US vs. Europe: Mind the gap

Introduction

Joe Biden's administration has put in place a vast investment programme that should strengthen the United States' dominant industrial position, particularly vis-à-vis Europe. But at what cost?

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PRIVATE BANKING

Quick rundown

At a time of environmental concerns and geopolitical upheaval, the importance of economic planning and the development of new industrial strategies has never been greater. Under the Biden administration, the United States has implemented a gigantic investment programme aimed at strengthening its position as the world's leading power. On the old continent, the EU and the UK seem to be moving in the opposite direction, grappling with challenges such as de-industrialisation and energy dependency.

On the face of it, the strategic turn taken by the United States should give it a major competitive advantage over Europe. Their energy independence and local production of semi-conductors give them a definite advantage in a world prey to "slow-balisation" and geopolitical risks. But the price of Bidenomics is high. In particular, budget deficits will widen, and indebtedness will accelerate (see below for the CBO's projections for the coming years). Such a headlong rush will have consequences for future taxes and/or inflation ("the hidden tax"). As President Ford once said, "A government that is big enough to give you everything is a government that will also be there to take everything from you..."

Another price to pay for 'Bidenomics' is what is known as 'crowding out', an economic phenomenon characterised by a fall in investment and private consumption as a result of increased public spending. In simple terms, Uncle Sam's massive public spending is absorbing not only available capital but also labour (with effects on wages and hence inflation). The very large Treasury bond issues needed to finance Bidenomics are pushing up bond yields, with effects on the cost of capital for companies. As mentioned by Gavekal Group, Biden's interventionism should lead to a more stable US economy, but with negative effects on labour productivity growth and, by extension, on US structural growth.

For Europeans, there is an urgent need to modernise their industrial base and secure access to energy. This means putting in place a new foreign affairs policy common to the whole Union. It also means resorting to major investment plans similar to the Bidenomics. But the room for manoeuvre is limited. Firstly, because the level of debt is already very high. But also, because Germany's debt brake rules prevent the pursuit of such policies. Last week, the German Council of Wise Men came out in favour of reforming these rules. Europe urgently needs to take action.

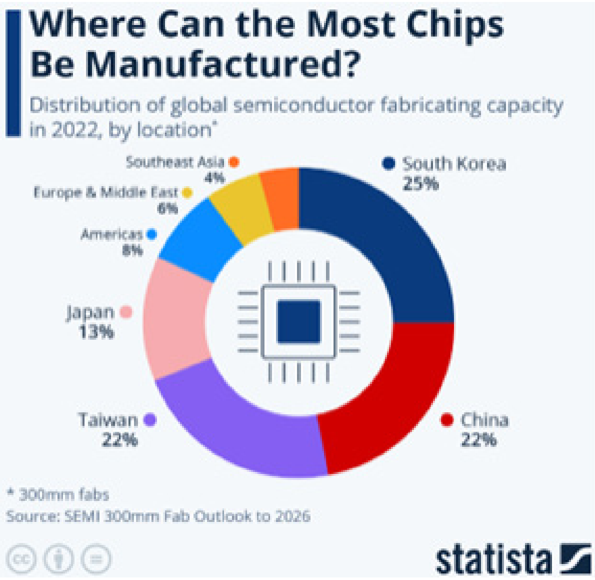
Bidenomics and their implications

Bidenomics, the term used to describe President Joe Biden's fiscal stimulus policy, is characterised by major public investment in US infrastructure, technology, and labour policy.

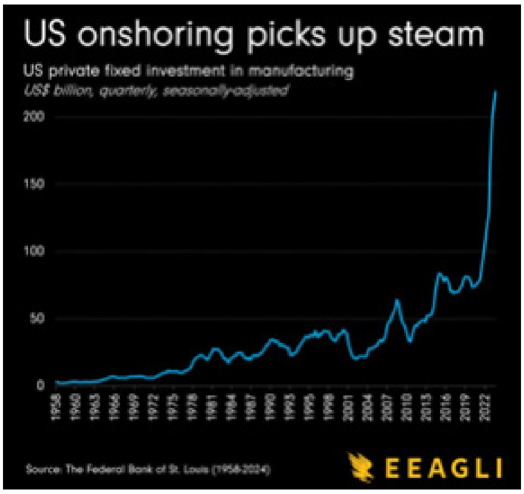
These investment programmes include those related to inflation reduction (the IRA), local semiconductor production (the CHIPS Act), infrastructure and employment.

