Europe Between Rearmament and Industrial Rescue: How Has the US-China Conflict Forced a Reshaping of the European Economic Model?

(Translated)

https://www.al-waie.org/archives/article/20486

Al Waie Magazine Issue No. 482

Forty first Year, Rabi' I 1448 AH corresponding to August 2026 CE

Nabil Abdel Karim

Europe today faces not merely a fleeting economic crisis—one manageable through stimulus packages or monetary policies—but a structural dilemma that impacts both its economic and strategic future. The continent that spearheaded the Industrial Revolution for decades now finds itself compelled to rebuild its military capabilities, even as its industrial base faces unprecedented pressures: soaring energy costs, intensifying Chinese competition, and the transformation of the United States into an economic rival every bit as fierce as its traditional competitors.

The paradox lies in Europe's need to fund two simultaneous strategic undertakings: first, rearmament and the bolstering of defense capabilities following the erosion of security certainty caused by the war in Ukraine; and second, the rescue of its civilian industrial sector, which underpins its economic strength and competitiveness. Yet, with limited financial resources, high public debt, and sluggish economic growth, achieving both goals simultaneously presents an immense challenge.

First: The Collapse of the European Model: The End of One Era and the Beginning of Another

What Europe has witnessed since 2022 was not merely the fallout from a regional conflict on its eastern borders; it marked the collapse of an economic model that had remained stable for decades and was considered one of the world's most successful. Europe's modern industrial resurgence was built upon a seemingly stable equation: low-cost Russian energy, vast Asian markets, open global trade, and a US security umbrella that minimized the need for heavy military spending. This equation enabled European companies—led by German firms—to achieve high levels of competitiveness. Factories operated using low-cost energy and exported their products to China and emerging markets, while governments channeled resources into education, scientific research, and infrastructure rather than military armament.

However, the Russia-Ukraine war completely altered this equation. Mutual sanctions, the halt of Russian gas supplies, and the sharp rise in energy prices revealed that economic interdependence could turn into a strategic vulnerability. The question is no longer how Europe can achieve the highest growth rates, but rather how it can sustain production amidst an increasingly risky international environment.

Concurrently, European governments realized that long-standing security reliance on the United States was no longer sufficient in a world of rapidly accelerating geopolitical shifts. Washington has increasingly focused on the Indo-Pacific region to counter China's rise, prompting European questions regarding the sustainability of the US security umbrella in the form the continent has known since the end of World War II.

Second: Rearmament—A Strategic Necessity or An Economic Burden?

Amid these changes, most European states have announced their largest rearmament programs in decades. Defense spending is no longer merely a policy choice; it is now framed as a necessity for protecting national security, securing borders, and rebuilding military capabilities that had eroded during years of spending cuts.

Yet, this return to rearmament raises a crucial economic question: who will foot the bill?

European economies are already grappling with sluggish growth, high debt levels, and mounting pressure on public budgets due to aging populations and rising social welfare costs. Adding hundreds of billions of euros to defense budgets inevitably means reducing resources available for investment in other equally vital sectors—such as industry, energy, education, and scientific research.

Herein lies the fundamental paradox: defense requires a strong economy to fund it, while the economy requires massive investment to remain competitive. If this balance is disrupted, military spending risks shifting from a source of protection to a burden that undermines the very economic foundations upon which security itself rests.

Third: European Industry Facing an Existential Crisis

The crisis facing European industry today extends beyond soaring energy costs; it has developed into a comprehensive crisis of competitiveness. Production costs have risen relative to competitors, and sustaining energy-intensive industries has become increasingly difficult. This is occurring at a time when China is expanding industrial production at an unprecedented pace and the United States is attracting global investment through generous financial and tax incentives.

Faced with this reality, some European companies have begun relocating production lines abroad—to regions where energy is cheaper, government support is greater, and markets are more attractive. Europe now faces the threat of “reverse industrialization”—the relocation of industries away from the continent, rather than their expansion within it.

The losses involved go beyond factories alone, extending to jobs, supply chains, innovation, and technological development capabilities. Every factory that leaves Europe leaves behind a vast network of suppliers, research centers, and skilled workers, making it increasingly difficult to bring these industries back in the future.

Consequently, European governments have returned to policies that, until recently, were considered a departure from free-market principles—such as providing direct industrial subsidies, encouraging the reshoring of production, imposing import restrictions, and shielding strategic sectors from foreign competition.

Fourth: Europe’s Ambivalence Toward China—Between Partner and Competitor

While Russia prompted Europe to rethink its energy security, China has compelled it to reconsider the future of its industry.

China is not merely a trade rival; it has emerged as an industrial and technological powerhouse capable of challenging Europe in sectors once considered the exclusive domain of European industry—such as electric vehicles, batteries, solar panels, and industrial equipment.

Consequently, Europe has moved to impose tariffs and launch investigations into Chinese state subsidies, seeking to shield European companies from competition that Brussels views as unfair and lacking a level playing field.

Yet, the paradox is that Europe cannot do without China. China is one of Europe’s largest export markets and dominates critical segments of global supply chains; it produces a significant share of refined Rare Earth Elements (REEs) and essential components required for the digital transformation and the transition to clean energy.

For this reason, Brussels has adopted a policy of “de-risking” rather than “decoupling.” The goal is not to sever economic ties with China, but to reduce reliance on it in sensitive sectors while maintaining trade cooperation wherever possible.

However, this balance appears fragile. As European protectionist measures intensify, so does the likelihood of Chinese countermeasures targeting European exports or companies operating in the Chinese market—rendering the relationship between the two sides a complex mix of economic cooperation and strategic rivalry.

