An EPICENTER report

DRAGHI'S DILEMMA

Competitiveness, great power competition and Europe's next move

Carl-Vincent Reimers

September 2025

TIMBRO

EPICENTER
European Policy Information Center

Table of Contents

About the author

Carl-Vincent Reimers is the project manager for European competitiveness at Timbro and has previously worked as a speechwriter for Sweden's Prime Minister Ulf Kristersson and as a political advisor at the Swedish Ministry for Foreign Affairs. He holds a bachelor's degree in Political Science from the Institut d'études politiques de Paris and a master's degree in History from Lund University.

The author would like to thank Dr Pehr-Johan Norbäck, Dr Jacob Lundberg, Patrick Krassén, and Dr Calle Håkansson for their valuable comments and feedback in preparing this report.

Summary

- This report seeks to reconcile market-liberal and geopolitical perspectives on EU competitiveness, by addressing some of the complex trade-offs between market economics and geopolitical realities.
- Mario Draghi's analysis identifies a lack of innovation, energy issues, economic insecurity, and underdeveloped capital markets as central to the EU's competitiveness challenges.
- National regulatory fragmentation poses significant barriers to trade within the single market, equivalent to a 45 per cent tariff on goods and a 110 per cent tariff on services.
- This report proposes phasing out directives in favour of regulations and developing a harmonised EU company law framework to eliminate market fragmentation.
- A European equivalent to the US Defense Advanced Research Projects Agency (DARPA) is recommended to concentrate innovation funding for breakthrough technologies with national security applications.
- The competition policy should be adapted to allow more 'European Champions' to emerge on the market in strategic sectors while avoiding harmful micromanagement and public intervention.
- Creating a true capital markets union with a single European regulator could free up to €8 trillion in capital for investment – ten times what Draghi estimates is needed annually.
- Europe's cultural values and quality of life provide competitive advantages for attracting talent, which could become decisive if combined with the proposed competitiveness reforms.

Will Europe become *what it is in reality* -- that is, a little promontory on the continent of Asia? Or will it remain *what it seems* -- that is, the elect portion of the terrestrial globe, the pearl of the sphere, the brain of a vast body?

Peace is perhaps that state of things in which the natural hostility between men is manifested in creation, rather than destruction as in war. Peace is a time of creative rivalry and the battle of production; but I am not tired of producing?

Paul Valéry (1919)

Introduction:
Will Europe die?

When the poet Paul Valéry published his essay on the mortality of civilisations just over a century ago, he did so against the backdrop of the horrors of World War I. Rarely has Europe's own mortality been so bitterly exposed as when the pale sun of peace illuminated the littered and decaying trenches.

But perhaps it is only now, more than a century later, that we really understand the full meaning of his words. In today's international economy, Europe is increasingly seen as a backwater, a small 'promontory on the continent of Asia' – we can hardly be described as the 'brains' of the world's 'vast body'. We see it in the way Europe, the continent that gave birth to modern science and capitalism, is being overtaken by other, more dynamic economies in terms of technological innovation. We also see it in what Valéry describes as production fatigue, as fewer and fewer European companies invest in research and development and the technologies of the future. Increasing competition from major powers has exposed Europe's weaknesses, and given the scale of these problems, we have now come to doubt our own ability to do anything about them. The EU's economic model – exemplified by the German economy's transformation from Wirtschaftswunder (economic miracle) to stagnant industrial belt – faces an uncertain future. While the Russian invasion of Ukraine exacerbated the EU's weaknesses, geopolitical problems were already brewing in peacetime.

In recent years, Europe's leaders have recognised this and have shown a willingness to change the scenario. It was, therefore, no coincidence that it was precisely Valéry's insight that French President Emmanuel Macron echoed when he spoke of 'the mortality of Europe' in his second major speech on Europe at the Sorbonne University in spring 2024 (Elysée 2024). Former European Central Bank (ECB) President Mario Draghi also

used similar language when he presented his momentous report on Europe's competitiveness to the European Commission (EC) the following autumn, which elaborates on a whole range of measures to address Europe's challenges. According to Draghi, we need to fear for our 'self-preservation'.[1]

In European policy circles, it is hard to overestimate the agenda-setting impact of the Draghi report. Danish commissioner Dan Jørgensen summarized it well during a press conference in February: 'For some political positions, you have to swear an oath on the Bible. In the European Commission, I had to swear on the Draghi report' (European Commission, 2025). While green lobbying groups and the European left have remained suspicious to the potential ecological effects of some proposals, the report has been broadly welcomed from the European parliament and the business sector. Daniel Ek, founder of Spotify, writes on X that he 'couldn't agree more when he describes Europe as facing an existential challenge' (X, 10 September 2024). The left-leaning economist Mariana Mazzucato has instead criticized the Draghi report for falling short of addressing the magnitude of the challenge, not least underestimating the role of public investment and an 'entrepreneurial state'.[2]

Unfortunately, with the recent changes in US security policy and the developments in the rest of the world, the political discussion on competitiveness has faded all too quickly in member states' policy debates to be replaced by a focus on defence and security policy, even though these issues are equally important.

This report aims to return to the heart of Draghi's analysis, but also to demonstrate that the situation is far from insoluble, as Janan Ganesh, the *Financial Times* columnist, would have us believe. In response to the Draghi report, he opines that the US has enduring demographic, geographical, and cultural advantages that Europe cannot emulate, implying that the EU's lack of competitiveness is a structurally unsolvable problem.[3]

1 'EU facing existential risk without investment – report', *BBC*, 9 September 2024 (https://www.bbc.com/news/articles/c4gq1e7k2j8o).
2 'The EU's Draghi Agenda Isn't Ambitious Enough', *Project Syndicate*, 22 May 2025 (https://www.project-syndicate.org/commentary/draghi-report-recommendations-not-enough-to-strengthen-eu-technology-competitiveness-by-mariana-mazzucato-and-bengt-ake-lundvall-1-2025-05)
3 'Europe will not catch up with the US', *Financial Times*, 17 September 2024 (https://www.ft.com/content/298008a0-b75d-4062-9cb1-86b12ac30fbd).

In this report, I show why such pessimism is misplaced. I not only discuss how the problems of European economies can be understood as the result of specific institutional and geographical factors, which can, however, be addressed through concrete policy solutions, but also why the EU – despite its problems – is uniquely well-positioned to solve them. Europe's economic problems are real, but we are not in a state of crisis. We have one of the world's highest-quality higher education and research systems; a modern, well-functioning rule of law; well-capitalised companies; a well-educated population; and a high degree of economic freedom. In fact, no continent offers such favourable conditions for solving political and economic problems as Europe.

Whether we choose to capitalise on these strengths to solve our long-term problems is a political question. Europe itself is not the result of inevitable historical processes but of ideas and political decisions. The same applies to the future of European competitiveness.

As I argue in the report, solving these problems will require political effort to move ideas from the drawing board to action. This means implementing large-scale regulatory simplification, accepting a higher degree of centralisation of rules at the EU level to truly achieve a fully harmonised market, and having the courage to concentrate common resources on cutting-edge research and a fully integrated single European capital market.

Achieving this will require increased political trust between member states. In plain language, I aim to use this report to demonstrate why nation-states should pursue policies that prioritise maximising the common interest of EU as a whole instead of maximising the individual national interest.

As Valéry reminds us, understanding the mortality of civilisations is essential if we are to grasp the ultimate consequences of political choices. Historic civilisations have perished before, and it is a fate that could befall Europe too, unless we choose to take collective control of our destiny. But what distinguished Valéry from other thinkers of civilisation's mortality, notably the German philosopher Oswald Spengler, is his opposition to defeatism; just as he sees the realisation of mortality as a call to action, it is up to us to decide how to act on this realisation.

Background: A broader view of competitiveness

Although the term ‘competitiveness’ has been broadly used in European policy circles since at least 1994 and has a positive connotation, it is a difficult concept to define. ‘Time for EU leaders to focus on competitiveness’, wrote Swedish Prime Minister Ulf Kristersson in a debate article in the spring of 2024.[4] Earlier, in 2023, it was precisely this term that defined the priorities of the Swedish EU presidency better than any other word. In the same year, the Swedish centre-right government adopted a new strategy for Sweden’s ‘foreign trade, investment and global competitiveness’. However, political usage rarely includes an explicit definition of what competitiveness means. Let us therefore look closer on the usage of the word ‘competitiveness’ in the EU context and its different theoretical influences from both economic and political theory.

a) The history of ‘competition’ in the EU

In June 1993, Jacques Delors, then president of the EC, delivered a speech in Copenhagen on the theme of competitiveness. The speech addressed Europe’s problem of high unemployment, but it also focused on the increasing competition between Europe, the US, and Japan. It was then that European leaders decided to produce a so-called ‘white paper’ (European Commission 1994) – the first produced by the EC on the theme of competitiveness – which was presented the following year.

4 ‘Time for EU leaders to focus on competitiveness’, *Dagens Industri*, 18 April 2024 (https://www.di.se/debatt/dags-for-eu-s-ledare-att-fokusera-pa-konkurrenskraften).

The preface to this white paper states that over the past twenty years, Europe has seen its potential growth decline, unemployment rise, and the ratio of investment to GDP fall. Most notably, the paper recognises that Europe's position relative to that of the US and Japan has deteriorated, not least in terms of research and development. It also recognises that the US has taken the lead in the development of new information technologies, although the paper completely misjudges the nature of the technological developments. Among other things, the report forecasts that 'by the end of the century, there will be ten times as many TV channels and three times as many subscribers to cable networks' (European Commission 1994: 13). This statement is a good example of how wrong politicians can be about technological progress. Although cable TV networks were a major technology in the 1990s, it was not this technology but the internet that came to dominate the market, adding thousands of new platforms and users in subsequent years.

The report concludes that the new single market legislation required 'simplification' and that the risk of conflict between national and EU law must be addressed (European Commission 1994: 14). The need to avoid inconsistencies between union law and national law was seen as especially important in the case of environmental legislation. The paper also acknowledges that research efforts must be better coordinated, albeit in very cautious terms.

Thus, as early as 1994, EU leadership was aware of the problems that have since grown in importance. Since then, competitiveness has been a recurring theme in several European reports. As early as 2010, the EU initiated its now well-established tradition of commissioning top Italian politicians to write reports on EU competitiveness, starting with a report by former Italian commissioner, Mario Monti (2010). This tradition was continued in 2024, when two former Italian prime ministers were commissioned to write reports: Enrico Letta's report on the future of the single market (Letta 2024) and Mario Draghi's (Draghi 2024) report on Europe's competitiveness, which forms the primary basis of this report.

It is an interesting fact that, over time, the reports on competitiveness have gradually increased in size. The 1994 white paper was only 21 pages, the Monti report was 46 pages, the Letta report was 147 pages, and the Draghi report's in-depth version was 328 pages long. The political will to address the whole complexity of the competitiveness problem, appear to have grown as the issue becomes increasingly apparent.

b) Competitiveness in a geopolitically aware market economy

An obvious shortcoming visible in Draghi's report is that he makes no attempt to define competitiveness; instead, it uses a wide range of buzzwords whose content is partly contradictory: 'skills', 'knowledge', 'security', 'industrial policy', 'sustainable growth', and 'market'. This reflects a political weakness because competitiveness can mean different things in different regions. It also has to do with a deeper ideological contradiction between, on the one hand, a northern European perspective – which emphasises microeconomic factors such as productivity and business conditions – and, on the other hand, a macroeconomic or geopolitical approach, perhaps most associated with France, which emphasises global great power competition.

In this report, I aim to begin with a problem description that encompasses both perspectives. Geopolitics plays a central role in Draghi's analysis of what constitutes the EU's problems, but so does a market-liberal analysis of the internal market's weaknesses and lack of productivity. Including a geopolitical perspective should not automatically lead us to abandon market-liberal lessons about what contributes to a productive and innovative economy in the long run, as there is much to suggest that these lessons also play a central role in determining the competitiveness of states at the macro level.

