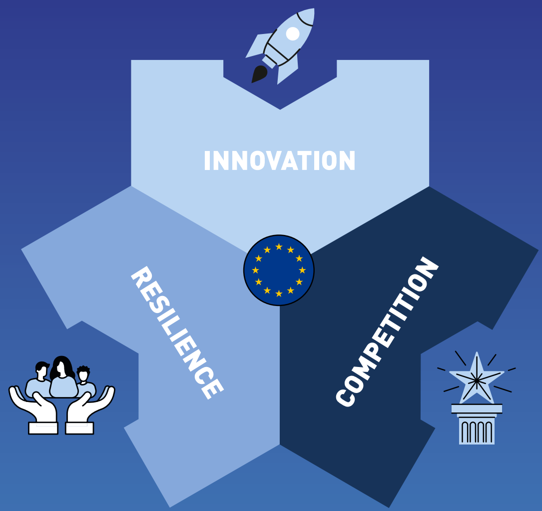


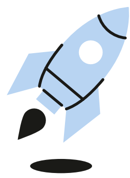
DRIVING EUROPE'S ECONOMIC FUTURE

FOR AN INNOVATIVE, COMPETITIVE, AND RESILIENT EU

The **global order is shifting**, rivalries between the U.S. and China are intensifying, regional conflicts and protectionism are increasing the fragmentation of the global economy. At the same time, new geopolitical alliances and blocs are forming. Unexpected global crisis situations are overlapped by long-term global structural trends such as the **digital and ecological transformation** ("twin transition") and **demographic change**.

In this context, the EU faces the need of realignment. An analysis of the three critical **location aspects - innovation, competitiveness, and security** - reveals the central ⚙ challenges and → outlines solutions. A strong **internal market**, the reduction of excessive **bureaucracy, affordable energy supply**, and the conclusion of **international trade and raw material agreements** play a key role.

An innovative Europe



In terms of innovation and future investments, the EU lags behind China and the U.S. This innovation gap has significant macroeconomic consequences.

⚙ Too little R&D investment – and Europe remains stuck in the mid-tech trap

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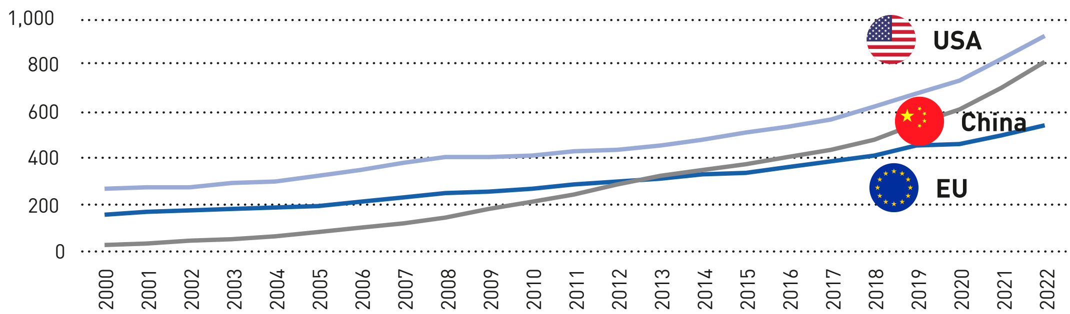
Both the U.S. and China show higher R&D activity than the EU. China's R&D share rose from under 0.6 % of GDP in 1995 to 2.6 % in 2022, thereby surpassing the EU in both absolute spending (since 2013) and R&D share (currently 2.11 %).

The U.S. and China both prioritize high-tech industries to a much greater extent: In the EU, around 48 % of R&D investment is allocated to so-called **mid-tech industries**.
By contrast, around 85 % of R&D spending in the U.S. is directed toward the high-tech sector.
The focus of European companies on mid-tech industries weakens long term competitiveness, as these sectors offer lower **growth and scaling potential** compared to high-tech sectors.

Development of gross R&D spending
in USD billions, PPP-adjusted



Source: OECD

Lack of venture capital prevents growth and innovation

When comparing venture capital investment relative to GDP internationally, four of the top-6 countries - Israel, the United States, Estonia, Canada, Luxembourg, and South Korea - are not EU members. The unweighted average of venture capital investment across EU countries amounts to just 0.04% of GDP. By comparison: Israel invests 2.86%, the U.S. 0.47%, Canada 0.23%.

