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Not yet Trump-proof: an evaluation of the European Commission's emerging policy platform

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Executive summary

THE ECONOMIC STRATEGY being defined by the 2024-2029 European Commission seems to follow the prescriptions on innovation and single market reform, and the expansive approach to industrial policy, set out by Mario Draghi in his September 2024 report on European Union competitiveness, with two important differences. First, the Commission stops short of calling for World Trade Organisation-prohibited subsidies – this is welcome. Second, the Commission proposes a new state aid framework for national industrial policy rather than expansion of EU-level public investment funding. This runs the risk of weakening the single market and harming competition, with the unintended consequence of protecting incumbents and inhibiting structural change.

IN TERMS OF specific policies, on defence, the Commission is right to face up to the challenge of defining an EU procurement mechanism that offers sufficient speed and cost advantages to justify large-scale funding. On economic security and international partnerships, the Commission is right to take a broader approach than a foreign economic policy focused only on supply chains. What is lacking is a much greater commitment to providing support for climate mitigation in developing countries.

THE SECOND TRUMP PRESIDENCY creates risks for the Commission strategy. President Trump has gone further than expected in threatening territorial expansion and with the speed, aggression and disregard for the rule of law with which he has started to implement his policies. These factors will complicate the EU-United States relationship.

THE BEST DEFENCE against both Trump and the competitive and security threats posed by China is to accelerate policies that address the EU's structural weaknesses: raising productivity growth, defence capacity and economic security. Economic security, in turn, requires more resilient trade relationships, less financial dependence on the US and an improved standing with emerging market and developing economies.

THE EU SHOULD also seize the opportunity offered by the shift in US policy from subsidies to deregulation. While the EU should not race Trump to the bottom on environmental or financial deregulation, it should rapidly improve its own regulatory framework while building on its core strengths: human capital and the rule of law. Unlike tariff wars or discriminatory subsidies, a competition to provide a good business environment is not a zero-sum game.

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1 Introduction

The return of President Trump has produced yet another major medium-term challenge for Europe. Trump's commitment to the defence of Europe against Russian aggression is uncertain. He has threatened to impose tariffs and to double taxes on companies and citizens of countries that implement the Organisation for Economic Co-operation and Development's global minimum tax. He has withdrawn the United States from the Paris Agreement and embraced an aggressive strategy to expand US fossil-fuel production. He has reintroduced territorial expansion as an objective of US foreign policy, naming Canada, the Panama Canal and Greenland as targets while refusing to rule out the use of force.

Trump's policies and actions exacerbate the EU's deep structural challenges and make it harder to tackle them. After the European elections in 2024, the EU received updated diagnoses of its ills and elements of a cure, including in official reports to the EU institutions by two former Italian prime ministers, Mario Draghi (2024) and Enrico Letta (2024), and in Bruegel's own *Memos to the European Union leadership 2024-2029* (Demertzis *et al*, 2024). Meanwhile, European Commission President Ursula von der Leyen set out her institution's response to the EU's challenges in mission letters to her incoming team of top officials, which together constitute the platform on which the 2024-2029 Commission's work will be based.

In this Policy Brief, we answer two questions. First, how promising is the Commission's policy platform as a strategy for defining and addressing the EU's structural challenges? We answer this question against the benchmarks defined in the Bruegel memos and in Draghi (2024) and Letta (2024). Second, does the strategy require modification to address the extra challenges posed by Trump? To help answer this question, some of the Bruegel scholars involved in our memos offer updated assessments (see the annexes).

We start by focusing on four major challenges: increasing productivity growth while meeting decarbonisation objectives (section 2); improving Europe's own defence capabilities (section 3); developing an effective foreign economic policy (section 4); and finding money for all these objectives (section 5). We then turn to the new challenges created by President Trump, as far as can be assessed at the start of his second term (section 6). We conclude in section 7 by setting out the main ways in which the Commission's strategy should be reinforced.

2 Raising productivity growth while succeeding in the green transformation

The EU needs to reconcile faster productivity growth – or improved competitiveness, as some prefer to call it – with a successful transition to a low-carbon economy. In the longer term, there is no conflict between these objectives. The EU's best bet to reduce the energy cost gap with other economies – and make the EU immune to the high price uncertainty of fossil fuels – is to follow through with the clean-energy transition (Heusaff, 2024). Greater energy and resource efficiency will also create a competitive advantage for European firms (Grabbe and Moffat, 2024), while manufacturing and services around emerging clean technologies could be a source of productivity growth. For these reasons – and because decarbonisation in the EU remains essential to global decarbonisation – President von der Leyen has been right to emphasise that the EU must persevere with its green targets despite political headwinds[1].

In the short and medium term, however, there is a trade-off. Decarbonisation creates costs to EU businesses and requires significant public investment, which must be financed by raising taxes or cutting spending elsewhere. This can stifle growth and weaken the competitiveness of EU industries compared to businesses operating in the US or other regions with abundant fossil fuels or plentiful renewable energy sources. It might threaten the survival even of European industries expected to regain competitiveness later in the transition and to constitute an important source of growth once it is completed. Trump's aggressive fossil-fuel agenda makes this problem worse (for an updated assessment, see annex A).

A strategy to raise productivity growth while maintaining (or, preferably, accelerating) the green transformation should have three main prongs: single market reforms and better (often meaning less) regulation; more national and EU-level public investment to support the digital and green transitions; and an effective industrial and innovation policy.

With some exceptions – including how to best to close the digital investment gap with the US (see Annex B), and how to finance them (see below) – there is broad agreement on the first prong. The main actions should be to reduce cross-border barriers to services and labour within the EU, decrease regulatory burdens without lowering standards essential to environmental or financial safety; deepen capital markets and integrate them better; complete the banking union; and exploit EU-level efficiency gains in energy production and electricity markets by better coordinating policies and investment. Draghi (2024), Letta (2024) and the Bruegel memos (Demertzis *et al*, 2024) described these policies, and they are reflected in the Commission's policy platform[2]. But there is far less agreement on the second and third prongs:

- To what extent should higher public investment be provided at EU rather than member-state level? The answers to this question tend to follow the familiar boundaries of Europe's 'fiscal divide'. High debt/high deficit countries generally argue for more EU-level spending, while low debt/deficit countries generally worry that such spending will result in redistribution rather than efficiency.
- How far should industrial policy go, and how should it be conducted? Should it be used to preserve the current industrial geography of Europe as much as possible, even though energy-intensive industry might become more competitive by relocating to energy-richer regions? Should it subsidise specific technologies, such as solar, wind and clean hydrogen? Should it be supported by trade policy such as local content requirements, even when these violate World Trade Organisation rules?

Public goods should be financed at the level that can provide them most efficiently

On public investment, the Draghi (2024) report, Bruegel's memos (Demertzis *et al*, 2024) and our updated assessments in the annexes to this Policy Brief have similar views. Public goods should be financed at the level that can provide them most efficiently, with strong mechanisms to ensure that provision is in the common interest (see also Claeys and Steinbach, 2024, and Anev Janse *et al*, 2025). The Commission's policy platform does not contradict this view, but neither does it affirm it, nor does it suggest that the budgetary envelope of EU-level spending should be expanded. We return to this point in section 5.

In contrast, on industrial policy, Draghi (2024) and Bruegel's memos do <u>not</u> agree fully. Draghi (2024) took an expansive view of industrial policy and argued that trade policy should be at the service of industrial policy. In contrast, Bruegel's memos (and the updated

1 Mission letters from Ursula von der Leyen to Executive Vice-President-designate for Clean, Just and Competitive Transition Teresa Ribera, and to Commissioner-designate for Climate, Net Zero and Clean Growth Wopke Hoekstra, 17 September 2024, available at https://commission.europa.eu/about/commission-2024-2029/commissioners-designate-2024-2029_en.