In a broad review of research on the strategic competition of great powers, the American think tank, RAND Corporation, points to five factors as particularly crucial in determining the national strength and competitiveness of countries: overall economic productivity, ability to dominate in cutting-edge technologies, ability to mobilise capital, quality of national institutions (including the rule of law and corruption), and military resources and capabilities (Mazarr et al. 2022: 13). Economic productivity thus plays a major role in geopolitical great power competition.

At the same time, geopolitical analysis is also relevant from a market-liberal perspective, as the politically motivated measures that states are currently taking to assert themselves in global great power competition may lead to market failures and hamper free market competition. In the worst case, these measures can create significant costs for European businesses. Sometimes, that is the very purpose (see more under the sections on green transition and economic security).

The growing importance of geopolitics is something that defenders of the free market must consider if they are interested in establishing a competitive European economy. Even though policy proposals that aim to disrupt markets and stifle economic development in other countries can be advantageous for a nation from a geopolitical perspective, they could be economically counterproductive. In plain language, then, there is both a conflict of objectives and an overlap between economic competitiveness and geopolitical competition.

The challenge for today's market-liberal Europeans is to pursue policies that strengthen internal drivers of competitiveness in the long term while countering the destructive geopolitical forces that undermine it. In this report, I make an attempt at such an analysis based on a definition of competitiveness that be summarized by the following three fundamental questions:

1. How can the EU boost its long-term productivity growth?
2. How can the EU enhance its attractiveness in the global competition to localise factors of production (capital, talent, and technology)?
3. How can the EU address and respond to costs borne by businesses and citizens arising from the geopolitically motivated actions of other states – e.g., tariffs, non-monetary barriers to trade, and economic warfare – that distort competition in a free market?

This report will not give an exhaustive answer to all these questions, but rather guide the focus when looking into Draghi's analysis and the proposed reforms. I will start by presenting a brief review of the economic and geopolitical theory that forms the starting point for my analysis.

c) Competitiveness in economic theory

'Competitiveness' can imply several different things depending on one's perspective on the forces that shape an innovative economy. However, as the questions above suggest, most economists agree that productivity is an important ingredient. The following aphorism by economist Paul Krugman (1994a) is apt: 'Productivity is not the only thing – but in the long run it is almost everything'. When a country's domestic productivity grows, it can get more out of the same resources, and as a consequence, it becomes more competitive in an international market.

Productivity, which contributes to investment attractiveness, is in turn influenced by a range of factors. The classical liberal economist Horst Siebert – a long-standing member of the German Economic Council[5] and economic advisor to both Romano Prodi and José Manuel Barosso – argues that countries compete geographically for factors of production: capital, technology, and talent (human capital). In the German academic tradition, this is called *Standortswettbewerb* (locational competition).

Accordingly, the ability to attract capital, technology, and talent depends largely on the choices made by countries themselves, which affect their relative attractiveness, depending on the availability of public goods (e.g. research environment and infrastructure), the tax burden, labour conditions, business climate, and institutional framework. There is often a trade-off between these factors: a country needs to balance the value of a particular public good – such as a new airport or railway link – while keeping the tax burden at a reasonable level (Siebert 2005).

While some economists consider this kind of competition a plus-sum game, in practice, it often becomes a competition for capital, technology, and talent among countries at similar levels of development. Sweden and Brazil do not, for obvious reasons, compete for the localisation of production factors in the cultivation of exotic fruit. But, under certain conditions, Germany or China, for example, may compete for production factors in the electric car industry (Prestowitz 2000).

Krugman was previously very critical of politicians' focus on state competitiveness in global markets. In his article 'Competitiveness: A Dangerous Obsession' in *Foreign Policy*, published in 1994 – the same year the EC white paper was published – he expressed scepticism about

5 Council of Experts on Macroeconomic Development (SVR).

the concept of competitiveness in relation to states because it encourages the adoption of a mercantilist logic and a view of the international economy as a zero-sum game. What applies to individual companies does not apply to states, he concluded. In addition, states lack the well-defined outer limit that for any company is the ultimate measure of its performance: bankruptcy (Krugman 1994b: 34).

More recently, however, Krugman seems to have had a change of heart, reflecting a shift in the way countries view the factors that determine their competitiveness.[6] Indeed, if twenty years ago the discussion had been almost exclusively about productivity and growth, today, it is at least as much about how states should deal with negative externalities in the form of geopolitical competition (economic security) and climate change (e.g. the cost of carbon), which is well described in Håkansson's (2024) review of the von der Leyen Commission.

Therefore, it is necessary to provide a brief overview of why geopolitical perspectives are also relevant when discussing the competitiveness of countries and the EU.

d) Geopolitical perspectives on competitiveness

The role of geopolitics in the competitiveness of states cannot be explained by economic theory. Hence, we turn to political science. The reason is that the economic relationship between states is not only influenced by economic factors, but also by their political objectives. For example, Siebert (2005) notes in his analysis that market-oriented, economic locational competition is rendered ineffective by the political actions of states.

According to the realist school, this relationship is characterised by a zero-sum game (Guizzini 2013). The state, its territory, and its exercise of power cannot grow indefinitely without encroaching on another state. This does not mean that peaceful coexistence is impossible – for example, in multilateral frameworks such as the United Nations or the World Trade Organization – but rather that state power is often the lowest common denominator in international relations. The realist school's perspective has gained significant ground recently, particularly in light of China's economic foreign policy, as well as in the context of the new US foreign

6 'Paul Krugman talks trade, industrial policy, and Trump [podcast]', *Trade Talks*, 16 March 2025 (https://ie.radio.net/podcast/trade-talks).

policy under President Donald Trump. These two countries are increasingly challenging the rules of multilateral institutions to protect their own (great) power interests.

In political science, this is sometimes referred to as 'strategic competition', which includes the use of all dimensions of statecraft: military, diplomatic, cultural, and economic means. Strategic competition ranges from 'cooperation' to 'total war' and includes means of power such as espionage, economic competition, intellectual property theft, cyber warfare, trade sanctions, legal activism, military positioning, diplomatic and military blackmail, intimidation, and alliance building.[7] The RAND Corporation's analysis of great power competition further lists seven areas in which states compete with each other: relative power (economic and military), domestic security, status and prestige, resources, territorial claims, values and ideology, and ability to shape the character of the international system and paradigm (norms, values, rules, and institutions) (Mazarr et al. 2022: 6).

The EU has successfully managed to contain the strategic competition between its member states in several of these areas within an institutional framework and for higher political purposes: peace, the rule of law, and a common market. However, there could be circumstances where such containment of competition is not possible. For example, the competition between the US liberal-capitalist model and the communist Soviet Union centred on ideology. This competition was judged by US strategists to be unbridgeable because the ideological claims of the two states were incompatible. For instance, a key geopolitical strategy document, US National Security Council Document 68 (1950: IV 2), states: 'What is new, what makes the continuing crisis, is the polarization of power which now inescapably confronts the slave society with the free' (Federation of American Scientists 1950: 8).

Recent developments have confirmed the relevance of the geopolitical perspective in the study of markets and international economics. From a regime in the 1980s and 1990s characterised by a convergence of the geopolitical interests of states and a classically liberal view of international economics and globalisation, we are now instead experiencing what political scientists refer to as a 'fizzy bifurcation' (Balfour 2024: 97) between geopolitics and globalisation. A classic example of a market-liberal idea

7 'What is 'strategic competition' and are we still in it?' *The SAIS Review of International Affairs*, 2 February 2024 (https://saisreview.sais.jhu.edu/what-is-strategic-competition-and-are-we-still-in-it/).

of economic development coinciding with geopolitics is what was commonly referred to as the Washington Consensus in the 1980s and 1990s, which was a set of policy recommendations applied primarily to Latin American countries and advocated by the World Bank, the International Monetary Fund, and the US Treasury Department as measures for crisis-ridden countries. Recommendations included tax reform, trade liberalisation, and openness to foreign direct investment.[8]

In contrast, we are now witnessing the collapse of the liberal multilateral order and the emergence of new chasms between geopolitics and economic globalisation. One could argue that there is a similar ideological rivalry between China and the free world (the US and its European allies) as existed between the US and the Soviet Union. Worse, China is a tougher economic rival today than the Soviet Union was in its final decades. Moreover, following China's adaptation to a capitalist logic while retaining its state control apparatus, Europe's economic exchanges with China are significantly larger. It is a major economic player and trading partner of the EU. A total decoupling from China would likely be very economically costly for the EU, as Draghi also notes in his report. Much of the trade between the EU and China is mutually beneficial and an important component of the EU's open economic model.

At the same time, China exploits the weaknesses of economic rivals through espionage, intellectual property theft.[9] China's use of force not only destroys free competition for localisation between players in an international market but also poses a direct threat to our prosperity and freedom.

Externally, China maintains a façade of operating within the rules-based institutional norms established in the West since the post-war period. For example, China's Foreign Minister Wang Yi writes in the propaganda journal *Foreign Affairs Journal* (2024: 10):

> We will actively engage in economic diplomacy, facilitate inbound and outbound travels, and foster a first-rate business environment that is market-oriented, law-based and internationalized for foreign investment and trade.

8 'What is the "Washington consensus"?' *Peterson Institute for International Economics*, 8 September 2021 (https://www.piie.com/blogs/realtime-economic-issues-watch/what-washington-consensus)

9 How China's Political System Discourages Innovation and Encourages IP Theft, *The SAIS Review of International Affairs*, 31 July 2023 (https://saisreview.sais.jhu.edu/how-chinas-political-system-discourages-innovation-and-encourages-ip-theft/)

Under the surface, however, China is working to change the international framework by introducing new rules that could potentially strengthen the Communist Party's control and are tailored to an authoritarian view of society at odds with the historical values of the multilateral system. This applies to the UN system and the WTO as well as bilateral relations (Council on Foreign Relations 2020).

There are many indications that the ongoing technological race has further strengthened the ability of states to militarise economic relations in the form of investment, technology, and communication – precisely the type of production factors that states, in Siebert's (2005) words, compete for in a market. The ongoing technological globalisation, in the form of global mobile communications, connected devices (cars and household appliances), and digital networks, has opened up opportunities for states to exploit the same for military or semi-military purposes against other states.

If, in the twentieth century, an exported car was merely a piece of dead metal whose political utility was limited to a form of passive soft power – as a BMW is a symbol of German quality – today, a self-driving and connected car can be a weapon (mobile control), a spy (eavesdropping), and a means of blackmail (shutdown and cyber hacking of software). This is particularly applicable to China, which regularly uses business interests to further the state's and the Communist Party's strategic political objectives, not just to gain access to strategically important infrastructure and technology, but also to use economic coercion against companies and states into not criticising China's authoritarian and expansionist foreign policy. The past years we have witnessed several such cases: China's use of rare earth minerals to blackmail Japan over a fishing dispute in 2010[10], or the blocking of imports from Australia and Canada due to claimed sanitary reasons (European Parliament, 2024: 12).

It is in the light of these changed circumstances that one should consider why EU laws, policies, and regulations in recent years have increasingly taken into account geopolitical perspectives on economic development. For example, the concept of 'strategic autonomy' – which was previously mostly used in a few French security policy circles – has now become a fully fledged concept in the EU's policymaking machinery, spanning areas such as the economy, health, and technology.

10 "How Japan solved its rare earth minerals dependency issue", *World Economic Forum*, 13 October 2023 (https://www.weforum.org/stories/2023/10/japan-rare-earth-minerals/)

Unfortunately, it is the rule rather than the exception that politicians conclude from such an analysis that protectionism is the best way to protect competitiveness. Concepts such as strategic autonomy have therefore not only raised awareness of geopolitical risks, but also provided a political opening in the EU for interests that broadly favour neo-mercantilism (Schmitz and Seidl 2022). We see this in part in the EU's economic security strategy as well as in Chinese and US policies. In the US, it was precisely the strategic competition with China in three areas – (1) economic strength and innovation, (2) alliances, and (3) American values – that motivated a surge of economic nationalism, not least the original $2 trillion American Jobs Plan to subsidise US industry with government aid (Winkler 2023).

