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The future of Europe's economy amid geopolitical risks and global fragmentation

Lectio Magistralis by Fabio Panetta,
Governor of Banca d'Italia,
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I am deeply honoured to receive this honorary degree in Juridical Sciences in Banking and Finance from the University of Roma Tre.

The profound links between law and economics have been studied by eminent scholars.[1]

Laws and legal institutions shape economic interactions, aligning them with the needs and aspirations of citizens. At the same time, economic transformations – especially when accompanied by technological progress – are powerful drivers of change in legal norms.

Law is therefore an essential part of any economist's cultural and professional playbook.

My knowledge of the legal system and my belief in its importance for the economy and finance stem from my experience as a central banker. As a civil servant, over the years I have dealt with the implementation of monetary policy, the safeguarding of financial

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* This lecture is part of a reflection on European governance carried out during the years I was a member of the Executive Board of the ECB, and follows other public speeches on the same subject. Its preparation began when I was at the ECB and continued at Banca d'Italia. I wish to thank the following colleagues for their valuable insights and contributions: M.G. Attinasi, M. Ca' Zorzi, E. Dorrucci, C. Grynberg, D. Kapp, J.F. Jamet, D. Ioannou and B. Meunier at the ECB; P. Alessandri, L. Bellomarini, A. Borin, L. Carpinelli, F. Colonna, I. Faiella, V. Memoli, R. Pisano and P. Rizza at Banca d'Italia.

1 Ronald H. Coase, winner of the Nobel Memorial Prize in Economic Sciences, underlined how 'the rights which individuals possess, with their duties and privileges, will be, to a large extent what the law determines. As a result, the legal system will have a profound effect on the working of the economic system and may in certain respects be said to control it.' (R.H. Coase, 'The Institutional Structure of Production', Lecture to the memory of Alfred Nobel, Stockholm, 9 December 1991). Cesare Vivante, one of the founding fathers of commercial law, advised his students about how to approach their legal dissertations at the dawn of the twentieth century, 'Never venture into a legal discussion without thorough knowledge of the technical structure and economic function of the legal institution that is the subject of your studies. [...] If it is the task of law to regulate the effects of such an institution, it is clear that the practical study of its nature must precede that of the law.' (C. Vivante, *Prefazione a Trattato di diritto commerciale. Vol. I: I commercianti*, Milan, Vallardi, 4[a] ed., 1911).

stability, and the supervision of intermediaries. I can thus safely say that I have always been immersed in economic, banking, and financial law.

Along the way, I have had the privilege of serving two prestigious institutions – Banca d'Italia in the first place, and then the European Central Bank – which have contributed to my understanding of the links between law and economics. Today I would like to express my sincere gratitude to all those who work in these institutions for the loyal cooperation and friendship they have shown me over the years.

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My lecture will touch on some of the most pressing issues we face today.

The rules governing international relations are being severely tested by tensions and conflicts that have erupted almost simultaneously in many parts of the world: from Eastern Europe to the Middle East, and from Asia to Africa.[2] The number of violent conflicts in 2023 was the highest since the Second World War.[3]

Geopolitical disputes have repercussions far beyond the borders of the countries directly involved. Conflicts generate economic risks and hinder international trade and the free movement of capital, potentially splitting the global economy into opposing blocs. The weaponization of trade and financial policies exacerbates these risks.[4]

The European economy is particularly exposed to the consequences of a fragmentation of world trade, both because of its close productive and financial integration with the rest of the world and because of its growth model, which relies heavily on the import of raw materials and the export of final goods and services to foreign markets.[5]

How can we, as Europeans, respond to a level of uncertainty that seems destined to remain 'higher-for-longer'? What measures must we take to strengthen the competitiveness, strategic autonomy and international standing of the European economy? To answer these questions, I will analyse the recent upsurge in geopolitical tensions and their impact on the global economy, on policies, and on European governance.

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2 For more details, see the page, 'Fragility, Conflict and Violence' on the World Bank's website.

3 United Nations, 'With Highest Number of Violent Conflicts Since Second World War, United Nations Must Rethink Efforts to Achieve, Sustain Peace, Speakers Tell Security Council', Press Release, SC/15184, 26 January 2023.

4 'Beyond money: the euro's role in Europe's strategic future', address by F. Panetta at the 'Ten years with the euro' conference, Riga, 26 January 2024.

5 For an analysis of the EU's economic interdependencies and their macroeconomic implications, see 'The EU's Open Strategic Autonomy from a central banking perspective. Challenges to the monetary policy landscape from a changing geopolitical environment', European Central Bank, Occasional Paper Series, 311, 2023.

1. Globalization after the Second Word War

Economic shocks can lead to geopolitical clashes and conflicts.

The Great Depression, for example, contributed to the political, economic and social tensions that led to the outbreak of World War II.[6] More generally, empirical analyses show that large terms-of-trade shocks caused by higher commodity prices increase the likelihood of conflict.[7]

The causal link works both ways: geopolitical disputes, in turn, often lead to economic upheaval.

The two World Wars, for example, caused the largest decline in GDP per capita and the greatest destruction of physical capital in modern history. The 1973 Arab-Israeli war triggered a series of oil price hikes that ultimately destabilized the global economy.[8] More recently, we have witnessed the inflationary and recessionary effects of Russia's attack on Ukraine.

Geopolitical tensions and trade are also closely linked. Throughout human history, territorial expansion by the great powers of the day – from ancient Rome to the colonial era – has often been followed by economic integration.

Because of these links between the economy and trade on the one hand, and geopolitical hostilities on the other, a paradigm took hold in Western democracies after the devastation of World War II, whereby only close international economic integration could ensure lasting peace.[9]

The relationship between economic integration and peace is explicitly mentioned in the Havana Charter, which in 1948 envisaged the creation of an international organization for world trade, in line with the United Nations' determination to create the conditions of stability and prosperity necessary for peaceful and friendly relations among nations. The Charter never came into force, but the talks led to the General Agreement on Tariffs and Trade (GATT), which was replaced in 1995 by the World Trade Organization.

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6 E.J. Hobsbawn, *Age of Extremes. The Short Twentieth Century 1914-1991,* published in Italian by Rizzoli, 1995; S. Broadberry and M. Harrison (eds.), *The Economics of the Second World War: Seventy-Five Years On*, London, CEPR Press, 2020.

7 P. Leepipatpiboon, C. Castrovillari and T. Mineyama, 'Macroeconomic Shocks and Conflict', IMF Working Papers, 68, 17 March 2023.

8 Another example is the Iranian revolution in 1979 and the Iran–Iraq War in 1980, which led to a collapse in oil production and a rise in crude oil prices, pushing many countries into recession; see F. Corsello, M. Gomellini and D. Pellegrino, 'Inflation and energy price shocks: lessons from the 1970s', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 790, 2023.

9 On the fiftieth anniversary of the General Agreement on Tariffs and Trade in 1998, President Bill Clinton recalled the principles on which the post-war economic order was built: 'And so, at mid-century, a farsighted generation of leaders acted on the bitter lessons of protectionism, devastating depression and war. They embraced the revolutionary idea that freedom – free democracies, free markets, the free flow of ideas, the free movement of people – would be the surest route to the greatest prosperity for all. They were confident that growing economic interdependence would lead to greater peace among nations. And the economic alliances and institutions they created – the IMF, the World Bank, the GATT – built a platform for prosperity that has lasted to this day'. A. Wolff, 'Trade for peace', speech at the Graduate Institute, Geneva, 28 September 2022.

In 1944, the Bretton Woods Conference established a multilateral system based on a common set of rules, a system capable of promoting cooperation and trade on a global scale.[10] Other multilateral institutions followed over time, such as the World Bank (1944), the International Monetary Fund (1945), the OECD (1961), the G20 (1999) and the Financial Stability Board (2009).

In Europe, the creation of the European Coal and Steel Community in 1951 and the European Economic Community in 1957 were inspired by Robert Schuman's statement that European economic integration would make war 'not merely unthinkable, but materially impossible'.[11]

Thanks in part to these institutions, the world economy became increasingly integrated in the post-war period. The share of world trade in GDP rose from 20 per cent in 1950 to 34 per cent in 1975 (Figure 1).

Globalization continued with the end of the Cold War and the participation of new countries in international trade – notably China, which joined the WTO in 2001. By 2021, trade accounted for 57 per cent of world GDP.

The dismantling of trade barriers and advances in transport spurred the development of global value chains, which were designed to exploit cross-country differences, in both specialization and the cost of production factors.[12]

Trade expansion was concentrated in goods, but was also significant in the services sector.[13] The most surprising development was in finance: from the 1990s until the global financial crisis of 2007-08, the foreign financial assets held by G20 countries doubled.[14]

This open, multilateral trade system has been an engine of prosperity.[15] The freedom to trade goods and services, to invest across borders, and to share knowledge and ideas

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10 B. Eichengreen, *Globalizing capital: a history of the international monetary system*, Princeton, Princeton University Press, 1966; M. Obstfeld and A.M. Taylor, *Global capital markets: integration, crisis, and growth*, Cambridge, Cambridge University Press, 2004.