Eliminating the venture capital bottleneck in Europe is a key prerequisite for a future-oriented and innovation-driven business landscape.

Lower productivity causes wealth gap between the EU and the U.S.

GDP per capita, adjusted for purchasing power, is approximately 33 % higher in the United States than in the European Union. The EU performs especially poorly in comparison when it comes to productivity and labour market participation. This is partly due to the persistent lack of innovation in high-tech sectors. The strong focus on mid-tech industries hampers productivity gains and limits growth.

In light of demographic change, measures to boost our labour productivity will become even more urgent.

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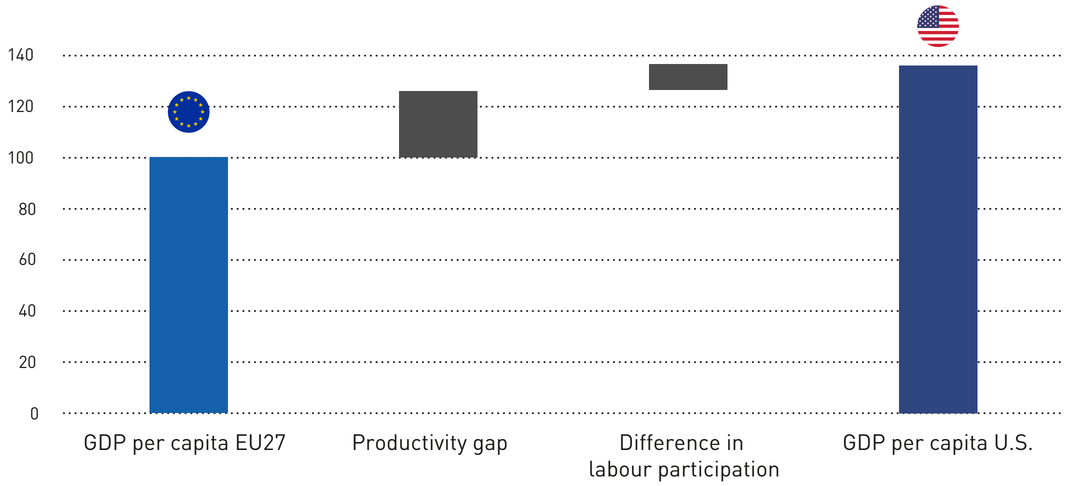
> **Around 70 % of the EU's growth gap is due to lower labour productivity.**

GDP per capita (PPP-adjusted), 2023, Index EU27 = 100



Source: Eurostat, Draghi (2024), AMECO

PROPOSED SOLUTIONS

- Establish a **European Strategy for Research and Innovation** to increase public and private R&D spending. In the next financial framework, prioritise research and innovation – with at least €200 billion for FP10 and a focus on key technologies
- Implement a **Savings and Investment Union** to create a better financing environment for innovative companies, especially more risk-tolerant capital
- Unlock **Europe's labour force potential** – including an education and training agenda focused on future-relevant skills and increasing regional labour mobility

A competitive Europe

Rising supply-side costs due to **high energy prices** and **increasing bureaucratic burden**, subsidy-driven distortions in the global business location competition and the persistent **fragmentation of the internal market** are putting pressure on Europe´s competitiveness. Decarbonization and economic competitiveness must finally be addressed hand in hand.

Decline in industrial production

Through targeted **industrial policy, China** has repeatedly managed to become a technological leader in key strategic sectors. As a result, its share of global industrial value added has steadily increased.

China has evolved **from a low-cost supplier and major buyer into a direct competitor** in Europe's key industrial sectors (automotive, machinery, chemicals, etc.). China´s share of global industrial goods exports continues to rise, while Europe´s is declining.

