

SPEECH

The economic and human challenges of a transforming era

Speech by Christine Lagarde, President of the ECB, at "Les Essentiels des Bernardins", Paris

Paris, 18 November 2024

It is both an honour and a privilege to address you at the esteemed Collège des Bernardins, a site rich in history and intellectual tradition.

As I stand in this restored medieval college, I am reminded of the profound role that monastic institutions have played in spreading Christian values throughout Europe.

In these environments, ideals of social responsibility flourished through communal living. The principle of “ora et labora” (pray and work) underlined the dignity of labour. And the study of theology and major disciplines of human knowledge contributed to Western thought.

These moral foundations contributed to the emergence of the Church’s social doctrine in the 19th century and the creation of the welfare state.

The welfare state developed in response to rising inequality, hazardous working conditions and urban poverty triggered by the Industrial Revolution. Yet it was the wealth created by this very same Revolution and these new technologies that provided governments with the spending capacity to help the less fortunate.

As tax revenues rose, it became possible to provide people with more social insurance, healthcare and education. To echo the words of German Chancellor Otto von Bismarck – creator of the world’s first welfare state in the 1880s – welfare spending became an expression of “practical Christianity”.^[1]

As the years have gone by, Europe has stayed true to this model, combining technological progress with social protection. However, as I outlined in my Camdessus lecture last September, our European way is now under pressure from significant shifts that are taking place.^[2]

First, we are living through a period of rapid technological change, driven in particular by advances in digital innovation. And unlike in the past, Europe is no longer at the forefront of progress. Our productivity growth – the key factor driving our long-term prosperity – is diverging from the United States.

Second, we are witnessing a shifting geopolitical landscape, one that is fragmenting into rival blocs, where attitudes towards free trade are being called into question and approaches to regulating the technology sector are diverging among advanced economies.

In this changing landscape, Europe is under growing pressure to redefine its position in order to remain competitive.

In this setting, two principles are critical: *adaptation* and *anticipation*.

We must adapt to the changing world around us and make up the ground we have lost in terms of productivity and technology. Otherwise, we will not be able to generate the wealth we will need to meet our rising spending needs to ensure our security, combat climate change and protect the environment. But we must also anticipate the disruptions that technological and geopolitical shifts will bring – and prepare for them by renewing our social model.

Adaptation

At the heart of the European model lies a unique commitment to equity and cohesion.

European economies – more than other advanced economies – strive to ensure that economic growth enhances social wellbeing. The level of public social spending in many European economies exceeds the average of other advanced economies.^[3] And this resonates strongly with Europeans. Today, almost nine out of ten citizens consider a social Europe to be important.^[4]

Over time, labour market reforms have encouraged people to develop specialised skills.^[5] Our highly educated workforce has historically played a key role in driving innovation in Europe, allowing it to gain a competitive edge in high value-added sectors ranging from machinery to luxury goods.

Today, however, two megatrends are challenging our economic model.

First, we are facing a new geopolitical landscape, in which key economic dependencies are turning into geopolitical vulnerabilities. Europe's economy, more open than others and characterised by a trade-to-GDP ratio exceeding 50%, is now facing pressure in an increasingly inward-looking global environment.

Compared with the United States, Europe is facing much stronger competition from China in its traditional areas of strength.

ECB analysis finds that the share of sectors in which China directly competes with euro area exporters has increased significantly from about one-quarter in 2002 to nearly two-fifths today.^[6] At the same time, the EU's share in world trade is declining, with a notable fall since the onset of the COVID-19 pandemic.^[7]

Furthermore, the shifting geopolitical landscape is leading western economies to rethink their attitude towards free trade and adopt divergent approaches to the regulation of competition, technology and digital technologies. These changes will have a varying impact on individual countries' industrial competitiveness at the global level and will weigh on Europe's economic growth model.

This brings me to the second trend: Europe is falling behind in emerging technologies that will drive future growth.

While the impact of artificial intelligence (AI) on growth is still uncertain, estimates suggest it could be transformative.^[8] But the EU is caught in what has been called a "middle technology trap". We are specialised in technologies that were mostly developed in the last century. Only four of the world's top 50 tech companies are European.

One key reason we are lagging behind is because our innovation and financing ecosystems are not suited to developing new advanced technologies.