11 For more information, see on the ECB's website, 'Schuman's declaration in May 1950', and F. Panetta, 'Europe's shared destiny', *Lectio Magistralis* marking the conferral of an honorary degree in Law by the University of Cassino and Southern Lazio, 6 April 2022.

12 In 2007, almost half of the international freight transport was due to trade within global value chains; see A. Borin, M. Mancini and D. Taglioni, 'Economic Consequences of Trade and Global Value Chain Integration: A Measurement Perspective', World Bank, Policy Research Working Paper Series, 9785, 2021.

13 The share of trade in services in world GDP rose from 8 per cent in 1990 to 14 per cent in 2019.

14 Net foreign direct investment also continued to grow strongly, driven by the expansion of multinationals' networks of foreign affiliates; see P.R. Lane and G.M. Milesi-Ferretti, 'The External Wealth of Nations Revisited: International Financial Integration in the Aftermath of the Global Financial Crisis', *IMF Economic Review*, 66, 2018, pp.189-222.

15 Since World War II there has been a strong positive link between trade openness and GDP growth; see J. Feyrer, 'Trade and Income-Exploiting Time Series in Geography', *American Economic Journal: Applied Economics*, 11, 4, 2019, pp. 1-35; S. Aiyar, et al., 'Geoeconomic fragmentation and the future of multilateralism', IMF Staff Discussion Notes, 1, 2023.

has fuelled growth for many countries and for much of the world's population.[16] Workers, especially women, have moved into more productive jobs.[17] Hundreds of millions of people in developing countries have been lifted out of poverty. Worldwide, inequality has declined since the 1980s, thanks to greater convergence among countries.[18]

Despite the sometimes strong social tensions it has generated due to fierce competition, globalization has proven beneficial overall, especially when accompanied by investment in education, healthcare, and social safety nets.[19] International competition and the dismantling of trade tariffs have pushed down the prices of imported goods – mostly to the benefit of low-income consumers in advanced economies.[20]

2. Geopolitical risks and economic fragmentation

The three pillars of the post-World War II multilateral order – trade openness, economic growth and geopolitical stability – are all being tested today.

First, globalization is facing opposition in many advanced economies.[21]This backlash reflects perceptions that it leads to inequality; the growth of imports from, and offshoring of production to, low-income countries is often blamed for reducing real wages and employment opportunities for low-skilled workers.[22]

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16 J.A. Frankel and D.H. Romer, 'Does Trade Cause Growth?', *American Economic Review*, 89, 3, 1999, pp. 379-399; D. Rodrik, *One Economics, Many Recipes: Globalization, Institutions, and Economic Growth*, Princeton, Princeton University Press, 2007; M.J. Melitz and S.J. Redding, 'Trade and Innovation,' NBER Working Paper Series, 28945, 2021.

17 N. Rocha and D. Winkler, 'Trade and Female Labor Participation: Stylized Facts Using a Global Dataset', Policy Research Working Paper, 9098, World Bank, 2019.

18 L. Chancel, T. Piketty, E. Saez and G. Zucman, *World Inequality Report 2022*, World Inequality Lab, 2022.

19 J. Bhagwati and T.N. Srinivasan, 'Trade and Poverty in the Poor Countries', *American Economic Review*, 92, 2, 2002, pp. 180-83; D. Dollar and A. Kraay, 'Trade, Growth, and Poverty', *The Economic Journal*, 114, 493, 2004, pp. F22-F49.

20 P.D. Fajgelbaum and A.K. Khandelwal, 'Measuring the Unequal Gains from Trade', *Quarterly Journal of Economics*, 131, 3, 2016, pp. 1113-80; L. Bai and S. Stumpner, 'Estimating US Consumer Gains from Chinese Imports', *American Economic Review: Insights*, 1, 2, 2019, pp. 209-224; X. Jaravel and E. Sager, 'What are the price effects of trade? Evidence from the U.S. and Implications for Quantitative Trade Models', Board of Governors del Federal Reserve System, Finance and Economics Discussion Series, 2019-068, 2019.

21 This is not a new phenomenon. Resistance to international openness has emerged in the past when trade created competition between countries with different endowments of production factors, such as capital, labour and natural resources. In the late 1800s, Europe, which had limited land resources, became more integrated with the Americas, which had an abundance of land. This led to resistance to globalization in Europe and led to the introduction of tariffs on agricultural products. See H. James and K.H. O'Rourke, 'La prima globalizzazione e i suoi contraccolpi', in G. Toniolo (eds.), *L'Italia e l'economia mondiale. Dall'Unità a oggi*, Venice, Marsilio, 2013 (Collana storica della Banca d'Italia. Contributi, 12), pp. 53-95.

22 'Fostering Inclusive Growth', IMF Staff Note prepared for the G20 Leaders' Summit held in Hamburg on 7 and 8 July 2017, pp. 7-8; P. Saumik, 'Understanding the global decline in the labor income share', *IZA World of Labor*, 472, 2020. Another criticism is that the expansion of global value chains could have come at the expense of an environmental deterioration; see World Bank, *World Development Report 2020*: *Trading for Development in the Age of Global Value Chains,* 2020.

To some extent, these perceptions reflect the temporal overlap between the growth of international trade and the rise in inequality, and are partly unfounded.

Inequalities between countries have been falling steadily since the early 1990s, while income disparities within countries have been rising (Figure 2). However, these differences reflect several factors, most of which have little to do with globalization. For example, technological progress is much more likely to affect wage differentials than offshoring or firms' participation in global value chains.[23]

Furthermore, the tendency to relocate production is mostly due to advances in transport and telecommunications rather than to trade liberalization.[24] The best way to fight domestic inequalities is through domestic policies – especially education, healthcare, the protection of workers' rights and social security policies.

Second, the decline in economic growth in advanced economies compared with the post-war boom, which was exacerbated by the global financial crisis, can sometimes lead to the misconception that development is a zero-sum game, with gains for one group of workers coming only at the expense of another.[25] This stokes up social divisions and spurs anti-globalization and anti-immigration measures, fuelling the geopolitical polarization we are witnessing in many countries today.[26]

Finally, global geopolitical conflicts often stem from the insecurity and consequent social unrest experienced by large sections of the population, as well as from the loss of economic and political standing of some countries and regions of the world (Figure 3). They are probably the most insidious threat to the post-war multilateral order.

In recent years, geopolitical instability has been accompanied by a fragmentation of world trade. There have been several examples of this, including waning US support for the WTO, protectionist disputes between the US and China,[27] Brexit, and the opposition of many Western countries, including from within the EU, to Chinese investors acquiring

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[23] R.C. Feenstra and G.H. Hanson, 'The impact of outsourcing and high-technology capital on wages: estimates for the United States, 1979-1990', *Quarterly Journal of Economics*, 114, 3, 1999, pp. 907-940; R.C. Feenstra and G.H. Hanson, 'Global production sharing and rising inequality: a survey of trade and wages', in E. K. Choi and J. Harrigan (eds.), *Handbook of international trade*, Oxford, Blackwell Publishing, 2003, pp. 146-185; 'Fostering Inclusive Growth', 2017, op. cit.

[24] J. Amador and S. Cabral, 'Global Value Chains: A Survey of Drivers and Measures', *Journal of Economic Surveys*, 30, 2, 2016, pp. 278-301; P. Antras, 'Conceptual Aspects of Global Value Chains', *The World Bank Economic Review*, 2020, 34, 3, 2020 pp. 551-574; S. Cigna, V. Gunnella and L. Quaglietti, 'Global value chains: measurement, trends and drivers,' European Central Bank, Occasional Paper Series, 289, 2022; and C. Freund, 'Intersecting paths', *Finance and Development*, International Monetary Fund, June 2023.

[25] S. Chinoy, N. Nunn, S. Sequeira and S. Stantcheva, 'Zero-Sum Thinking and the Roots of U.S. Political Divides', NBER Working Paper, 31688, 2023.

[26] L. Guiso, H. Herrera, M. Morelli and T. Sonno, 'Global crises and populism: the role of Eurozone institutions', *Economic Policy*, Vol. 34, 97, January 2019, pp. 95-139.

[27] The US administration imposed tariffs on imports of solar panels (30-50 per cent tariff rate) in January 2018, and on imports of steel (25 per cent tariff rate) and aluminium (10 per cent tariff rate) in March of the same year. In September it imposed a 10 per cent tariff on around $250 billion worth of imports of other goods from China.

strategic firms and critical infrastructure.[28] More recently, the international community has responded to the invasion of Ukraine with trade and financial sanctions against Russia. And there is a risk that the ongoing tragic conflict in the Middle East could end up destabilizing energy markets.

