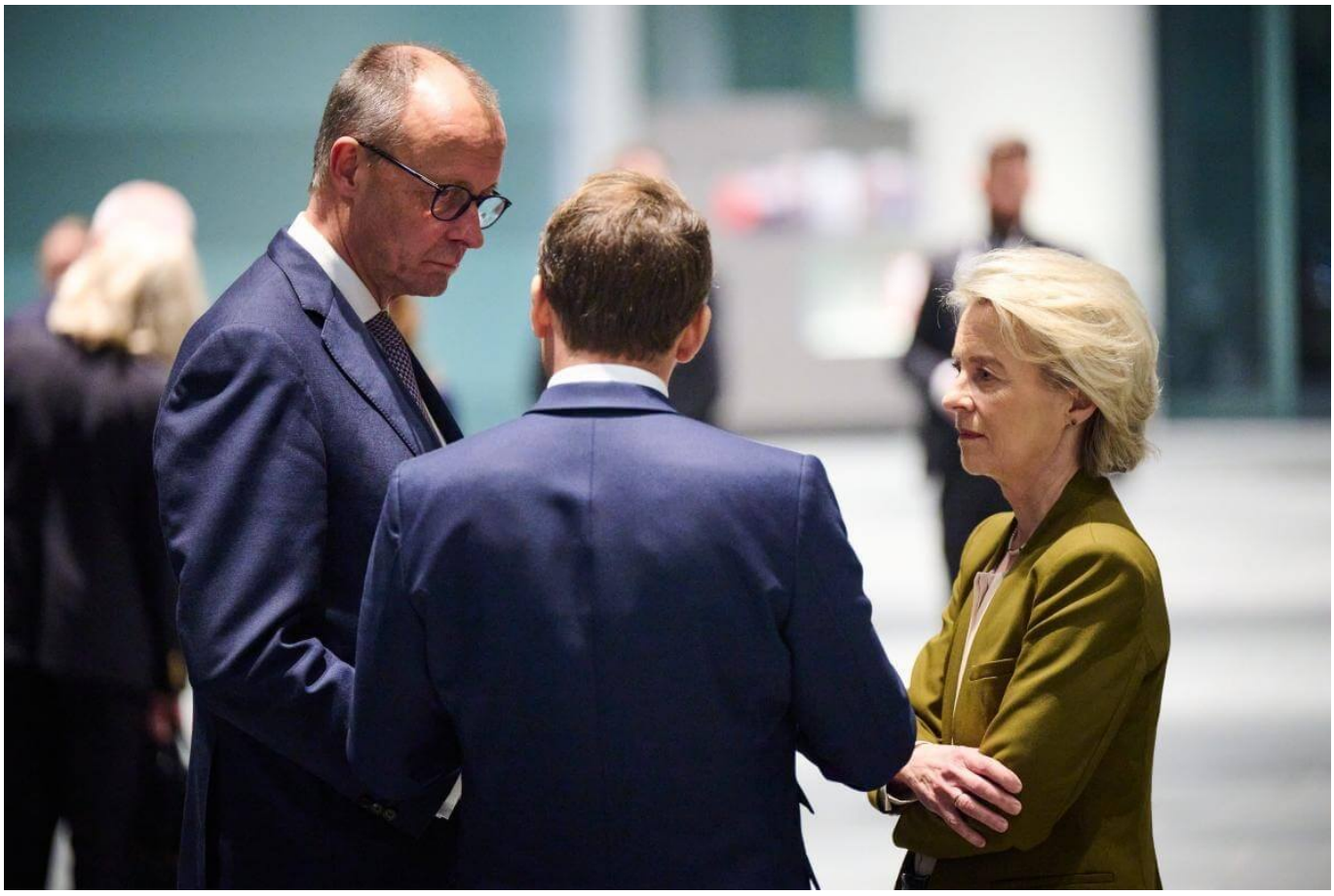
Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

By: Nouriel Roubini

Can Europe overcome its own economic and technological backwardness?



US President Donald Trump's new National Security Strategy offers a misguided assessment of Europe, long regarded as America's most reliable ally.

Unrestrained immigration and other policies derided by administration officials as "woke," it warns, could lead to "civilizational erasure" within a few decades.

That argument rests on a fundamental misreading of Europe's current predicament.

While the European Union does face an existential threat, it has little to do with immigration or cultural politics. In fact, the share of foreign-born residents in the United States is slightly higher than in Europe.

The real threat facing Europe lies in its own economic and technological backwardness.

Between 2008 and 2023, GDP rose by 87% in the US, compared to just 13.5% in the EU. Over the same period, the EU's GDP per capita fell from 76.5% of the US level to 50%.

Even the poorest US state – Mississippi – has a higher per capita income than that of several major European economies, including France, Italy, and the EU average.

Economic gap

This widening economic gap cannot be explained by demographics. Instead, it reflects stronger productivity growth in the US, largely owing to technological innovation and higher total factor productivity.