Thus, Europe finds itself caught between the need to protect its domestic industry and the need to maintain relations with the world's second-largest economy—a situation representing one of the most complex paradoxes in contemporary international economic policy.

Fifth: The United States—Security Ally and Economic Competitor

As Europe seeks to reorder its priorities, another equally significant paradox has emerged: the United States, while serving as the continent's primary security guarantor, has simultaneously become one of its leading economic competitors.

Amid escalating competition with China, Washington has adopted a new industrial policy centered on channeling massive investments into advanced technology, semiconductors, clean energy, and strategic industries—backed by tax incentives and extensive government funding designed to attract global companies.

This policy has had a direct impact on Europe; numerous European firms have begun reassessing their investment plans, drawn by lower energy costs in the U.S., generous subsidy programs, and easy access to capital. Consequently, Europe is losing a portion of its investments—not to China, but to its closest ally.

It is evident, then, that the transatlantic relationship is no longer defined solely by security cooperation; it is now increasingly intertwined with economic and technological competition. The United States is striving to bolster its domestic industry and reduce external reliance, even at the expense of its European partners.

This reality presents Europe with a dual challenge: it must maintain its strategic alliance with Washington while simultaneously safeguarding its economic interests and preventing the erosion of its industrial base.

Sixth: From Market Economy to National Security Economy

Over the past three decades, the world has witnessed the dominance of an economic model based on free trade, the international division of labor, and the pursuit of the lowest possible production costs. However, successive crises have demonstrated that economic success alone is insufficient to guarantee security and stability.

Consequently, major powers have begun to redefine the concept of economic strength. Industry is no longer merely a driver of growth; it has become a component of national security. Supply chains, microchips, energy, rare minerals, and artificial intelligence have emerged as fundamental elements in the balance of power between states.

In this context, European governments no longer hesitate to intervene directly to support strategic industries, impose restrictions on certain foreign investments, or offer incentives to reshore production within the continent—measures that were previously viewed as departures from free-market principles.

Europe is not abandoning the market economy. Instead, it is reshaping it in light of national security considerations. This shift reflects the global transition from an era of economic globalization to one of geopolitical competition, wherein the state acts as a direct partner in shaping industrial policy rather than merely a market regulator.

Seventh: Is Europe Returning to a War Economy?

Security challenges are prompting some politicians to view military industries as a new engine for economic growth, citing the potential for investment, job creation, and technological advancement.

Undoubtedly, expanding defense industries would stimulate various sectors—such as metallurgy, engineering, electronics, and scientific research. However, shifting toward an economy increasingly reliant on military spending entails strategic risks.

A war economy differs fundamentally from a civilian-oriented productive economy. The former is tied to persistent tensions and conflicts, whereas the latter is driven by innovation, productivity gains, improved living standards, and the creation of new markets. Moreover, regardless of its significance, military spending cannot substitute for long-term investment in education, universities, infrastructure, and advanced civilian industries.

Another dilemma arises here: a substantial portion of the increase in European defense spending goes toward purchasing military equipment from the United States. This means that European funds are contributing more to stimulating the US industrial sector than to bolstering Europe's own industrial autonomy.

Consequently, calls are mounting within the European Union to establish an integrated European defense industrial base, transforming defense budgets into a driver of growth within the continent rather than a means of boosting foreign economies.

Eighth: Europe’s Future... Between Strategic Autonomy and International Pressures

Europe is entering a pivotal phase in its modern history. It can no longer return to the economic model that prevailed after the Cold War, yet it has not yet succeeded in formulating a new model that balances economic openness with strategic sovereignty.

The success of this transformation will hinge on the European Union’s ability to answer three key questions:

Can it build an industrial base capable of competing with the United States and China in technology and advanced industries?

Can it achieve greater defense autonomy without undermining its strategic relationship with Washington?

And can it succeed in reducing its reliance on China without losing one of its most important trading partners?

The answers to these questions will determine Europe’s future for decades to come, as the true challenge is no longer merely economic or military. It concerns the continent’s standing in an international order shifting toward multipolarity, where major powers compete over technology, energy, industry, and geopolitical influence.

A major economic paradox reveals that Europe is not facing a cyclical crisis that can be resolved through fiscal or monetary measures. Instead, it is undergoing a fundamental restructuring of its economic and strategic model. The continent—which once flourished through globalization, free trade, and low production costs, and which relied on colonialism—now finds itself compelled to revisit concepts of economic sovereignty, industrial security, and strategic autonomy. Yet, the success of this transformation will not depend on the volume of funds European governments spend, but rather on their ability to craft an integrated vision that weaves security, industry, technology, and energy into a single, cohesive civilizational project. The world has entered a new era where power is measured not merely by the size of armies or Gross Domestic Product, but by a state’s ability to possess an advanced industrial base, secure strategic resources, master technology, and build resilient supply chains. In this new landscape, Europe faces a historic test: it must either succeed in transforming its crises into an opportunity to rebuild its strength, or remain trapped between Chinese industrial supremacy and American economic allure—gradually slipping from its former role as a shaper of events to a mere observer, and ultimately to a passive subject of them.

Perhaps the deepest paradox is that Europe’s battle is no longer about choosing between rearmament and industrial revitalization. Instead, it lies in recognizing that each has become a prerequisite for the other. There is no security without a productive economy, no strong economy without an industrial base, and no advanced industry without a strategic vision that grasps the nature of the new international order—an order in which geopolitics has once again come to drive the economy, reversing decades where the economy drove politics.