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The EU's need for a new growth model

Innovation under strategic capitalism

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Summary

The emerging geoeconomic environment of strategic capitalism is reshaping both the conditions under which the EU operates and the underlying logic of growth. The EU's current growth model relies heavily on externally sourced inputs, technologies, and infrastructures, leaving it structurally fragile in this new environment.

Europe's innovation future therefore hinges on developing a growth model that better aligns competitiveness, control over critical economic flows, and the direction of innovation. This will require stronger alignment of policies at the national and EU levels.

Four innovation futures scenarios illustrate Europe's possible growth-model trajectories: Dependent Europe, Fortress Europe, Fragmented Europe, and Strategic Europe. Only the last succeeds in aligning all the key elements of the new growth model, leading to sustained European technological leadership.

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Introduction

Over the past decade, and especially since the Covid-19 pandemic and Russia's invasion of Ukraine, industrial policy, investment screening, export controls, and public–private coordination have become central tools of economic statecraft across major economies. From the United States' sharp turn to tariffs to China's state-led technology strategies and the European Union's own initiatives in semiconductors, clean technologies and critical raw materials, economic policy is increasingly judged by its ability to enhance resilience, reduce dependencies, and secure a position in critical technologies and value chains.

Europe has been comparatively slow to adapt to this shift. Its economic growth model has relied heavily on externally sourced inputs and infrastructures, such as cheap energy, globally distributed supply chains, and foreign digital platforms. At the same time, its internal constraints – including fragmented markets, limited scale-up capacity, and uneven coordination of policies at the national and EU levels – have become more apparent. Although the European Commission has launched a series of initiatives, such as the EU Chips Act, the Net-Zero Industry Act, and the Critical Raw Materials Act, these efforts have often remained more reactive than strategic. In other words, the focus has been primarily on mitigating vulnerabilities rather than building new sources of technological and industrial advantage. The key challenge for Europe is how it can respond to the new geoeconomic environment in a way that enhances its position in global markets in the long term.[1]

In the context of intensifying European debates on strategic autonomy, economic security, and industrial policy, this Research Paper argues that, in addition to facing an innovation challenge, the EU also faces a broader growth-model transition. The market-driven growth model that underpinned European prosperity during the high tide of globalisation is becoming increasingly fragile in an era of strategic capitalism, in which states actively shape markets to secure competitiveness, reduce critical dependencies, and enhance geopolitical leverage.[2]

Europe's innovation future will depend on whether the EU can develop a new growth model capable of aligning competitiveness, control over critical economic flows, and strategic direction within a coherent governance framework. The key issue is whether the EU can reconcile three objectives that are increasingly in tension: first, remaining open to global markets and committed to rule-bound economic behaviour while strengthening control over the conditions underpinning economic security; second, strengthening European capacity for innovation and technological leadership; and third, directing innovation towards key structural transformations, particularly in the green and digital domains.

This requires moving beyond a reactive approach to resilience towards a more coherent strategy that links industrial policy, innovation ecosystems, and strategic priorities. The paper first examines these dynamics conceptually and then develops four alternative scenarios for Europe's future growth model in the emerging era of strategic capitalism.

1 Bercero and Poitiers 2025.

2 Choer Moraes and Wigell 2020.

1. Tracing the evolution of Europe's growth model

The European growth model has undergone significant transformations over the decades. The post-war 'social market economy' combined market efficiency with equal opportunities, creating a stable and predictable framework for economic growth.[3] From the 1970s onwards, economic downturns and structural crises began to challenge this model and act as drivers of reform. They contributed to deeper European integration, culminating in the launch of the EU's Single Market in 1993, which helped strengthen Europe's position in an increasingly globalised economy. By the early 2000s, global trade and capital flows had surged, production had shifted to Asia and, following the EU's eastern enlargement, low-wage competition within Europe had intensified. In response, the European growth model adapted by aligning more closely with free trade and market openness. It evolved into a more competitive and globalised version of the social market economy, incorporating elements associated with Anglo-American market capitalism.

In the early 2000s, European economies benefitted from offshoring as firms reorganised production within global value chains, retaining high-value activities in Europe while relocating labour-intensive stages to Asia and Central and Eastern Europe. German manufacturing networks in new EU member states, for example, became a core pillar of this model, combining cost efficiency with geographic proximity. The resulting products could then be exported to rapidly growing Asian markets. This growth model was calibrated for a world in which economic openness, rules-based trade, and incremental technological change ensured European prosperity and societal stability.[4] This high tide of globalisation began to recede with the 2008 financial crisis, as the limits of market-led globalisation became more apparent and states began to shape markets more actively.