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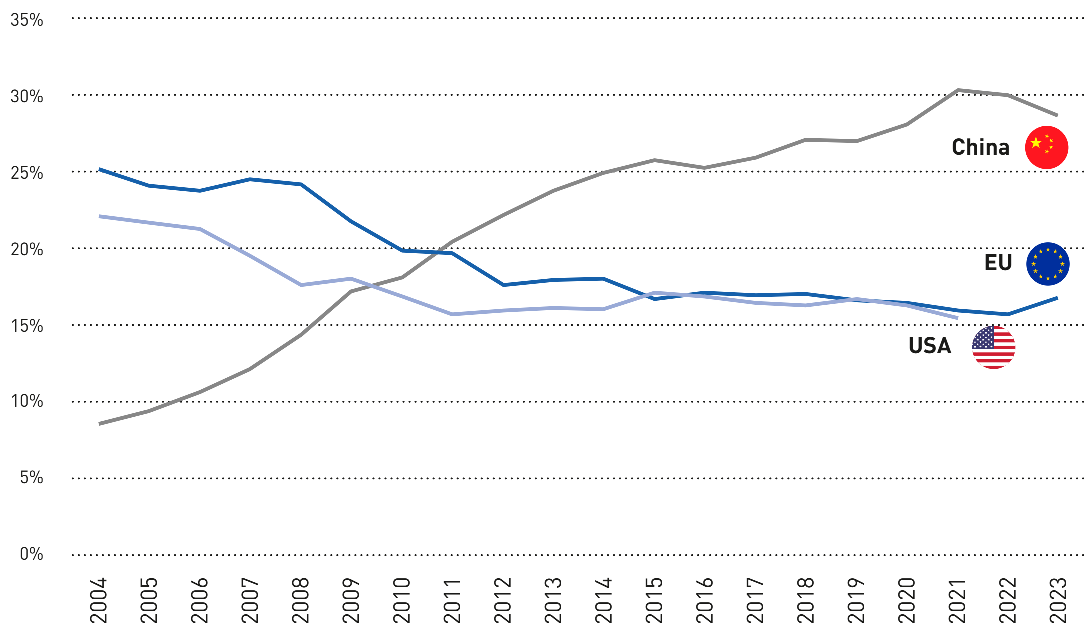
In 2023, around 29% of global industrial value added was generated in China. The EU accounted for 17 % - with a downward trend, highlighting the declining industrial competitiveness of Europe.

For Europe, **maintaining and expanding key industries** is therefore essential for promoting both economic growth and decarbonisation.

Share of global gross value added in manufacturing in %



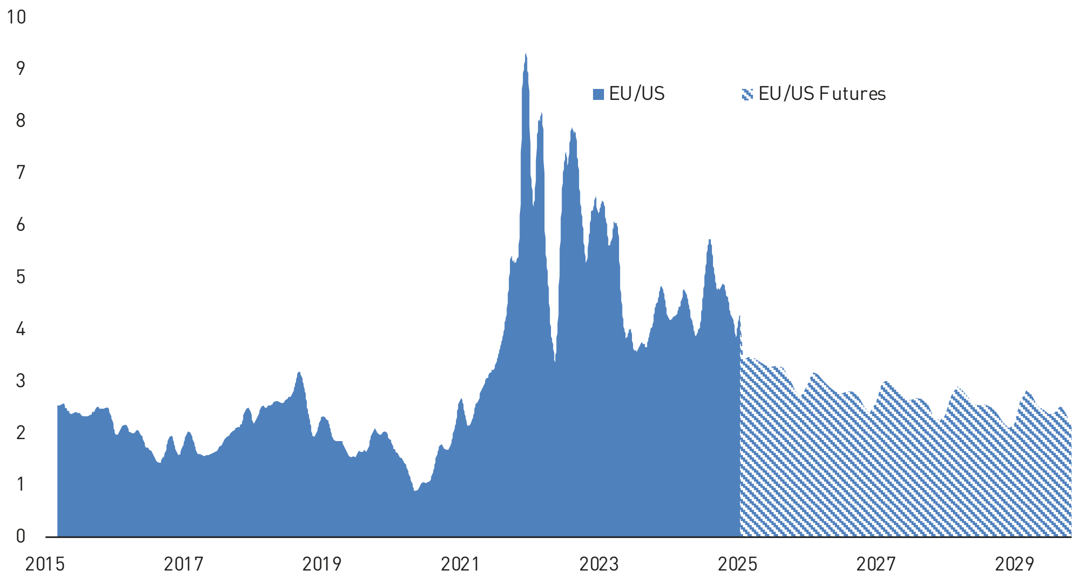
Source: World Bank, own calculations

Price competitiveness under pressure

European enterprises are burdened with **substantial structural cost**s that not only curb industrial output but also damage Europe's **cost competitiveness** in the global market.

- **Energy costs:** European companies continue to pay gas prices that **are four to five times higher** than those faced by their U.S. competitors. Intensifying competition from both China and the United States further exacerbates the situation. On top of that, future U.S. tariff policies may impose further burdens on Europe's manufacturing sector.