Trade restrictions, such as tariffs, subsidies, and restrictions on exports and foreign investment (Figure 4), have exacerbated the disruptions in global commodity supply chains that emerged in the aftermath of the pandemic.

3. From globalization to fragmentation?

The events I have just described have stimulated debate about the costs and benefits of over-reliance on third countries for the supply of critical raw materials and inputs.

In an ideal world, trade integration brings undoubted benefits, allowing producers to rely on the most efficient suppliers and financial intermediaries to diversify their activity internationally. In our real, geopolitically unstable world, however, interconnectedness can quickly turn into vulnerability.

The governments of the major countries are responding to these vulnerabilities.[29] They are now less willing to rely on imports of strategic resources – such as food, energy or technology – from trading partners with whom they do not have stable relations and political, economic and cultural ties. Some of them are offering incentives to bring back previously offshored production to their country of origin (reshoring) or to 'friendly' countries (friend-shoring).[30] This is sometimes to the detriment of geopolitical allies.[31]

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28 See 'The geopolitics of decarbonisation: Reshaping European foreign relations', *Climate Diplomacy Report*, Adelphi Research, Berlin, 2020.

29 The main examples are the Dual Circulation Strategy (DCS) in China, the Chips Act (CA) and the Inflation Reduction Act (IRA) in the United States, and the Open Strategic Autonomy (OSA) in the EU. The DCS, passed in 2020, aims to reduce China's dependence on foreign technology, both by vertically integrating its production and relying mainly on its domestic market, and by internationalizing Chinese companies and stimulating foreign demand. The CA of 2022 provides subsidies for R&D and production activities carried out in the US in the technological sector. The IRA grants tax credits for electric vehicles and renewable energy equipment that meet certain specific technical requirements. The OSA aims to strengthen the EU's ability to operate in areas of strategic importance by reinforcing the resilience of the EU industrial sector and its capacity to supply of strategic goods. Similar measures have also been adopted in the UK (see S. Kinkel, D. Pegoraro and R. Coates, 'Reshoring in the US and Europe', in L. De Propis and D. Bailey (eds.), *Industry 4.0 and Regional Transformations*, Routledge, London, 2020, pp. 176-194) and in Japan (see J.I. Dingel and B. Neiman, 'How many jobs can be done at home?', *Journal of Public Economics*, 189, 2020).

30 Reshoring is the process of bringing production back to, and sourcing inputs from, its country of origin. Friend-shoring is the process of producing or sourcing inputs from suppliers in geopolitically allied countries.

31 In some cases, for example, the incentives provided by the Inflation Reduction Act adopted in the United States penalize European manufacturers.

Companies are also rethinking their strategies,[32] reviewing their location choices in order to repatriate activities, or diversifying their outlet markets and sources of supply to create regional value chains (regional reshoring).[33]

Partly as a result of these developments, trade in goods and services relative to world GDP is stagnating after decades of strong expansion (Figure 5a) and the geographical distribution of trade is shifting towards new centres of gravity (Figure 5b).

However, these trends have not yet translated into outright deglobalization.[34]

Reversing the trend of globalization would be costly. Technological advances make it easier for companies to manage offshored or outsourced production and to trade in services that once required direct contact between counterparties.[35] In addition, cost and wage differentials continue to make offshoring attractive, although the destination countries are changing.[36]

The degree of integration in the international monetary system is high: the euro and especially the US dollar remain the main global reserve currencies.[37] However, some central banks are increasing their holdings of gold and reducing those of major currencies, and there is an ongoing debate about the risk of trade and financial sanctions affecting the design of the system.[38]

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32 McKinsey & Company, 'Taking the pulse of shifting supply chains', August 2020. A business survey conducted by the German Ifo institute in July 2022 found that 87 per cent of responding firms had taken steps to increase the resilience of their supply chains. In the aftermath of the pandemic, European companies in the health and pharmaceutical sectors have reshored or are considering re-shoring part of the production previously located abroad.

33 Evidence from a recent Banca d'Italia business survey shows that Italian manufacturing firms that rely on Chinese inputs are replacing Chinese suppliers with EU-based alternatives; see A. Borin, G. Cariola, E. Gentili, A. Linarello, M. Mancini, T. Padellini, L. Panon and E. Sette, 'Inputs in geopolitical distress: a risk assessment based on micro data', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 819, 2023. A joint survey conducted by Banca d'Italia, Deutsche Bundesbank and Banco de España found a similar pattern for German and Spanish firms.

34 In its *2023 World Trade Report*, the WTO notes that trade tensions are starting to affect trade flows, suggesting potential fragmentation. However, international trade continues to thrive, driven by the digital revolution, which is facilitating trade in goods and, even more so, in services. Overall, there does not yet seem to be any evidence of deglobalization. See also M. Di Sano, V. Gunnella and L. Lebastard, 'Deglobalisation: risk or reality?', The ECB Blog, 12 July 2023.

35 Services such as business consultancy, medical diagnostics, education, translation and marketing. See R. Baldwin, *The Globotics Upheaval: Globalization, Robotics, and the Future of Work*, New York, Oxford University Press, 2019.

36 In recent years, many Western companies have shifted production from China to other countries such as Vietnam and Mexico; see L. Alfaro and D. Chor, 'Global supply chains: the looming "great reallocation"', Harvard Business School, Working Paper 24-012, 2023.

37 ECB, 'The international role of the euro', June 2023.

38 F. Panetta, 'Beyond money: the euro's role in Europe's strategic future', 2024, op. cit.

Overall, there is a clear case for maintaining a global economy that is open to international trade. Breaking trade links would be costly,[39] and would have a strong negative impact on the welfare of much of the world's population.[40]

4. The euro area: strengthening resilience and competitiveness

At the same time, we cannot ignore geopolitical risks and their implications. We need to consider the possibility that we may face further protectionist pressures and a deglobalization of the world economy, and develop appropriate responses.

The solution is to strengthen the European economy along three main directions: rebalancing its growth model; improving its strategic autonomy; ensuring its capacity to provide for its external security, and enhancing its role in the international debate. The aim is not to set itself against others or to retreat behind national borders, but to become stronger in order to contribute to competition, integration and dialogue between countries. Achieving these objectives will require structural interventions.

Reducing dependence on foreign demand

First, the European growth model needs to be reconsidered. Over the past two decades, Europe's economy, unlike that of the United States, has been overly dependent on external demand, to the detriment of domestic demand (Figure 6).[41] But trade disputes and global shocks are making this growth strategy less sustainable and riskier.

Going forward, the EU must strengthen domestic demand and make the most of the single market.[42]

This recipe is consistent with current developments in the world economy. For example, China, long one of the main markets for European exports, is reducing its openness to trade (Figure 7) as a result of both stronger domestic demand and policies to reduce

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[39] In the EU the imposition of limits on international trade would have would have negative effects on exports and on the availability of intermediate inputs. It could also trigger retaliation measures that could affect the importation of strategic inputs; see U. von der Leyen, speech on EU-China relations to the Mercator Institute for China Studies and the European Policy Centre, 30 March 2023.

[40] Recent estimates suggest that a fragmentation of international trade would reduce global wealth by 5 per cent and trade flows by 25 per cent. These effects could be magnified by rigidities, such as restrictions on the reallocation of production factors or shortages of key inputs, as well as by greater uncertainty or higher risk premia. If fragmentation were to limit access to technology, the loss of wealth would rise to 10 per cent; see M.G. Attinasi, L. Boeckelmann and B. Meunier, 'Friend-shoring global value chains: a model-based analysis', *ECB Economic Bulletin*, 2/2023, Frankfurt am Main, 30 March 2023, pp. 59-66.

[41] Domestic demand has fuelled growth in the United States; see F. Panetta, 'Monetary autonomy in a globalised world', welcome address at the joint BIS, BoE, ECB and IMF conference on 'Spillovers in a "post-pandemic, low-for-long" world', Frankfurt, 26 April 2021.

[42] These considerations are consistent with the main conclusions of the Single Market Report presented in recent days to the European Council; see E. Letta, *Much more than a market: speed, security, solidarity. Empowering the Single Market to deliver a sustainable future and prosperity for all EU Citizens*, April 2024.

dependence on foreign inputs, especially in technological sectors.[43] But the problem is not just the drying up of markets: Chinese producers are becoming increasingly competitive and, in some sectors, are gaining global market shares.[44]

Enhancing energy security

In the current geopolitical context, and in order to contribute to the fight against climate change, the European economy can no longer rely on a stable supply of energy resources imported at low cost,[45] nor can it continue to depend on fossil fuels.[46]

We must increase clean energy production without excluding any technological option,[47] promote industrial decarbonization and invest in an integrated gas and electricity infrastructure network.[48] This will keep energy costs down and improve our competitiveness.

Yet not even this transformation will entirely free us from dependence on foreign suppliers of energy inputs: even with a higher share of renewables, the EU will continue to import key resources from a very small number of countries, which are also subject to geopolitical tensions.