2 As expressed in von der Leyen's September 2024 mission letters to commissioners-designate, which frequently reference Draghi (2024). In referring to the Commission's policy platform throughout this paper, we rely on an analysis of the content of the mission letters.

assessments in the annexes to this Policy Brief) took a narrower view, arguing for respect for international trade rules (Demertzis *et al*, 2024). However, there is a common emphasis that industrial policy must be competition and single-market friendly (Scott Morton, 2024a; Poitiers *et al*, 2024). This means that it should facilitate entry of new firms rather than propping up incumbents. It also means that subsidies should be deployed at EU level rather than left to national governments that might favour their own firms. Both Draghi (2024) and Bruegel's memos opposed any extension or revival of the current temporary crisis and transition framework for state aid.

The Commission's approach to industrial policy differs from both Draghi (2024) and the Bruegel memos. It can be summarised as follows[3]:

1. In line with the consensus, the Commission will seek to establish a facility to finance EU-level industrial policy: a 'European Competitiveness Fund'.
2. In addition, there will be an 'Industrial Decarbonisation Acceleration Act' and a 'steel and metals action plan' – consistent with the view in Draghi (2024) that the decarbonisation of hard-to-abate industries should be supported by public subsidies.
3. While calling for a *"preference for European products in public procurement for certain strategic sectors and technologies"*, von der Leyen has stopped short of proposing subsidies linked to EU content. Her September 2024 mission letters also broadly affirmed the EU's commitment to rules-based trade – like our update on trade policy (Annex C), but unlike Draghi (2024), who argued that *"trade policy needs to be fully aligned with the European industrial strategy"*[4]
4. Unlike Draghi (2024) and Bruegel's memos, the Commission appears to favour a review of horizontal merger control guidelines to favour 'European champions' (Annex D).
5. Contrary to Draghi (2024), Letta (2024) and Bruegel's memos, the Commission seems keen on accommodating an expansion of state aid. EVP Ribera is asked to *"develop a new State aid framework to accelerate the roll-out of renewable energy, to deploy industrial decarbonisation and to ensure sufficient manufacturing capacity of clean tech. This should build on the experience of the Temporary Crisis and Transition Framework"*[5].

One way to interpret this approach is that the Commission is trying to pursue the vision in Draghi (2024) of industrial policy within two constraints. First, WTO rules: as an EU institution, the Commission cannot simply call for a violation of international agreements. Second, limited availability of public funding to finance industrial policy at the EU level. The Commission may have decided to accommodate an expansion of state aid (and possibly changes to merger control) as a second-best solution – subject to a framework that seeks to contain the negative impact on the single market.

Figure 1 summarises the differences between Draghi (2024), the Commission's policy platform and Bruegel's memos on EU state aid and trade rules. We recommended a more narrowly focused, technology-neutral and mission-oriented approach to industrial policy than proposed by Draghi (2024). Because of the adverse effects on competition and the single market, we also opposed a relaxation of state aid rules[6].

3 Based on the mission letters to Executive Vice President (EVP) for Clean, Just and Competitive Transition Teresa Ribera; EVP for Prosperity and Industrial Strategy Stéphane Séjourné; and Trade and Economic Security Commissioner Maroš Šefčovič.

4 Draghi (2024) also called for "*explicit minimum quotas for local products and components*".

5 Mission letter from Ursula von der Leyen to Executive Vice-President-designate for Clean, Just and Competitive Transition Teresa Ribera, 17 September 2024, https://commission.europa.eu/document/5b1aaee5-681f-470b-9fd5-aee14e106196_en.

6 See also Brandao Marques and Toprak (2024) for new firm-level evidence on the competition distortions caused by EU state aid.

Figure 1: Three approaches to industrial policy

		New state aid framework building on the TCTF?	
		No	Yes
Subsidies based on local content?	No	Bruegel memos	Commission platform
	Yes	Draghi (2024)	

Source: Bruegel. Note: 'Commission platform' refers to the Commission policy approach as set out in the September 2024 mission letters. TCTF = Temporary Crisis and Transition Framework.

If the Commission were to pursue an expansive, state-aid friendly industrial policy, it is essential that this addresses two questions:

1. *To what degree should industrial policy seek to preserve energy-intensive activity in its current locations?*

A collapse of EU energy-intensive industry must of course be prevented. Furthermore, industrial relocation could be expensive and have major distributional effects, benefitting new locations at the expense of old ones. At the same time, the eventual relocation of energy-intensive production stages to energy-abundant regions – both within and outside the EU – is likely to be in the long-term interest of industry, given the high costs of transporting electricity and renewable energy. In a structurally energy-poor continent, it is also in the interest of the rest of the economy. Even 'green' energy-intensive production contributes to high energy prices for everyone, including manufacturing activity in which the EU retains a comparative advantage, and households, which need to see the benefits of the energy transition in lower prices.

The EU and national governments need to develop a coordinated strategy to deal with these trade-offs. This requires a conceptual framework to decide whether, where and how industrial change – including relocation of energy-intensive production within or outside the EU – should be resisted or supported, and what role EU cohesion policy can play in this context.

2. *How can a new state aid framework be designed to approximate an EU-level industrial policy?*

To approximate the outcomes of a centralised, EU-level industrial policy, a new state-aid framework should go beyond just publishing a new set of guidelines. It should aim to create a coordination framework, conceived as an institution that brings together the perspectives of the European Commission and national governments, setting priorities for industrial policy and approving member-state proposals. If the framework succeeds in creating consistency in policy across EU countries and focusing subsidies on activities with EU-wide benefits, this might offset some of the distortions created by member-state preferences for subsidising their own firms.

3 Expanding defence industrial capacity

The Commission is off to a promising start in its quest to create a defence portfolio that would help close critical European security gaps by strengthening procurement coordination, improving defence-related infrastructure and creating a defence single market (see the updated assessment in Annex E). The portfolio is substantive enough without detracting from the role of the EU High Representative for Foreign and Security Policy (HRVP).

But Defence Commissioner Andrius Kubilius faces huge challenges. First, legal constraints prevent the EU from funding *"operations having military of defence implications"* (and hence arms purchases) from the EU budget (Clapp *et al*, 2024). Second, EU members have different security policies. Four EU countries (Austria, Cyprus, Ireland and Malta) are not NATO members, while Hungary has blocked previous EU efforts to help Ukraine and do mutual defence. Third, there is the challenge of special interests and the preference of national defence planners for national procurement (unlike other areas of procurement, this is explicitly allowed by the EU treaties). Finally, mobilising common funding for European public goods is difficult politically, even when there are no legal barriers to doing so (for example, by creating an extra-budgetary fund).

Considering the magnitude of Russian threat, common or coordinated defence procurement is needed at much greater scale

These difficulties did not stop the EU from establishing in 2004 the European Defence Agency (EDA) to facilitate joint procurement. The EU also has a framework for collaboration on military projects (PESCO, created in 2017), involving all EU members except Malta. The EU also has a small European Defence Fund within the 2021-2027 EU budget to fund defence R&D, a European Peace Facility established outside the budget to finance arms purchases by Ukraine, and two more recent instruments that support common procurement and ammunition production (allocating €310 and €500 million, respectively[7]). The European Commission has also proposed the European Defence Industry Programme (EDIP), which would seek to facilitate procurement by harmonising procurement rules and offering financial incentives[8].

