Strategic autonomy: issues for central banks

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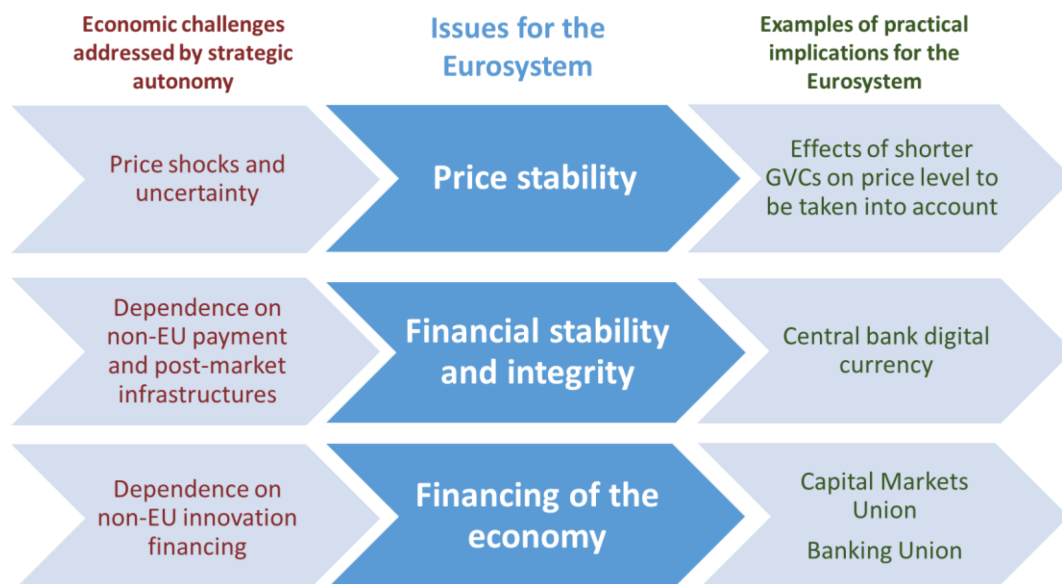
Policies aimed at fostering strategic autonomy have emerged in the European Union (EU) as a response to a geopolitical and economic environment that has been disrupted by major crises. Given their consequences for price stability, financial sovereignty and financing of the economy, these policies raise questions for the Eurosystem.

Diagram 1: Euro area strategic autonomy



Note: GVCs = global value chains

Source: authors.

With globalisation under stress, the economic role of European strategic autonomy

The concept of strategic autonomy – or the "*capacity [of the European Union] to act autonomously when and where necessary*" (Council conclusions, 2016) – is critically important to the security of the EU's economic and financial relations, and not just for the Union's security and defence policy, which is where the term was used for the first time in 2013 (European Council conclusions).

The concept is a complex one, due to its closeness to the notion of sovereignty. This has spawned differing domestic considerations, setting proponents of economic openness against those who feel that Europe should play a stronger international role (van den Abeele, 2021). The term "*open* strategic autonomy" (Commission, 2020) therefore represents something of a compromise. The idea is that upholding the Union's interests and reducing its dependencies can help to preserve security, while not standing in the way of the EU's openness.

Meanwhile, recent events, including strained US/China relations, the Covid-19 pandemic and Russia's invasion of Ukraine, have exposed areas of vulnerability for the EU in connection with its economic and financial dependencies. This spurred a gradual shift in how Member States perceive the effects of globalisation.

On the trade front, these vulnerabilities stem from reliance on non-European partners in key sectors, such as commodities (particularly energy, where 55% of consumption is met through non-EU sources, ECB, 2023), manufacturing (e.g. intermediate goods such as electronic components, with China accounting for 14% of value added in European imports in 2018) and strategic inputs (China accounts for 13% of value added in imports of basic metals, for example, ECB, 2023).