This is the case for metals and minerals needed for the energy transition, such as lithium, nickel, cobalt and rare earth elements. Europe currently has less affinity with nations rich in these input resources than other countries that have established close relations

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43 The main instrument used by the Chinese authorities to implement these strategies is the Dual Circulation Strategy (see Footnote 29).

44 This is true, for example, of electric and hybrid vehicles for which imports to Europe from China are increasing and the European trade balance is rapidly getting worse.

45 In recent decades, the ample supply and low cost of fossil fuels have made it convenient to specialize in energy-intensive activities (such as the chemical sector, which in Germany provides essential inputs to domestic manufacturing) that lose competitiveness as the prices of raw materials go up (e.g. moving from pipeline gas to the more expensive liquefied natural gas). These inefficiencies are analogous to the 'resource curse', the paradox whereby countries rich in natural resources are less developed than countries with very few of them. This can happen if a wealth of natural resources favours income over productivity and innovation; see S. Mansoob Murshed, *The Resource Curse*, Newcastle upon Tyne, Agenda Publishing, 2018.

46 Fossil fuels (oil, gas, coal) account for almost three quarters of Europe's energy consumption and are mostly imported; see F. Panetta, 'Greener and cheaper: could the transition away from fossil fuels generate a divine coincidence?', speech delivered at the Italian Banking Association, Roma, 16 November 2022.

47 Having a wide range of technological options allows advancing in the decarbonisation process while minimising the risks for supplying the population. Among the different options, the European Commission (among others) has recently mentioned that of next-generation nuclear power, promoting an industrial alliance to accelerate the development of small modular reactors (SMRs). See on the European Commission website: European Industrial Alliance on SMRs.

48 F. Panetta, 'Greener and cheaper: could the transition away from fossil fuels generate a divine coincidence?', 2022, op. cit.

with them. Prominent among these countries is China, which now dominates the global supply and processing chain for these materials (Figure 8).[49]

A farsighted strategy requires building economic and diplomatic ties with the countries that produce most of the inputs needed for the energy transition.[50] Mutually beneficial relationships can be established by seizing the opportunity to provide them with the technologies they need to integrate into global production chains.[51] We must promote partnerships and strengthen supply chains, along the lines of the Resilient and Inclusive Supply-chain Enhancement (RISE) project, which is at the heart of the G7 agenda under the Italian presidency.[52]

Advancing the production of technology

Europe lacks specialization in the production of cutting-edge technology services (Figure 9). At a time when technology is subject to protectionist measures and reshoring, Europe's competitiveness in this sector needs to be strengthened and its foreign dependence reduced.[53] This would stimulate competition in sectors where monopolies of a few global technological giants are emerging; it would deliver benefits that go beyond the economic dimension and affect the fundamental rights of citizens – think of privacy and pluralism in the information sector.

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49 The International Energy Agency (IEA) estimates that demand for the metals and minerals needed for the climate transition – lithium, copper, nickel, cobalt, manganese and graphite – will quadruple by 2040. The supply of these resources is concentrated in developing and emerging economies that have closer economic and political relationships with China than do the EU or the US. South American countries play a dominant role: Chile is among the leading suppliers of lithium and copper, while Peru is the third largest supplier of raw copper in the world. The nickel, cobalt and graphite markets are each dominated by one major producer (Indonesia, the Democratic Republic of Congo (DRC) and China, respectively). China has also strategically positioned itself in the green metals and minerals supply chain. It holds 80 per cent of the cobalt mines in the Democratic Republic of Congo and is the largest processor of nickel, copper, lithium and cobalt. Moreover, Chinese companies have invested in mining operations in Australia Chile and Indonesia.

50 The Raw Material Information System (RMIS) of the European Commission assesses the availability of a wide range of raw materials exposed to supply-side risks. In 2023, it identified 16 Strategic Raw Materials and drew up a map of countries where such materials are found and a classification of the relative supply side risks; see on the website of the European Commission, 'Critical, strategic and advanced materials'.

51 The development and transfer of technologies to support the fight against climate change is an essential part of international climate negotiations. The United Nations Framework Convention on Climate Change urges the advanced economies to promote access by developing countries to technologies for the transition. The Paris Agreement establishes an institutional framework for creating the Technology Mechanism, set up to accelerate the technological transfer for the mitigation of climate change.

52 The RISE initiative is designed to help low- and medium-income countries to become more integrated in supply chains for products that are key to the energy transition; see 'G7 Finance Ministers and Central Bank Governors' Statement', 12 October 2023.

53 This strategy creates dilemmas for politics that are hard to solve. For example, the green transition would be accelerated by focusing on rapidly adopting low-cost technologies, mainly produced in China, but at the cost of a growing strategic dependence.

Progress is necessary in technologies behind the production and use of carbon free energy sources.[54] In the coming years, these technologies will not only provide the energy security benefits mentioned above, but will also attract large investments and generate productivity gains and jobs.[55]

Other countries have launched initiatives along these lines.[56] The response to these initiatives must be European measures that do not weaken the single market. Instead, the Commission's Green Deal industrial plan[57] envisages measures funded not by new European resources, but by relaxing state aid rules. This mechanism favours countries with greater fiscal space and risks segmenting the single market by triggering a race to the bottom in which each Member State seeks to offer greater incentives than the others. The end result would be less effective policies and fewer competitiveness gains for the EU economic system as a whole.

There is also a need to increase public and private investment in advanced technologies, bringing them up to the level of the most advanced countries and exploiting existing centres of excellence in Europe in sectors such as AI, robotics, digital infrastructure and communications, space exploration and biotechnologies.[58]

To turn academic excellence into business opportunities, the technology transfer process must be bolstered and the fragmentation of Europe's digital market needs to addressed through decisive action to simplify legislation and promote the integration of data and IT systems.[59]

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54 In terms of the spread of decarbonization technologies, the EU has achieved positive results, such as the high share of electricity generated from renewable sources (22 per cent for wind and solar power, as against 20 per cent for gas) and the widespread availability of heat pumps; see Strategic Perspectives, *Competing in the new zero-carbon industrial era*, Brussels, 2023.

55 For example, it is estimated that in Italy green interventions under the NRRP will create 120,000 new jobs by 2025. Considering only initiatives explicitly aimed at reducing greenhouse gas emissions, the number of new jobs would be over 50,000; see G. Basso, F. Colonna, D. Depalo and G. Mendicino, 'The green transition and the Italian labour market', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 811, 2023.

56 Such as the Inflation Reduction Act in the United States and the Dual Circulation Strategy in China, see Footnote 29.

57 The GDIP is based on four pillars: a simplified regulatory environment, enhancing skills, open trade, and faster access to funding.

58 In the field of artificial intelligence, Europe can draw on a huge group of cutting-edge, highly talented scientists (see B. Lanvin and F. Monteiro (eds), 'The global talent competitiveness index 2023: what a difference ten years make, what to expect for the next decade', Fontainebleau, INSEAD, 2023); there are also many firms with a market valuation of at least one billion dollars (according to the calculations of Crunchbase.com). As regards civil satellite positioning and navigation technologies, the European Galileo system is an alternative to the United States' Global Positioning System. In addition, according to the European Commission, biotechnology is a rapidly expanding sector, which contributes €31 billion to GDP and employs 210,000 people directly and 625,000 people indirectly (data from ANSA, March 2024).

59 For example, there is the Common European Data Spaces initiative, part of the AI Innovation Package, which aims to improve the availability of high-quality data for start-ups and innovative communities, for the training of AI models.

In the field of digital payments, the Eurosystem is already helping to place the EU at the forefront of technology, strengthening the international role of the euro and thus our ability to influence global economic and financial developments.[60]

Rethinking our participation in global value chains

I have already mentioned that European companies are reshaping their value chains.

In this regard, Europe's less developed regions (Figure 10) offer important opportunities. While they have higher labour costs than emerging economies, their economic and institutional frameworks are stable and integrated into the EU single market, and their geographical location limits transport and connectivity costs to European economic centres.

In addition, they have large untapped labour resources: an increase in their level of economic activity and aggregate demand would turn them into outlet markets for many goods and services. Moreover, some of these regions – such as those bordering the Mediterranean – benefit from favourable climatic conditions for renewable energy production.[61]

Enhancing European structural and cohesion fund programmes and the ability to carry out funded projects can make these areas more attractive as investment destinations than offshore centres. This would not only strengthen European supply chains, but also promote economic convergence and underpin domestic demand in Europe.