For Europe, one of the most consequential developments was the shift in Chinese economic policy towards a more statist capitalist model. Industrial policy initiatives such as the Made in China 2025 programme, launched in 2015, intensified competition in high-value sectors, including advanced manufacturing, robotics, and clean technologies. Supported by state financing, subsidies, and preferential market access, Chinese firms were able to move rapidly up the value chain. Meanwhile, external initiatives such as the Belt and Road Initiative extended China's economic and geopolitical reach, reshaping trade corridors, investment patterns, and infrastructure dependencies across Eurasia and beyond. Together, these developments created structurally asymmetric competition for European firms and increased Europe's exposure to dependencies in critical technologies and strategic infrastructure.[5]

Since then, a series of shocks has further exposed the fragility of the European model. The Covid-19 pandemic disrupted global supply chains and revealed dependencies in areas such as pharmaceuticals and medical equipment. Russia's war of aggression in Ukraine highlighted Europe's reliance on external energy supplies, triggering a rapid and costly adjustment in energy sourcing. Furthermore, the reorientation of US economic policy – most notably through "America First" measures and large-scale industrial subsidies – has intensified competitive pressures and challenged the openness of transatlantic economic relations. In this new environment, dependency on American digital platforms, social media, and payment systems, for instance, has also raised new concerns among EU decision-makers.

2. Innovation-oriented growth in the age of strategic capitalism

In addition to altering the external conditions under which European economies operate, the turn from market capitalism to strategic capitalism is also reshaping the underlying logic of growth and innovation. The earlier era of market capitalism prioritised efficiency and the optimisation of global value chains. Firms and states alike benefitted from deepening interdependence, while economic policy focused on enabling openness and correcting market failures. Innovation was largely treated as an outcome of market dynamics rather than an object of strategic policy.

3 Claassen et al. 2019.

4 Hall and Soskice 2001.

5 Wübbeke et al. 2016.

In contrast, under strategic capitalism, the emerging environment is characterised by a more deliberate effort by states to shape markets in line with strategic objectives. It places greater emphasis on the capacity to manage, steer and, where necessary, restrict cross-border economic flows. This marks a shift from maximising *flow efficiency* to strengthening *flow control*.[6]

Flow control refers to the ability of states and firms to shape the conditions under which critical economic flows – such as energy, advanced technologies, data, finance, and key materials – are accessed, routed and governed. It is through such control that interdependence is translated into both resilience and influence. Access to and control over critical economic flows increasingly conditions the ability of firms and states to innovate, scale technologies, capture value, and maintain strategic agency within globally interconnected markets. Rather than striving for full autonomy and independence, the focus here is on maintaining effective room for manoeuvre by securing access to critical nodes, such as semiconductor manufacturing equipment, cloud computing infrastructure, payment and financial messaging systems, critical mineral processing, and key logistics hubs, reducing asymmetric dependencies, and strengthening positions within global networks.[7]

A clear illustration is Europe's position in the semiconductor ecosystem. Although European firms such as the technology company ASML occupy critical nodes in the production of advanced lithography equipment, Europe lacks the large-scale capacity to manufacture cutting-edge chips and remains dependent on external manufacturing hubs. This asymmetry highlights how control over specific nodes in a value chain can coexist with broader systemic dependence.

This shift from flow efficiency to flow control has direct implications for innovation. In the previous strictly market-based model, innovation was largely treated as a function of market dynamism, competition, and the diffusion of knowledge across open systems. While these factors remain important, innovation is now increasingly conditioned by the structure of dependencies within which industries and ecosystems operate. Access to critical inputs, infrastructure, and platforms can enable or constrain technological development, while geopolitical considerations increasingly shape investment, collaboration and standard-setting. This is evident, for example, in how access to advanced semiconductors, cloud infrastructure, and critical materials is increasingly shaping the pace and direction of innovation in sectors ranging from artificial intelligence to clean energy technologies.[8]

In this environment, competitiveness as such is becoming more closely linked to what can be termed *strategic competitiveness*: the ability to build and sustain capabilities that generate cumulative advantages across the economy.[9] Strategic competitiveness emphasises the development of interconnected ecosystems that reinforce each other over time. For example, advances in clean energy technologies depend on the co-evolution of energy systems, materials supply chains, digital infrastructure, and regulatory frameworks. Investments in areas such as clean energy systems, digital infrastructure, and defence technologies can produce multiplier effects, strengthening specific industries as well as the wider technological and industrial base.