In some countries, such as France, there is a long tradition of giving 'strategic interests' a very high profile, to the extent that state intervention can be justified in almost any sector. We saw this back in 2005 when rumours that Pepsi was considering a bid for French dairy company Danone prompted Prime Minister Dominique de Villepin to call for a mobilisation in the 'interests of France'. It prompted Brussels officials to joke about 'strategic yoghurt' and illustrates what happens when geopolitical arguments are taken out of context and given free rein.[11]

Thus, when analysing EU competitiveness, we need to evaluate both economic and geopolitical perspectives on the functioning of international markets, taking care not to be drawn into protectionism.

11 'The revenge of strategic yogurt', *The Economist*, 3 October 2020 (https://www.economist.com/europe/2020/10/03/the-revenge-of-strategic-yogurt).

A summary of the Draghi report

a) The root of evil: Laziness or laptops?

As in economic theory, productivity plays a crucial role in Draghi's analysis of Europe's problems. Both the report and the subsequent debate argue that the EU has lagged behind the US in productivity growth. What was claimed to be on the way in the 1994 Delors report has now become a fait accompli, according to Draghi. Unfortunately, the political debate has greatly exaggerated the magnitude of the lag.

First, the productivity gap per hour worked between the US and the EU did not emerge in the last decade, but between 2000 and 2009. Indeed, as the economist Harry Flam shows in his review after 2009, the growth in GDP per hour worked – adjusted for differences in inflation rates, price levels, and exchange rate changes – was effectively the same: 18 per cent in the US and 15 per cent in the EU (Flam 2024). Thus, over the past fifteen years, no significant gap in productivity growth has emerged between the US and the EU. On the contrary, if we look at the economy as a whole, the EU has kept pace with the US (Flam 2024).

Second, the difference in GDP between the EU and the US has been greatly exaggerated in the political debate following the release of the Draghi report. Although Americans are still richer than Europeans (measured in GDP per capita), the figures have been misinterpreted. For example, Erik Magnusson writes in Swedish regional daily *Sydsvenskan* that 'Twenty years ago, the US economy was 17 per cent larger than that of the EU

countries. Last year it was 30 per cent larger'.[12] This is a correct statement in nominal terms – measured in dollars – but it says very little about the actual economic standard of the American economy compared to the European economy because a large part of the difference can be explained by changes in exchange rates.

In 2000, the EU economy was about one-third smaller than the US economy in nominal terms, as it is today. Then, from 2000 to 2008, the EU economy grew strongly relative to the US, so the gap was almost cancelled out, which intuitively runs counter to the relative productivity deterioration that occurred over the same period. However, the gap then widened again until 2022, to the point where it now represents around 30 per cent of the GDP. Exchange rates explain a large part of this historical trend, which could otherwise be wrongly interpreted as a European economic miracle (2000–08) followed by a disaster (2008–22). In 2000, €1 was worth $0.92. By 2008, this had risen sharply to $1.47, boosting the EU GDP in dollar terms. However, this rise was temporary, as by 2022 the euro was only worth $1.05. A strong dollar is thus a major reason for the widening of the GDP gap in nominal terms between the US and the EU.

The relevant measure that compensates for these fluctuations – that is, GDP adjusted for inflation rates, price levels, and exchange rate changes (purchasing power parity or PPP) – presents a radically different picture. The EU economy has gone from being slightly larger than the US economy in 2002 to being around 12 per cent smaller in 2022. Though this is a difference worth taking seriously, it is markedly smaller than the one-third being emphasised in the political debate.

If we incorporate a comparison with GDP per capita (PPP), the picture changes further. The EU has then slightly increased from a GDP per capita equivalent to 67 per cent of that of the US in 1995 to 72 per cent in 2022. The difference becomes even smaller if we compensate for the fact that Europeans work fewer hours and have more days off than Americans. The EU has then gone from about 73 per cent to 82 per cent of the US GDP (PPP) per hour worked over the years 1994 to 2024. Europeans have thus become more productive compared to Americans if we examine

12 'Hur i hela friden ska det gå för oss i Europa?', *Sydsvenskan,* 22 januari 2025 (https://www.sydsvenskan.se/2025-01-22/hur-i-hela-friden-ska-det-ga-for-oss-i-europa/)

the entire period from 1994 to 2024.[13] In some of the more productive countries, such as Germany, this figure is just over 100 per cent of US productivity. Of course, the fact that Europeans work fewer hours overall than Americans can still be seen as part of the EU's competitiveness problem, regardless of productivity per hour worked.

However, the difference observed by Flam in the superior productivity growth of the US between 2000 and 2009 at constant prices (US$) is worth taking seriously, and it is also the one that Draghi focuses on when developing his analysis of Europe's productivity problem. This difference can be almost entirely explained by the fact that during this period, a productive IT industry developed in the US. In fact, the gap in productivity growth between the US and the EU is almost entirely explained by this industry as well as its effects on the productivity of the US finance sector. In other industries, EU productivity is comparable to that of the US.

The EU thus has a limited but serious problem of lower productivity growth in the innovative domains of the economy, which is almost exclusively explained by the lack of an 'American-style' IT industry. As our population is expected to decline, compensatory productivity growth is necessary in this sector for generating growth in the long term (Draghi, 2024: 5). In the long run, the EU's social model, which is ultimately based on a continued innovative and productive economy, is therefore jeopardised without increasing competitiveness..

b) Why the geopolitical turnaround is hitting the EU harder

Draghi also states that increased geopolitical uncertainty makes competitiveness problems worse for the EU than for other countries. First, the EU has benefitted more than the US from the global free trade boom the world experienced between 2000 and 2019. Despite its economic size, the US economy relies less on foreign trade than the EU for its prosperity, which in times of turmoil has reduced the cost of economic security for US companies (Draghi, 2024: 5). However, it has made the EU more vulnerable to the huge increase in trade barriers seen between 2010 and 2022 (European Commission 2023).

13 'The European Union's remarkable growth performance relative to the United States', *Bruegel*, 26 October 2023 (https://www.bruegel.org/analysis/european-unions-remarkable-growth-performance-relative-united-states).

Second, what has historically been a key competency for growth – a stable and cheap energy supply – has disappeared with the Russian invasion of Ukraine. Europe's industrial model, which comprised a strong export industry, relied on cheaply available Russian gas for a long time despite the major geopolitical risks associated with such heavy dependence on a single country. In contrast, the US has been able to meet its own energy needs thanks to considerable domestic production of oil and gas – something Europe does not have, except for Norway.

In addition, further geopolitical weaknesses have emerged, notably, the dependence on, for example, Chinese minerals for the production of technologies that are crucial for the development of green industries and digitalisation.

In the following sections, I provide a more detailed analysis of the EU's competitiveness problems, which largely follows the analysis of the Draghi report as well as, to some extent, that of the Letta report. The analysis of the problem is carried out in terms of four main areas, which are also central to the Draghi report: the innovation gap, the green transition, economic security, and capital markets. However, I have chosen to place particular emphasis on the first area, the innovation gap, which is the area most clearly linked to a market-liberal perspective on the EU's faltering competitiveness.

Analysing the EU's lack of competitiveness

a) The innovation gap

In the past fifty years, no EU company has reached a market capitalisation of more than €100 billion, while all six US companies that have reached such market capitalisation were launched during this period. The absence of innovative firms is particularly noticeable in the EU's IT sector, which explains almost the entire difference in productivity growth between the US and the EU.[14] The tech sector now accounts for such a large share of economic growth that its shortcomings affect the entire EU economy, not least the finance sector and the financing of future technologies. For example, of the world's leading quantum computing companies, five are from the US, four from China, and zero from Europe.

The situation the EU finds itself in has therefore been described as a 'technology trap'.[15] While we have excellent companies in technologies that are still widely used and which we sell to other countries, we are weak in the new, breakthrough technologies where much of the future growth potential lies.

The main reasons behind this lie in three factors: the fragmented innovation system, the lack of high-quality market harmonisation and an archaic competition law.

14 Productivity growth is slightly lower in western European countries than if the new post-communist countries of eastern Europe are included. However, the difference is only 0.27 per cent.

15 'Europe in the technology trap', *Frankfurter Allgemeine Zeitung*, 18 May 2024 (https://www.faz.net/aktuell/wirtschaft/mehr-wirtschaft/hochtechnologie-wie-die-eu-von-den-usa-lernen-kann-19701446.html).

i) Fragmented and bureaucratic innovation system

Draghi outlines several reasons for the stagnation of the European innovative economy. The lack of investment in the most innovative sectors has created a vicious circle where the absence of innovation leads to even less investment. European companies spend half of what the US spends on research and innovation as a share of GDP (€270 billion), driven mainly by investment in the tech sector in software, databases, and intellectual property (Draghi 2024). However, the share of public expenditure on R&D (0.74 per cent of GDP) in the EU (including the member states) is higher than that of the US (0.65 per cent of GDP) (Draghi, 2024: 29). The US performs better due to strong private capital mobilisation for R&D.

Steering companies' investment decisions through the government to spend more on research is not a desirable path and a very questionable policy from a market-liberal perspective, but much can be done indirectly to encourage companies to move in this direction, for instance, through regulatory simplification and capital markets. However, the lowest-hanging fruit politically is reforming the systems where the US and the EU are comparable but where the EU performs worse: namely, publicly funded research.

Firstly, the EU has fragmented and nationalised funding for research and innovation. This is a problem because innovation in new technologies such as AI and quantum computing not only requires a high concentration of capital but also good connections between universities and investors. Both the US and China can achieve this, as they have large-scale innovation clusters linking universities with capital-intensive companies. However, this is extremely difficult for the relatively smaller European states and companies that want to enter the race. According to Draghi, European universities are much less integrated into such large-scale clusters – networks of universities, start-ups, and venture capitalists – which has a particularly negative impact on high-tech sectors that rely more heavily on such networks for innovation. This is evident from the fact that only one-third of the patents registered at European universities are commercialised (Draghi 2024: 29).

None of the world's ten largest large-scale innovation clusters is located in the EU, while four are in the US and three in China (Draghi 2024: 29). Two examples of such clusters are Shenzhen–Hong Kong–Guangzhou (China) and the Silicon Valley cluster in San Jose–San Francisco (US). While the EU has a major research programme, Horizon, with a budget

of €100 billion, Draghi notes that Horizon's resources are spread across too many different research programmes and are too bureaucratic to have any meaningful commercial impact on innovative technologies. Moreover, only one-tenth of public research money is spent at the EU level, with nine-tenths spread across 27 different national research administrations. This, in turn, discourages the emergence of large-scale innovation clusters. The main EU institution with the primary task of funding cutting-edge research, the European Innovation Council (EIC), has a budget of €256 million, compared to its US counterpart Defense Advanced Research Projects Agency (DARPA) and its non-defence sister organisations, which have a combined budget of just over $6 billion: 23 times more. Thus, although the EU has a large-scale publicly funded research programme, the funds are not spent on the things that drive innovation.

DARPA was founded in 1958 to address what was perceived as Soviet superiority in advanced missile technology. Over time, however, the organisation's focus has broadened to include other cutting-edge technologies, but the focus remains on technologies of interest to national security. The organisation has played a key role in some innovations that most of us are familiar with – for instance, technologies that originally had military purposes and were then further developed by private industry: the internet, virtual reality, jet engines, CCTV, GPS, rockets, remote control, microwaves, radar, networked computers, wireless communications, and satellite surveillance (Chin 2019: 770). Such technological innovations were responsible for the American IT miracle.

The US has thus succeeded in building an industry-oriented research system in which, comparative to Europe, the slightly smaller public resources for research are concentrated on cutting-edge technologies of interest to national security and where there is as yet no market interest.