In the United States, policies to support growth in less developed areas have been implemented successfully, notably through reshoring programmes.[62] Public incentives have helped some States with lower incomes and wages become the destination for

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60 F. Panetta, 'Demystifying wholesale central bank digital currency', speech at the Symposium hosted by the Deutsche Bundesbank on 'Payments and Securities Settlement in Europe – today and tomorrow', Frankfurt am Main, 26 September 2022; F. Panetta, 'The cost of not issuing a digital euro', speech delivered at the Centre for Economic Policy Research (CEPR) - European Central Bank (ECB) Conference, 'The macroeconomic implications of central bank digital currencies', Frankfurt am Main, 23 November 2023; P. Cipollone, 'Preserving people's freedom to use a public means of payment: insights into the digital euro preparation phase' - Introductory statement by Pietro Cipollone, Member of the Executive Board of the ECB, at the Committee of Economic and Monetary Affairs at the European Parliament, Brussels, 14 February 2024.

61 K. Nabiyeva, *Energy Transition in South-East and Eastern Europe, South Caucasus and Central Asia*, Technical Report, Friedrich Ebert Stiftung, 2018.

62 The interventions were implemented above all as part of the Inflation Reduction Act; see E. Van Nostrand and M. Ashenfarb, 'The Inflation Reduction Act: A Place-Based Analysis', U.S. Department of the Treasury, November 2023.

large investments in renewable energy production,[63] generating significant employment growth.[64]

The reconfiguration of global production chains offers an opportunity to revitalize the economy of the Italian Mezzogiorno.[65] Seizing this opportunity requires policies to attract capital and strengthen the local productive environment by reinforcing infrastructure, re-skilling the workforce and improving the efficiency of local public administrations.[66] It is essential to pursue with determination the objectives set out in the National Recovery and Resilience Plan (NRRP) in these areas.

Governing migration flows

Many EU Member States face the challenge of an ageing and shrinking population. According to Eurostat, the working-age population in the EU will decline by 7 per cent over the next 15 years, and by as much as 13 per cent without the currently expected inflows of non-EU migrants.

To avoid a sharp reduction in labour supply, and hence in economic growth potential, Europe must make significant efforts to allow the legal and managed entry of migrants and their integration into the labour market.

The issue of migration flows cannot be tackled by each Member State individually.

We need a European immigration policy, both to coordinate legal entry for work purposes and to avoid imbalances between Member States in the face of asymmetric pressures generated by the massive influx of migrants from the Global South.

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63 Georgia, in the United States, is a case in point. In response to government incentives, in recent months leading international firms have made or announced largescale investments, which are transforming this State into a key hub for the production of renewable energies, electric batteries and zero-emission vehicles. One example among many is that of Hyundai, which is planning to build two giga-factories with a capacity of 35 GWh for the production of electric vehicles, capable of turning out 300,000 vehicles per year; see the video on the Financial Times website: How Biden's Inflation Reduction Act changed the world, 6 December 2023 and Hyundai, 'Hyundai Motor Group and SK On to establish EV battery cell production joint venture in US', press release, 25 April 2023.

64 L. Bermel et al., *Clean Investment at the Community Level*, Rhodium Group-MIT Center for Energy and Environmental Policy Research, November 2023; E. Van Nostrand and M. Ashenfarb, 2023, op. cit.

65 An example of an opportunity to be seized is the location of the data centres required for the operation of artificial intelligence. Powering these facilities will require huge and rapidly growing amounts of electricity, which according to the International Energy Agency will reach the level of 1,000 TWh (equal to the electricity used by the entire Japanese economy each year) in 2026. Meeting such needs will require a significant increase in electricity generated from renewable sources, and developers are looking at economic areas with the necessary natural resources. Among these areas, the public debate frequently refers to southern Italy; see C. Hodgson, 'Booming AI demand threatens global electricity supply', Financial Times, 17 April 2024.

66 A. Accetturo, G. Albanese and R. Torrini (eds.), 'The North-South divide: economic development and public intervention', Banca d'Italia, Seminars and conferences, 25, 2022 (only in Italian); S. Galano, L. Sessa and S. Zuccolalà, 'The quality of electricity supply: a comparison among Italian regions', Banca d'Italia, Questioni di economia e finanza (Occasional Papers), 737, 2022 (only in Italian).

It is also essential to attract skilled workers who can contribute to innovation in production systems, including as entrepreneurs. Given the difficulties that companies face in recruiting highly-skilled labour force in many advanced countries, international competition for this type of worker is intense.[67]

Enhancing external security

In the current international context, it is clear that the EU must strengthen its capacity to protect its own external security.

In the Versailles Declaration of March 2022, European leaders called for an increase in defence spending to reach the NATO guideline of 2 per cent of GDP. However, Europe's military budget is still insufficient and characterized by a high degree of fragmentation between countries, which leads to project overlaps and a bias towards personnel salaries, thereby reducing its efficiency.[68]

EU-wide investment in our external security would avoid duplication of spending, and generate synergies and economies of scale, freeing up resources to build infrastructure and for research and development.[69] This would also help to increase the productivity of businesses in the civilian sector.[70]

5. Boosting investment in the euro area

The measures I have just described require considerable increases in public and private investment compared with the pre-pandemic period, when capital accumulation in the euro area was decidedly modest.

Public spending on investment – which stood at 4 per cent of GDP before the global financial crisis (Figure 11) – fell by more than 1 percentage point over the following decade. The picture is even more disappointing if we look at investment net of depreciation of the capital stock, which fell to zero between 2010 and 2013 and then remained at that

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67 In choosing to migrate, or to move to another country, skilled workers may be discouraged by complex and inconsistent administrative procedures, issues with the recognition of academic qualifications and limited legal entry routes. The introduction and recent revision of the Blue Card, an EU-wide work permit, is a step in the right direction. Strengthening tools like these could increase Europe's competitiveness in attracting talent. Here too, policy actions should be timed and coordinated across the EU to avoid imbalances and tensions between Member States.

68 M. Freier, D. Ioannou and F. Vergara Caffarelli, 'EU public goods and military spending', in The EU's Open Strategic Autonomy from a Central Banking Perspective. Challenges to the Monetary Policy Landscape from a Changing Geopolitical Environment, European Central Bank, 2023, op. cit., pp. 144-154.

69 F. Panetta, 'Investing in Tomorrow: Future-Proofing Fiscal Policies and Governance in Europe'. Opening remarks at the joint workshop of the European Independent Fiscal Institutions and the ESCB 'European fiscal policy and governance reform in uncertain times', 20 September 2023.

70 E. Moretti, C. Steinwender and J. Van Reenen, 'The intellectual spoils of war? Defense R&D, productivity and international spillovers', NBER Working Paper Series, 26483, November 2019.

level until 2019,[71] making it the lowest among advanced economies (with the exception of Japan).[72]

The dynamics of public investment, both gross and net, have also been procyclical, shrinking during the financial and sovereign debt crises. In particular, European governments invested around €500 billion less between 2011 and 2019 than between 2000 and 2009.

A rebalancing of public spending towards investment would make public finances more growth-friendly,[73] especially if capital accumulation is concentrated in expenditure items with high multipliers, such as research, infrastructure and education.[74] There has been a shift in this direction in recent years, partly thanks to the Next Generation EU (NGEU) programme launched after the pandemic.

The dynamics of private-sector investment since the global financial crisis have also been unsatisfactory. In the fifteen years from 2008 to 2023, it grew by barely 7 per cent in real terms,[75] less than half the increase recorded in the five years before the crisis. This has limited the growth potential of Europe's economy. It also widened the gap with the US economy, where private investment instead grew by around 50 per cent after the global financial crisis.[76]

One aspect that is often overlooked is the negative effect that the low volume and pro-cyclical nature of investment has had on monetary policy. During the global financial crisis, national central banks in the euro area had to shoulder the entire burden of stimulating demand in order to prevent the recession from turning into a depression. Indeed, the unconventional measures taken at that time were to some extent the consequence of austerity policies.

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71 M. Sandbu, 'The investment drought of the past two decades is catching up with us', Financial Times, 20 July 2022.

72 F. Panetta, 'Investing in Europe's future: The case for a rethink', speech delivered at the Istituto per gli Studi di Politica Internazionale (ISPI), Milan, 11 November 2022.

73 European Central Bank, 'The composition of public finances in the euro area', *ECB Economic Bulletin*, 5/2017, Frankfurt am Main, 22 May 2017, pp. 44-62.

74 Investment in these sectors can generate a return above the cost of borrowing and, over time, drive the reduction in the debt-to-GDP ratio. See R. Martino, 'Public investment, convergence and productivity growth in European regions', Università degli Studi di Firenze, Dipartimento di scienze per l'economia e l'impresa, Working Paper, 19, 2021; J. de Jong, M. Ferdinandusse, J. Funda and I. Vetlov, 'The effect of public investment in Europe: a model-based assessment', Working Paper Series, 2021, ECB, Frankfurt am Main, February 2017; A. Abiad, D. Furceri and P. Topalova, 'The Macroeconomic Effects of Public Investment: Evidence from Advanced Economies', IMF Working Papers, 95, 2015; and A. Mourougane, J. Botev, J-M.Fournier, N. Pain and E. Rusticelli, 'Can an Increase in Public Investment Sustainably Lift Economic Growth?', OECD Economics Department Working Papers, 1351, 2016.