3. The European approach to strategic competitiveness

The interplay between flow control, strategic competitiveness, and the direction of innovation is therefore central to the question of how Europe can build a new growth model. Greater control over critical economic flows can reduce exposure to disruption and coercion, but it does not automatically translate into innovation or growth. Conversely, strong innovation performance without sufficient control may leave economies vulnerable to external dependencies that can undermine long-term resilience. Innovation that is not strategically directed may fail to generate the capabilities required for long-term transformation.

Furthermore, both the *level* of innovation and its *direction* matter. At the EU level, innovation is increasingly expected to contribute to broader structural transformation, including the green and

6 See Wigell and Hadi forthcoming 2026. See also Borchert 2019.
7 Edler et al. 2023.
8 Stacciarini and Santana 2025.
9 Wigell 2025.

digital transitions. This is reflected in major EU-level initiatives such as the European Green Deal, the Net-Zero Industry Act, and digital policy frameworks. This adds a third dimension to the policy challenge, namely how to steer innovation in ways that address societal and strategic priorities.[10] In the EU context, a fourth challenge emerges: strategically aligning EU-level and national economic policies.

The task for policymakers is therefore threefold: first, ensuring that efforts to enhance economic security do not stifle dynamism; second, avoiding a model of openness that generates vulnerabilities faster than it creates value; and third, aligning innovation trajectories with long-term transformation objectives. Managing these tensions is central to building a growth model that is resilient, competitive, and can be steered strategically.

Compared to the United States and China, Europe combines relatively strong regulatory capacity with a more fragmented market structure and weaker mechanisms for scaling innovation.[11] It has the potential to shape markets – for example through standards, regulation, and public funding – but it often lacks the coordination and strategic focus needed to translate this into sustained technological leadership.

10 Ibid.; see also Mazzucato 2021.
11 Draghi 2024.

Europe has also positioned itself at the forefront of transformative green and digital agendas. However, the pursuit of transformation further amplifies existing structural weaknesses, as it increases dependence on critical technologies, infrastructures, and external actors. This is particularly visible in areas such as clean energy technologies, where Europe's ambitious decarbonisation agenda increases demand for inputs such as critical minerals and battery components, which are heavily concentrated outside Europe. The result is a risk of partial adaptation: a system that becomes more interventionist and transformation-oriented without becoming more competitive or capable of acting strategically.

Understanding Europe's future growth model therefore requires a framework that captures the interaction between these three dimensions: the capacity to exercise control over critical economic flows, the capability to generate sustained innovation-driven competitiveness, and the ability to strategically direct innovation towards long-term transformation objectives. In addition, policies at the national and EU levels need to be carefully aligned.

The following section builds on this perspective to map alternative growth-model trajectories and to show how Europe's innovation future may unfold within them. It highlights the conditions under which control, competitiveness, and directionality either reinforce or undermine one another.