This is not because we lack talented people and ideas, or because we lack the savings to invest in those ideas. The difficulty stems from a lack of scale in our digital single market and from a lack of capital markets to channel savings to entrepreneurs.

In fact, more than one-third of EU savings sit in cash and low-yielding bank deposits,^[9] compared with around one-tenth in the United States. As a result, a majority of tech investment in Europe comes from US venture capitalists, while only a small minority originates from EU-based investors.^[10]

The upshot of all this is that our productivity growth in Europe is progressively slowing, which means that our ability to generate income is diminishing. If left unchecked, we will face a future of lower tax revenues and higher debt ratios, which will have serious implications for our financing capacity.

We face a rising old-age dependency ratio which will drive up public spending on pensions.^[11] And it is estimated that governments will need to spend in excess of €1 trillion a year to meet our investment needs for climate change, innovation and defence.^[12]

If we cannot raise productivity, we risk having fewer resources for social spending. We also risk not having the means to deliver on our other European ambitions. These include enhancing our security by modernising our defence capabilities as well as successfully navigating the green transition to combat climate change.

So, we have to adapt – and we can adapt. All the ingredients are there. Collectively, the EU is a large, rich economy. But we are not acting collectively. Simply unlocking our single market for goods and capital could lead to huge gains. The trade barriers that still exist within the EU represent a shortfall of around 10% of our economic potential.^[13]

According to the IMF, internal barriers within Europe are equivalent to a 44% tariff for manufacturing and 110% for services.^[14] Imagine the possibilities for innovative companies to grow in Europe if they did not have to contend with those costs.

Moreover, if we were to give EU households better opportunities to invest their savings, up to €8 trillion could be redirected into long-term investments. We would have ample funding to develop innovations and develop and transform the technologies of the future.

Anticipation

All this is well known. To be ready, we need to anticipate the changes that are coming now.

First, we must anticipate the impact of technology on people.

This will largely depend on the values that underpin the design of digital technologies and the intentions of the people who use it.

For example, in the case of a broad and unchecked expansion of AI, ECB staff estimate that around one-quarter of jobs in European countries are highly exposed to AI-enabled automation, while a further one-third are moderately exposed.^[15]

But unlike previous waves of computerisation, AI is capable of performing complex cognitive tasks such as analysis, decision making and even creative work. As a result, its effects are likely to be more

widespread, impacting low and highly-skilled workers alike.

People will be expected to perform new tasks in their current jobs, or move to new jobs as old tasks will become obsolete more quickly. There will be a much greater emphasis on adult learning than we see today to ensure that workers can keep up with technological change.

And there will likely be some social consequences during the transition: the workers who are the quickest to adjust will see outsized gains, which could exacerbate inequality.

So our aim in adapting to digital technology should not solely be to do things faster or more efficiently at the expense of inclusion. Instead, we must prioritise development that serves the common good, not necessarily by expanding social protection but by enhancing individual empowerment and capabilities.

We can do so through a renewed, EU-wide focus on skills. Inclusion depends on everyone having the skills they need to benefit from digitalisation.

Research shows that when workers are given the right skills, the benefits of AI can be more widespread. Less experienced or low-skilled workers can increase their productivity by 35% when using AI, more so even than highly skilled workers.^[16]

But currently, a significant portion of Europeans lack basic digital skills.^[17] And neither the public nor the private sector is filling the gap.

Participation in adult education and training is relatively low overall. Only around one-third of adults participated in training in 2016 and this rate has barely increased since then. And almost 60% of workers say that the formal digital training offered by their employers is not enough.^[18]

So, we will need an overhaul of education, training and adult learning, with the public and private sectors working together to identify skills gaps and find solutions.

The second is anticipating the implications of geopolitical shifts on the way Europe works together.

We can no longer see ourselves as a loose club of independent economies. That perspective is outdated in a world that is fragmenting into geopolitical blocs centred around the largest economies. Today we need to see ourselves as a single, large economy with predominantly shared interests.

This paradigm shift also calls for joining forces in more areas.

We face and will continue to face growing expenditure arising from a changing security environment, ageing populations and the climate transition – challenges that we will only be able to meet together. And if we do not, we will face some difficult choices between adjusting our social model, delivering on our climate ambitions and playing a leading role in global affairs.