Ratio of EU gas price benchmark to U.S. equivalent
Dutch TTF / Henry Hub in EUR/MWh, dashed area = futures



Source: Trading Economics, Barchart, Investing.com

Europe's competitiveness depends critically on a secure, affordable, and diversified energy supply. This requires a massive expansion of energy infrastructure and a reform of the electricity market design.

- **Bureaucratic costs:** Bureaucracy ties up capacities that are missing elsewhere in companies – such as in research, digitalisation, or market expansion. The Draghi Report addresses overlaps in European and national legislation: this "duplication of work" costs about €200 billion per year due to the complex procedures, excessive national requirements, and inconsistent labelling standards. **That amounts to more than 1 % of the EU's GDP.**

Reducing bureaucratic hurdles is a key element on the path to greater competitiveness. Europe needs major administrative deregulation and simplification.

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Around 28% of SMEs in the EU employ at least one tenth of their staff for regulatory tasks.
Source: EIB Survey

Internal market barriers

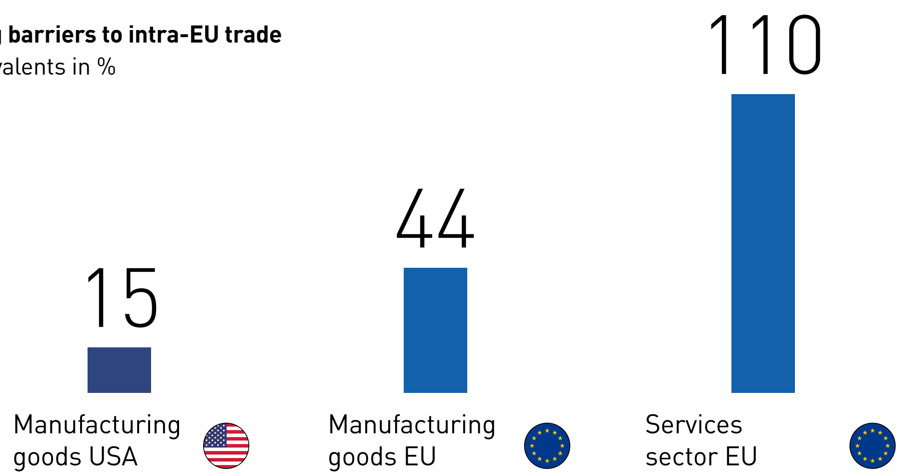
The **EU Single Market** includes 450 million consumers and 31 million active companies, most of which are SMEs. Over the past 30 years, it has steadily increased trade between member states and is estimated to have created around 56 million additional jobs. The EU single market is the largest common market in the world and is considered more integrated than other major economic areas.

The Single Market is in our own hands; it acts as **both a geo-economic buffer and a lever**:

- **Buffer**, because around 70 % of Austria's exports go to the Single Market. As a result, declines in demand in other key export markets have less impact.
- **Lever**, because all EU Member States together, as a trading partner, are about as significant to China as China is to the EU.

Even after 30 years, barriers within the EU single market remain substantial. For the manufacturing sector, they are equivalent to **quasi-tariffs** of 44%, and for the services sector, as high as 110%

Remaining barriers to intra-EU trade
Tariff equivalents in %



Source: IMF

If existing trade barriers in services were reduced by 25 %, Austria could achieve a 3.8 % increase in value added, according to the ifo Institute. Across the EU, this would translate to a medium-term increase in value added of around €350 billion.

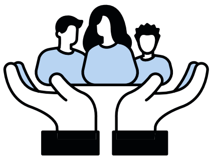
PROPOSED SOLUTIONS

→ **European Industrial Strategy:** A strategically aligned, coordinated industrial and innovation policy to strengthen Europe as a location for innovation and business, **Strengthen "Made in EU"** by committing to local value creation

→ **Enhance competitiveness through joint action:** Prioritise European public goods in areas such as infrastructure, strengthen R&D in high-risk and large-scale projects as well as defence

→ **Affordable energy:** Secure energy supply and low energy costs are prerequisites for all economic activity and for achieving climate and sustainability goals

→ **Deepen, strengthen, and expand the Single Market:** Enforce existing Single Market rules, strengthen the rule of law in economic matters, and expand the Schengen Area to include candidate countries



A resilient Europe

The security policy dimension is becoming increasingly important for Europe. In light of global dependencies and protectionist policies pursued by other economic powers, a strategic rethink is necessary. What is needed now is greater strategic resilience along with fresh momentum for open markets and free trade.

