Financing European competitiveness

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Disclaimer

With this paper, the Netherlands explicitly does not want to anticipate the yet to be determined position of the Netherlands on the next Multiannual Financial Framework (MFF) from 2028. It says nothing about the continuation of specific funds or budgets in Europe or the Netherlands, nor about the governance surrounding the deployment of future funds in the Netherlands. The overarching MFF position is leading in the event of conflicting formulations.

The EU builds upon a strong economic foundation and a high level of prosperity. Benefiting from a strong internal market, European companies have access to a market of more than 450 million people. Together with a relatively stable environment over the past decades, this market makes the EU one of the most developed and wealthiest places to live.[1] Trade flourishes, within the EU and with third countries, there are many jobs and relatively low levels of inequality. Moreover, high levels of product standards and services and tax incomes enable governments to provide solid public services such as education, healthcare, and social welfare.[2]

At the same time, several challenges impede preserving our high level of prosperity. Labour productivity growth has been declining over the past decade[3] while at the same time, the EU-population is aging rapidly and the workforce declining.[4] This results in a considerable rising of social welfare and healthcare needs,[5] while the green and digital transitions also require significant investments. In addition, international unrest is rapidly evolving due to increased trade tension between global actors and the economy is increasingly being used as a geopolitical weapon. And with Russia's war of aggression against Ukraine, a resilient EU is more important than ever.

To remain competitive, boost the green and digital transitions and raise productivity, effective financing is needed along different lines Since public funding is limited, the EU has to make clear choices and target its financing efforts. In this paper, we focus on five relevant aspects to finance European competitiveness: 1) capital, 2) research and innovation, 3) cohesion, 4) resilience and 5) governance.

1. Capital: a prerequisite for competitiveness

- European Union succeeds in creating new start-ups in relevant sectors, essential for a prosperous future. These companies, however, broadly get stuck in and after the scale-up phase.[6] A fragmented internal market, which hinders innovative companies to profit from economies of scale, and a lack of available capital, in particular risk capital, are one of the root-causes for the scale-up problem.[7]
- To overcome these challenges and fulfil this prerequisite for competitiveness, coordinated efforts should be made to increase available private capital, also for small and medium enterprises. Continuous work should be put in **deepening and integrating the capital markets union.**[8] At the same time, EU programs and investments should contribute to

[1] 26 out of 27 EU Member States score a "Very high human development." In the Human Development Report 2023-2024.
[2] See '*The future of European competitiveness*', 9 September 2024, Part A, page 7 for a variety of examples on Europe's high welfare statistics regarding among others inequality, life expectancy, education, rule of law and environmental protection.
[3] Up to 2005, this growth was almost 2 percent. Since then, it has been declining with the 5-years average not exceeding the 1% growth per year. See also figure 1 in the annex.
[4] Whereas the old-age dependency ratio was 36% in 2022, this would rise to 59% in 2070, with most of the increase expected already by 2045. See the '2024 Ageing Report - Economic & Budgetary Projections for the EU Member States (2022-2070)', European Commission, Institutional Paper 279, April 2024.
[5] The same Ageing report (p 5-6) projects a substantial increase in ageing costs (>3%/GDP) in 13 EU-countries, including NL.
[6] '*The future of European competitiveness*', 9 September 2024, Part B, page 232.
[7] See also '*The future of European competitiveness*', Part B on pages 242-243 and Anita Quas et al., *The scale-up finance gap in the EU: Causes, consequences, and policy solutions*, European Management Journal, 40:5 2022, pages 645-652,
[8] See also the '*Deep and integrated capital markets for a resilient and competitive EU, Dutch vision and priorities for the next steps in strengthening the Capital Markets Union*'.

mobilising private capital and creating multiplier effects, while a fit for purpose **state aid framework** should preserve a level playing field in the internal market. If the right conditions are set and resources are spent on the basis of excellence, pooling public resources at the EU level can serve as an efficient means of fostering capital with fewer distortions than national investments.

- In addition, increased attention should be given to the role of specific financial actors as well. To strengthen the important role of the EIB Group in the EU's financial landscape, the European Investment Bank (EIB) should invest more in forms of capital that bear **more risk**, such as (private) equity, venture capital (VC) and venture debt, and increase its investment in strategic sectors. Moreover, providing guarantees through the EU budget via **InvestEU** and instruments like the **European Innovation Council (EIC) accelerator** is an effective and efficient way of spending the scarce resources at the EU-level. Finally, the **European VC landscape** can be strengthened through large pan-European funds like the **EIF**, particularly in their role in attracting private capital, such as institutional investments.

