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A GAME OF JENGA WITH EUROPEAN INDUSTRY

THE STRATEGIC VALUE OF DUTCH INDUSTRY IN A GLOBAL CONTEXT

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AUTHORS
Coby van der Linde

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Centre for International Energy Policy (CIEP)

ADDRESS
Breitnerlaan 299, 2596 HA The Hague, The Netherlands

TELEPHONE
+31 70 374 67 00

EMAIL
contact@ciep.energy

WEBSITE
ciep.energy

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ABSTRACT

This paper explores the external competitive pressures on EU industry. The orientation of the EU on open international markets as a resource-poor group of countries was based on the idea that everything could be bought on depoliticized international markets, and that the EU market was large enough to exert sufficient buying power to comply with the ever-growing body of EU rules and regulations. This is a stark difference from China's strategic approach to manage its import dependencies and the protection of its domestic market.

Much attention is focussed on the United States and the (impending) trade measures of the Trump Administration, but the export of Chinese domestic economic problems to world markets may be a more important issue to tackle. China has developed large overcapacities in many manufactured products, while domestic demand remains subdued. Ideally, economies will adapt to new fundamentals in an orderly fashion, but the reality is that the emergence of reforms is usually quite disorderly.

The EU has adopted an institutionalised short-term view on the economy and a belief that its soft and regulatory powers can be used to discipline the rest of the world into following its route to climate neutrality. However, the EU has come under increasing pressure from geopolitical and economic moves by the US and China, as well as by the larger emerging economies that comprise the BRICS-group. Trade agreement partners can be used for reshoring practises that do not play by the rules. For instance, China is engaged in practises to secure the best mineral ores for its smelters, reducing the competitiveness of smelters elsewhere and maintain a firm grip on critical minerals. The higher energy costs in the EU (and the Netherlands) are another worrisome factor in the uneven playing field in the EU.

The Trump Administration's trade policy should be seen as a geopolitical instrument to redress both international political and economic imbalances. China has failed to comply with the mores of the multilateral system. Instead, it has played its own game with its own rules. With the long growth spurt coming to an end, China may be challenged by the US, and maybe others, to comply and restructure its economy. The EU is exposed to this US-China battle, while the avenues to prevent EU industry from becoming collateral damage in this conflict may be limited. Both the US and the EU have become structurally dependent on certain Chinese supply lines, and it will take time to diversify these.

EU industry is confronted with the shock of structurally higher energy costs compared to those of producers elsewhere and is now dealing with the potential absorption of

Chinese oversupply in many products due to its open markets. Moreover, the EU may also encounter US trade policies, while Dutch industry also must grapple with an uneven playing field in the EU due to national policymaking.

The Draghi report pinpointed the ailments of the EU economy as the result of lower productivity (compared to the US), a lack of innovation (tech (US) and clean tech (China)), insufficient risk capital, and energy costs. The EU energy transition is, foremost, a so-called 'brownfield' transition and not a 'greenfield' transition, where current local industrial ecosystems play an important role. The EU may also simply lack the institutional make-up to organise an attractive economic climate for industry, despite its newly communicated competitiveness compass, while its policies limit or complicate the member states' ability to create such an environment for its industry.

The renewed focus on security also repositions the importance of oil refineries, particularly those that are connected to the NATO pipeline system to deliver the needed fuel for tanks, trucks and planes. Strategic liquid fuel storage is also an important part of this value chain and the ability to quickly send out fuel to where it is needed. Ports that fulfil a function in the defence supply lines will have to maintain their capacities and, perhaps, expand them for future use. The same applies to steel, mineral processing, a wide variety of chemicals, and large and small manufacturing industry, needed for the energy transition and security-related industries.

In addition to coal, oil and natural gas, steel, mineral processing and certain chemical products also fall within the dependencies in the energy-intense supply chains. The integration of chemicals, steel or other minerals into many other manufacturing sectors and end-products, as well as the importance of understanding the economics of co-production, are often underappreciated in discussions on strategic industries or, perhaps, better strategic industrial ecosystems where knowledge intense labour is at stake.

In the Netherlands, apart from the energy crisis in the EU, energy costs increased due to national policy choices and measures, such as the national CO2 tax and network costs. Energy costs for industry in the Netherlands are substantially higher than in the surrounding member states. This uneven playing field in the EU is already problematic and comes on top of the growing competitive gap between EU industries and industries in the US, China and, potentially, other countries.

The locational benefits of Dutch industries, the deep integration of basic industries with a wide variety of other industries further down the value chain, infrastructure connecting the wider NW European industrial ecosystem, and technological competence should be supported by a healthy investment climate in the new geopolitical and international economic climate. Many of the basic industries are important for the energy transition, for small and medium sized companies, for strategic autonomy and for national security.

The Draghi report is focussed largely on longer-term structural internal ailments of the EU economy, innovation, and energy sector. However, urgent short-term matters are also arising in redressing the external imbalances to gain time for the policy reforms needed here. The window of opportunity to maintain the most important parts of the EU industrial base is shorter than the proposed remedies in the Draghi report imply. Once disinvestments start, the solid looking Jenga tower will weaken and instigate other disinvestments, causing industrial ecosystems to unravel and collapse. The priority should be to make the EU and the Netherlands attractive for investments again.

Apart from the inter-EU policy competition and the impact on the uneven playing field for Dutch industry (energy costs and taxation), EU de-industrialisation may also occur due to higher energy costs compared to those of China and the US, the relatively small scale of EU industries compared to newer facilities in China, India and/or the Middle East, the lack of demand for low-carbon intermediates and final products, and the impact on innovation (attrition) due to lower demand in general in the downstream part of the various value chains. They add up to a critical combination of weaknesses in the international arena.

The result of the various pressures on EU industry and Dutch industry is that vital (semi-finished) products for the energy transition, health and consumer goods – of which the EU is now a producer – may be imported in future. Moreover, the deep industrial integration of the various EU and Dutch value chains may become imbalanced and reduce the robustness of the European and Dutch value chains, also impacting industries important for national security. Once deindustrialization takes hold and industries disappear, other (small and large) industries in the value chain may follow suit. This 'Jengafication' can cause irreversible deindustrialization and a diminishing ability to realise the industrial energy transition, security of supply and strategic autonomy.