Today, roughly half of the world's 50 largest technology firms are American, while only four are European.

Over the past five decades, 241 US firms have grown from startups into companies with market capitalizations of at least $10 billion, compared with just 14 in Europe.

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These trends raise a critical question: Which countries will lead the industries of the future, and where does Europe fit in?

The race for technological leadership now spans a wide range of fields, including AI and machine learning, semiconductor design and production, robotics, quantum computing, fusion energy, fintech, and defense technologies. Europe enters this race at a clear disadvantage.

Whether the US or China currently leads the industries of the future remains open to debate, but most observers agree that it's essentially a two-horse race, with America still ahead in several key areas.

Technological gap

Beyond that, innovation is concentrated in countries like Japan, Taiwan, South Korea, India, and Israel.

In Europe, by contrast, innovative activities are largely confined to the United Kingdom, Germany, France, and Switzerland – two of which are not even EU member states.

It is hardly a surprise, then, that while the US and China dominate global technological rankings, Europe finds itself far from the top.

And the outlook is anything but reassuring, given that the next wave of innovation is widely expected to be more disruptive than anything we have seen over the past half-century.

The technological gap between the US and Europe can be attributed to several factors.

The US benefits from a deeply integrated academic-military-industrial complex, while Europe's chronic underinvestment in defense has weakened its innovation capacity

First, the US has a far deeper and more dynamic ecosystem for financing startups, while Europe still lacks a genuine capital markets union, limiting the scale and speed at which new firms can grow.

Second, Europe is hampered by excessive and fragmented regulation. A US startup can launch a product under a single regulatory framework and immediately access a market of more than 330 million consumers.

The EU has a population of roughly 450 million but remains divided among 27 national regulatory regimes.

An International Monetary Fund analysis shows that internal market barriers in the EU act like a tariff of around 44% for goods and 110% for services – far higher than the tariff levels the US imposes on most imports.

Third, cultural attitudes toward risk-taking differ sharply. Until relatively recently, a failed entrepreneur in some EU countries (like Italy) could face criminal penalties, while in the US, a tech founder who has never failed is often seen as too risk-averse.

Fourth, the US benefits from a deeply integrated academic-military-industrial complex, while Europe's chronic underinvestment in defense has weakened its innovation capacity.

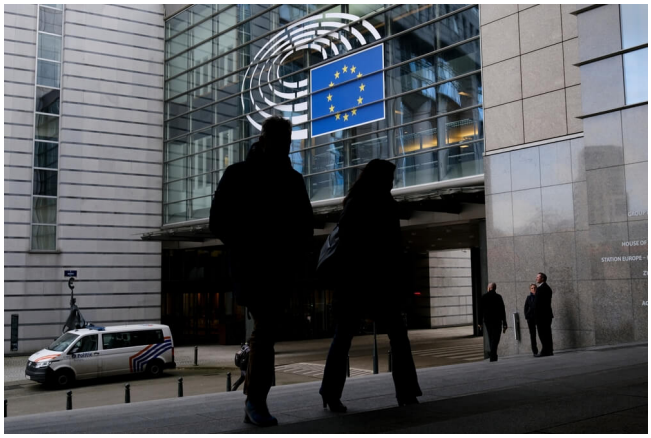
Technological leaders like the US, China, Israel, and, more recently, Ukraine spend heavily on defense, with military research often producing technologies that have civilian applications.

Reasons for cautious optimism

Despite this, many European political leaders continue to frame higher defense spending as a tradeoff between security and social welfare.

In reality, free-riding on US defense spending since the end of World War II has limited the type of innovation that could have generated more of both through higher productivity.

Paradoxically, sustaining Europe's social model will require greater investment in defense, beginning with meeting NATO's new spending target of 3.5% of GDP.



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If Europe allows its technological lag to grow over the coming decades, it risks prolonged stagnation and continued economic decline relative to the US and China.

There are, however, reasons for cautious optimism. Increasingly aware that Europe faces an existential challenge, policymakers have begun to advance serious reform proposals.

The most notable examples are the two major 2024 reports on EU competitiveness and the single market by former Italian prime ministers Mario Draghi and Enrico Letta, respectively.

Europe also retains considerable strengths, including high-quality human capital, excellent education systems, and world-class research institutions.

With the right incentives and regulatory reforms, these assets could support much higher levels of commercial innovation.

With a better environment for entrepreneurship, Europe's high per capita income, large internal market, and elevated savings rates could help unleash a wave of investment.

Crucially, even if Europe never leads in cutting-edge technologies, it could still significantly boost productivity by adopting and adapting American and Chinese innovations.

Many of these technologies are general-purpose in character, benefiting both adopters and pioneers.

All of this leaves Europe at an inflection point. As Ernest Hemingway famously observed, bankruptcy happens "gradually and then suddenly."

So far, Europe's technological decline has been gradual. But if it fails to confront its structural weaknesses, today's slow erosion could give way to a sudden and irreversible loss of economic relevance.

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