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More competitiveness, resilience and sovereignty for the EU

Brief analysis of the Commission's proposals for the electricity market, green technologies, critical raw materials and competitiveness

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Geopolitical and industrial pressures mean that the EU needs to take action to avoid being left behind by the USA and China in the coming years. The Commission has recognised that this will involve strengthening EU sovereignty, competitiveness and resilience, and last week presented four important drafts to that end. cep has analysed them based on their most important points and their overarching goals:

Key propositions:

- Net-Zero Industry Act: Green technologies will be promoted in a targeted manner and at least 40% produced domestically.
- Critical Raw Materials Act: Domestic mining and the circular economy are to be expanded.
- EU electricity market design: Renewable energy will be uniformly promoted with bilateral CfDs (Contracts for Difference).
- Long-term competitiveness: Access to capital and infrastructure will be improved.
- Overall, the drafts are strategically over-defensive and risk losing their impact. The Commission is chasing goals which it cannot achieve by itself but which will force it to make far-reaching interventions in the internal market. It would make more sense to base the strategy on common interests: strengthening security of supply, technological leadership, the industrial base and innovation skills.
- Some of the proposals involve very small-scale instruments which, most notably, will greatly increase the bureaucratic burden. A more functional rather than instrumental approach would have greater impact.

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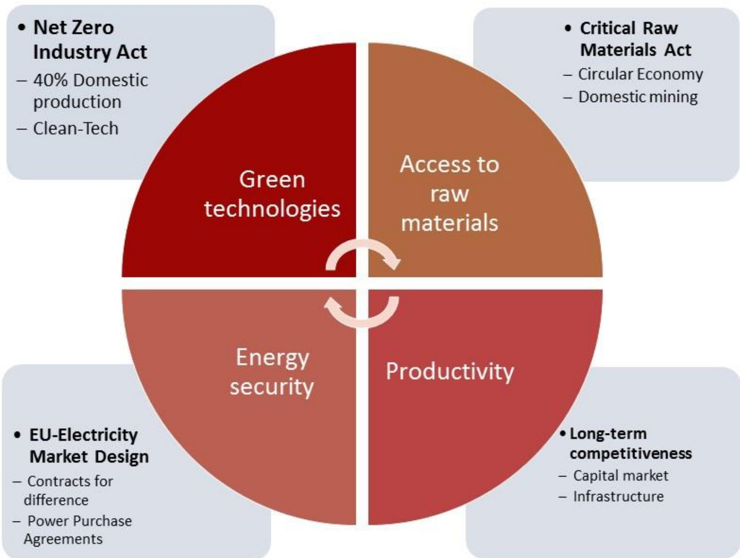
3. Geopolitics and Industrial Transformation: What matters now

Europe is in the midst of a global realignment of geopolitics and security policy and at the start of a fundamental technological and industrial transformation. The associated remapping of the world is often characterised as systemic rivalry with China and the USA. Against this background, the Commission has recognised the need to strengthen the EU's competitiveness and sovereignty. Energy security, access to raw materials, stable supply chains, technological development, innovation skills and digital sovereignty will play an important role in this regard. The Commission is calling its wide-ranging approach "open strategic autonomy".

This week, the Commission presented drafts of no less than four major EU projects, all of which are intended to have a significant impact on the future of the European economy in terms of competitiveness, sovereignty and resilience. Its immediate goals are to promote green technologies, improve access to raw materials, secure the energy supply and boost long-term productivity (cf. Figure 1). In this analysis, cep comments on the most important aspects of all four drafts.

Figure 1: Commission drafts and their objectives



Source: own diagram

4. Summary: Commission's legislative proposals

1.1 Critical Raw Materials Act

With the draft **Critical Raw Materials Act,** published on 16 March 2023, the Commission is delivering on its promise to present a comprehensive strategy to increase Europe's security of supply regarding critical raw materials, such as lithium and rare earths. It has not given in to the calls for the unilateral promotion of domestic mining and in this respect has refrained from new subsidy instruments and from distortive market intervention, such as purchase obligations. Instead, it is relying on a variety of measures at different levels of the supply chains, which, in addition to European raw material extraction, should serve to establish raw material reserves, strategic partnerships and, in particular, the launch of a circular economy for critical raw materials. The decision to focus on recycling permanent magnets makes sense in view of their future economic importance and the currently still under-developed recycling technology. For centralised supervision of the numerous activities at Member State level, establishing a Critical Raw Material Board as a Europe-wide coordination body is a good and leaner alternative to setting up a new European authority.