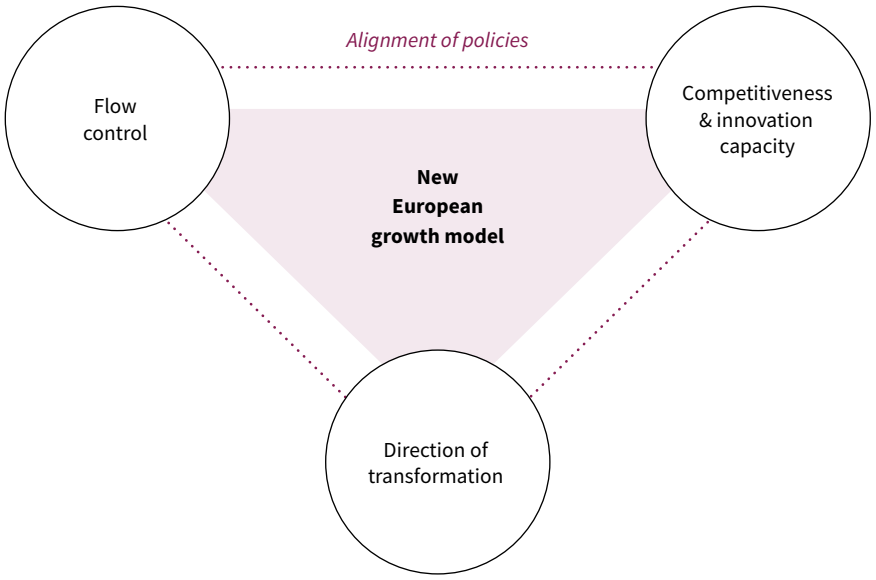

Figure 1. The EU's innovation-oriented growth trilemma

4. Four European growth-model trajectories

Europe's future growth model in the medium term can be understood through the interaction of three core dynamics: (1) its capacity to exercise control over critical economic flows; (2) its capability to generate competitiveness through innovation; and (3) its ability to direct innovation towards long-term structural and societal transformation. The extent to which these objectives can be aligned depends in large part on the degree of coordination between EU-level and national policies. Together, these factors shape the range of plausible growth models available to Europe in the emerging era of strategic capitalism.

The scenarios that follow reflect different configurations of flow control, competitiveness, directionality (constituting the general innovation-oriented growth trilemma), and policy alignment (constituting an EU-specific driver), and highlight the extent to which these elements reinforce or undermine one another. They should not be understood as fixed endpoints, but as stylised representations of possible trajectories shaped by policy choices, institutional capacity and external conditions. The scenarios assume that the emerging geoeconomic trajectories described above, including stronger state intervention, heightened concern over dependencies, and intensified competition over critical technologies, will continue to evolve in a similar direction.

4.1. Dependent Europe: Innovation without control, direction and alignment

In the **Dependent Europe** scenario, the EU remains deeply embedded in global economic networks but lacks control over the critical flows that underpin its innovation system. While pockets of dynamism persist and some sectors produce high-quality research and technology, this capacity remains structurally dependent on external infrastructures, inputs and platforms.

Crucially, innovation is weakly directed. Technological activity is largely shaped by market forces and external ecosystems. Coherent and shared strategic objectives are missing. As a result, the EU generates innovation but struggles to translate it into strategic capabilities or long-term transformation capacity.

This scenario encompasses both weaker and stronger variants. In weaker cases, the EU faces low investment, limited scaling and declining technological relevance. In stronger cases, it performs well in upstream innovation – such as research and niche technologies – but fails to convert this into industrial leadership, with value capture going elsewhere. In both cases, the EU risks becoming a participant in innovation systems shaped by others.

Industrial policy is limited and mainly focuses on market correction. The EU's performance is constrained by external conditions and the absence of a coherent innovation framework. Crucially, strong signs of this scenario are already apparent: while Europe continues to digitalise and innovate, core

Table 1. Drivers in the Dependent Europe scenario

Driver	Driver condition	Implications
Flow control	**Low**	**The EU lacks control over the key flows that support its innovation system.**
Competitiveness and innovation	**High**	**Some sectors produce strong research and technology.**
Transformative direction	**Low**	**Markets and external actors mainly shape innovation, rather than clear strategic goals.**
Policy alignment	**Low**	**Industrial policy remains limited or fragmented, allowing dependencies to persist.**

platforms, cloud infrastructure, and value capture are concentrated in non-European firms.

4.2. Fortress Europe: Control, direction and alignment without dynamism

In the **Fortress Europe** scenario, the EU responds to geopolitical uncertainty by prioritising control and resilience through a highly interventionist and state-directed policy approach. Control over critical economic flows is strengthened, and EU-level policy provides direction. However, this direction is predominantly shaped by security concerns, risk management, and the protection of existing industrial structures. Broader innovation or transformation objectives are sidelined.

In this future, directionality is established but interpreted narrowly. European policy focuses on safeguarding strategic sectors, ensuring supply security, and reducing external dependencies. Resources are mobilised and coordinated but directed towards defensive rather than generative ends. Measures such as reshoring and industrial protection reduce dependencies but rely on heavy-handed interventions that may raise costs and limit competition. Economic security is treated as an end in itself, rather than as a means of enhancing strategic agency and long-term competitiveness. This approach favours large, established firms at the expense of smaller, more innovative actors and reinforces existing structures.