Increasing dependencies and new alliances

Strategic dependencies in forward-looking sectors (e.g. raw materials, semiconductors) not only endanger the implementation of the green transition but Europe's overall supply security. The semiconductor market is growing rapidly, but chip production is heavily concentrated in Asia. When it comes to critical raw materials, China remains the primary source globally and for the EU. Dependence on a few supplier countries for critical raw materials increases Europe's economic vulnerability.

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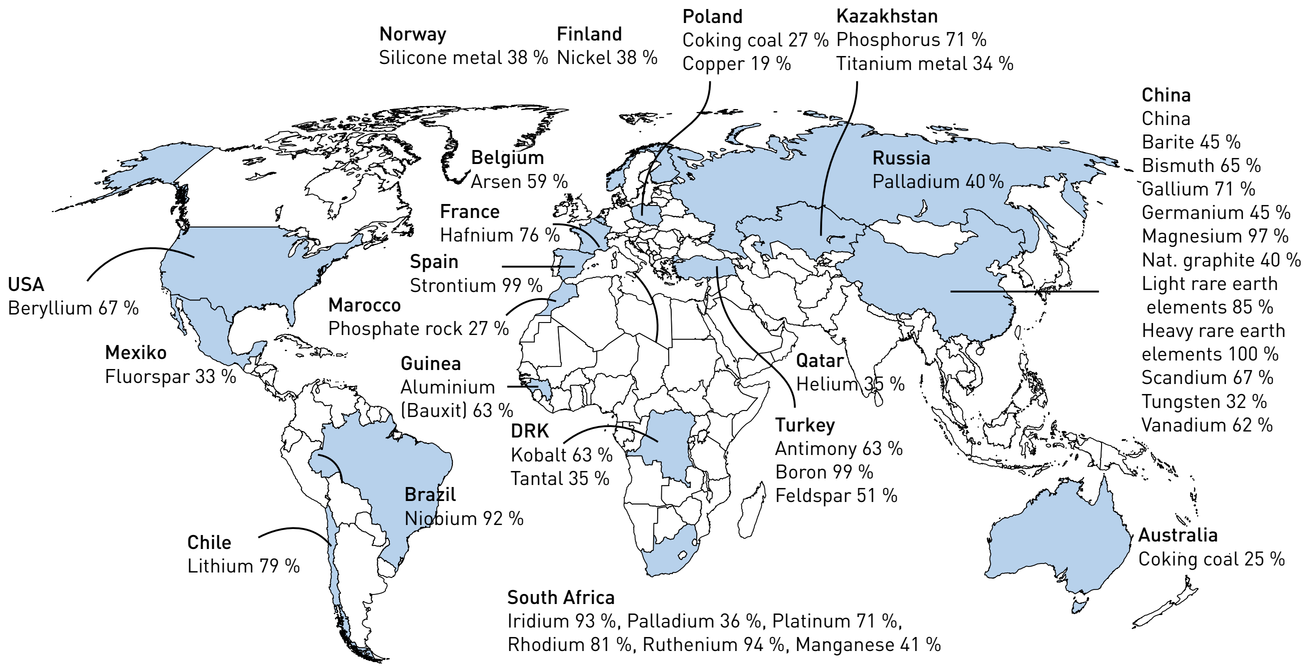
The EU is strategically dependent in the field of advanced semiconductors. Manufacturers from Taiwan and South Korea supply around 3/4 of the global market.

Therefore, Europe needs a real shift in the area of raw materials with strong investment incentives for European mining and recycling projects.