These are good steps, but considering the magnitude of Russian threat, they remain small. Common or coordinated procurement is needed at much greater scale – in the tens or even hundreds of billions, rather than hundreds of millions, of euros (Mejino Lopez and Wolff, 2024; Wolff *et al*, 2024). To accommodate the different constitutions and security arrangements in Europe, this could take the form of an intergovernmental rather than EU-level fund (the EDA could still play a central role as a planner and coordinator of use of funds). This might allow non-EU members to participate, particularly the United Kingdom, which largely shares the EU's security interests. The scale and urgency of the expansion of European defence capacity – and its benefit to future generations – justify common borrowing to finance the fund – though a sufficiently large fund financed by borrowing at the level of member states might be an acceptable second best[9].

Two approaches could be taken to expand defence capabilities quickly and cost-effectively: competitive common procurement involving defence contractors from all member countries of the arrangement (and possibly beyond), or disbursements to member governments, on condition that the money is spent in line with the objectives of the fund and does not discriminate against defence contractors from other member countries. The former is preferable because it would involve greater scale, but the latter would require less coordination. By creating greater competition, both arrangements would be far more efficient than the *status quo*. Both would be powerful instruments for expanding the European defence industrial base.

The EU has months, not years, to reach agreement and start action on defence. In addition, it needs to send an immediate signal that the EU is willing to procure whatever weapons

7 Regulations (EU) 2023/1525 and (EU) 2023/1525.

8 See https://defence-industry-space.ec.europa.eu/eu-defence-industry/edip-future-defence_en.

9 Scazzieri and Tordoir (2024) and Anev Janse et al (2025) offer visions of potential financing mechanisms.

Ukraine needs and to pay for them, if necessary through an *ad-hoc* financing vehicle of a coalition of the willing.

4 Building an effective foreign economic policy

Draghi (2024) coined the term *"foreign economic policy"* to refer to policies to secure supply chains, mostly to reduce dependence on China. We like the term, but think it should be defined more broadly. The EU's economic security requires more than just resilient supply chains for imports: the EU also needs to worry about dependencies and potential pressure points related to exports, foreign direct investment, assets held abroad and the payments system (Pisani-Ferry *et al*, 2024). Furthermore, the EU's prosperity is shaped by foreign economic relationships – multilateral, regional and bilateral – in ways that go far beyond economic security.

Hence, the *goals* of foreign economic policy should also include the defence and improvement of rules-based trade (from which the EU benefits through market access and competitively priced imports), effective international climate action (which lowers the massive economic costs of climate change and its knock-on effects, such as disruptive migration) and soft power (by fostering the interests of partners around the world in maintaining constructive relationships with the EU). The *instruments* of EU foreign economic policy should include budget-funded initiatives such as the Global Gateway (which needs much greater financial support than it has received so far to have real impact), the European Investment Bank, membership and reform of multilateral institutions and forums including the WTO, the International Monetary Fund, the World Bank and other multilateral development banks, reform of the Paris Agreement, and the ratification and negotiation of preferential trade agreements.

The Commission's policy platform is generally consistent with this view. HRVP and Commission Vice-President Kaja Kallas has been asked to *"work with the Executive Vice-President for Prosperity and Industrial Strategy* [Séjourné] *to shape a new foreign economic policy, focusing on economic security and statecraft, free and fair trade and investing in mutually beneficial partnerships around the world"*. EVP Séjourné is asked to ensure *"that our trade and economic security policies enables our companies to benefit from markets around the world and fair global competition and European competitiveness"*[10].

Working *"under the guidance of"* the EVP, Trade Commissioner Šefčovič is asked to *"ensure that Europe leads and improve rules-based trade, notably through a reformed and strengthened World Trade Organization"* [sic], develop *"Clean Trade and Investment Partnerships to bolster our competitiveness, diversify our supply chains and boost the economies of our partners"*, implement an updated FDI regulation[11], improve cooperation with member states on export controls and tackle *"risks associated with certain outbound investments"*. Commissioner for International Partnerships Jozef Síkela has been asked to ensure that EU partnerships *both* serve EU economic security objectives[12] *and* promote the UN Sustainable Development Goals.

10 Oddly, however, neither the mission letter to EVP Séjourné nor that to trade and economic security Commissioner Šefčovič contained a corresponding request to work with the HRVP. For the mission letters, see https://commission.europa.eu/about/commission-2024-2029/commissioners-designate-2024-2029_en.

11 The European Commission proposed an update in early 2024. See European Commission (2024).

12 "*You should work to ensure that partnerships and Global Gateway investments are developed in synergy with new Clean Trade and Investment Partnerships to help secure supply of raw materials, clean energy and clean tech from across the world.*" Mission letter from Ursula von der Leyen to Commissioner-designate for International Partnerships Jozef Síkela, 17 September 2024, https://commission.europa.eu/document/download/6ead2cb7-41e2-454e-b7c8-5ab3707d07dd_en.

Commissioner for Enlargement Marta Kos and Commissioner for the Mediterranean Dubravka Šuica are asked to deepen EU partnerships and economic ties with specific countries and regions. Climate Commissioner Hoekstra is asked to *"ensure that Europe strengthens its climate diplomacy and its leading role in international negotiations, including on carbon markets"*, while Commissioner Síkela is responsible for the EU's engagement in Just Transition Partnerships to decarbonise the power sector in specific developing countries.

Assigning responsibilities in this way has two benefits. The first is to ensure that the economic, foreign policy and security objectives of EU foreign economic policy are shared by all commissioners whose portfolios touch on foreign economic relations. The other is that many of these commissioners are asked to reconcile objectives that could potentially be in tension. Most will need to worry about both new concerns about economic security and traditional objectives related to growth and efficiency. This reduces the risk of infighting within the College of Commissioners.

But the Commission President's approach – to a throw a large set of objectives at a large set of commissioners with overlapping responsibilities – also creates three significant risks.

Throwing a large set of objectives at a large set of commissioners with overlapping responsibilities creates significant risks

The most obvious is that coherent action will require intense coordination. Close coordination is required not just between HRVP Kallas and EVP Séjourné, but particularly between Kallas, Šefčovič and Síkela (on trade, economic security and broader foreign policy objectives), then between this group, and Commissioners Kos and Šuica (as far as neighbourhood countries are concerned), and between Commissioners Síkela and Hoekstra (on EU international climate action)[13].

The second risk relates to a lack of guidance on how conflicts between objectives should be resolved. In relation to international partnerships, there is an inherent tension between economic security, particularly if defined mainly as security of supply, and EU 'soft power' objectives (Grabbe *et al*, 2024). Security of supply requires shaping economic relationships in the direct self-interest of the EU, while soft power requires a credible commitment to the economic and development interests of the EU's partners. This tension could be reduced by clarifying that the Global Gateway will always serve the latter, while identifying different instruments to serve the former whenever there is a conflict. So far it seems the Global Gateway will remain overloaded with multiple objectives, ranging from EU security interests to the Sustainable Development Goals. The risk is that it will end up so diluted, both financially and as a signal, that it serves none of these objectives.

The final concern is that the Commission's policy platform will fail to do justice to the massive interest of the EU in effective international climate action, even more so since President Trump has again withdrawn the US from the Paris Agreement (Annex F). Commissioner Hoekstra appears to be tasked to promote international mitigation through instruments that do not cost money: *"Climate diplomacy"* and negotiations in forums such as the UN's Conference of the Parties (COP). Commissioner Síkela is in charge of Just Transition Partnerships, in which coalitions of advanced countries contribute to the energy transition in developing countries. These are currently woefully underfunded, including because financial contributions to these partnerships must come out of aid budgets. But unlike aid, climate mitigation in developing countries is primarily in the interests of the global community – and within this community, the richest countries – rather than in the interests of the aid recipient (Bolton *et al*, 2024). There is no sign from the Commission's policy platform that the EU intends to change this narrow and ultimately self-defeating approach.