2. Research and innovation: the backbone for long-term welfare

- Research and innovation (R&I) is crucial for long term productivity and competitiveness and the EU scores well when it comes to collaborative research, scientific publications and patenting.[9] In addition, coordinated R&D spendings drives significant increases in GDP[10] and is crucial to tackle societal challenges. However, EU spending on R&D lags behind the US, China and Japan, particularly due to lower corporate R&D spendings.[11] Moreover, public R&D spendings are scattered at the national levels.[12] This results in a widening of the productivity and economic gap,[13] particularly in tech-related industry relevant for future growth such as automation, connectivity, AI and quantum.[14] Europe is stuck in a middle-technology trap and fails to make the transition to productivity-enhancing high-tech sectors.
- To become ready for the future, Europe should invest in **cutting edge research and innovation** across the R&I value chain. The next Framework Programme for research and innovation ('FP10') should support the most **excellent** research and innovation projects with the largest **impact.** It should continue to fund the **full spectrum of knowledge development**: from fundamental research, to applied R&I. commercialisation and valorisation. Moreover, FP10 should further support **successful flagship instruments** such as the European Research Council, the European Innovation Council, strategic European partnerships and put more attention to the **implementation** of the results of research and innovation and **market uptake**.
- The EU should explore various options to **facilitate cross-fertilisation** between **civil and defence-related R&D programmes**. Simultaneously, the EU needs to carefully analyse and discuss the potential impact of the proposed options to broaden the scope of FP10 to allow for dual-use research, for instance in view of the desired openness of the programme.
- Additionally, the Digital Europe Program and CEF-D remain crucial for bridging the gap between research and market deployment of **key digital technologies**. These EU co-financing programs also help strengthening the (EU) digital infrastructure and make EU ready for the transition to the Industry 4.0 and 5.0.[15] Finally, investing in education, talent and skills, especially Science, Technology, Engineering, Mathematics (STEM), remains crucial to be able to enhance competitiveness and meet the societal challenges we face.

[9] See 'The future of European competitiveness', 9 September 2024, Part B page 230.
[10] The wider economic impact of Horizon 2020, with a budget of around 80 billion euros, has been projected at around 430 billion euros. See the European Commission's 'Ex-post evaluation of Horizon 2020, the EU Framework Programme for Research and Innovation', page 56.
[11] See figure 2 in the annex.
[12] See '*The future of European competitiveness'*, 9 September 2024, Part B page 226.
[13] See also '*The future of European competitiveness*', 9 September 2024, Part B page 229.
[14] See: Reinventing our economy from within, How Europe's start-up ecosystems can learn from each other to ignite and scale up entrepreneurship. McKinsey September 2023.
[15] Whereas Industry 4.0 focuses on automation, connectivity, and advanced-manufacturing technology, Industry 5.0 puts research and innovation at the service of the transition to a sustainable, human-centric and resilient European industry.

- To enhance societal impact and competitiveness, more focus is needed on **strategic research priorities and relevant technologies**.[16] Around these areas, more and stronger **cooperation between ecosystem players** such as universities, startups, small and large companies, research organisations and investors is necessary to increase impact. In conjunction with the challenges related to scaling up innovation policies should better capitalise on the power of research and innovation ecosystems. In order to leverage scale benefits more, these ecosystems also need to become better mutually connected at European level. FP10 should better facilitate this (see *the Netherlands' vision paper on the future EU Framework Programme for Research and Innovation*.

3. Cohesion: ensuring convergence and competitiveness

- Cohesion policy funds add up to around a third of the total EU-budget, thereby being one of its largest instruments. It is therefore essential that cohesion policy enables regions to invest in people and projects that contribute to long-term growth and the competitiveness of the EU.
- In practical terms, this means that cohesion policy should invest in innovative and sustainable projects in the **digital, social (demographic and labour market) and green transitions**. Throughout these transitions, investments in **research and innovation** (and the rollout of innovation) are the cross-cutting theme. This boosts the EU's competitiveness through innovative ecosystems, sustainability and a sufficiently large, highly skilled workforce and adds to the resilience of the EU as well.
- **Reforms and investments** strengthen national and regional economies and thereby contribute to EU competitiveness. Hence, to promote the implementation of reforms and investments, cohesion policies should seek to further link the EU funds with the European Semester. Moreover, submitting claims based on **outcomes** and results should be explored.
- When it comes to **co-financing**, local, regional and/or national ownership of projects is important and therefore 100% EU co-financing is in principle undesirable. This could lead to distorted incentives, as the need for efficient and effective spending of own resources is diminished.
- For an elaboration, we refer to the *Joint vision paper Cohesion policy post-2027 of the Dutch central, regional and local government*.