The IRA, signed into law in August 2022, covers major investments in the fight against climate change, healthcare, and the revitalisation of the US manufacturing industry. The legislation represents a deliberate move towards a more sustainable and resilient economy, with a focus on renewable energy and reducing the carbon footprint. The legislation is part of Mr Biden's ambitious goals of reducing emissions by 50% by 2035 (compared to 2005 levels) and achieving a net zero carbon footprint by 2050. This text has already produced promising results: the IRA has already created more than 170,000 jobs in the clean energy sector and companies have announced investments of $110 billion in clean energy production in 2022 alone.

Complementing the IRA is the CHIPS Act, a strategic initiative aimed at regaining and securing the United States' position in the global semiconductor industry. Figures from the semiconductor lobbying organisation SEMI show that around 70% of total manufacturing capacity is in South Korea, Taiwan and China, with North America in fifth place at 8% of global capacity. Guaranteeing the independence of this sector is particularly important at a time when technology underpins every facet of the economy and national security. The law aims to strengthen the domestic supply chain, encourage research and development, and ultimately reduce dependence on foreign semiconductor production. By investing in this critical sector, the United States is protecting its economic interests and guarding against geopolitical risks (e.g., China's possible invasion of Taiwan).

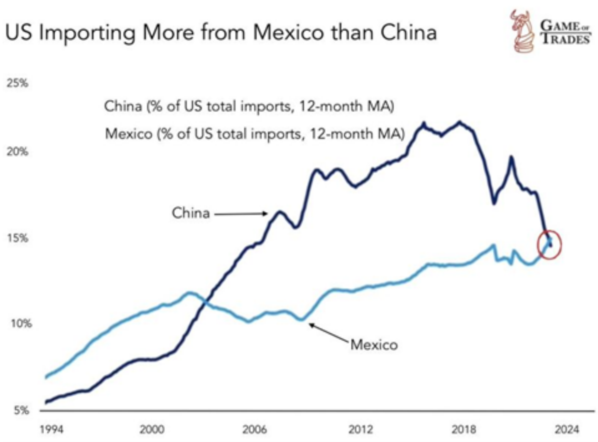


Signed into law by President Biden in November 2021, the Infrastructure Investment and Jobs Act (IIJA) will provide more than $1 trillion in federal spending to address infrastructure needs, including repairing and building roads and bridges, expanding high-speed internet access, and upgrading electricity and water systems. Now approaching its third year, this investment programme has launched more than 40,000 projects in all 50 states, stimulating economic growth and improving the quality of life for all Americans.



In addition to substantial investment in its own infrastructure, the United States has changed its business dynamics through "Friendshoring". Also known as "nearshoring", this trend appears to be a strategic manoeuvre aimed at reshaping supply chain dynamics and commercial relationships. The aim is to strengthen and diversify supply chains by relocating or establishing manufacturing and service facilities closer to home, often in allied nations or neighbouring countries. The principle is to respond to vulnerabilities exposed by global shocks such as the COVID-19 pandemic and recent conflicts (Russia-Ukraine, Middle East, etc.). In this way, the US is seeking to mitigate the risks associated with long-distance supply chains, including transport delays, increased costs, and political instability.

The “friendshoring” policy offers economic benefits such as job creation, encouraging technological collaboration and promoting environmental sustainability by reducing transport emissions. For the countries involved in relocation efforts, this represents opportunities for economic growth, investment, and access to the US market. Mexico is one of the countries seizing these opportunities, having eclipsed China as the United States' largest trading partner in 2023.



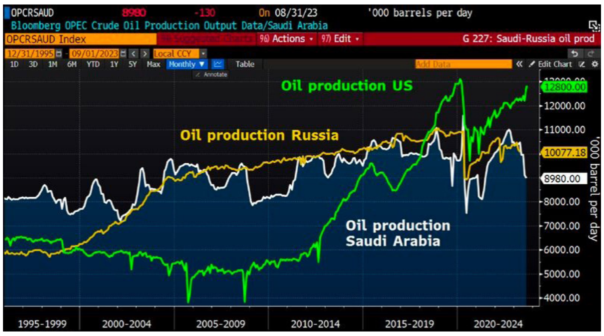
Source: Game of Trades

The implications of Bidenomics are also proactive, long-term measures that should enable the US economy to benefit from growth that is both sustainable and better able to protect itself from external shocks.