In the context of the next EU budget cycle (2028-2034), international climate finance should be folded into an expanded budget for climate action in both the EU and internationally. In the meantime, it should be stepped up using both available room under the budget and new extrabudgetary funding.

13 If this sentence appears confusing, that is the point: overlapping responsibilities could confuse outcomes.

5 Financing the EU's most pressing spending priorities

Financing the EU's investment needs will require both private and public funding. The Commission has appropriately emphasised that the former requires a much more effective EU financial system: a Savings and Investment Union. An essential step in such a system is to reduce supervisory complexity by unifying capital markets supervision (see the updated assessment in Annex G).

Unfortunately, the Commission is less clear on the financing of *public* investment. A central implication of the previous three sections is that the EU will need to substantially raise its funding for three sets of European public goods: the green transition and an industrial policy that supports it, defence capabilities and international climate action. The magnitude of these increases is uncertain, but are likely to exceed one percent of EU GDP per year over the next five to ten years[14]. To the extent that the additional investment benefits all of the EU, there are strong arguments for planning and funding a significant portion at EU level.

With the notable exception of the last category (international climate action), the Commission seems to focus on the need to raise EU-level public investment[15]. What is lacking, however, is a sense of how higher EU-level spending would be financed. By definition, it will need to come from some combination of: (1) reassigning the existing budget at the expense of the largest existing categories (cohesion funds and agriculture); (2) increasing the size of the EU budget (which is not possible within the current, 2021-2027 medium-term cycle, but could be pushed for the next, 2028-2034 cycle); or (3) additional extra-budgetary funds, including by raising the capital of the European Investment Bank or by replacing the post-pandemic recovery fund, the Recovery and Resilience Facility (RRF), which expires in 2026, with a new facility of similar size.

The Commission has been essentially silent on these choices. Budget Commissioner Piotr Serafin has been directed to look for greater spending efficiency within existing budget categories but not at a reallocation of spending across categories (eg from agriculture or cohesion to innovation, cross-border infrastructure, or climate) (see our updated assessment in Annex H). Instructions issued to Serafin, Economy Commissioner Valdis Dombrovskis and others are also silent on a potential replacement for the RFF, or potential extra-budgetary funding streams for common defence procurement.

It is possible that this reflects a tactical choice by the Commission President: to avoid an early confrontation with constituencies likely to defend existing spending categories, such as agriculture, or who will oppose higher common funding. Perhaps a vigorous push will follow later. But another interpretation is that the Commission is disinclined to put up a fight for significantly higher common funding of EU priorities. The instruction to EVPs Ribera and Séjourné to prepare a revision of the state aid framework in support of EU industrial policy is one hint of this.

14 Bouabdallah *et al* (2024) estimated the EU public investment financing gap for the green and digital transitions and defence spending – defined as the difference between available and needed public funding for these items – at minus €900 billion between 2025 and 2031, about 0.8 percent of GDP per year. This includes about €150 billion in extra defence funding required to reach the 2 percent of GDP NATO target in all EU countries, which will likely need to come out of national resources, but excludes funding for rearmament. It also excludes funding for the financing of the climate transition outside EU, which Bolton and Kleinnijenhuis (2024) estimated at 0.5 percent of GDP.

15 EVPs Ribera and Séjourné have been called on to establish a European Competitiveness Fund "*to ensure that we invest in the innovation and technologies that will shape our economy and drive our transition*". Commissioner Hoekstra is asked to "*Support the implementation of the Innovation Fund to invest in highly innovative clean technologies and flagship projects with European added value*." Commissioner Kubilius is asked to "*identify investment needs to deliver full-spectrum European defence capabilities based on joint investments*." See https://commission.europa.eu/about/commission-2024-2029/commissioners-designate-2024-2029_en.

If so, the EU will stand little or no chance of meeting its defence or climate objectives. The Commission must understand this, and push EU governments to understand this, too.

6 Dealing with President Trump

The volley of policy announcements and executive orders in the first days of the new US administration has mostly been in line with President Trump's rhetoric during the presidential campaign and in the aftermath of the election, with two exceptions:

1. First, territorial expansion has returned as an objective of US policy for the first time since the late nineteenth century. This is ominous, contradicting the prevailing view of President Trump as an advocate of a cautious US foreign policy that attempts to avoid international entanglements.
2. Second, Trump has sought to implement his policy priorities with speed, aggression and disregard for the rule of law. On the domestic front, this includes the blanket pardoning of those convicted in relation to the 6 January 2021 attack on the US Capitol, executive orders that appear obviously unconstitutional, intimidation of federal employees, firing career prosecutors, and the willingness to use state power to serve private interests; on the international front, the immediate freezing of all foreign aid and threats of double taxation on foreign companies and citizens. While some of these policies will be (and have already been) constrained by the US courts, they signal that Trump's second administration will be even more aggressive and challenging than European policymakers were anticipating.

With one important exception, Trump will make all of the EU's challenges described in the four preceding sections more difficult, both because of his domestic policies and his stated intentions on Europe.

Trump's approach to the US economy and trade will have economic contagion effects in the EU

Trump's approach to the **US economy** and trade will have economic contagion effects in the EU, disrupting trade and driving up inflation in the US through some combination of negative supply shocks – such as tariffs and deportations – and fiscal expansion. The bond market's reaction to a federal deficit exceeding 7 percent of GDP may impose discipline on the Trump administration's ability to finance rising government debt, but may not help the EU to raise money for its public goods through borrowing (except in the – historically unprecedented – case of a 'safe haven' effect benefiting euro-area government bonds at the expense of US treasuries).

- **US tariffs** are likely to hit all EU economies to some extent, given the integration of supply chains across the single market. This will make it harder to improve the competitiveness of European firms that sell into the US market. Trump's energy policy – expanding oil and gas production and repressing renewable energy – makes it harder for European renewables companies to expand into the US market and to raise capital there. As argued by Garcia Bercero *et al* (2024), the EU should both threaten a robust response to US tariffs and offer to buy more US liquified natural gas (LNG) to placate Trump. That strategy brings the co-benefit of phasing out residual purchases of Russian LNG, but it will not narrow the energy price differential with the US and other energy-rich regions. Therefore, the EU needs to double down on expanding renewable power production and building the grids and interconnectors to carry greener electricity to industry and households.
- **US withdrawal from the Paris Agreement** and federal government disengagement from the energy transition may have a chilling effect on Europe's own decarbonisation efforts as companies complain about an unfair burden that US counterparts do not face – from carbon taxes to reporting requirements. Europeans will need to work harder with other countries on global climate mitigation, including with China, and with pro-climate US states

such as California. A broad international alliance will be needed to keep the UN climate process on life-support over the next four years.

- The EU's digital and sustainability agendas are also threatened by Trump and the opposition of his big-tech supporters **to the extraterritorial reach of EU regulation**. US companies may be encouraged and even forced not to comply with EU reporting requirements and digital services laws. While the EU should simplify and streamline its requirements, it cannot afford to go along with non-compliance. The rule of law is fundamental to the EU's governance and its regulatory power depends on maintaining a stable legal framework for business. Moreover, the EU's tech and green policies are vital to prevent public harms, from social media's undermining of democratic elections to pollution, and they are generally supported by the European public.
- On **defence**, Europe has no choice but to pay more for its own security as Trump withdraws US support, which increases the urgency of creating new collective funding arrangements and joint arms procurement, as described above. Not only do EU countries need to raise their defence spending as a percentage of GDP, in line with Trump's obsession, but they must also spend that money much more efficiently on arming themselves and Ukraine.

