effective industrial policy with sufficient direction and scale. But unless simultaneously a solution is found for the growing trade imbalances, we risk spending vast amounts of public money, and jeopardising key European values and aspirations in areas such as privacy, working conditions and climate policy – without actually reducing our critical dependencies. Therefore, the core message of this report is that both are needed in combination: a response to the growing trade imbalances and a commitment to a strong innovation system.

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