75 Excluding Ireland, the data for which take account of multinationals' patents. Including Ireland, the rate of growth would rise to around 9 per cent.

76 P. Lopez-Garcia and B. Szörfi, 'Key factors behind productivity trends in Euro area countries', *ECB Economic Bulletin*, 7/2021, Frankfurt am Main, 15 July 2021, pp. 92-114.

6. Joint investments in European public goods

In some of my previous speeches, two years ago,[77] I spoke about the European Commission's estimates of the public and private investment needed to finance the climate and digital transitions and to raise military spending to 2 per cent of GDP. Those estimates, which then stood at around €600 billion per year through 2030, have now risen to €800 billion per year,[78] as has the number of measures needed to ensure the competitiveness and strategic autonomy of Europe's economy.

It is clear that sums of this magnitude require tapping into the EU budget. Even if the portion drawn from the public budget were relatively small – say, between a third and a quarter of the total – the resources required would still be enormous, and if they were to fall exclusively on the shoulders of the individual member states, it could lead – depending on the country – to underinvestment or a narrowing of fiscal space. And cross-country heterogeneity and financial fragmentation could also increase, to the detriment of the single market.

Moreover, the policies I described earlier – on energy security, digital transition, technology production, immigration and defence – are European public goods and thus require a European response, as underinvestment would produce negative externalities and impacts on all EU Member States and citizens.[79]

The benefits of joint action in these sectors go well beyond the financial sphere.

Coordinated investments financed at European level are necessary to achieve economies of scale and to generate positive externalities for all Member States.[80] This would reduce duplication of outlays and distortions in the single market that would instead be inevitable if programmes were implemented at national level. It would also prevent expenditure from shrinking during economic downturns, thereby behaving pro-cyclically. It would be a driving force for attracting private resources.

Financing investment in common public goods from the EU budget would also have significant benefits for European economic governance.

Financing investments through the issuance of common bonds would lead to the creation of a European safe asset. This would remove the main obstacle to the formation

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77 F. Panetta, 'Europe's shared destiny, economics and the law', 2022, op. cit., and F. Panetta, 'Investing in Europe's future: the case for a rethink', 2022, op. cit.

78 The public and private climate-related investment needs in the EU are around €620 billion per year on average. See European Commission, *2023 Strategic Foresight Report. Sustainability and people's wellbeing at the heart of Europe's Open Strategic Autonomy*, COM(2023), 376, final, 6 July 2023, p.7. To this is added approximately €125 billion annually for the digital transition and around €75 billion to increase defence spending to 2 per cent of GDP, in keeping with the NATO commitments.

79 Investment in European public goods is analysed in F. Panetta, 'Investing in Europe's future: the case for a rethink', 2022, op. cit.

80 F. Panetta, 'Investing in tomorrow: future-proofing fiscal policies and governance in Europe', 2023, op. cit.

of a genuine Capital Markets Union,[81] and would be a crucial step towards providing Economic and Monetary Union with an essential tool for financing the ambitious investment programme I described earlier. More generally, a Capital Market Union is needed to allocate citizens' savings efficiently and to attract capital from abroad.

If we were to adopt spending programmes at the EU level, European fiscal policy would no longer be the simple sum of national policies, but could rather be determined on the basis of the needs of the entire euro-area economy. This would ensure consistency between fiscal and monetary policy stances[82] and would be a decisive step towards the completion of Economic and Monetary Union, putting to rest the idea that it can function well without a permanent central fiscal capacity.[83]

I do not intend to dwell here on the other reforms needed to make Europe’s economy competitive, such as creating a more business-friendly economic environment, simplifying regulation and boosting sources of finance for small and medium-sized enterprises.

The European fiscal rules agreed upon last February herald an innovative approach to the coordination of national fiscal policies, combining the need for sound public accounts with the necessity to increase investment and undertake structural reforms.[84] Fiscal moderation is essential, but must be compatible with growth.

Finally, we need to fully implement the NGEU in the last three years of the programme. European governments still have to utilize €500 billion from the NGEU and REPowerEU funds, with 80 per cent of these resources earmarked for investment projects. This would add 2.5 percentage points to euro-area public investment by 2026, taking it to its highest level since the global financial crisis.[85]

Conclusions

After decades in which globalization seemed unstoppable, geopolitical conflicts are now threatening international trade and the stability of the world economy. Old fears of a world divided into economic, political and even military blocs, have resurfaced.

81 F. Panetta, ‘Europe needs to think bigger to build its capital markets union’, The ECB Blog, 30 August 2023.

82 F. Panetta, ‘Investing in tomorrow: future-proofing fiscal policies and governance in Europe’, 2023, op. cit.

83 F. Panetta, ‘Europe’s shared destiny, economics and the law’, 2022, op. cit.

84 F. Panetta, ‘Investing in tomorrow: future-proofing fiscal policies and governance in Europe’, 2023, op. cit.

85 K. Bańkowski et al. estimate that, if fully implemented, NGEU may increase the level of real GDP in the euro area by up to 1.5 per cent by 2026 (K. Bańkowski, M. Ferdinandusse, S. Hauptmeier, P. Jacquinot and V. Valenta, ‘The economic impact of Next Generation EU: a European perspective’, European Central Bank, Occasional Paper Series, 291, 2022). For an overview of the challenges related to the implementation of NGEU, see E. Dorrucci, and M. Freier, ‘The opportunity Europe should not waste’, ECB blog, 15 February 2023.

Given its high degree of openness to the rest of the world, trade and financial fragmentation pose significant risks to the European economy. More broadly, geopolitical disputes threaten the principles of international cooperation and the multilateral order that has underpinned global economic development and fostered a lasting peace among the major powers since the end of World War II.

As Europeans, it is in our interest to defend vigorously the progress made so far in global openness and integration.

At the same time, we cannot ignore geopolitical risks and their consequences. We must find ways to operate effectively in a less stable and less open world.

The solution lies in strengthening the European economy: by rebalancing its growth model and by making the most of the single market, by making it more competitive, by positioning it at the forefront of technology and energy, by empowering it to defend its external security, by providing it with the strength and authority necessary to amplify its voice and contribute to dialogue and cooperation between countries.[86]

This is an enormous challenge and European countries will only succeed if they join forces and move towards a fully-fledged economic and monetary union, with stronger financial and fiscal integration.[87]

In the middle of the last century, Europe was born out of the desire to never relive the horror of war. Faced with the risks of economic fragmentation and the conflicts that are emerging in several parts of the globe, today its reinforcement is imperative: the Union must be able to rely on greater internal integration to counter divisions outside its boundaries.

The European Union must draw on the collective strength of its members.

After the Second World War, my illustrious predecessor, Luigi Einaudi, who went on to become President of the Italian Republic – mindful of the need to move towards an ever closer union – declared, 'The need to unify Europe is clear. States today are dust without substance. No single state can bear the cost of autonomous defence. Only the union can make them last. It is not a matter of choice between independence and unification; the choice is between existing together or disappearing'.[88]

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86 See also M. Draghi, speech at the High-level Conference on The European Pillar of Social Rights, La Hulpe, 16 April 2024.

87 See also I. Visco, 'A future for Europe: demographics, technology, the markets', conference held at the *Accademia nazionale dei Lincei*, Rome, 15 December 2023.

88 L. Einaudi, *Lo scrittoio del Presidente (1948-1955)*, Turin, Einaudi, 1956, p. 89. Luigi Einaudi was Governor of Banca d'Italia from 1945 to 1948 and President of the Italian Republic from 1948 to 1955. As his writings testify, in the mid-twentieth century he was already a sincere advocate of the need to progress towards greater European integration. The Ventotene Manifesto, which mapped the route to European integration was in part inspired, according to one of its first authors, Altiero Spinelli, by Einaudi's writings.

His words of warning strike a terribly resonant note at this time of fragmentation and war.

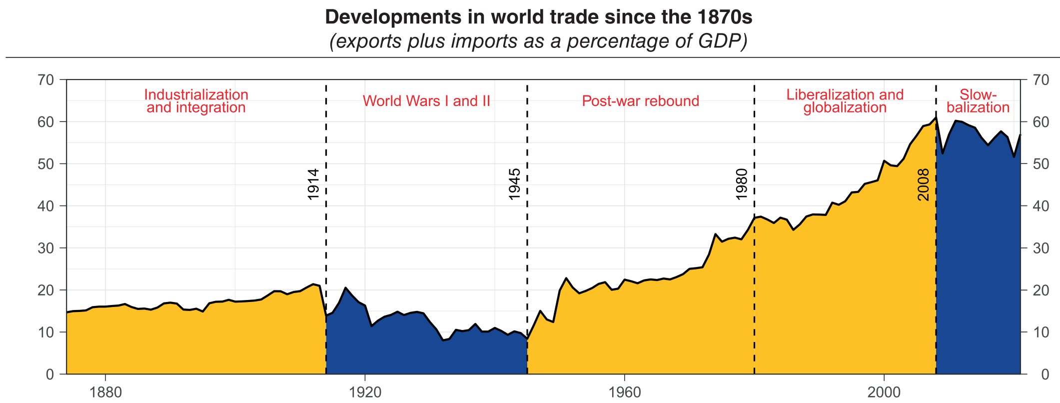
Our response must be equal to the challenges that we are facing.