A potential benefit for Europe of Trump's policies is his attempt to end the massive subsidy policies of the Biden administration

A potential benefit for Europe of Trump's policies is his attempt to end the massive and often protectionist subsidy policies of the Biden administration. Trump's aim is to replace these subsidies with a combination of lower corporate taxes and de-regulation, benefiting particularly the fossil-fuel industry, but also other sectors, including finance. From the perspective of global climate action, this is clearly bad. From the perspective of lowering the pressure on the EU to engage in a subsidies race with the US – with inevitable fiscal costs and unintended distortions, including single market fragmentation – it is good.

An important question is whether this policy shift merely replaces one US-EU race with another that the EU is likely to lose[16]. The answer is 'not quite'. Unlike a tariff war or a race involving discriminatory subsidies, a race for a good business environment that raises private investment is not a zero-sum game. Nor does it have to be a race to the bottom. The EU cannot and does not wish to match the Trump administration's planned corporate tax breaks, environmental deregulation or financial deregulation – nor should it. But it can and should review its own regulatory environment to make it more attractive as a place to invest, and it can build on and amplify its strengths, including rule of law, state-provided healthcare and high human capital. The EU should be doing these reforms anyway. As long as essential environmental and financial-stability standards are maintained, Europe will benefit from pressure to reform faster and more deeply than might otherwise have been the case.

7 Conclusion

The analysis in this Policy Brief leads to three main conclusions.

First, there is no contradiction between what Europe needs to do to address its structural problems and what it needs to do to respond to Trump. The policies of the second Trump administration add layers of complication and additional urgency. But this does not fundamentally change the EU's strategy, which is driven by the need to resolve medium-term structural problems that are largely independent of US policies and by policy objectives that the EU should hold onto even if the US does not. The most important of these is to reconcile higher growth with the energy transition while defending social cohesion.

Second, the European Commission has clearly learned from Draghi (2024) and the debate

16 Izabella Kaminska, 'Europe hasn't grasped the real economic threat from Trump', *Politico*, 24 January 2025, https://www.politico.eu/article/donald-trump-economic-policy-threat-europe-bidenomics-tariffs-trade/.

that preceded it and is trying to take it seriously. In areas related to the single market, defence, innovation and the EU green transition, the Commission's policy platform is largely aligned with Draghi (2024) and/or Bruegel's own recommendations. Unlike Draghi (2024), the Commission also reaffirms the EU's commitment to rules-based trade.

Third, the Commission policy platform as set out in the September 2024 mission letters to incoming commissioners does not yet add up to a coherent strategy. Critical questions remain unanswered. How can the collapse of Europe's energy-intensive industry be prevented while allowing for some combination of relocation and modernisation of energy-intensive production stages? How should EU-level defence funding be used? How can the EU's most important foreign economic policy objectives – economic security, soft power, climate change mitigation outside the EU's borders – be reconciled and jointly pursued? How far should the EU go in lightening regulatory burdens without creating environmental and financial risks?

Another missing element is a strong, explicit case for adequate financing in addition to the reprioritisation of existing spending. The Commission cannot shy away from the fact that any reasonable answer to the previous set of questions will point to much larger funding needs than the current budget envelope. It will need to make the case and fight for it, but has given no hint so far that it is prepared to do so.

The Commission has no time to spare. In the next few months, it will need to find answers to the open questions above. It has promised a 'clean industrial deal' to recognise and address the risks of both rapid de-industrialisation and of defending the *status quo*. It will need to make a case for an accelerated, EU-level approach to defence procurement that goes into specifics of how an expanded EU defence fund would be spent. It must take a fresh look at how to promote international emissions mitigation after the US withdrawal from the Paris Agreement, backed by the strongest and widest possible like-minded coalition. And it must make the case that joint spending on these EU level public goods will ultimately save money and put the EU in a strong position to incentivise the coordination of policies that is necessary for effective reform and a deeper single market.

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Annexes: updated assessments of the EU's priorities

Annex A: energy and climate

Simone Tagliapietra and Georg Zachmann

The European Union has rolled out a wave of legislation to reach its relatively ambitious climate targets. However, decarbonisation, especially of buildings and transport, is happening too slowly and will have to be sharply accelerated during the term of the 2024-2029 European Commission. A speeding-up will only work politically, socially and economically if decarbonisation is accompanied by industrialisation and an effective green social contract that addresses the distributional implications of climate policy.

Domestic backtracking or procrastination is not good for the EU. Delivering on its climate targets is a prerequisite for it to credibly push for the needed acceleration of decarbonisation globally. Lowering domestic ambition would also result in high costs for companies that have already invested in ambitious climate action and would erode investor trust.

What changes as a result of Trump? President Trump is expected to dismantle US climate and environmental policies, substituting them with a push for fossil fuels. He has pledged to halve natural gas and electricity prices, largely through increased natural gas production. For the EU, this represents both a threat and an opportunity.

- The threat is the further widening of the EU-US energy price gap, further undermining the competitiveness of the EU's energy-intensive industry. Unlike the US, the EU is not endowed with fossil-fuel resources. To address this fossil energy competitiveness gap, the EU must double down on its energy transition.
- The opportunity is that US policy will become far less clean tech-friendly than it was in the Biden era. This presents an opening to attract clean investment that now may not materialise in the US, advancing the EU's competitive edge.

Both threat and opportunity point in the same direction: accelerating the EU's green transition and the industrial policy that supports it.

The European Commission's approach. Commission President Ursula von der Leyen has confirmed that the EU is committed to its European Green Deal goals. She has promised a Clean Industrial Deal to boost clean industrialisation, and to adopt a new energy strategy aimed at reducing energy prices for both households and companies, accelerating the deployment of clean energy sources and phasing-out Russian liquid natural gas imports. The main risk inherent in this strategy is that it will go too far in accommodating EU member state subsidies, weakening competition and overly protecting incumbents.

Assessment and updated recommendations. The main elements of the Commission's climate strategy remain valid and have added urgency in the era of Trump. Europe's economic interest is to push ahead with the clean transition. New clean manufacturing processes will make the best of existing industrial value chains, infrastructure and knowledge. Reduced fossil-fuel imports will increase economic security. To reinforce international partnerships, the EU should be ready to increase financial support for decarbonisation projects in developing countries[17].

The challenge is to minimise the costs of this transformation for European consumers and businesses. This requires EU-wide coordination of renewables investment, the creation of a unified EU energy market and a governance structure that ensures that industrial subsidies benefit the EU as a whole while enabling the restructuring or relocation of energy-intensive industry that would otherwise suffer from a permanent competitive disadvantage.

Annex B: digital policy

Bertin Martens

The digital investment and uptake gap between the European Union and the United States is large, with the US leading not only because of market concentration around its big tech giants but also because of EU domestic barriers to investment and adoption, ranging from difficulties in accessing venture capital and private equity to multiple and partly overlapping data regulations. Narrowing the gap required harmonising EU rules across regulations, particularly with regard to access to data, EU-wide payments and identity platforms, standardising data-processing consent notices and implementing the EU Artificial Intelligence Act (Regulation (EU) 2024/1689) in a way that keeps market entry and compliance costs low (Martens, 2024).

What changes as a result of Trump? The Biden administration's push-back against the market power of big tech will probably slow down under Trump. The new administration is likely to go full speed on AI, particularly for cybersecurity and defence. Right-wing disinformation on social media platforms such as X is becoming more aggressive and targeted to exacerbate political and national divisions within the EU.