By acting as a union to raise our productivity growth, and by pooling our resources in areas where we have a tight convergence of priorities – like defence and the green transition – we can both deliver the outcomes we want and be efficient in our management of public spending.

Conclusion

Let me conclude.

Since the dawn of the industrial age, Europe has prided itself on a unique economic model – one that balances technological progress with comprehensive social welfare.

Today, however, Europe is under pressure. The rapid pace of technological change triggered by the digital revolution has left us trailing behind. We need to adapt quickly to a changing geopolitical environment and regain lost ground in competitiveness and innovation. Failure to do so could jeopardise our ability to generate the wealth needed to sustain our economic and social model, which the vast majority of Europeans nevertheless hold dear.

Let me finish with a quote from Marcus Aurelius: “The impediment to action advances action. What stands in the way becomes the way.”

1.

Busch, M. (1898), *Bismarck: Some Secret Pages of His History*, Vol. II, Macmillan, New York, p. 282.

2.

Lagarde, C. (2024), “[Setbacks and strides forward: structural shifts and monetary policy in the twenties](#),” speech at the 2024 Michel Camdessus Central Banking Lecture organised by the IMF, Washington, D.C., 20 September.

3.

By five to ten percentage points of the OECD average of 21% of GDP in 2022. For further details, see “[Compare your country – Expenditure for Social Purposes](#)”.

4.

European Commission (2024), “[Abstract – Social Europe](#)”.

5.

Estevez-Abe, M., Iversen, T. and Soskice, D. (2001), “[Social Protection and the Formation of Skills: A Reinterpretation of the Welfare State](#)”, in Hall, P.A. and Soskice, D. (eds.) (2001), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, Oxford University Press, 30 August.

6.

Based on an analysis of revealed comparative advantage. See Al-Haschimi, A., Emter, L., Gunnella, V., Ordoñez Martínez, I., Schuler, T. and Spital, T. (2024), “[Why competition with China is getting tougher than ever](#)”, *The ECB Blog*, ECB, 3 September.

7.

EU firms have also been experiencing competitiveness losses owing to increased input costs exacerbated by elevated energy prices in Europe compared with other regions.

8.

See, for example, Acemoglu, D. (2024), "[The Simple Macroeconomics of AI](#)", Massachusetts Institute of Technology, 5 April; Briggs, J. and Kodnani, D. (2023), "[The Potentially Large Effects of Artificial Intelligence on Economic Growth](#)", *Global Economics Analyst*, Goldman Sachs, 26 March. For an overview, see Filippucci, F. et al. (2024), "[Should AI stay or should AI go: the promises and perils of AI for productivity and growth](#)", *VoxEU*, 2 May.

9.

€11.5 trillion.

10.

55% of tech investment in Europe comes from US venture capitalists and only 15% from EU investors.

11.

Moshammer, E. and Schroth, J. (2024), "[Ageing cost projections – new evidence from the 2024 Ageing Report](#)", *Economic Bulletin*, Issue 5, ECB.

12.

Boubdallah, O., Dorrucci, E., Hoendervangers, L. and Nerlich, C. (2024), "[Mind the gap: Europe's strategic investment needs and how to support them](#)", *The ECB Blog*, ECB, 27 June.

13.

in 't Veld, J. (2019), "[Quantifying the Economic Effects of the Single Market in a Structural Macromodel](#)", *Discussion Paper Series*, No 94, European Commission, February.

14.

International Monetary Fund (2024), "[A recovery short of Europe's full potential](#)", *Regional Economic Outlook for Europe*, October

15.

Albanesi, S. et al. (2023), "[New technologies and jobs in Europe](#)", Working Paper Series, No 2831, ECB.

16.

Brynjolfsson, E., Li, D. and Raymond, L.R. (2023), "[Generative AI at Work](#)", NBER Working Paper Series, No 31161, National Bureau of Economic Research, April.

17.

42% and 37% respectively. The EU Digital Decade sets out to ensure that 80% of working age Europeans have basic digital skills by 2030.

18.

See "[Nearly half of European workers expect AI to "significantly" impact their jobs by 2024](#)", *Euronews*, 13 September 2023.