While Fortress Europe strengthens certain aspects of economic security, this growth model constrains innovation and long-term competitiveness at European and national levels. Reduced openness, weaker competitive pressures, and an inward-looking policy stance limit the emergence of start-ups, new technologies and business models. Industrial policy reinforces incumbents rather than enabling the emergence of new capabilities and success stories.

The result is a system with high control and strong direction, but weak innovation performance. This scenario resembles aspects of Japan's post-1990 period of economic stagnation, in which strong industrial coordination and support for incumbent manufacturing sectors preserved stability but contributed to weak dynamism and slower adaptation to new technological paradigms.

Table 2. Drivers in the Fortress Europe scenario

Driver	Driver condition	Implications
Flow control	**High**	**The EU strengthens control over critical economic flows.**
Competitiveness and innovation	**Low**	**The EU's innovation and long-term competitiveness are constrained.**
Transformative direction	**High**	**Policy provides strong direction, but focuses mainly on security and risk reduction.**
Policy alignment	**High**	**The EU mobilises and coordinates resources.**

4.3. Fragmented Europe: Ambition without alignment

In the **Fragmented Europe** scenario, most EU member states recognise the need to adapt to a more geoeconomically competitive environment. They pursue policies aimed at strengthening their innovation capacity and providing strategic direction. However, a wide range of initiatives in areas such as semiconductors, clean technologies, digital infrastructure, and defence are launched at the national level without effective EU coordination. As a result, Europe punches below its weight.

The defining feature of this scenario is fragmentation, which hampers long-term competitiveness and directionality. While member states pursue strategies to enhance innovation and steer technological development, these efforts remain uneven. Advances in specific countries or sectors do not translate into broader EU competitiveness or integration across markets and value chains. This generates duplication, competing initiatives, and inefficient resource allocation, limiting the development of integrated ecosystems. Member states increasingly compete to attract investment, subsidise strategic industries, and secure technological leadership, further weakening collective capability-building. Financial resources are dispersed, while regulatory barriers continue to hinder cross-border scaling. As a result, the EU becomes more strategically active without achieving the scale or coherence needed for sustained competitiveness.

The outcome is a system with pockets of strong competitiveness and direction but insufficient coordination to generate cumulative advantages. Nationally driven efforts fail to translate into EU-wide competitiveness or sustained technological leadership. Evidence of this can already be seen in the proliferation of national industrial strategies and subsidy schemes across Europe, particularly in the areas of semiconductors, hydrogen, and defence.

4.4. Strategic Europe: Aligning control, competitiveness and direction

In the **Strategic Europe** scenario, the EU and its member states align control over critical economic flows, innovation performance, and the strategic direction of economic transformation within a coherent governance framework. The EU remains integrated into global markets while strengthening its position in key technologies, infrastructures, and value chains. Existing initiatives such as Important Projects of Common European Interest (IPCEIs), joint investments in batteries and hydrogen, and coordinated regulatory frameworks illustrate how this kind of alignment could develop.[12]

12 IPCEIs are EU instruments designed to support large-scale cross-border innovation and industrial projects in strategically important sectors. European Commission 2024.

Table 3. Drivers in the Fragmented Europe scenario

Driver	Driver condition	Implications
Flow control	**High**	**Member states pursue policies to strengthen capacity.**
Competitiveness and innovation	**Uneven**	**Some countries and sectors make advances, but these do not translate into broader EU competitiveness.**
Transformative direction	**High**	**Member states steer technological development and provide clearer strategic direction.**
Policy alignment	**Low**	**The EU mobilises and coordinates resources. Yet national strategies remain weakly coordinated, and EU-level mechanisms play a secondary role.**

A central feature of this scenario is the close coordination between EU and national policies. Strategic priorities are translated into joint action through the pooling of resources, the creation of more integrated markets, and the expansion of innovation efforts. Policy instruments across industrial policy, competition policy, trade, regulation, and innovation funding support one another and reduce fragmentation between member states.

EU policy has an enabling role focused on systemic areas such as clean energy, digital infrastructure, advanced manufacturing, and defence-related technologies. This does not involve rigid top-down planning or the selection of individual "winners". Instead, EU-level policy shapes broader ecosystems, reduces uncertainty, and creates conditions in which firms and institutions can invest, innovate, and scale. The EU also strengthens flow control by improving its capacity to manage critical dependencies in areas such as energy, data, technologies and raw materials, while remaining embedded in global networks. Control therefore primarily supports strategic agency.