The European Commission's approach. The early focus for the 2024-2029 European Commission has been put on the well-worn path of Europe's 2030 Digital Decade targets – mostly

17 Simone Tagliapietra and Cecilia Trasi, 'Making the most of the new EU Clean Trade and Investment Partnerships', First Glance, 16 October 2024, Bruegel, https://www.bruegel.org/first-glance/making-most-new-eu-clean-trade-and-investment-partnerships.

hardware and network spending plans that have marked the Commission's digital policy agenda for decades, amplified by the intention to develop an EU Cloud and AI Development Act to increase computational capacity for innovative SMEs. The Commission has also announced a European Data Union Strategy that aims to simplify and bring more coherence to current EU data regulations, devotes considerable attention to (cyber)security, and argues for a *"European Democracy Shield"*, building on the EU Digital Services Act (DSA, Regulation (EU) 2022/2065) to combat disinformation[18].

Assessment and updated recommendations. EU hardware subsidies can enable private-sector investment decisions, but the main question is what the EU will do to improve the enabling environment for firms. Facilitating the emergence of EU hyperscale cloud infrastructure in support of AI – including through mergers and acquisitions among smaller EU players – requires thinking about business models and what prevents firms from going that way currently. Draghi (2024) did not explain how to turn hardware initiatives into viable commercial undertakings that boost the EU's productivity growth and strengthen its competitiveness.

The planned Cloud and AI Development Act might fill some of this gap provided it addresses monopolistic positions in cloud software without eroding the beneficial network effects of cloud interoperability. Throwing taxpayer money at cloud hardware will not solve this issue. Executive Vice-President Henna Virkkunen, who is responsible for digital issues, will have to work out mechanisms that can foster capital markets for EU start-ups, implement the proposal in Draghi (2024) for a twenty-eighth regime for innovative start-ups and enable them to prosper into scale-ups (Martens, 2024).

The DSA and Digital Markets Act (Regulation (EU) 2022/1925) focus mainly on reining in the market power and conduct of very large big-tech firms. But even if big tech's monopolistic rents can be reduced, this alone will not enable EU start-ups to scale up; US firms will likely retain market leadership in digital ecosystems. Accelerating AI investment will entail huge costs that require large market scale. Finding routes for closer collaboration between the US and the EU would be a win for both sides.

To counter disinformation and political interference promoted through social media, the application of the DSA is essential but may not be sufficient (as the plan for a European Democracy Shield proposal seems to acknowledge). The Commission should also explore the role that digital policies could play in modern geopolitical conflicts.

Annex C: trade policy

Ignacio Garcia Bercero, Petros C. Mavroidis and André Sapir

The 2019-2024 European Commission rightly made 'open strategic autonomy' the centrepiece of its geopolitical strategy. The term 'strategic autonomy' was meant to capture resilience and self-reliance where necessary. 'Open' was the counterbalancing factor suggesting that open-trade policies must continue to be the bedrock of the European Union approach. The two components of the strategy can and should be married together.

Pursuing open strategic autonomy is the appropriate insurance policy to avoid sliding towards protectionism. The EU should continue to be the champion of multilateralism and be ready to build coalitions in support of the World Trade Organisation (WTO) and its reform. The US administration is unwilling to play this role and China is incapable of doing so, so the EU must be the voice of reason at a time when global cooperation is needed more than at any time in recent history, including to fight climate change.

What changes as a result of Trump? Trump has threatened to double down on the tariffs against China and the rest of the world. His new administration might increase US tariffs to 60

18 Mission letter from Ursula von der Leyen to Henna Virkkunen, Executive Vice-President-designate for Tech Sovereignty, Security and Democracy, 17 September 2024, https://commission.europa.eu/document/download/3b537594-9264-4249-a912-5b102b7b49a3_en.

percent on potentially all imports from China, and to 10 percent to 20 percent on potentially all imports from other trading partners, including the EU. This new violation by the US of its WTO commitments would not only negatively affect EU exports but would also undermine the rules-based multilateral trading system.

The European Commission's approach. In the 2024-2029 Commission, the Trade Commissioner is also responsible for 'economic security'. This begs the question of whether and how economic security and trade openness will go together. Hints are given in the instruction to Maroš Šefčovič, the Commissioner for Trade and Economic Security, that he should design and implement an EU trade policy that *"focuses on the core objectives of competitiveness, security and sustainability"* and will *"ensure Europe leads and improve*[s] *rules-based trade, notably through a reformed and strengthened World Trade Organization and through its own network of trade agreements"*[19]. Šefčovič is also called on to develop an economic security doctrine, which should better clarify the relationship between promoting, partnering and protecting economic security.

Assessment and updated recommendations. The Commission's renewed commitment to rules-based trade and the centrality of the multilateral WTO is highly welcome, especially in view of the threatening declarations by President Trump. It is equally positive that the Commission intends to pursue and finalise new regional and bilateral trade agreements with partners worldwide, a measure that will also help the EU navigate better the more dangerous world announced by Trump. It is crucial that the EU signs and ratifies the EU-Mercosur agreement[20]. A third course of EU action in response to Trump's tariff threat is to be ready to engage in discussions with the US to seek to avoid the risk of tariffs, and to retaliate if necessary.

The increased shift of EU trade policy from a single objective – economic efficiency – to multiple objectives – competitiveness, security and sustainability – which started during the 2019-2024 Commission, is bound to continue, and will probably be reinforced. This shift has already created and will likely create more trade-offs, which will need to be made explicit and quantified in order to guide political choices. But whatever choices are made, they should respect multilateral rules.

Annex D: internal market, industrial policy and competition

Fiona Scott Morton, Simone Tagliapietra and Jeromin Zettelmeyer

The European Union's central challenge remains raising productivity growth. To achieve this, the EU needs to break down remaining single market barriers and develop procompetitive industrial policy tools (Scott Morton, 2024b). We have argued that these tools should operate at EU level, that state aid rules remain essential to protecting the single market and that they should not be loosened (Poitiers *et al*, 2024, Scott Morton, 2024a). Trade policy should be supportive of industrial policy but stay within World Trade Organisation rules, as rules-based trade remains essential to EU growth and competitiveness. In the same vein, vigorous competition enforcement remains essential to business dynamism, entry and growth, but must be adapted to meet new challenges, particularly to protect competition in future innovation.

What changes as a result of Trump? Likely new tariffs will add to the cost shocks faced by EU producers, and reduction or withdrawal of support for Ukraine and international climate action would add to the EU's fiscal burden. This makes a pro-growth agenda even more urgent but does not fundamentally change the elements of that agenda. The fact that US protectionism will now likely take the form of higher tariffs rather than subsidies reduces the

19 Mission letter from Ursula von der Leyen to Maroš Šefčovič, Commissioner-designate for Trade and Economic Security, 17 September 2024, https://commission.europa.eu/document/download/4047c277-f608-48d1-8800-dcf0405d76e8_en.

20 See European Commission press release of 6 December 2024, 'EU and Mercosur reach political agreement on groundbreaking partnership', https://ec.europa.eu/commission/presscorner/detail/en/ip_24_6244.

pressure for a subsidy race with the US. The new US administration's deregulatory agenda will also increase pressure on the EU to deregulate.

The European Commission's approach. The mission letters suggest that the Commission will push Draghi's (2024) innovation, regulatory and single market agenda. The Commission has also embraced Draghi's push for industrial policy, calling for a "European Competitiveness Fund" and industrial policy focused on clean tech and the decarbonisation of industry (von der Leyen, 2024). But it appears to be less concerned than Draghi about protecting competition, calling for (1) "a new State aid framework to … deploy industrial decarbonisation and to ensure sufficient manufacturing capacity of clean tech", and (2) "*a review of the Horizontal Merger Control Guidelines to give adequate weight to … the time horizons and investment intensity of competition in certain strategic sectors*"[21]. While the Commission has stopped short of endorsing local content requirements as a condition for receiving subsidies, the mission letter to Executive Vice-President Stéphane Séjourné called for a "*preference for European products in public procurement for certain strategic sectors and technologies*"[22].