4. Resilience: a strong Union to realise the transitions

- The geopolitical reality requires increased focus on the defence readiness, economic security and resilience of the Union. A strong and fair internal market contributes both to Europe's competitiveness and its resilience, as it enables European companies to compete internationally while it creates flexibility to adapt in case of external shocks. Moreover, to strengthen our position in strategic sectors and thereby our open strategic autonomy, measures should be taken in line with the European Economic Security Strategy along the axes of promote, protect and partnerships, along with strengthening the defence industry. Only a secure and resilient Union can realise the green and digital transitions ahead.
- First, increased efforts should be put in **promoting innovation** (see also above), digital infrastructures, critical technologies and sectors such as semiconductors, AI, cyber security and space, biotech and raw materials to boost the EU's competitiveness.[17] In addition, **CEF-E** should keep focusing on cross-border renewable energy projects, interoperability of networks and better integration of the internal energy market, which in turn reduces energy prices.
- Second, the EU should increase diversification within supply chains and enhance production capacity within the Union, as currently the objective is with critical raw materials and pharmaceuticals. To effectively address existing (risky) strategic dependencies and labour

[16] See also the Netherlands' National Technology Strategy, which prioritises 10 key enabling technologies.
[17] For a clear overview of the dependency for both extraction and processing of raw materials on particular countries, see '*The future of European competitiveness*', 9 September 2024, Part B page 47.

shortages, it is necessary to develop a mechanism for critical sectors, which harmonises both "promote" and "protect" measures in an integrated framework across the EU. An active and ambitious EU trade policy, seeking partnerships with third countries, can contribute to diversification of supply chains.

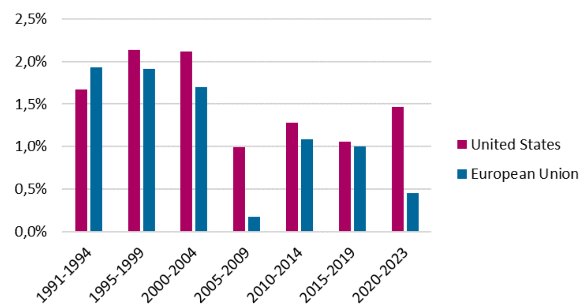
- Third, to ensure the security of the Union, the next European Defence Fund should be a **comprehensive (industry) defence program** that brings together R&D (current European Defence Fund and STEP), industrial reinforcement, industrialisation of R&D, procurement, maintenance and resilience (current EDIP, EDIRPA and ASAP) to strengthen the EU-defence industry and to ensure that the industry can address the capability needs of Member States.[18] The EU should furthermore focus on increased cooperation between member states and work towards European defence supply chains where suppliers of the European prime contractors compete on an equal basis.
- Finally, **Important Projects of Common European Interest (IPCEIs)** should target strategic technologies that demand EU-level action, with streamlined, swift procedures that minimise administrative burdens.

5. Governance: an efficient European Commission with effective EU-programs

- With close to 50 spending programs, the current effectiveness of EU-spending is hampered by fragmentation, complexity and rigidity.[19]
- In order to strengthen the effectiveness and flexibility of the EU-budget, **enhanced coordination** and coherence between the different programs is required. A coordinating authority could be beneficial, if this prevents gaps and overlap between different funds and allows for more strategic guidance, while preserving the strengths of individual funds.
- In addition, administrative burdens can be decreased by creating a **one-stop-shop** by means of a single portal. In such a portal, organisations can file requests for different EU-funding programs and go through a swift process. A one-stop-shop with advanced IT-systems would also prevent organisations from delivering the same information multiple times and allow for a '**once-only'** administration.

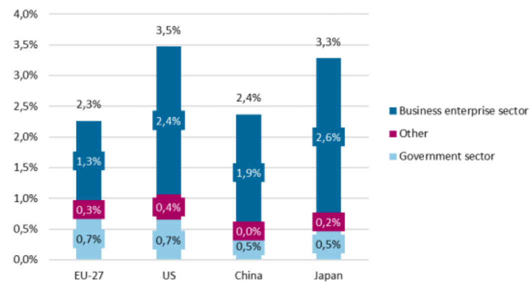
Annex

Figure 1: Labour productivity growth in EU and US 1991-2023.



Source: World Bank data

Figure 2: EU R&D spending (% of GDP) lags behind US, China and Japan, particularly due to lower corporate spendings



Source: Eurostat data

[18] Expenditures on defence were generally below 2% of GDP for the past 30 years and EU-defence expenditures are about a third of the US'. See '*The future of European competitiveness*', 9 September 2024, Part B pages 160-161.
[19] '*The future of European competitiveness*', 9 September 2024, Part B, page 289.