US energy independence

Energy security has become synonymous with national security, and the United States is gearing its strategy towards energy independence, a goal that promises greater economic stability and strengthens its geopolitical position.

Diversification of the energy portfolio is at the heart of this strategy. The US is not only increasing its production of oil (now the world's leading producer - see graph below) and natural gas, which guarantees a steady domestic supply, but is also investing aggressively in renewable energies such as wind, solar and bioenergy. Thanks to the IRA, wind power generation is set to triple by 2030 and solar power generation is set to increase sevenfold. This balanced approach to energy independence mitigates the risks of over-reliance on any single energy source and paves the way for a smooth transition to cleaner, more sustainable energy.



Source: Bloomberg

The effects of energy independence extend far beyond national borders, influencing global energy markets and geopolitical dynamics. These changes in the global supply and demand equation, could stabilise or even lower world energy prices.

Europe's de-industrialisation and energy dependence

While the United States is moving towards energy independence and revitalising its industrial base, the picture on the other side of the Atlantic is very different. Continental Europe and the UK are facing de-industrialisation and heavy energy dependency. The implications for their economic and geopolitical future should not be underestimated.

De-industrialisation in the EU and the UK is characterised by a steady decline in manufacturing and heavy industry, due in part to globalisation, automation, and stricter environmental regulations than in the rest of the world. This loss of competitiveness has economic consequences, such as the loss of traditional industrial jobs and the erosion of the national manufacturing base (see the case of Germany below). It also has repercussions for trade balances, technological sovereignty, and the overall resilience of their economies.

Energy dependency on the EU and the UK only exacerbates this loss of industrial competitiveness. Heavily dependent on imports to meet their energy needs, these regions are sensitive to the vagaries of international energy markets. The dangers of this overdependence became real when the war in Ukraine broke out and countries like Germany, which received more than 50% of its natural gas imports from Russia, saw this supply threatened.

By 2023, the EU will still be 60% dependent on imports to cover its energy needs. This exposes it to volatile prices, supply disruptions and geopolitical manoeuvring. The situation is further complicated by ambitious environmental targets and a difficult transition to renewable energies, which, while laudable, require substantial investment and structural change. In addition, countries such as Germany have closed all their nuclear power stations, exacerbating their dependence on imports of non-renewable energy.

The combination of de-industrialisation and energy dependency poses significant challenges to the long-term economic competitiveness of the EU and the UK. The erosion of manufacturing capacity can limit their participation in global value chains and the benefits that accrue from this, particularly in high value-added sectors such as technology and advanced manufacturing. These factors have profound implications for policy autonomy. Energy dependence can translate into geopolitical leverage for supplier countries, which can influence diplomatic positions and political decisions. The energy transition involves a balance between environmental objectives and economic and industrial priorities.

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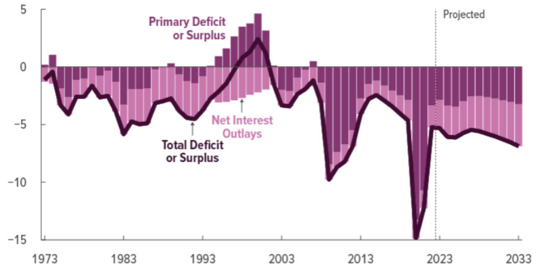
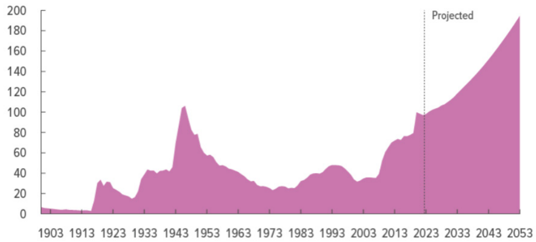
Total Deficits, Primary Deficits, and Net Interest Outlays

Percentage of Gross Domestic Product



Federal Debt Held by the Public, 1900 to 2053

Percentage of Gross Domestic Product



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