From a European perspective, DARPA's governance model is particularly interesting as it differs from the European one in several respects. While programme managers in frontier research at the EU level are usually EU officials, in DARPA, they are instead innovation experts from industry and academia. They manage programmes on three-year assignments in a model called 'active programme management'. The model is cited as a success story by Draghi but has also been praised by economist Dani Rodrik, who has noted that the more business-oriented nature of the model is part of its great success (Rodrik et al. 2023). The model has also

previously been highlighted as a pioneering example in European political debate, for example, in a debate book by France's then–finance minister Bruno Le Maire.[16]

Draghi also takes stock of the EU's place in the world of research and finds that it is lagging. Most worryingly, China has now overtaken both the EU and the US in high-impact papers, that is, research with groundbreaking results. In 2024*, The Economist* reported on the Chinese lead in cutting-edge research.[17] China is now a world leader in fields such as materials science, chemistry, engineering, and computer science, which are crucial for innovation and new advances in digital technology, AI, and quantum computing.

However, all is not doom and gloom in Europe's research landscape. The EU still has a very high-quality education and research system, not least high-quality basic research and high-standard universities. The problem is that we lack world-leading institutions that conduct cutting-edge research.[18] Of the world's top 50 research institutions, 21 are in the US, 15 in China, and only 3 in Europe. China's situation is the reverse: it excels in cutting-edge research, but its universities outside the major innovation clusters are still of substandard quality, which is a result of concentrating large amounts of capital and research resources in a few institutions.

ii) Over-regulation, poor regulation, and false harmonisation

The second major problem identified by Draghi is the growing regulatory apparatus and bureaucratisation of the single market. In 2019–24, the EU adopted 13,000 new laws. In the same period, the US adopted 3,500 legislative acts and 2,000 resolutions. There has also been a large increase in policy documents, which are sometimes difficult to interpret within a legal framework. Over-regulation is ubiquitous, but this is perhaps most detrimental for the tech sector, where regulations prevent new innovative companies from emerging and wanting to stay in Europe. In recent years, the EU has adopted 100 laws for the tech sector and 270 regulations for digital networks.

16 Le Maire, 2019.

17 'China has become a scientific superpower', *The Economist*, 12 June 2024 (https://www.economist.com/science-and-technology/2024/06/12/china-has-become-a-scientific-superpower).

18 There are some exceptions, such as the CERN, which is the world's largest particle physics laboratory outside Geneva, Switzerland, created thanks to co-operation between European states.

Draghi cites the example of EU regulations on data collection, which effectively prevent infrastructure for AI from emerging (Draghi, 2024: 30). Training of AI models in the EU is made so difficult that companies choose to conduct the training abroad. Either new companies do not emerge or move when they want to expand. In short, over-regulation has become an obstacle for the EU in the localisation competition.

Apart from the fact that the number of new laws and regulations stands out in an international comparison with the US, the Draghi report presents some evidence suggesting that EU regulations are of substandard quality. Draghi bases this, among other things, on an analysis by the European trade association Business Europe, which examined 13 EU laws and found differences in requirements in 29 per cent of cases. One-tenth of the rules in the laws also had outright contradictions (Draghi 2024: 29).

Letta also addresses this issue in his report, concluding that the problem lies in the EU's unique legislative process. Because the EU institutions' legislative process is based on a search for compromise between three institutions – the so-called trilogue between the parliament, the commission, and the council of ministers – under time pressure, the result is often legislation that reflects the balance of power between the sometimes divergent interests of these institutions, rather than the purpose of the law itself. Such legislation lacks coherence and comprehensibility, creating difficulties for businesses that want to comply with the law, ultimately undermining the single market.

However, it is a little too easy to blame the legislative process alone. There is much to suggest that the legislative proposals that the EC puts on the table of the European parliament and the council is also lacking in quality. The EC's impact assessments of new legislation do not adequately analyse the social costs. For example, it uses a very narrow model when calculating the cost of implementing new laws. This model originates from the German authority Normenkontrollrat and is based on a conservative calculation of how long it takes a person to read through new legislation. This is the model that led the EC to conclude that it only takes three minutes for a company to understand the requirements of the AI Regulation and that the total cost of implementing the AI Regulation was only in the range of €100–€500 million (European Commission 2021). Apart from the fact that the figure of three minutes is in itself a very optimistic estimate, this model also does not take into account the dynamic costs of the AI Act, such as reduced innovation and investment. These factors would likely have made

the actual cost significantly higher (Bauer et al. 2023). Thus, if the EC had taken these costs into account in its internal drafting processes, the legislative proposals could have been of better quality.

Yet other studies show that labour law rules create high costs for European companies. For example, in the policy brief 'Cost of failure and competitiveness in disruptive innovation' researchers Yann Coatenlem and Olivier Coste at Bocconi University in Milan have calculated that the cost of restructuring is ten times higher in western Europe than in the US, not least because of the nature of labour law. This hurts the innovation landscape, as the higher cost of business failure for breakthrough technologies makes European companies more cautious than their US counterparts. This is reflected, for example, in the fact that the leading European investors in the tech sector – Ericsson, Nokia, and SAP – are more likely to invest in improvements to products already in use, rather than in breakthrough technologies, in contrast to US such as Google, Nvidia, or OpenAI (Coatanlem and Coste 2024: 22).

Letta also describes EU legislation as characterised by something we can call false harmonisation. This is characterised by EU legislation that is motivated by the aim of creating a common regulatory framework at the Union level, but which sows the seeds of national divergences through exemptions, minimum requirements, and openings for what is known as 'gold-plating' –(Letta, 2024: 125) that is, opportunities for member states to go further than what the legislation proposes. Thus, even though politically there appear to be a set of common rules, in reality there is national fragmentation, which is sometimes even reinforced by the very rules that are meant to lead to harmonisation. The General Data Protection Regulation (GDPR) is a good example of such legislation, whose original aim of a common European model has in fact resulted in partly different national regulations. In some member states, like Sweden, gold-plating has become a structural problem. The Board of Swedish Industry and Commerce for Better Regulation (NNR) has published a long list of EU laws that are subject to gold-plating. (Fors 2024).

There are also a number of areas in the single market where the EU simply lacks harmonised law. To illustrate, European company law differs across European countries. By way of comparison, the US has a universal company law, the Uniform Commercial Code (UCC), enforced as early as 1952, which has since been adopted by all its states, with the exception of Louisiana. Work on the UCC began in 1945, and it was one of the

largest codification projects in American legal history, run by two private legal organisations. Consequently, the UCC itself was only a recommendation, which has since been adopted by almost every state through legislation.

The UCC serves as an interesting example of how private actors can contribute to the harmonisation of actual legislation. In the EU, by contrast, national company law forms a patchwork quilt, which means that the harmonisation of the internal market cannot be compared to that of the US. In a comparison with the US, harmonising company law on the EU level therefore appears as a fundamental key stone for completing the single market. The fact that the US did this through a couple of private legal firms also show the potential for a similar private law harmonisation on the European level. Harmonisation of company law can also be seen as a natural continuation of the legal harmonisation that took place in the twentieth century within European states in the field of civil law, for example in Scandinavia. In his report, Letta supports the view that a common European company law framework is necessary, which is also reinforced by the opinion of European entrepreneurs. In a 2024 market survey conducted by Eurochambres – a European umbrella organisation of European chambers of commerce – 68 per cent of respondents cited differences in contract law or legal practices in the single market as a 'significant' barrier to trade (Letta 2024: 108). Letta further argues that these barriers hit SMEs hardest, as they lack the legal and technical expertise of large companies to deal with national differences in company law (Letta 2024: 108). He sees the solution in creating a fully harmonised European company law through a so-called '28th regime', that is, a set of rules that companies can choose as an alternative to the internal market's patchwork of different national regulations (see more on this in the section on policy proposals).

In conclusion, the fragmentation of rules has implications for the business landscape. The International Monetary Fund has shown that internal trade barriers within the EU are equivalent to a 45 per cent tariff on goods and a 110 per cent tariff on services.[19] By comparison, the tariffs imposed by the US in 2025 on steel and aluminium imports are 25 per cent. The trade barriers between EU countries are thus significantly higher than the external tariffs imposed on the EU.

19 'Forget the US - Europe has successfully put tariffs on itself', *Financial Times*, 14 February 2025 (https://www.ft.com/content/13a830ce-071a-477f-864c-e499ce9e6065).

(iii) An archaic competition law

The third major issue to tackle within the EU's innovation problem is the outdated competition law. Current EU competition law takes the EU as the given market where competition should be maintained. In this way, the legislation ensures that large companies, or cartels, do not exploit a dominant position. These are all reasonable principles in a well-functioning market, of course, and have enabled the EC to prevent mergers of companies that would have undermined competition in a European market, resulting in higher consumer prices.

In some cases, however, Draghi argues that the EC has used a narrow, national context when assessing competition (Draghi 2024: 35). This is the case in the telecoms market, which has locked the EU into a fragmented patchwork of 34 mobile network operators, often in structures where formerly state-owned companies have cemented a leading position. This is because competition within each national market, rather than in the EU as a whole, is seen as desirable. The result is inefficient corporate structures that make it impossible to mobilise the necessary private resources, which Draghi says have had a negative impact on European investment in 5G networks (Draghi 2024: 31).

This relates to the concern of the Austrian economist Joseph Schumpeter that too much competition would reduce the opportunities for companies to make a profit and thus finance R&D.[20] This is partly confirmed by empirical studies, provided that companies are in fact exposed to a preventive threat of creative destruction (Nicholas 2003: 1054-55). A prerequisite for maintaining such a 'preventive threat' (Nicholas 2003: 1054-55) is, in turn, a functioning market with low thresholds where states or the EU do not design regulations to favour individual companies.

In addition, competition has changed. Whereas competition used to be intra-European, today, in many sectors, European companies compete against much larger American or Chinese rivals. However, because current competition law keeps European companies artificially fragmented, based on intra-European competition, it reduces their ability to compete in an international market and delays innovative investment in the technologies of the future. In several sectors, this international competition is also

20 Creative destruction was understood by Schumpeter as the organic and dynamic process of innovation in manufacturing, in which new technologies replace old ones and leads to increased productivity.

characterised by geopolitical objectives and strategic competition, as discussed further in the following section.

b) Green transition and the energy issue

According to Draghi, competitiveness is strongly linked to the green transition, which involves both climate and energy issues. Half of the European companies surveyed see high energy prices – which are 30 per cent higher than in the US – as a barrier to investment (Draghi 2024: 39). Assuming that this reflects reality, the cost of energy will thus be a clear advantage for the US in the localisation competition for energy-intensive industries that is now taking place.

To understand the importance of energy for European competitiveness, it may be useful to place it in its historical context. The crux of the issue is that since the emergence of the oil-dependent industrial society, Europe has relied heavily on cheap energy from other continents as it is a relatively energy-poor continent. However, Scandinavia is an exception as it produces a large amount of hydropower, which has historically made it less dependent on oil for electricity generation, even before the development of nuclear power.

In the first half of the twentieth century, Europe's access to cheap energy was facilitated by imperialism. Europe's imports of the Middle East's vast oil deposits were secured by Britain's military control of the Arabian Peninsula, mandated by the League of Nations. This energy geopolitics often pitted European states against each other. For example, in the 1920 San Remo Conference agreement, the French Compagnie Française de Petroles took over 25 per cent of the shares of the Turkish Petroleum Company (which had a monopoly on Iraq's oil deposits) from Deutsche Bank in exchange for France recognising Mosul as part of the British protectorate.

After the rationing of World War II, this policy was continued, but by a united western European front through its ally, the US. As part of the so-called Carter Doctrine, Europe's oil imports were secured through the patrolling of the Persian Gulf by the US Navy. This was a type of political and military domination policy that mainly favoured the US's ally, Europe, not the US itself. The US had already started to exploit its own domestic resources. We see the continuation of this policy in the close cooperation between western countries and the Persian Gulf countries of Saudi Arabia, the United Arab Emirates, and Kuwait.

In the 2000s, the US further expanded its domestic oil and gas production to the point where it is now self-sufficient. The EU, on the other hand, met this need by importing mainly natural gas from Russia. This came to an abrupt end with the full-scale invasion of Ukraine in 2022, and the EU is looking for other sources in order to avoid energy blackmail from Russia. Unfortunately, it has not fully succeeded in this task. This is a major reason why electricity prices are about two to three times higher in Europe than in the US, and natural gas prices are about four to five times higher.