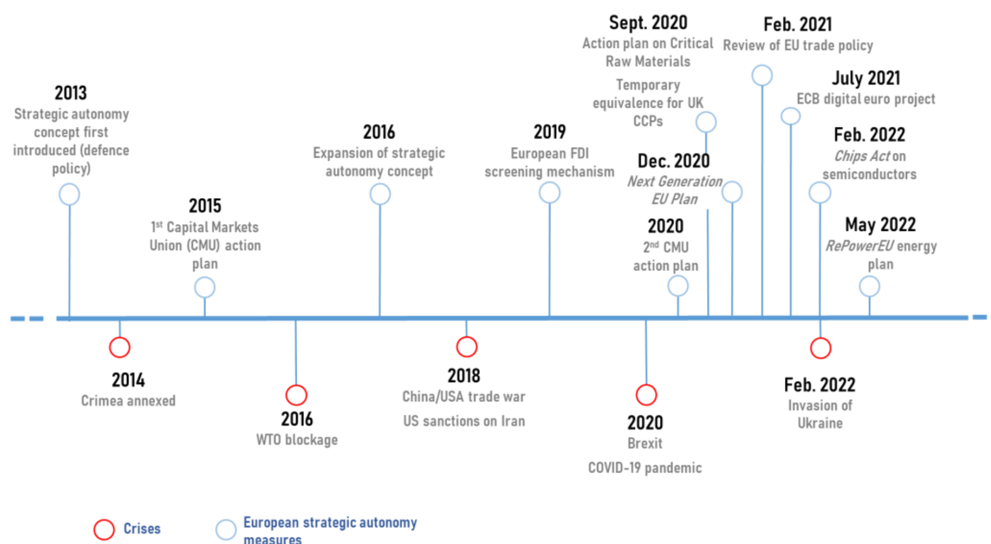
In investments, the EU is primarily interconnected with developed countries. The United States, in particular, is responsible for nearly 30% of mergers and acquisitions in the EU (ECB, 2023). But investments by major emerging countries in the EU have been rising since the mid-2000s, especially in strategic sectors such as energy infrastructure and transportation.

New public policies aimed at fostering strategic autonomy

Against this backdrop, Europe's "strategic autonomy" concept is designed to ensure that the EU can defend its economic interests on the international stage.

With this in mind, Europe has launched several strategic autonomy initiatives over the last decade, aimed at developing specific industrial and trade policies (Diagram 2). Among the recent measures, the EU Chips Act (2022) seeks to bolster the Union's capacity to produce semiconductors, which are manufactured extensively outside the European Union at present. In investment flows, Europe set up a cooperation mechanism in 2020 to screen inward foreign direct investments in order to prevent non-EU ownership of certain sectors that are sensitive in terms of national security.

Diagram 2: Stepping up the adoption of public policies to foster strategic autonomy



Source: authors.

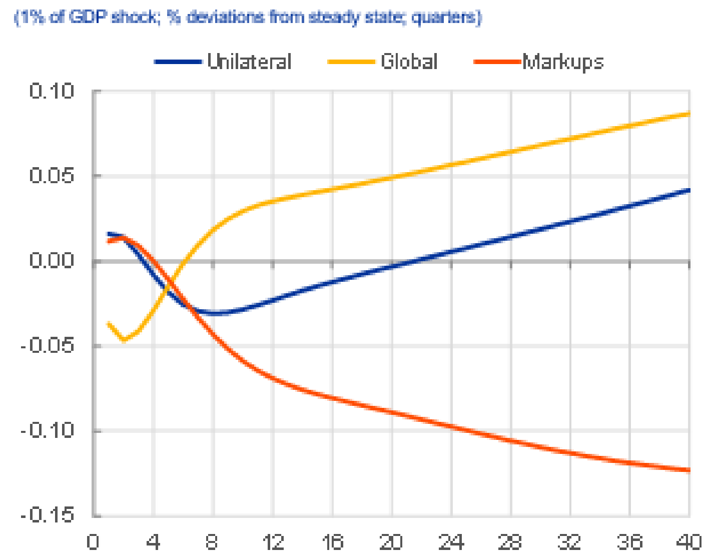
At a broader level, the strategic autonomy agenda raises the question of the benefits of policies that support a reconfiguration of GVCs. Whether the idea is to secure supply through re-shoring (Lagarde, 2022), to bring production closer to consumers through nearshoring, or to review economic partnerships by giving preference to allies through friend-shoring (Yellen, 2022), such economic policies could represent a turning point for the latest stages of globalisation.

Significant implications of strategic autonomy for the Eurosystem

Europe's more aggressive strategic autonomy agenda raises questions for the Eurosystem, due to the potential effects on price stability, sovereignty and integrity of the financial system and financing of the economy (Diagram 1).