Hence, competitiveness emerges through the interaction of directionality, innovation and control. Innovation is created, expanded, and shared across European markets, helping to build stronger capabilities and support long-term growth. Trade-offs between openness, control and innovation remain, but they are managed through coordinated EU- and national-level governance. The result is a system in which these key elements are aligned and produce dynamic European strategic competitiveness.

This scenario shares certain elements with the Draghi report (2024), particularly its emphasis on coordinated EU action, integrated markets, scaling innovation, and reducing strategic dependencies in key technologies and infrastructures.[13] However, the scenario places stronger emphasis on directionality and selective control over economic flows, linking competitiveness more explicitly to strategic governance and coordination.

By combining market scale, regulatory coordination, technological capabilities and selective flow control, Europe creates cumulative advantages that are difficult for competitors to replicate. Strategic competitiveness emerges not from protectionism or subsidies alone, but from the interaction of openness, coordination and ecosystem development.

13 Draghi 2024.

Table 4. Drivers in the Strategic Europe scenario

Driver	Driver condition	Implications
Flow control	**High**	**The EU strengthens flow control selectively and strategically.**
Competitiveness and innovation	**High**	**The EU scales and diffuses innovation across integrated markets.**
Transformative direction	**High**	**Policy provides strong direction in areas such as clean energy, digital infrastructure, advanced manufacturing, and defence technologies.**
Policy alignment	**High**	**EU and national policies align, enabling resource pooling, market integration and the scaling of innovation.**

Conclusions: Towards a European growth model for strategic competitiveness

The scenarios outlined above suggest that the EU's key challenge is how to develop a growth model in which competitiveness, control over critical economic flows, and the direction of innovation evolve in an aligned and mutually reinforcing manner. The EU experience highlights the limits of unbalanced approaches. The Union's earlier growth model, based primarily on openness and market-driven innovation, generated significant technological capabilities but also exposed European economies to structural dependencies in critical inputs, infrastructures, and platforms. Conversely, more defensive approaches to economic security, focused on control and risk reduction, have tended to constrain dynamism and reinforce existing industrial structures without generating new sources of growth. Fragmented attempts to combine these two approaches have often increased policy activity without delivering corresponding gains in system-level competitiveness.

Strengthening competitiveness in the context of emerging strategic capitalism requires four policy shifts at the EU level. First, the EU needs to move beyond a narrow focus on sectoral performance towards the development of interconnected ecosystems capable of generating cumulative advantages. This implies prioritising domains with high systemic impact – such as clean energy, advanced manufacturing, digital infrastructure, and defence – where investment can generate cross-sectoral spillovers and reinforce the EU's technological base.

Second, sustaining competitiveness depends on greater control over critical economic flows. This should be understood as the capacity to manage interdependencies in ways that enhance strategic agency. In practice, this means securing access to critical inputs, strengthening positions in value chains, and reducing asymmetric dependencies, while remaining embedded in global networks. Without control, innovation capacity remains exposed to external disruptions and geopolitical pressures.

Third, directionality is becoming a more central feature of economic policy. Innovation needs to support both growth and structural transformation – particularly in the green and digital domains – as these underpin future competitiveness. The challenge is to ensure that direction expands the innovation frontier. This requires moving beyond both laissez-faire approaches and rigid state control towards more adaptive policies that combine guidance with experimentation.

Fourth, and finally, the effectiveness of the growth model depends on alignment between EU and national governance. The EU's persistent constraint has been fragmentation across member states, policy instruments, and strategic priorities. Where alignment is weak, progress remains partial and fails to translate into system-level advantages. Where coordination is stronger, the EU can better leverage its scale and support the scaling of innovation.

The EU's comparative strengths – predictable regulation, capacity for cooperation, and rules-based governance – remain significant even in the current geoeconomic context. However, they are no longer sufficient on their own. Without the ability to shape markets, secure positions in critical technologies, and act with strategic coherence, these strengths risk becoming sources of inertia rather than advantage.

The key question facing Europe is no longer whether it should pursue competitiveness, resilience, or transformation. Under strategic capitalism, these objectives have become inseparable. The challenge is to build a growth model in which they reinforce one another. Europe's future prosperity will depend less on preserving the assumptions of the previous era of globalisation than on its ability to align control, competitiveness, directionality, and governance within a coherent framework of strategic competitiveness. ⬢

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