Assessment and updated recommendations. The Commission's endorsement of Draghi's innovation and single market agenda is welcome, but relaxing state aid rules and merger control in "certain strategic sectors" will weaken competition and harm the single market. To minimise these risks, the Commission should (1) stick to Draghi's competition policy agenda, resisting the temptation to relax merger rules in order to promote European champions; (2) bolster any new state aid framework with a governance structure that coordinates industrial policy across EU countries and with EU-level policy, and ensures that it benefits all of the EU; (3) ensure that the proposed European Competitiveness Fund is deployed in a competitive fashion.

The Commission should also develop a framework for supporting the decarbonisation of energy-intensive industry that does not stand in the way of needed restructuring, including the shedding or relocating of production that is too expensive in the EU in the longer term. Finally, the Commission should eliminate or recast regulations that increase net costs while holding firm on regulations that protect society from harm – not mainly as a reaction to President Trump, but as part of a broader strategy to raise productivity growth.

Annex E: defence

Guntram Wolff

The central security challenge for the European Union is to meet the threat posed by Russia while reducing security dependence on the United States. This requires increasing support for Ukraine to ensure that Putin's war of aggression fails, expanding military production, improving procurement and creating a single market for defence production.

What changes as a result of Trump? The return of President Trump and the situation in Ukraine have added urgency to this agenda. Trump has named a Ukraine-Russia envoy, General Keith Kellogg, who has stated he wants to achieve a peace deal quickly while excluding Ukrainian NATO membership. While US foreign policy remains to be defined, Vice-President Vance and security analysts close to the administration have suggested the US should reduce military support for Ukraine and prioritise instead other strategic theatres (Asia in particular). Trump has stated that he will insist that NATO members raise defence spending to 5

21 Mission letter from Ursula von der Leyen to Teresa Ribera Rodríguez, Executive Vice-President-designate for a Clean, Just and Competitive Transition, 17 September 2024, https://commission.europa.eu/document/download/5b1aaee5-681f-470b-9fd5-aee14e106196_en.

22 Mission letter from Ursula von der Leyen to Stéphane Séjourné, Executive Vice-President-designate for Prosperity and Industrial Strategy, 17 September 2024, https://commission.europa.eu/document/download/6ef52679-19b9-4a8d-b7b2-cb99eb384eca_en.

percent of GDP[23]. While NATO expects military spending in 2024 to surpass 2 percent of GDP in 23 of its 32 members, only five countries – Poland, Estonia, the US, Latvia and Greece – are expected to exceed 3 percent (Lithuania is very close)[24].

The European Commission's approach. The structuring of the 2024-2029 European Commission has settled the discussion on the division of labour between the High Representative for Foreign Affairs and Security Policy and Vice-President of the European Commission (HRVP) Kaja Kallas, and the Defence and Space Commissioner, Andrius Kubilius. The HRVP retains overall responsibility for security, support for Ukraine, sanctions and the EU-NATO partnership, while the defence commissioner is responsible for creating the industrial and regulatory conditions and the physical infrastructure to boost defence production, making military procurement more efficient, incentivising public and private investment in defence and strengthening military mobility. At the heart of this effort will be the creation of a "*true single market for defence*". The steps to achieve this will be set out by the end of February 2024 in a plan for the future of European defence, for which the defence commissioner and the HRVP are jointly responsible (Mejino-López and Wolff, 2024).

Assessment and updated recommendations. The Commission's new focus on defence is off to a strong start. The division of labour gives the defence commissioner an important portfolio without diminishing the HRVP's role. This is a consequence of the Commission setting for itself defence-related regulatory and coordination tasks, including the development of a defence production single market. These tasks are new in scope and ambition.

Meeting these challenges involves three priorities:

1. Mobilise funding nationally and supranationally (if EU-level funding proves too difficult for legal or political reasons, an intergovernmental mechanism could be designed). After years of underinvestment, additional funding needs now total around €500 billion over the next five years.
2. Reduce fragmentation in defence markets. The European defence industrial base remains small, and lack of scale translates into lower production capacity and high costs. Raising scale and efficiency requires a much higher degree of standardisation of military hardware, common procurement and specialisation. Apart from the common threat, the best argument supporting this approach is budgetary savings for taxpayers.
3. Effective collaboration with key allies, in particular the United Kingdom with its significant military-industrial capabilities, and Ukraine, which can produce much more cost effectively than most, if not all, EU countries, and which has a substantial defence industrial base.

Annex F: EU foreign, enlargement, and partnerships policy

Heather Grabbe, Jean Pisani-Ferry and Jeromin Zettelmeyer

The European Union has thrived in an environment of peace in Europe and rules-based international cooperation. These conditions have fundamentally changed. Russia continues to assault Ukraine and is bringing hybrid war into EU member states and candidate countries. President Trump is talking about territorial expansion as an objective of his administration. China and the United States have been undermining rules-based trade and the confrontation between them is likely to escalate. Resentment of the Western-dominated world order has grown in developing and emerging countries, yet there is no agreement among them on an alternative to the current governance architecture.

23 Piero Cingari, 'Trump at Davos: NATO 5% push, tariff warnings for Europe', *Euronews*, 23 January 2025, https://www.euronews.com/business/2025/01/23/trump-at-davos-nato-5-push-tariff-warnings-for-europe.

24 See NATO press release of 17 June 2024, 'Defence Expenditure of NATO Countries (2014-2024)', https://www.nato.int/cps/cy/natohq/news_226465.htm.

What changes as a result of Trump? Donald Trump's return reinforces the trend towards transactional relationships, the weakening of rules-based international governance and a might-is-right mentality. The prospect of a reduced US role in European security and a worsening situation in Ukraine are encouraging faster EU common action, but some member countries would prefer bilateral deals that please Trump and Putin. Trump may not care about Ukraine and Moldova joining the EU, but there is a risk that Putin might ask for their membership to be held up as part of a deal with Trump on Ukraine. Trumpism might also affect enlargement by encouraging candidate-country leaders to push back against EU good-governance and anti-corruption conditions for accession, or to influence voters to support pro-Russian and anti-EU parties.

Trump's anti-China policies will present the EU with difficult choices. As Chinese exports are redirected to Europe, US tariffs on China are likely to fuel demand for similar protection in the EU. However, the EU might find it has more in common with China than with the US on climate and the preservation of fundamental trade principles.

The European Commission's approach. The EU is preparing for a tariff war with the US while standing by its enlargement, development and climate policies. The Commission aims to rapidly expand the EU's defence capability and pay greater attention to economic security while preserving the rules-based system. Commission president Ursula von der Leyen has clarified that the role of High Representative of the Union for Foreign Affairs and Security Policy will neither gain nor lose responsibilities – the role of the Defence and Space Commissioner is largely additional and focused on the defence industry.

Assessment and updated recommendations. The Commission's strategy is broadly right. But it is also narrow, particularly because it focuses foreign economic policy almost exclusively on security concerns and supply-chain resilience. The EU needs to take additional steps to get ahead of expected actions by Trump and Putin:

Prepare options for a deal with Trump on Europe taking increased financial and operational responsibility for its own security, rather than wait for him to decide to change the US's engagement with EU;

Chart its own path in relation to China, treating China as a partner on climate change while reducing its vulnerability to hostile Chinese actions (economic and otherwise);

Build new alliances with countries that continue to regard multilateral cooperation as beneficial, including Brazil, India and Indonesia. To do so, the Commission should be ready to align the EU's formal weight within multilateral institutions with its diminished economic weight, conditional on major emerging countries committing to effective action.