Thank you.

FIGURES

Figure 1

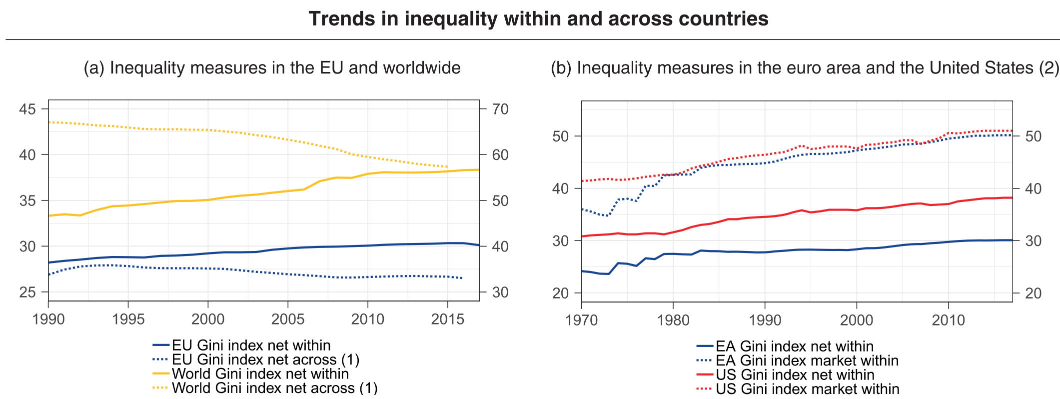
Developments in world trade since the 1870s
(exports plus imports as a percentage of GDP)



Sources: Based on ECB staff calculations and on data and methodologies from M.J. Klasing and P. Milionis, *'Quantifying the evolution of world trade, 1870–1949'*, Journal of International Economics, Vol. 92, 1, January, 2014, pp. 185-197, and from K. Barbieri, O. Keshk and B.M. Pollins, *'Trading Data: Evaluating our Assumptions and Coding Rules'*, Conflict Management and Peace Science, Vol. 26, 5, November 2009, pp. 471-491.

Figure 2

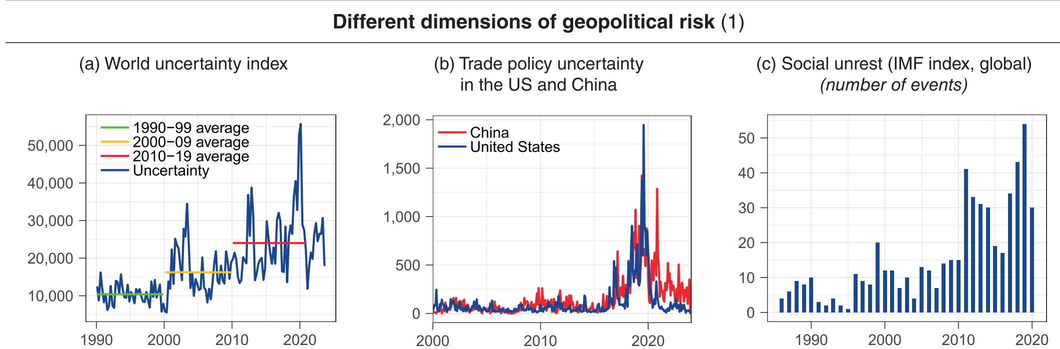
Trends in inequality within and across countries



Source: M. Ca' Zorzi, P. Cova and A. Jochem, *'Globalisation and inequality'*, in *'The implications of globalisation for the ECB monetary policy strategy'*, European Central Bank, Occasional Paper Series, 263, 2021, pp. 32-33.
(1) Right-hand scale. – (2) The Gini Market index is pre-tax; the Gini Net index is post-tax.

Figure 3

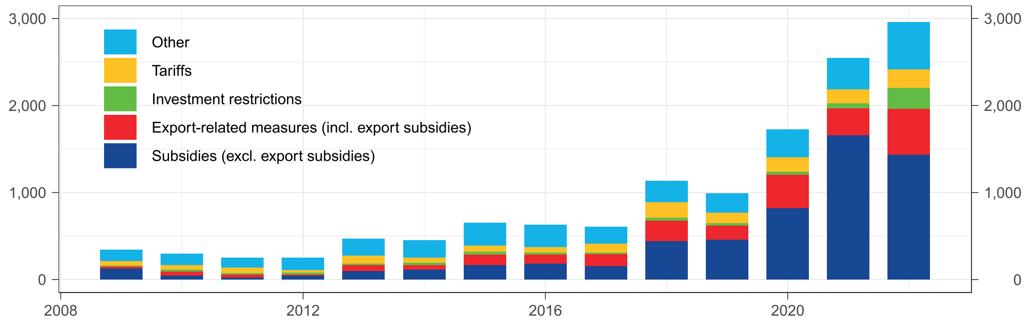
Different dimensions of geopolitical risk (1)



Sources: IMF and *the Economic Policy Uncertainty Index*.
(1) The world uncertainty index is computed by counting the percentage of the word 'uncertain' or its variants in the Economist Intelligence Unit country reports (see H. Ahir, N. Bloom and D. Furceri, *'The Word Uncertainty Index'*, NBER Working Paper Series, 29763, 2022). The trade policy uncertainty index reflects the frequency of articles in newspapers that discuss economic policy uncertainty and also contain references to trade policy (see S.R. Baker, N. Bloom, S.J. Davis, 'Measuring economic policy uncertainty', The Quarterly Journal of Economics, 131, 4, 2016, pp. 1593-1636). The IMF social unrest index reflects the frequency of unrest events linked to social tensions (see P. Barrett, M. Appendino, K. Nguyen and J. de Leon Miranda, *'Measuring social unrest using media reports'*, IMF Working Paper, 129, 2020).

Figure 4

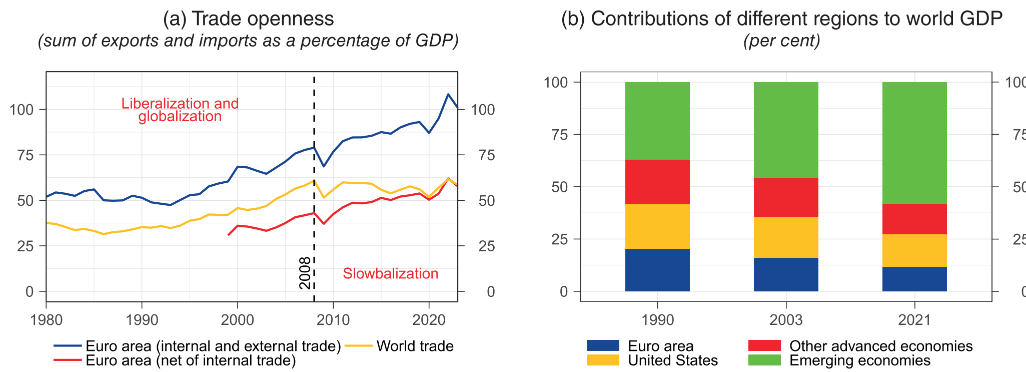
Type of trade restrictions imposed at global level (1)
(number)



Source: Global Trade Alert database and based on ECB staff calculations.
(1) The Global Trade Alert database documents all unilateral changes in the relative treatment of foreign versus domestic commercial interests, with reference to both trade flows and foreign direct investment; see S.J. Evenett and J. Fritz, *The Global Trade Alert Database Handbook*. *Manuscript*, 26 October 2022.

Figure 5

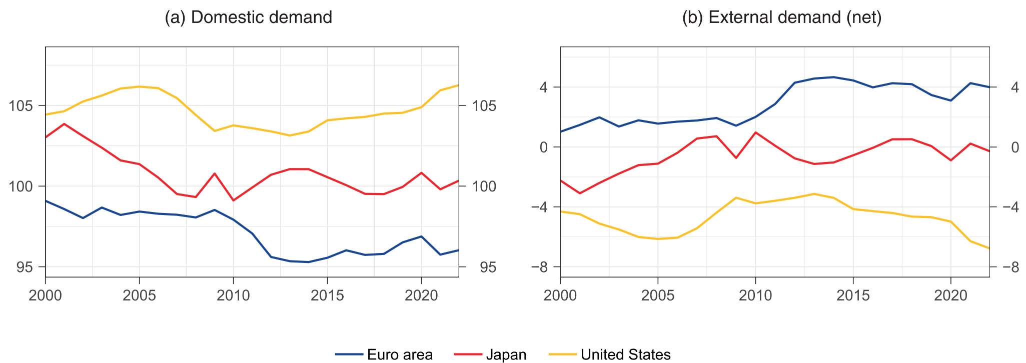
Key globalization trends



Sources: IMF, *World Economic Outlook database*, October 2023; for world GDP in panel (b), World Bank, *World Development Indicators*.