In addition, the EU has further increased the cost of energy through a variety of instruments that aim to reduce carbon emissions. The EU's climate policy is the most ambitious in the world, significantly more ambitious than those of the US and China. The tools and targets are legitimate from a climate perspective but have increased the cost of energy even more from already high levels, as Draghi also notes (Draghi 2024: 39).

This is particularly true for energy-intensive industries. The cost for European companies in the four most energy-dependent sectors – chemicals, metals, minerals, and paper – is expected to increase by €500 billion as a result of the EU's climate policies. By comparison, the European chemical industry's sales totalled just under €655 billion in 2024.[21]

The EU Emissions Trading System (ETS) has created a well-functioning market for carbon trading, but this is partly cancelled out by new instruments, such as the EU's carbon border adjustment mechanism (CBAM). In addition, the EU has high energy taxes, mainly due to high national taxation. In comparison, the US has no federal taxes on electricity or natural gas consumption.

If high taxes are seen as a 'push factor' in the localisation competition for new industries, tax subsidies and state aid can be seen as a 'pull factor'. Adding these makes the playing field even more uneven, to the EU's disadvantage. China is a world leader in providing heavy subsidies to green industries. According to Draghi, China accounts for 90 per cent of the $70 billion in global subsidies for the aluminium industry, and it also provides large subsidies for the steel industry (Draghi 2024).

The situation is similar in the electric car industry, a key sector in the green transition, where, over the years, China has been providing large state

21 The European Chemical Industry Council, 2024.

subsidies to Chinese electric car manufacturers. EU institutions point to Chinese state support as a key explanation for the increased market share of Chinese car manufacturers in Europe, with Chinese cars being around 20 per cent cheaper than European cars (Grieger 2023). This active industrial policy was already in force during the 10th Five-Year Plan (2001–05), when the EU had still been focused on internal combustion engines. However, other qualified observers have said that, although historical state subsidies have probably played a significant role in China's advantage, the current relative competitiveness in terms of price and quality is mainly due to factors other than state subsidies: China's huge economies of scale, low labour costs, well-established supply chains for technologies and raw materials, and high domestic competition between manufacturers.[22]

The EC has good reason to believe that China is violating WTO rules with its state aid. At the same time, China's market share in the European market has increased from 5 per cent in 2015 to 15 per cent in 2023. According to a study by the Confederation of Swedish Enterprise and the University of Copenhagen, US state aid in the form of the Individual Retirement Account (IRA) package has probably prompted European green companies to move production to the other side of the Atlantic (Confederation of Swedish Enterprise 2023). Engie, BASF, BMW, Solvay, Siemens, and Volkswagen are some of the major European companies that have already increased their investments in the US after the IRA package was announced in 2023.[23] It should not be forgotten that this heavily subsidises European consumers' car purchases and allows European car manufacturers to find a comparative advantage in a different price segment. But in the case of China, it is not clear that these benefits outweigh the long-term negative effects of increasing dependence on the Chinese car industry, given the security risks of a battery-powered, connected, and partly autonomous electric car fleet.

In parallel, the EU has entered the state aid race as a player but in a fragmented and uncoordinated way. Member states' state aid increased threefold between 2015 and 2021: the EC granted €733 billion in state aid between March 2022 and August 2023 alone, with Germany accounting for half of it. Not infrequently, the EU has acted reactively to match Chinese

22 'The European Commission's duties on Chinese electric vehicles are a mistake', *Bruegel*, 8 October 2024 (https://www.bruegel.org/first-glance/european-commissions-duties-chinese-electric-vehicles-are-mistake).

23 'The US's industry is picking up as Europe's struggles', *Le Monde*, 29 August 2023. (https://www.lemonde.fr/en/economy/article/2023/08/29/the-us-s-industry-is-picking-up-as-europe-s-struggles_6114155_19.html).

or US state aid, as was the case with state aid to Northvolt's German plant in 2024.

Thus, while Chinese and US state aid eliminate market-oriented competition for green industries by promoting a level playing field, EU countries are placing additional burdens on themselves by fragmenting internal competition between manufacturers with their national state aid. Moreover, the EU, a geopolitically energy-poor continent, is trying to undertake an industrial transformation and build new energy-intensive industries by phasing out its largest energy supplier to date (Russia) while simultaneously pursuing a climate and energy policy, including high energy taxation, that further increases the price of energy relative to the prices of our competitors. The EU also lacks a common energy policy, even though national decisions on energy policy have far-reaching consequences for the entire Union. For example, Germany's decision to phase out nuclear power had consequences for several countries, especially southern Sweden.

c) Economic security and free trade

The third main focus of the Draghi report is the external dimension of competitiveness, namely, its relationship with international trade and security. The fact that both issues are addressed in the same section emphasises Draghi's geopolitical perspective on trade issues. Here, we need to remind ourselves of the observations raised in the introduction and the geopolitical perspectives on the concept of competitiveness – the extent to which the EU is affected by the military, diplomatic, and economic means used by the member states to disrupt the normal functioning of international markets.

In Europe's case, there are particular vulnerabilities, as around 40 per cent of our imports come from a small number of suppliers that are difficult to replace. Moreover, half of these originate in countries that do not share Europe's strategic values. At the same time, the geopoliticisation of trade flows is driving states towards what *The Economist* calls 'friend-shoring' (The Economist 2024) – a process whereby companies and states redirect trade flows and supply chains to countries that are closer to their own strategic outlook. The obvious example here is, of course, China.

China has already been touched upon in the previous section. A comprehensive review by the US think tank Council on Foreign Relations describes a coherent Chinese strategy to influence the global world order

with its own values (CFR 2020). Under Xi Jinping's leadership, the watchwords are 'fairness and justice', and under this seemingly innocuous slogan, western multilateral institutions that guarantee free and rules-based trade are being challenged. Meanwhile, China is building its own institutions in line with Communist Party values, such as the Asian Infrastructure Investment Bank (AIIB) and the Belt and Road Initiative.

One example of how China is steering away from liberal principles in multilateral relations is its cyber sovereignty agenda. In plain language, it is pushing for standards in various multilateral fora that enable more state control of the internet and methods to intervene in the free exchange of information. A similar philosophy is being utilised by Chinese companies. Huawei and Cloudtalk are two examples of Chinese IT companies that have given repressive regimes access to facial recognition technology, for example, in Venezuela and Zimbabwe (Council on Foreign Relations 2020).

Draghi notes that neither the EU nor China has an interest in accelerating the process of total decoupling from trade with China, which would likely be very costly for both (Draghi 2024). At the same time, Draghi is right that the EU's substantial dependence on China, in particular – combined with the use of trade as a geopolitical weapon – constitutes a major uncertainty factor that affects the business environment. By extension, this is also an obstacle to the EU's competitiveness. One objection to seeking an alternative to China that there is a price to pay for replacing suppliers with new, and perhaps less efficient, ones. Draghi counters that in a situation where a geopolitical rival is exploiting economic vulnerabilities, the opportunity cost is so extreme that it is still worth 'insuring' the EU against over-dependence (Draghi 2024: 55).

Unfortunately, we have already learnt what such a Chinese policy of economic blackmail, aimed at damaging the competitiveness of European companies, could mean. In 2021, Lithuania was hit by a blockade by China, following the former's upgrading of diplomatic relations with Taiwan. This had a serious impact on the country's high-tech laser industry, which depends on trade with China (Cutler and Wester 2024). In 2020, Sweden was also hit by an unjustified ban on imports of Chinese graphite, crucial for the production of anodes for electric car batteries. China has not commented on the import ban, but it should be seen as a form of economic warfare in the context of the fact that Sweden was the only European country that was close to being able to produce its own car batteries

(through Northvolt), as the Swedish public radio broadcaster pointed out in a reportage in October 2024.[24]

The EU's dependence on China is highest for critical raw materials, and the cases of Lithuania and Sweden are examples of what could happen in this sector with economic warfare. However, other areas have also been affected. Draghi notes that Chinese export restrictions across various sectors increased ninefold between 2009 and 2020. (Draghi 2024).

China's policy of geopolitical dominance in this area is the result of a deliberate strategy. As early as 1987, during a visit to one of China's largest mines in Inner Mongolia, its then-leader Deng Xiaoping uttered these famous words, 'the Middle East may have its oil, but China has rare earths'[25]. Developing such supply chains has turned out to be a shrewd strategic priority. China's dominance in rare earth minerals is not just based on the existence of mineral deposits, which are also found in Europe (not least Sweden), but on how it has gradually built up an entire, extremely efficient value chain to process raw materials into finished products. This is precisely the infrastructure that we lack in Europe, but which Japan, in particular, has gradually built up since it was itself blackmailed by China in a similar sequence of events in 2010. The US Inflation Reduction Act has also been used to address geopolitical weakness and build domestic capacity for processing critical raw materials, including rare earths.

However, the EU lacks such a coherent value chain, although it has now adopted a strategy to create one. This is where the gap between ambition and results becomes apparent. For example, although Sweden unveiled the discovery ofone of Europe's largest deposits of rare earth elements in Kiruna at the start of the Swedish EU Presidency, large-scale production is unlikely to start until after 2030. Similarly, Northvolt was successful in selling the idea of large-scale European battery production but unsuccessful in realising it.

24 'China's secret moves in the battery war against Sweden', *Swedish Radio*, 27 September 2024 (https://www.sverigesradio.se/avsnitt/kinas-hemliga-drag-i-batterikriget-mot-sverige).

25 'China's dominance leaves US vulnerable, as critical minerals become political', *ABC*, 24 April 2025 (https://www.abc.net.au/news/2025-04-25/china-dominates-rare-earths-leaving-trump-with-dud-hand/105213972).

d) Capital markets

All the three main thematic issues that Draghi's analysis cites for Europe's lack of competitiveness – the innovation system, energy supply, and economic security – require resources to be strengthened. Therefore, financing is intimately linked to the solutions put forward. In the section on financing, Draghi notes that the investment required is between €750 and €800 billion annually, equivalent to 5 per cent of the EU's GDP. He also recognises that private capital will not be sufficient to meet that need. As a result, he calls for more joint loans, following the model used after the pandemic, to finance at least part of the investments (Draghi 2024).

However, there is good reason to question whether the bulk of the investments that Draghi mentions should be funded by increased public resources. The ECB has shown that if Europeans saved as much in the stock market as Americans, €8 trillion would be made available for investment in Europe's capital markets (Lagarde 2024). This is about ten times more than the amount Draghi says is needed, mainly from the public sector, to meet investment needs and demonstrates the potential of European private capital mobilisation, as long as we manage to change Europeans' savings behaviour and foster better-functioning European capital markets. Draghi also notes that, historically, about four-fifths of productive investment has come from the private sector, while only one-fifth has come from the public sector. Based on this historical comparison, it would make sense to focus on private capital mobilisation to finance Draghi's proposals.

In the section on innovation, Draghi notes that the EU's innovative companies in the digital sector lack venture capital. The EU has only one-fifth of the venture capital invested in the US – a significant gap. In the section on investment, he analyses these differences in more detail. Notably, savings in financial markets account for a much larger share in the US – 43 per cent of household wealth compared to 17 per cent in Europe. However, the total amount of savings is higher in the EU than in the US – €1,390 billion compared with €840 billion. Europeans are thus saving more without investing their money in companies through shares or funds, depriving European companies of billions in investment capital.

i) The Swedish success story

Part of the reason for Europeans not investing in shares or funds may lie in a difference in economic culture, with a greater appetite for risk in the

US than in Europe. But it is probably also related to the archaic design of institutions and capital markets in the EU. In this respect, Sweden is an exception, both in terms of the interest Swedish savers have in saving in funds and shares as well as in the design of the capital markets, something which Draghi draws attention to as well.