With like-minded advanced countries, the EU must scale up the climate finance it provides to major developing countries, particularly for decarbonisation. As a major contribution to the global commons, this should not be financed from aid budgets. The EU also needs to develop a strategy to reconcile its industrial and economic-security interests with the development interests of its partners.

EU-level foreign, defence, and climate spending – including support for international climate mitigation – will have to be significantly expanded. This may require temporary common borrowing.

Annex G: financial services

Nicolas Véron

The European Union's major achievements in the past decade include the successful implementation of European banking supervision and the recent establishment of a new EU agency that promises to greatly increase the effectiveness of anti-money laundering supervision[25]. But the goal of a single market in financial services, identified by Letta (2024) and Draghi

25 The EU Anti-Money Laundering Authority (AMLA); see https://www.amla.europa.eu/index_en.

(2024) as a critical component of their broader ambitions for the EU, remains distant. Banking union is unfinished in the absence of an integrated crisis-response framework, which itself cannot happen without changes to the regulatory treatment of banks' sovereign exposures. The separate project of a capital markets union, trumpeted a decade ago by then European Commission president Jean-Claude Juncker, has failed to deliver anything big so far.

What changes as a result of Trump? Trump is likely to push financial deregulation in the United States, leading to lobbying from European banks to lower capital requirements and from multiple stakeholders to reduce the burden of sustainability-related reporting.

The European Commission's approach. The objective for Maria Luís Albuquerque, the Commissioner for Financial Services and the Savings and Investments Union for 2024-2029, is to make genuine progress towards a better EU financial system, relabelled the Savings and Investment Union. She has leeway to choose her reform priorities. She comes to the job with solid experience of her portfolio, and therefore more personal agency than arguably any of her recent predecessors.

Assessment and updated recommendations. Calls to lower capital requirements should be resisted: the EU has paid an extremely high price for its past lapses in banking regulation. Some of the ideas being debated – such as the harmonisation of corporate insolvency law or taxation of investments, not to mention pension regimes or mortgage frameworks – are seductive but provide limited prospects of transformational EU legislation in the short or even medium terms.

Reform potential is greatest in terms of reducing the mind-numbing complexity of the current supervisory environment, which in turn will allow regulatory complexity to be reduced. Over a hundred different bodies in the EU carry out banking, insurance, pensions, audit, AML and macroprudential supervision, as well as mandatory deposit guarantee schemes and resolution authorities, each with their own requirements and idiosyncrasies. That is far too many. Greater capital markets policy integration at EU level is the only credible way to structurally alleviate the regulatory burden over the medium term without increasing systemic risk.

Reform impetus should therefore be concentrated first on an overhaul of capital markets supervision. The best design would be to restructure the Paris-based European Securities and Markets Authority (ESMA) by streamlining its governance and creating ESMA offices in EU countries. These offices would not be separate decision-making entities but would provide bridges to local market participants and their environments, in place of the current national authorities, after an inevitable transition period. Moreover, some of the numerous supervisory mandates in capital markets supervision could be led from an office other than Paris without jeopardising consistency of implementation and enforcement. That could facilitate national buy-in without sacrificing supervisory consistency.

This 'multicentric ESMA' concept was hinted at in July 2024 by the French Council of Economic Analysis and the German Council of Economic Experts (Landais, Schnitzer *et al*, 2024). European Central Bank president Christine Lagarde (2024) has also spoken about it. A reform of this kind is not easy but would be achievable if there were enough pressure from heads of state and government. If adopted quickly, it could in turn open space for a renewed push to complete the banking union in the second half of the Commission's five-year term.

Annex H: EU budget

Zsolt Darvas

The European Union's multiannual budget for 2028-2035 must be crafted soon, in a context of climate emergency, war near EU borders, heightened security risks, rising protectionism, slow productivity growth and a fragile economic outlook. We previously advocated for budget reform focusing on European public goods (EPGs), cohesion and agricultural policy reforms and an expansion of the regular EU budget to 2 percent of gross national income (GNI) – a balance between desirability and feasibility (Buti *et al*, 2024). We also suggested off-budget instruments for emergency interventions and defence, as weapons cannot be financed by the regular budget, with EU borrowing as the funding source.

Draghi (2024) concluded that EU support for both public and private investment is constrained by the small size of the EU budget, its lack of focus and an overly conservative attitude to risk. Draghi (2024) suggested that the EU budget be refocused on jointly agreed strategic projects and objectives, while streamlining the budget structure and better supporting private investment through financial instruments and risk taking.

European Commission and Organisation for Economic Co-operation and Development forecasts predict that public and private investments (as a share of GDP) will remain practically unchanged in 2025 and 2026, leaving the European investment gap unresolved[26]. Without a successor to the post-pandemic recovery programme, NextGenerationEU (NGEU), which currently supports both public and private investment, investment might decline after NGEU expires in 2026.

What changes as a result of Trump? Trump's return will likely put further pressure on European budgets. It creates uncertainties around the US security guarantee for Europe, especially if NATO members fail to significantly raise defence spending. This will likely drive European defence expenditures higher. Trump may reduce or withdraw support for Ukraine, necessitating increased EU assistance. His disengagement from climate action makes it even more important for the EU to meet its own targets, which requires accelerated climate investment, and pushes the EU to strengthen its role as a provider of international climate finance. Lower US energy prices under Trump could widen the EU-US energy price gap, requiring expedited EU clean energy deployment to stay competitive while meeting sustainability goals.

The European Commission's approach. Piotr Serafin, European Commissioner for Budget, Anti-Fraud and Public Administration, has been tasked with establishing a European Competitiveness Fund, revamping external action financing, leveraging national, private, and institutional financing, and introducing new EU budget revenues[27]. A national plan for each EU country is envisioned to link key reforms and EU investments. Various anti-fraud measures and administrative reforms are also planned to enhance the efficiency and integrity of EU budget management.

Assessment and updated recommendations. While the budget priorities are about right, neither the desirable size of the EU budget nor the need for dedicated emergency and defence funds have been addressed. The 2024-2029 Commission has positioned itself as an 'investment Commission,' but it is unclear how the 5 percent of GDP investment gap identified by Draghi (2024) can be closed.

EPG provision would not require national reforms as a condition of EU-funded investment. However, given that it is unrealistic to expect all EU spending to focus solely on EPGs, such conditionality would be sensible. Additionally, performance-based budgeting should be expanded to various areas of the budget, particularly agricultural spending. This approach should improve upon the NGEU's Recovery and Resilience Facility, which was noteworthy for its inconsistent quantitative targets across national plans and focused primarily on inputs and outputs rather than indicators of results. For example, setting numerical targets for reducing harmful emissions and enhancing biodiversity within agricultural policy could significantly enhance the public good aspects of this policy.

26 See European Commission press release of 15 November 2024, 'Autumn 2024 Economic Forecast: A gradual rebound in an adverse environment,' https://ec.europa.eu/commission/presscorner/detail/en/ip_24_5787, and OECD press release of 4 December 2024, 'Economic Outlook: Global growth to remain resilient in 2025 and 2026 despite significant risks,' https://www.oecd.org/en/about/news/press-releases/2024/12/economic-outlook-global-growth-to-remain-resilient-in-2025-and-2026-despite-significant-risks.html.

27 Mission letter from Ursula von der Leyen to Piotr Serafin, Commissioner-designate for Budget, Anti-Fraud and Public Administration, 17 September 2024, https://commission.europa.eu/document/download/db369caa-19e7-4560-96e0-37dc2556f676_en.