The implementation of reshoring strategies to shorten GVCs is something that central banks, whose primary mandate is price stability, would have to pay attention to. By causing less expensive goods to be substituted for more expensive but "safer" ones, such policies could push the general price level up and production down in the short and medium term. Clancy, Valenta and Smith (2023) demonstrate the downside impact of reshoring policies on short-term production due to higher prices, whether policies are implemented unilaterally by the euro area (Chart 1, blue line) or globally (yellow line). If a unilateral reshoring policy is accompanied by decreased competition and a lasting increase in firms' market power – through increased markups – this type of policy could drive prices higher and lead to a persistent decline in production (orange line).

Chart 1: Effect of a re-shoring policy on euro area production



Note: effects on aggregate euro area production of an increase in regionally produced inputs up to 1% of GDP and an increase in firms' markups (EAGLE model).

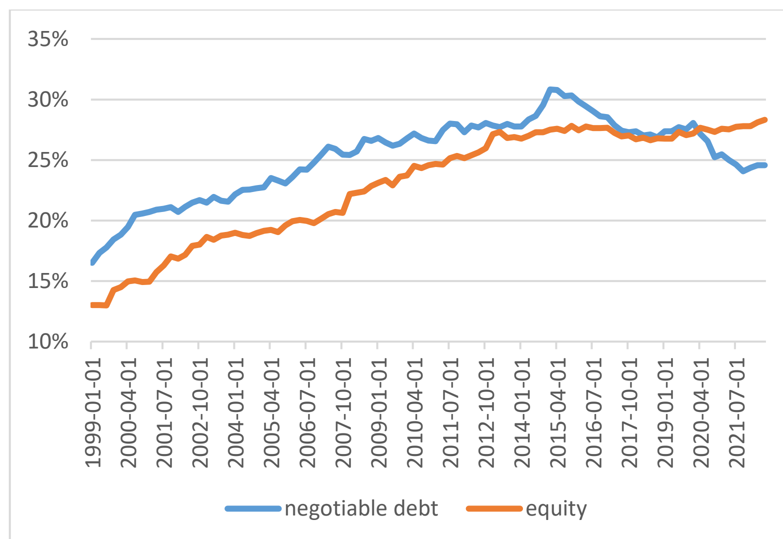
Source: Clancy, Valenta and Smith (ECB, 2023)

Moreover, by relocating certain activities, near shoring or re-shoring policies could reshape sector specialisations within the euro area, with potential effects on proper transmission of the single monetary policy in the event of divergences. These shocks, including those of a transitional nature, create significant uncertainty for economic participants (ECB, 2023), which could interfere with the smooth conduct of monetary policy (Villeroy de Galhau, 2022).

Recent geopolitical shocks could also create risks for financial stability (see Diagram 1). Brexit, for example, left the European Union reliant on clearing participants located outside its jurisdiction. Meanwhile, the dominant position of non-EU payment service providers in bank intermediation has implications for the European Union's financial resilience. The presence of major non-European bigtech and fintech firms, particularly US and Chinese companies, in European financial activities could amplify financial stability risks (ECB, 2023). Conversely the Eurosystem's digital euro project is promoting EU sovereignty in payments, as a response to both private initiatives and non-EU sovereign projects.

Financing for the EU green and digital transitions is another key autonomy issue. However, the Union's significant energy dependence raises questions about its capacity to decarbonise European industry quickly and independently (Von der Leyen, 2023). Investments by European firms in this transition remain limited, not least owing to a lack of equity financing in Europe (30% of this type of financing came from outside the European Union in 2022, Chart 2). Much of the gap is being made up through the growing involvement of US investors, particularly in European startups (Julien-Vauzelle et al., 2022).

Chart 2: Outstanding negotiable debt and equity from outside the euro area (stocks, percentage of total euro area liabilities)



Note: equity (equity and investment fund shares/units), negotiable debt (short- and long-term debt securities); latest available value Q3 2022.

Source: ECB, national accounts, author's calculations.

For this reason, deepening the Capital Markets Union is a matter of major importance to strategic autonomy, as this can help to lessen existing dependencies (ECB, 2023) while promoting more effective monetary policy transmission through improved capital allocation (Villeroy de Galhau and Nagel, 2022). The establishment of a European safe asset, which is to some extent partially embodied by the NGEU programme, would also play a role in the European Union's capacity to finance its investment needs (ECB, 2023).