Unlike the rest of the EU, Sweden has had a capital market with considerable participation from companies, small investors, and venture capitalists for several decades. This is reflected in the fact that Sweden holds the European record for the most initial public offerings (IPOs). Over the past ten years, more than 500 companies have been floated on its stock exchange, which is more than in France, Germany, the Netherlands, and Spain combined. The unique Swedish form of broad-based, popular capitalism began in the 1980s with the so-called *Allemansfonderna* and gained further momentum during the 1990s when share ownership became even more widespread.

Over time, the model has evolved and improved, most recently with investment savings accounts (ISKs), which have made it even more attractive for broad sections of society to invest in the stock market owing to favourable taxation and virtually no administrative requirements. Draghi specifically highlights the ISK as a model for other countries to emulate.

The second part of the Swedish success story that Draghi highlights is the well-functioning pension system. While many European countries are still stuck in a pension system based solely on contributions – called 'pay as you go' – the Swedish system is based to a greater extent on funded savings: for example, the second pillar pension system, wherein 2.5 per cent of pensionable income is allocated to private fund management companies or the Seventh National Pension Fund. This has made a large amount of Swedish pension contributions available to Swedish innovative companies and contributed to an environment conducive to such companies wanting to stay in Sweden and not move abroad. However, Sweden is an exception: in the EU as a whole, pension investments account for only 32 per cent of the GDP, while they account for 142 per cent in the US and 100 per cent in the UK, which is a remarkable and extreme difference.

The fact that the EU consists of countries that are at the forefront of modern and efficient capital markets (Sweden) and those that are hopelessly behind the US (most of the continental European countries) is related to the lack of integration between the member states' capital markets. While

the US has a handful of capital trading centres, the EU has a total of 295. A similar picture emerges with regard to clearing and settlement, that is, the financial systems that handle financial payments and transactions in securities, where, unlike in the US, the rules are not harmonised. Currently, the European Securities and Markets Authority (ESMA) has a coordinating role between national authorities but without the power to create common rules across the Union. The US, by contrast, has a single authority, the US Securities and Exchange Commission, whose rule making and oversight ensure compliance with a single, common US regulatory framework.

In the wake of this fragmentation, we see European capital markets locked into national structures, with little integration between countries. Despite its great success in Sweden, the ISK remains a uniquely Swedish phenomenon that has not been replicated in other countries.

Five policy proposals to boost European competitiveness

The numerous and detailed policy proposals presented by Draghi in his report largely correspond to the four aspects discussed in the previous sections. In addition, since the presentation of the report in September 2024, a new document has been added: the EC's Competitiveness Compass, presented in January 2025 by the president of the European Commission, Ursula von der Leyen. The Compass is the Commission's action plan, with a strong focus on sectoral interventions and legislative packages, and is closely aligned with the Draghi report in both analysis and action. The report focuses on the innovation gap, reducing emissions (climate/energy), and enhancing economic security by reducing dependencies. There is a high degree of convergence between the Draghi report and the Compass in terms of the policies proposed as well.

The five proposals in this section relate to the problem formulations presented in the introduction, as well as to the analysis above of the EU's lagging competitiveness. All five proposals have been chosen because they are far reaching, and because they answer to both a market liberal and a geopolitical analysis of Europe's falling competitiveness.

Four of the proposals (b–e) are highlighted in the Draghi report, while one proposal (a) is discussed in the Letta report. Given the considerable overlap and the similarities between the proposals in both the Draghi and Letta reports, it is not straightforward to formulate a strict division between them.

a) Phase out directives and make regulation the main rule in the single market

Draghi's analysis highlights that over-regulation is one of the primary reasons why the EU is lagging behind the US and China in innovation, particularly in new technologies that have the potential to drive productivity growth in the economy as a whole. In response, the EC has adopted the goal of reducing business reporting requirements by 25 per cent (35 per cent for SMEs) in the Competitiveness Compass. According to its calculations, such a measure could save businesses €37,5 billion annually.[26] Although the proposal will not lead to a significant reduction in the total number of regulations, it is still a good start to reduce the regulatory burden on European businesses and address the problem of over-regulation.

With this in mind, the Commission presented several regulatory relief measures (Omnibus I and II) in February 2025. Among other things, around 80 per cent of companies are to be excluded from the reporting requirements of the Corporate Social Responsibility Directive (CSRD), a necessary first step towards reducing the overall regulatory burden.[27]

A more complex internal market problem concerns the poor quality of legislation and the systematic national fragmentation of regulation, despite years of harmonisation ambitions. As outlined above, there may be several reasons for this development. One reason, as Letta points out, is the incentives in the EU's legislative process for institutions to prioritise the political interests of collaborating institutions rather than effective regulation. This has led to a form of 'false" harmonisation, that is, legislation characterised by a series of exceptions, minimum requirements, and openings for 'gold-plating', which we have seen in several cases of Swedish implementation of EU law (Letta 2024: 125).

Thus, Letta proposes gradually phasing out directives, making regulations the preferred type of law for establishing binding rules in the single market. He notes that regulations are best placed to achieve effective harmonisation of rules and, consequently, to achieve maximum harmonisation coupled with mutual recognition, otherwise known as the Delors method (Letta 2024). This is a reasonable general principle which, when applied to specific legal requirements, has the potential to eliminate the lack of

26 European Commission, "Simplification and Implementation", 2025.
27 European Commission, "A Competitiveness compass for the EU", 2025.

coherence in legal requirements and significantly reduce opportunities for gold-plating and introducing nation-specific rules.

One problem with such an arrangement is that, from a market liberalisation perspective, it would reduce the scope for countries to adopt better rules at the national level than the European rules. This highlights a key tension in EU policymaking between the common EU interest in harmonisation versus the interest of individual member states in establishing a particular type of regulation. However, this report is not concerned with what is in the interest of an individual member state but with what is in the common interest of the EU and how we can achieve this goal.

It can certainly be argued that directives can help create better national rules and in turn serve as a source of institutional competition between member states, benefiting the EU as a whole. However, we need to bear in mind what Draghi reveals in his analysis: that the lack of harmonisation itself is a key obstacle to competitiveness. However, we can assume that the value of harmonisation is, to some extent, related to and increasing to the quality of the EU's regulatory framework. In short, from a market-liberal perspective, specific national rules that are better adapted to business conditions may be preferable to a fully harmonised, bureaucratic regulatory framework. This is precisely why EU institutions must match their ambition to increase harmonisation with a political willingness to put forward legislative proposals of better quality.

However, making regulation the main rule will not remove national fragmentation in one stroke. The problems of false harmonisation and national fragmentation persist in single-market regulations. For example, the Commission's second report on the application of the GDPR shows that national fragmentation persists despite the ambition to create a single data protection framework (European Commission 2024). This is partly due to voluntary specification clauses, which are actually openings for national rules. Above all, stakeholders have reported that national fragmentation exists because national data protection authorities interpret the GDPR's provisions differently, creating legal uncertainty and hindering the free movement of data in the single market (European Commission 2024). The US-based Future of Privacy Forum notes that some stakeholders cite cases wherein national authorities do not follow the European Data

Protection Board (EDPB) guidelines or issue their own guidelines that directly conflict with these guidelines.[28]

This raises questions as to whether full harmonisation is even possible without European authorities having interpretative primacy over national authorities. However, while problems of interpretation of regulations by national authorities remain a basis for fragmentation, the proposal to make regulation the main rule could at least address part of the problem. Letta's principle should therefore be widely embraced by both member states as well as by the EU institutions, in combination with an increased political awareness of the importance of removing openings for gold-plating in EU legislation.

b) Starting the journey towards fully harmonised company law: a 28th framework

Another proposal that addresses the lack of harmonisation is the development of a fully harmonised European company law – a European Business Code. A thirteen-volume draft was presented in 2017 by the Paris-based legal association, Henri Capitant. Such a project will undoubtedly face significant challenges in reconciling the contract law tradition of northern Europe with that of continental Europe, but the goal of eventually creating a single legal framework for all company law should be pursued. As previously noted, many companies, particularly SMEs, perceive differences in contract law and legal practices as a significant obstacle to increased trade within the internal market (Letta 2024). A bold but by no means unattainable goal should be establishing a fully harmonised company law along the lines of the Uniform Commercial Code introduced in the US in 1952. Such an endeavour will undoubtedly take time and considerable resources, but a first step can be taken now.

Both Draghi, in "Innovative European Company," and Letta, in "Simplified European Company," present proposals for a new European company form. Both aim to create a company structure for the 28th regime – a fully harmonised and simplified set of rules on insolvency, labour law, and tax law – to be used by companies that want to rely on a common set of rules and avoid the patchwork of national company law. The feasibility of the proposal can be enhanced by avoiding contradictions between a common

28 'Does the GDPR need fixing? The European Commission weighs in', *Future of Privacy Forum*, 5 September 2024 (https://fpf.org/blog/does-the-gdpr-need-fixing-the-european-commission-weighs-in/).

European regulatory framework and national regulatory frameworks. It offers businesses a choice regarding which regulatory framework they want to adhere to, while offering SMEs the advantage of not having to deal with unreasonably high legal and bureaucratic requirements.

A counterargument to such a reform would be that there is already a pan-European legal company structure known as Societas Europaea (SE), which was introduced in 2004. However, European business organisations have testified that this model is cumbersome and ill-suited to smaller, innovative, and dynamic companies (France Digitale 2024). The SE also does not offer the kind of fully harmonised regulatory framework that both Draghi and Letta seek to create.

Another counterargument to establishing a fully harmonised company law, as in the case of phasing out directives, is that competition between different contract law and company law regimes constitutes a form of institutional competition, which is beneficial to the internal market. As we have seen, this argument can be applied to the competition between countries to offer the most advantageous conditions possible. This has long been a crucial argument used by market liberals to justify the positive effects of fragmentation. The question is whether this institutional competition positively outweighs the negative effects of fragmentation, where, not least in the tech sector, the effects of fragmentation can obstruct the achievement of a critical scale of investment. For example, the Brussels-based market-liberal think tank ECIPE sees the 28th regulatory framework as a key element in achieving 'competitive harmonisation' between EU member states (Bauer 2024: 3).

c) European Defence Technology Innovation Cluster: Creating a European DARPA based on the US model

If removing over-regulation and harmonisation is akin to easing off the brakes, better research systems would be equivalent to pushing on the gas in innovation policy. Draghi's report suggests doubling the budget for the EU's Horizon programme, but this is a dubious proposal. The EU's problem is not a lack of public funding for research. As pointed out earlier, the EU's total public funding for research, including the budgets of EU institutions and member states, represents a higher share of the GDP than in the US. The difference is that the US has a higher share of private company turnover going into R&D and, therefore, can concentrate its public resources in an industry-focused innovation system for cutting-edge

research. In this way, the US has established an innovation system in which public resources complement and leverage the R&D already funded by private resources. In contrast, as Draghi shows, Horizon is characterised by a dispersion of resources across too many projects in a system that lacks focus and is overly bureaucratic. Member states can do a lot to incentivise the private sector to boost innovation financing by providing tax breaks linked to innovation and capital (see proposals on capital markets). However, much of this falls outside EU decision-making competence.

What we can decide politically at the EU level, however, is how to spend the EU's public research funds. The EU should be cautious about establishing research systems that compete with the private sector in applied research on new technologies. However, there are areas where public funding has always been a central and natural component of technological innovation, namely, the defence sector. This is because it is linked to the defence priorities of states. At the same time, we know from the US experience with DARPA that innovation in technologies with a bearing on national security can also have spin-off effects for civilian technologies.

In light of geopolitical developments and the Trump administration's reorientation in terms of security policy, the EU now needs to increase its public investments in defence and security technologies significantly. It should, therefore, see this as an opportunity to create a large-scale defence technology innovation cluster that can, in turn, help accelerate innovation in other parts of the economy and enhance economic competitiveness. Better than doubling the Horizon budget, therefore, is another of Draghi's proposals – to create a European DARPA based on the American model. This could be achieved by transforming the EU institution responsible for funding low-maturity breakthrough technologies – the European Innovation Council (EIC) – and providing it with a budget similar to that of its US counterpart (around $6 billion). This could be achieved, for example, by reallocating some of the funds allocated to the Horizon programme or national research budgets.