Main EU suppliers of selected critical raw materials

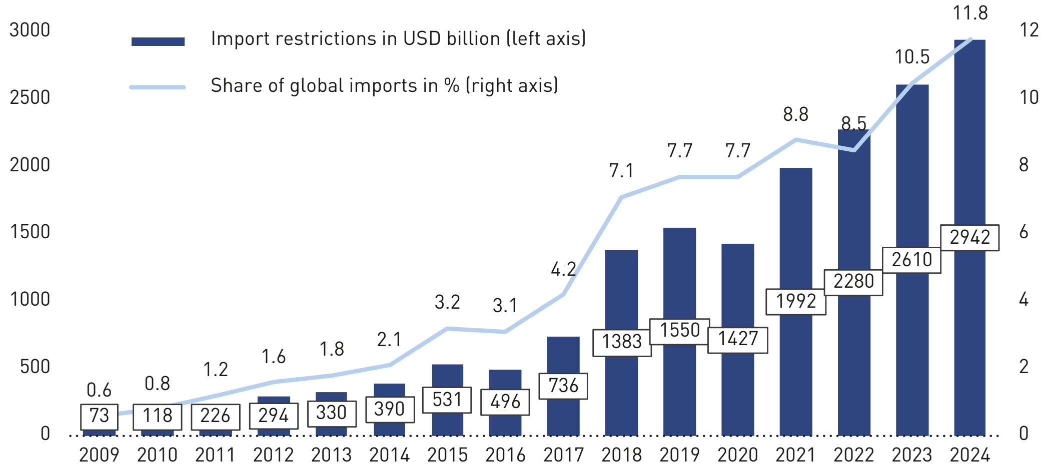


Source: European Commission

Free trade under threat

Global trade patterns are undergoing significant shifts, with trade-discriminatory policies gaining momentum. The World Trade Organisation (WTO) has observed a marked rise in protectionist measures globally, particularly since Donald Trump's first term. Before he took office in 2016, about 3 % of global imports were subject to trade restrictions; by 2024, this share had risen to about 12 %, according to the WTO. **Currently, the uncertainty within trade policy is higher than ever.**

Global imports affected by import-restrictive measures
in USD billion and as a percentage of global imports



Note: The estimate for 2024 is based on available data on import-restrictive measures up until 15 October 2024.
Source: WTO

China is gaining influence in trade policy, while the EU is losing its clout. This is most evident among developing and emerging Asian countries: Chinese exports to this region increased by a total of 127 % between 2013 and 2023. For comparison, the EU only managed a 20 % increase in exports to the same region during that time.

Overall, the number of bilateral and multilateral trade agreements involving the EU has steadily declined in recent years.

Pending trade agreements - especially with the MERCOSUR countries - should be finalised swiftly, and new agreements should be pursued with willing partners such as Australia, Indonesia, India, the Philippines, and Thailand.

New defence policy challenges

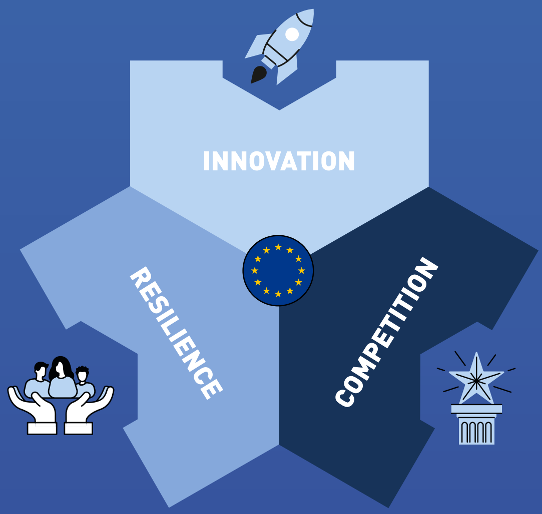
Security, geopolitical resilience, and external economic autonomy have become core elements of European competitiveness. Reducing security-related dependencies is also moving into focus for the EU. At the same time, building resilient supply chains is essential. The USA is increasingly shifting its security focus away from Europe and toward the Indo-Pacific, which will result in new expenditures for the EU. A withdrawal of US forces from Europe would, in the short term, require an annual increase of around €250 billion in EU defence investment, equivalent to about 3.5 % of GDP (Source: IfW Kiel).

PROPOSED SOLUTIONS

- **Implement a proactive trade policy:** Position Europe as the new centre of the liberal world. The EU should present itself as a reliable partner for free trade. Trade agreements are a key instrument. A united and decisive response to unfair practices is also needed; trade defence mechanisms should be used consistently
- **Strengthen strategic autonomy and supply security:** Promote resilient, diversified supply chains through partnerships and investments; secure access to raw materials and intermediate goods through trade agreements
- **Establish the security and defence industry as part of European industrial policy:** Military R&D spending increases overall economic productivity in the long term Strengthening the European defence industry is not only necessary for security policy but also makes strategic sense from an industrial policy perspective

Conclusion

The challenges of the **green and digital transition**, demographic change, and rapidly evolving geopolitical conditions require a **reorientation of European economic policy**. The **EU economic policy** should simultaneously address innovation, competitiveness, and security, to offer the best chances for **Europe as a business location** that can continue to guarantee freedom, security, and prosperity in the future.



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