Figure 6

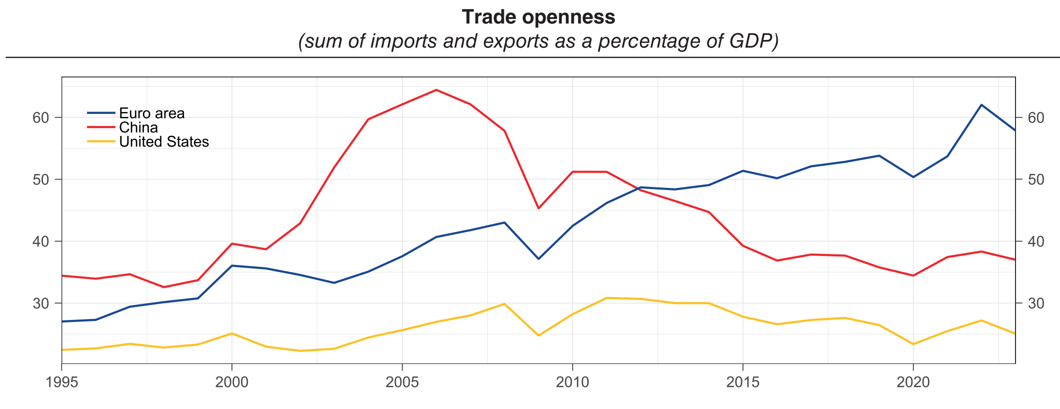
Domestic and external demand in the euro area, the US, and Japan
(per cent of GDP)



Source: IMF, *World Economic Outlook*, October 2023.

Figure 7

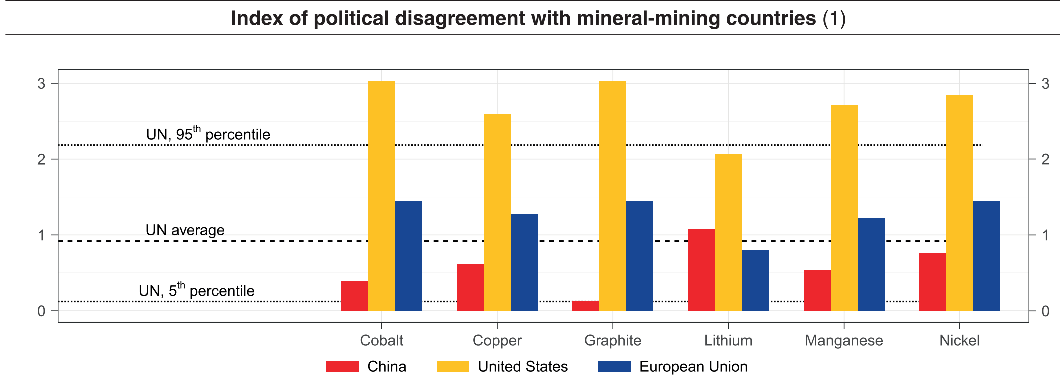
Trade openness
(sum of imports and exports as a percentage of GDP)



Source: IMF, *World Economic Outlook*, October 2023.

Figure 8

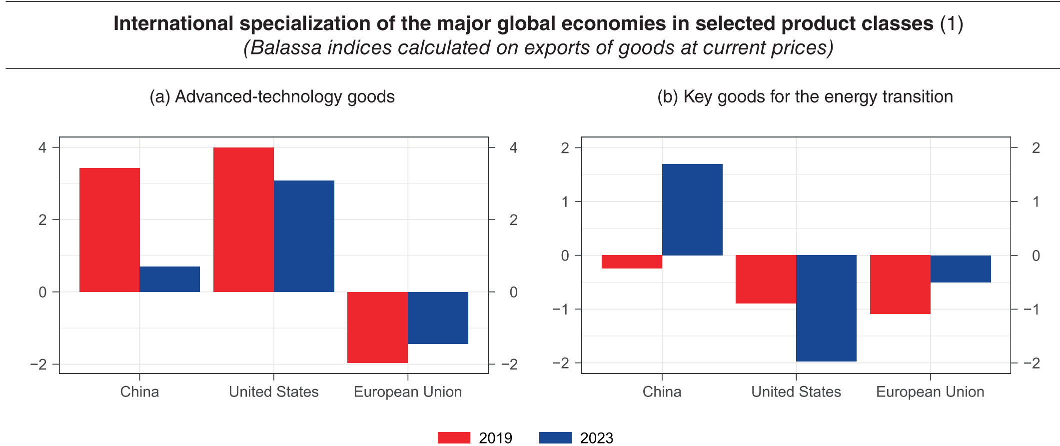
Index of political disagreement with mineral-mining countries (1)



Sources: U.S. Geological Survey, *Mineral Commodity Summaries*, 2022; M.A. Bailey, A. Strezhnev and E. Voeten, 'Estimating dynamic State preferences from United Nations voting data', *The Journal of Conflict Resolution*, 61, 2, 2017, pp. 430-456; ECB staff calculations.
(1) Higher values indicate more disagreement. In M.A. Bailey et al., 2017, op. cit., political disagreement between two countries is calculated as the distance between preference scores based on records of UN voting over the period 2011-20.

Figure 9

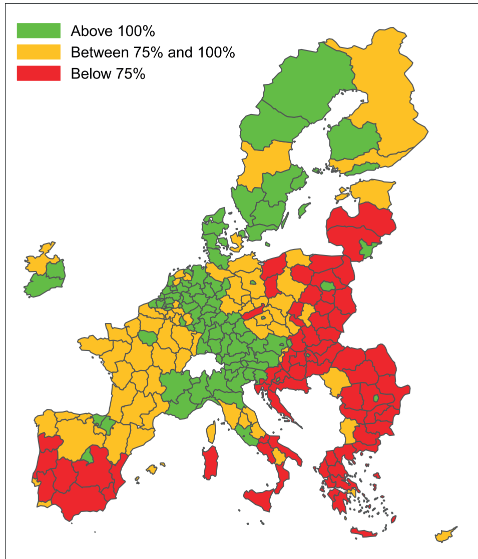
International specialization of the major global economies in selected product classes (1)
(Balassa indices calculated on exports of goods at current prices)



Source: calculations based on Trade Data Monitor data.
(1) Balassa indices are calculated as follows: $IB^p_{it}=x^p_{it}/x^p_t - x^{WORLD}_{it}/x^{WORLD}_t$, where: (a) x are the values of goods exports in euro; (b) i indicates the product class of exported goods (in accordance with the classifications contained in F.P. Conteduca, S. Giglioli, C. Giordano, M. Mancini and L. Panon, 'Trade fragmentation unveiled: exploring recent European trends in a shifting global context', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), forthcoming; (c) p indicates the exporting economy; (d) $WORLD$ refers to all exporting countries across the world; (e) t indicates the reference year. If the Balassa index for a given country-product class is positive (negative), that economy has (doesn't have) an international comparative advantage in those goods. Exports are calculated net of energy and, for the EU, net of intra-EU exports.

Figure 10

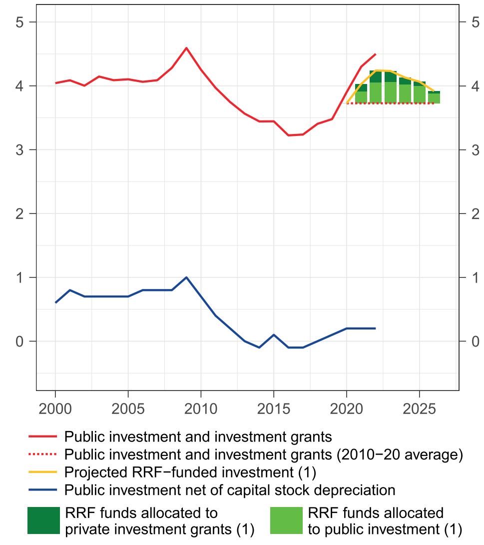
GDP per capita by region (1)
(percentage of EU27 average in 2021)



Source: World Bank.
(1) Purchasing power parity adjusted.

Figure 11

Public investment spending in the euro area (1)
(percentage of GDP)



Sources: Eurostat and K. Bańkowski et. al., 2022, op. cit.
(1) RRF stands for Recovery and Resilience Facility, under the NGEU programme. Projected RRF-funded investment is equal to the average of the continuous red line over the period 2010-20 (*dotted red line*) increased annually by the amounts of the estimated RRF allocations for public investment (light green bars) and private investment grants (dark green bars).

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