Establishing a European DARPA should not result in the kind of industrial policy that we know from historical experience will have negative economic consequences. However, this is an ongoing economic debate between market liberals and interventionists. The Italian-American economist, Mariana Mazzucato, argues for a state-governed mission-economy that

aligns the capitalist model around central state-planned goals.[29] This has met harsh criticism from market liberal economists, such as the book *Questioning the Entrepreneurial State* (2022) by Swedish economists Karl Wennberg and Christian Sandström. However, innovation in national security and military innovation seems to be partly governed by different rules of the game, compared to other civil sectors of innovation, as such innovation is driven by geopolitical logic and strategic competition between states. Research on the links (Chin 2019) between technology, states, and war shows that even in the most capitalist economies – such as the US and the UK during the Cold War – states were the central actors in financing defence innovation, accelerating creative destruction, and investing in new technologies. This model has continued to this day, both in western capitalist economies and in China (Chin 2019).

Therefore, a European DARPA could play a crucial role in European armament – a role that, if executed correctly, could also have positive spin-off effects for the civil economy. At the same time, this role should be strictly limited to technologies with a bearing on defence and security issues to avoid the creation of a harmful 'entrepreneurial state' in the area of purely civilian technologies that competes with the private sector.

Therefore, for a European DARPA to emulate US success and avoid replicating extant inefficient research systems, certain guidelines must be set. Firstly, a European DARPA should focus on a small number of innovation programmes where it can complement private funding, for example in breakthrough technologies and innovation in the defence sector, along the lines of the US system. The EIC currently lacks such a focus, and in 2023, it spent €159 million on 43 new projects across five domains.[30]

Second, a European DARPA must build on the positive aspects of the US industry-led model – that is, programmes should be managed by experts with a high degree of autonomy and not by EU officials. In the US, this autonomy has enabled DARPA programme managers to identify so-called 'technology white spots' where funding is lacking and prioritise them. This can be contrasted with the EIC, which is based on a institutionalised process of peer review, with strong political interests driving the research programmes' diverse objectives.

29 Among others, *The Entrepreneurial State* (2011) and *Mission Economy* (2021).

30 'Can Europe really build its own DARPA?' *Project Syndicate*, 24 October (https://www.project-syndicate.org/commentary/european-darpa-could-boost-innovation-if-implemented-correctly-by-lars-fr-lund-and-fiona-murray-1-2024-10).

According to tech expert Lars Frølund, an EIC board member, this slows down the creative innovation process and could lead to the exclusion of the most innovative technologies or ideas.[31]

Thirdly, a European DARPA must build on the approach of its US counterpart in terms of establishing strict investment requirements. US DARPA managers have full autonomy to cut off funding to those projects that, after a while, prove to lack potential. This rather heavy-handed approach is in sharp contrast to the EU funding approach, which, in principle, never suspends funding even if a programme fails to achieve the desired results.[32] A model based on these premises would require a much higher degree of trust from both member states and EU institutions in the independent decision-making powers of programme managers. This means putting innovative excellence firmly at the centre and moving away from considerations based on geographical balance or political micromanagement.

d) Reforming EU competition rules: Opening up to large European companies in strategic sectors

A natural conclusion of increased international competition, as well as the geopolitical aspects of global competition, is that EU competition rules need to be reformed. Draghi suggests that this can be achieved without a treaty change by having the EC update the merger guidelines that the Directorate-General for Competition (DG COMP) follows. He also suggests that more mergers between companies should be allowed if they can present valid reasons for why this would strengthen innovation capacity. Such a rules update should also consider geopolitical risks and economic security, for example, to eliminate potential costs resulting from geopolitical blackmail, like the kind we have seen from China in the areas of supply of strategic raw materials, innovation in digital infrastructure, and European microchip manufacturing.

At the same time, there is strong value in maintaining robust competition laws to prevent individual companies from exploiting the rules, and, in the worst case, creating monopolies. The Commission will therefore play a

31 'Can Europe really build its own DARPA?' *Project Syndicate*, 24 October (https://www.project-syndicate.org/commentary/european-darpa-could-boost-innovation-if-implemented-correctly-by-lars-fr-lund-and-fiona-murray-1-2024-10).

32 'Can Europe really build its own DARPA?' *Project Syndicate*, 24 October (https://www.project-syndicate.org/commentary/european-darpa-could-boost-innovation-if-implemented-correctly-by-lars-fr-lund-and-fiona-murray-1-2024-10).

crucial role in striking a balance between these interests through well-founded trade-offs. Such a balance, however, is not self-evident, as highlighted by the EC's decision to reject the merger of France's Alstom and Germany's Siemens in 2019, which was heavily criticised as an example of the EU's outdated competition law. The argument in favour of the merger was that, on an international scale, Alstom and Siemens are two relatively small companies, particularly compared to their Chinese rival, CRRC, which accounts for over 50 per cent of the global high-speed train market. However, the decision is defensible in light of the regional monopolies that would have been created in EU's national markets if a merger had been permitted.

The discussion highlights the conflict between microeconomic and macroeconomic competitiveness, with strong geopolitical elements. However, given that the relevant scale of competition has shifted from an intra-European to a global level, it is the latter that competition rules must primarily safeguard. The alternative would be establishing a system adapted to past competition conditions, which, in the worst case, could prevent the rationalisation and consolidation of the European market. This would result in European companies being eliminated in competition with Chinese or American (sometimes state-sponsored) competitors.

Subsequently, this would create a European market where Chinese and US companies exploit their market leadership, potentially using it as a form of geopolitical blackmail, resulting in high economic and political costs for the EU. Some examples of Chinese state-controlled companies engaging in this tactic have been presented above. In the last year, this strategy has also been increasingly adopted by the US political leadership, particularly by entrepreneur Elon Musk, a close associate of Donald Trump. Musk's threat to cut off Starlink's satellite connection to Ukrainian units and his aggressive rhetoric against the Polish government, to intimidate these countries and rally support for the Trump administration's foreign policy, are examples.[33]

As Draghi argues in his report, today, the global context is increasingly the most relevant when applying competition and antitrust principles, not the intra-European one. Therefore, a reformed competition law as he proposes is a reasonable way forward.

33 'Musk and Rubio spar with Polish minister over Starlink in Ukraine', *BBC*, 10 March 2025 (https://www.bbc.com/news/articles/cy87vg38dnpo).

Abolish national regulation of capital markets and modernise Europe's capital market

As already noted, Europeans save more than Americans, but these funds generally do not reach capital markets. This implies that there is less private capital available in the EU for productive investment, which has contributed to the innovation problem as well as systematically lower investment in R&D compared to the US. Based on the ECB's estimate of the potential capital that could be mobilised through smarter savings – €8 trillion – we can assume that measures that change the savings behaviour of Europeans could have major long-term positive effects on competitiveness as well.

First, Draghi notes that fiscal incentives 'appear necessary' (Draghi 2024:63) to unlock the potential of private finance. Here, for example, Draghi could be referring to a general reduction in the overall tax burden on capital in the EU, which is very much within the jurisdiction of the member states. However, the EU as a whole can also contribute to increasing the efficiency of its capital markets by integrating its national capital markets into a modern, common capital market union.

Draghi's main proposal to make achieve this is to transform the ESMA into the single regulator for European capital markets, with a role similar to that of the US Securities and Exchange Commission. He also proposes a model for ESMA that is inspired by the ECB's governing council, which has enforced mechanisms to avoid political interference in governance.

Such a reform would have several favourable effects on capital markets. First, a common regulatory framework would open up EU capital markets to a higher degree of market competition, with the potential to increase the number of financial savings products available on the market. Second, a single common regulatory framework has the potential to reduce compliance costs for firms operating in multiple capital markets. This, in turn, is likely to make the EU a more attractive destination for foreign capital.

All this is beneficial for creating a more efficient European capital market, but no single measure can increase Europeans' savings in the stock market. On the other hand, a common European regulation would open up the EU's capital markets to modern savings products that are already available to financial institutions in some member states, such as Sweden. In this way, ESMA and a harmonised regulatory framework could become a tool for modernising capital markets in those member states that are

still lagging far behind. Draghi mentions, for example, the Swedish model of ISKs – which should be made widely available to all Europeans – in addition to the Swedish model of second pillar pensions (Draghi 2024). The ECB President Christine Lagarde has also put forward the idea of a European savings standard (Lagarde 2024) a set of savings products that should be made widely available.

Inspired by this proposal, in March 2025, the EC presented its strategy for an Investment and Savings Union. It announced that in 2025, it will present a European blueprint based on the most successful models for savings and investment accounts, together with recommendations to member states for the taxation of such accounts. Such a savings standard would draw lessons from the Swedish ISK model, with flat-rate taxation, zero reporting requirements, and user-friendly and digital trading platforms.

However, making such new savings products available to European savers must be done by banks and financial institutions, not by EU institutions. This is why the integration of EU capital markets and common regulation through ESMA should be market-based. This is how the EU can effectively increase the amount of private capital available for business investment.

Conclusion: The difficult balancing act between the market and the superpower

Drawing on Mario Draghi's report as a starting point, I have attempted to formulate a vision for enhancing the EU's competitiveness. I have aimed to reconcile the different ideological perspectives that have come to characterise much of the European debate on competitiveness: on the one hand, a market-liberal idea with an emphasis on domestic productivity and, on the other hand, a geopolitical perspective on the intensifying competition between the world's major powers. In this way, I have endeavoured to present a pedagogical analysis that captures both real-world scenarios and the conflicting objectives that European politicians face today, without being exhaustive.

In recent years, developments in the world around us have in various ways strengthened the relevance of both market-liberal and geopolitical perspectives in analysing the EU's lack of competitiveness. Unfortunately, the ideological debate on these issues, both in the capitals of the member states and Brussels, has been conducted on parallel tracks, effectively avoiding the difficult trade-offs between market economics and geopolitics. Draghi breaks this pattern by placing the lack of innovation, energy issues, the need for economic security, and the importance of capital markets at the centre of his analysis. The answer provided by both the Draghi report and this analysis can be summarised somewhat succinctly as follows: the EU needs to maintain and significantly strengthen the single market's adherence to market economy principles while managing the geopolitical costs of external trade and foreign policies. In short, the EU must learn to be both a market and a great power – a trade-off that is not easy but is nevertheless essential to strengthen the EU's long-term competitiveness.

Such an approach requires new thinking and policy reforms, as reflected in the five policy proposals presented. Notably, these proposals have not received adequate attention in the European policy debate. They can be recapitulated as follows.

First, greater centralisation of rules is needed to eliminate national fragmentation in the internal market. That is why I propose that directives should be phased out and regulation should be made the favoured type of law in the single market. In addition, the EU needs to establish a fully harmonised company law through the 28th regulatory framework, in line with what Draghi and Letta propose. These measures are far-reaching but essential to address a bitter truth: despite decades of political ambition, the EU has failed to achieve what, from a market-liberal perspective, is the most important goal for optimal competition and a functioning single market – common, harmonised rules. As Draghi has shown, the remaining barriers to trade in the single market amount to a 45 per cent tariff on goods and a 110 per cent tariff on services.[34] To a large extent, these barriers are the result of national regulatory fragmentation resulting from systemic failures in legislative processes.

Second, the EU should view the global geopolitical landscape and the ongoing military build-up as an opportunity to reform its public research and innovation system. To increase productive investment in future technologies, I therefore argue for replicating the US and business-led model of DARPA. By allocating public innovation funds to breakthrough technologies that enhance national security, the EU can create a more business-friendly environment and cut red tape. A European DARPA could also be an incubator for a large-scale European innovation cluster, something we lack today, and become a lever for capital mobilisation in the private sector as well.

The EU also needs to adapt its competition policy to facilitate the emergence of 'European Champions'. This is necessary partly to increase the private funds available for investment in innovation and partly to respond to geopolitically motivated and, in many cases, unfair competition from other major powers. It would involve more business partnerships and mergers in strategically important areas, such as critical raw materials, chip manufacturing, and digital infrastructure, to eliminate harmful

34 'Forget the US - Europe has successfully put tariffs on itself', *Financial Times*, 14 February 2025 (https://www.ft.com/content/13a830ce-071a-477f-864c-e499ce9e6065).

dependencies and reduce exposure to unfair competition from state-funded competitors. A prerequisite should be that companies must demonstrate that such collaborations and mergers contribute positively to innovation and investment.

At the same time, the EU should resist harmful micromanagement and public intervention in the economy. Here, we can compare Deng Xiaoping's critical realisation of the economic importance of rare earths to China back in the 1970s with the misguided prediction in Jacques Delors's 1994 Competitiveness Report that by the end of the century, 'there will be ten times as many TV channels' (European Commission 1994: 13). Thus, the EU needs to make informed predictions about geopolitical risks to enhance economic security while being careful not to let this turn into the kind of technological and industrial micro-planning that we know from historical experience is ineffective for innovation.

Similarly, the EU should be careful that the geopolitical approach does not become so dominant that it devolves into broad protectionism, as exemplified by French 'strategic yoghurt'.

Third, the EU needs to fully realise a capital markets union and a single European regulator, following the US federal model. As Christine Lagarde has pointed out, if Europeans invested as much in the stock market as Americans, €8 trillion in capital could be freed up for investment – more than ten times the amount Draghi says is needed annually, mainly from the public purse, to implement his reforms in the coming years. Through a common European regulation, the EU could promote market-based modernisation of Europe's lagging capital markets, taking inspiration from the Swedish example. A proposal for a European savings standard is expected this year, drawing inspiration from Swedish ISKs, which is a good first step.

What all these measures have in common is that they involve extensive reforms that require a new mindset from member states. Strictly national interests must be set aside in favour of what is in the interest of the EU as a whole. This, in turn, requires an increase in ambition from our politicians.

As Draghi himself said when he spoke about the report to the European Parliament in February 2025: 'You cannot say no to everything. Otherwise, you also have to recognise that you are incapable of upholding the fundamental values of the EU'.[35]

It also means daring to ask a question that is uncomfortable for many, but which is necessary to create a truly dynamic single market without trade barriers. As this report notes, regulatory harmonisation and free competition are mirror images of each other and a cornerstone of establishing a single market. However, it must be recognised that the EU has failed in this, although it has been on its agenda for decades. As both Draghi and Letta show, EU legislation aimed at creating common rules has resulted in even more complex patchworks of national regulations.

Letta highlights inherent weaknesses in both political legislative processes and the administrative model, not least in how the role of national authorities in interpreting regulations undermines their coherence. At the same time, Draghi shows us how the US market's regulatory and federal governance models have helped create an economy capable of channelling resources to the most innovative industries. This includes establishing a harmonised company law, a fully harmonised capital market, and federal authorities that collectively eliminate ambiguities in implementation across states. The American example thus clearly demonstrates that harmonisation is the mother of dynamic capitalism.

Despite the policy proposals presented in this report, the question still needs to be asked: can a truly dynamic single market that maximises market liberal forces even be realised without a major treaty reform that establishes full-scale supranationalism on a federal model, not least in the form of common European authorities? I leave it to the reader to decide whether this is a political path that Europe, the region where modern capitalism emerged, should follow.

However, whether or not this is a desirable path for the EU, there are other problems that are more amenable to being addressed under the current EU Treaty. As I demonstrate in the problem description of the EU's innovation challenges, there is no strong evidence that the EU is generally at a disadvantage in terms of economic productivity compared to the US, except in certain specific sectors. The EU has strong companies, albeit

35 'Draghi warns the EU, "we will be alone, enough with the no"' *European Newsroom*, 20 February 2025.

in traditional sectors; massive capital; one of the world's most successful education and research systems; stable political structures; and a well-functioning rule of law. In other words, we have all the prerequisites to succeed in implementing the necessary reforms.

Europe also has a unique quality of life and soft values that are distinct to the continent and are the envy of even the most innovative cities in the US. A column in the San Francisco–based online magazine, *Palladium Magazine*, titled 'America and Europe Are Equally Poor', argues that Europe offers a quality of life that Americans can only dream of, with vibrant cities, a diverse cultural life, and high levels of equality.[36] This should lead to European self-confidence in its unique combination of well-run businesses and a high quality of life.

Such insights should not lead to a relativisation of actual competitiveness problems. But they are important to bear in mind if the analysis is not to turn into unfounded pessimism. The fact is that Europe's often overlooked advantages give us an edge in the competition to attract talent. Many people prefer to live in Europe due to its cultural values. As Draghi notes, if Europe were to implement the competitiveness reforms he proposes, there is a high probability that they will lead to success, by creating societies where people, ideas, businesses, and cultures can flourish.

36 'America and Europe are equally poor', *Palladium Magazine*, 26 April 2024 (https://www.palladiummag.com/2024/04/26/america-and-europe-are-equally-poor).

References

Balfour, R. (2024) EU political legitimacy in a post neoliberal world. In *Geopolitics and Economic Statecraft in the European Union* (eds R. Balfour and S. Ülgen). Brussels: Carnegie Europe.

Bauer, M., Erixon, F., Guinea, O., Lamprecht, P., Sharma, V., and Zilli, R. (2023) New regulations in Europe's digital economy: Design, structure, trade and economic effects. Report. Stockholm: Confederation of Swedish Enterprise.

Bauer, M. (2024) Competitive harmonisation: A collaborative framework for intra-EU reform and competitiveness. Brussels: European Centre for International Political Economy.

Chin, W. (2019) Technology, war and the state: Past, present and future. *International Affairs* 95(4): 765–83.

Coatanlem, Y. and Coste, O. (2024) Cost of failure and competitiveness in disruptive innovation. Milan: Bocconi.

Confederation of Swedish Enterprise. (2023) The effects of the US Inflation Reduction Act (IRA) on EU competitiveness. Stockholm: Confederation of Swedish Enterprise.

Consultation response from the Confederation of Swedish Enterprise, Dnr LI2023/03919 (2024-04-08).

Council on Foreign Relations. (2020) China's approach to global governance. https://www.cfr.org/china-global-governance/.

Cutler, W., and Wester, S. (2024) Resilience & resolve: Lessons from Lithuania's experience with Chinese economic coercion. London: Asia Society Policy Institute.

Draghi, M. (2024) The future of European competitiveness: Part A: A competitiveness strategy for Europe.

Elysée. (2024) 'Discours du Président de la Republique sur l'Europe à la Sorbonne [Europe Speech]'. Speech at the Sorbonne University, Paris, 25 April 2024 (https://www.elysee.fr/emmanuel-macron/2024/04/24/discours-sur-leurope).

European Commission. (1994) Growth, competitiveness, employment: The challenges and ways forward into the 21st century. White paper. Luxembourg: Publications Office of the European Union.

European Commission, 'Commission simplifies rules on sustainability and EU investments, delivering over €6 billion in administrative relief', 26 February 2025.

European Commission, 'Remarks by Commissioner Jørgensen at the press conference on the Action Plan for Affordable Energy', 26 February 2025.

European Commission. (2019) Competitiveness (https://web.archive.org/web/20190713092513/https:/ec.europa.eu/europeaid/sectors/economic-growth/private-sector-development/competitiveness_en).

European Commission. (2021) Laying down harmonised rules on artificial intelligence and amending certain union legislative acts. Brussels: European Commission.

European Commission. (2023) Global trade fragmentation: An EU perspective. Economic Brief 075. Luxembourg: European Union.

European Commission. (2024) Second report on the application of the General Data Protection Regulation. Brussels: European Commission.

European Commission. (2025). "Simplification and Implementation" (https://commission.europa.eu/law/law-making-process/better-regulation/simplification-and-implementation_en)

European Commission. (2025) A competitiveness compass for the EU. Brussels: European Commission.

European Parliament. (2024) "European Economic Security: current practices and further development". Brussels: European Union.

European Union. (2025) Competitiveness (https://eur-lex.europa.eu/EN/legal-content/glossary/competitiveness.html).

Federation of American Scientists. (1950) NSC 68: United States Objectives and Programmes for National Security. Washington: National Security Council.

Flam, H. (2024) The Draghi report: A faltering diagnosis but many prescriptions in the right direction. Stockholm: Swedish Institute for European Policy Studies.

Fors, C. (2024) Effectively implemented and applied EU law: Crucial for Swedish competitiveness. Stockholm: Board of Swedish Industry and Commerce for Better Regulation (NNR).

France Digitale. (2024) Non-paper: How can a 28th regime company status help young and innovative companies to scale in Europe? (https://media.francedigitale.org/app/uploads/prod/2024/10/22114209/France-Digitale-Non-Paper-28-Regime.pdf).

Grieger, G. (2023) EU anti-subsidy probe into electric vehicle imports from China. Brussels: European Parliament Investigation Service.

Guizzini, S. (2013) *Power Realism and Constructivism.* London: Routledge.

Håkansson, C. (2024) Von der Leyen's geopolitical commission: Vindicated by events? Stockholm: Swedish Institute for European Policy Studies.

Krugman, P. (1994a) *The Age of Diminished Expectations*. Cambridge: MIT Press.

Krugman, P. (1994b) Competitiveness: A dangerous obsession. *Foreign Policy* 73(2): 28–44.

Krugman, P. (1996) A country is not a company. *The Harvard Business Review* January/February.

Lagarde, C. (2024) Follow the money: Channelling savings into investment and innovation in Europe. Speech at the European Banking Congress, Frankfurt am Main, 22 November 2024 (https://www.ecb.europa.eu/press/key/date/2024/html/ecb.sp241122~fb84170883.en.html).

Le Maire, B. (2019) *Le nouvel empire: L'Europe du vingt-et-unième siècle*. Paris: Gallimard.

Letta, E. (2024) Much more than a market. Luxembourg: European Commission.

Mazarr, M. J., Frederick, B. and Crane, Y. K. (2022) Understanding a new era of strategic competition. Santa Monica: RAND Corporation.

Monti, M. (2010) A new strategy for the single market at the service of Europe's economy and society. Report. Brussels: European Union.

Nicholas, T. (2003) Why Schumpeter was right: Innovation, market power, and creative destruction in 1920s America. *The Journal of Economic History* 63(4): 1023–58.

Prestowitz, C. V. (2000) Response 1: Playing to win. In *From Adam Smith to Michael Porter: Evolution of Competitiveness Theory* (eds D. S. Cho, H. C. Moon and T. S. Cho). London: World Scientific, Asia-Pacific Business Series.

Rodrik, D., Lane, N. and Juhász, R. (2023) The new economics of industrial policy. *Annual Review of Economics* 16: 213–42.

Schmitz, L. and Seidl, T. (2023) As open as possible, as autonomous as necessary: Understanding the rise of open strategic autonomy in EU trade policy. *JCMS: Journal of Common Market Studies* 61: 834–52.

Siebert, H. (2005) Locational competition: A neglected paradigm in the international division of labour. Kiel Working Paper No. 1258. Kiel: Kiel Institute for the World Economy.

The European Chemical Industry Council. (2024). “Cefic launches 2024 Facts & Figures Report” (https://cefic.org/news/cefic-launches-2024-facts-figures-report/)

Valéry, P. (1919) . *The Athenaeum*, April 11 and May 2. *Nouvelle Revue Française*, 71(1).

Voinescu, R. and Moisoiu, C. (2015) Competitiveness, theoretical and policy approaches. Towards a more competitive EU. *Procedia Economics and Finance* 22: 512–21.

Wang, Y. (2024) Foster a favourable external environment for further deepening reform comprehensively to advance Chinese modernisation. *Foreign Affairs Journal* 153.

Winkler, S. C. (2023) Strategic competition and US-China relations: A conceptual analysis. *The Chinese Journal of International Politics* 16(3): 333–56.


TIMBRO
EPICENTER
European Policy Information Center