Looking at the detail, however, the Act also poses risks to Europe's future competitiveness. Thus, prioritising strategic projects for approval and financing with a view to rapid market entry makes perfect sense but, if this is detrimental to small projects, it could become an obstacle to innovation in the medium term (especially with regard to new recycling technologies). The Commission's additional definition of strategic raw materials also creates unnecessary confusion. It would have been better to divide the established concept of criticality assessment into different levels. The many new information requirements for companies in the affected supply chains (such as in connection with the regular auditing of risks, the monitoring of environmental impact, and obligations to provide evidence on the raw material content of industrial waste) risk generating considerable red tape. Key definitions and methodological requirements are reserved for future delegated acts.

Apart from the envisaged market monitoring, there is no concept for dealing with specific risks regarding external raw material procurement, in each country, either in terms of gauging these risks or managing them. Moreover, instead of focusing on building up public reserves of critical raw materials, the Commission would do better to ask Member States to increase incentives for private stockpiling (e.g. by accelerating write-offs). Finally, it is good that the Commission recognises strategic resource partnerships as a building block for greater resilience but there is no strategy for deciding which cooperation instruments Europe will use to secure the long-term partnership of resource-rich countries.

1.2 Net-Zero Industry Act

The draft **Net-Zero Industry Act**, also published on 16 March 2023, aims to increase Europe's competitiveness in climate-neutral technologies using a similar variety of measures as the Critical Raw Materials Act. It sets the target for manufacturing capacity of strategically important net-zero technologies at around 40% of EU needs by 2030, which it considers necessary to meet EU energy and climate targets. Strategically important net-zero technologies are defined as solar energy, wind power, batteries/electricity storage, heat pumps/geothermal energy, electrolysers, fuel cells, sustainable biogas production/processing, carbon capture and storage, and grid technologies.

The legislative proposal centres on lowering the administrative hurdles for net-zero industrial projects. To handle the regulatory approval processes for these projects, Member States will be obliged to create "one-stop shops" that will coordinate the exchange of documents and information between authorities and affected companies. In addition, maximum periods of 12 to 18 months will be defined for the length of permit procedures, depending on the scale of the planned production capacities. Beyond these general provisions, projects can also apply for *Net-Zero Strategic Project* status. These prioritised projects will have even shorter approval periods, and be granted additional public support for handling administrative processes and access to financing. To qualify, the project must contribute to the creation of production capacities for those components of net-zero technologies which have so far involved a high level of dependence for the EU on a single external supplier. Alternatively, qualification can be based on a contribution to the overall competitiveness of European net-zero supply chains, for which several criteria must be met. Separate regulations apply to projects in the field of carbon storage.

The fast-track approval procedures envisaged for net-zero industrial projects are, in terms of ambition, an important step towards faster implementation of the production targets that have been set. Setting time limits for basically all net-zero industry projects, rather than just for the prioritised strategic projects, also makes sense. However, it is doubtful whether Member States will be able to muster the necessary administrative capacities for this. The Commission's plan to address the issue of education and training in the field of net-zero technologies, by establishing *Net-Zero Industry Academies,* is welcome, even if Brussels only has limited room for manoeuvre here. Industry has expressed disappointment at the failure to propose any additional sources of support or other monetary incentives in connection with the draft, such as tax relief. However, this was to be expected given Brussels' limited room for manoeuvre on these issues.

The idea of introducing a new type of evaluation criterion for the public procurement of net-zero technologies poses a particular risk. In future, in addition to environmental impact, the quality criteria for decisions on awarding public tenders are to include the contribution to European resilience. As the latter is linked to the origin of the products used, fears were raised that the Commission wanted to use this to enforce a form of "Buy European" principle. Compared to the ideas that were circulating, however, the proposal appears to have been toned down on this point: The benchmark for assessing resilience is not the sourcing of products from third countries in general, but specifically the extent to which the products come from highly dominant supplier countries. The contribution to resilience is thus primarily understood to mean overcoming one-sided dependencies on individual countries rather than import substitution in general. Thus, for most net-zero technologies, the focus is very much limited to China, which could reduce the threat of trade conflicts with other third countries.

1.3 Reform of EU electricity market design

On 14 March 2023, the European Commission proposed a **reform of EU electricity market design** by way of amendments to the Internal Electricity Market Directive, the Internal Electricity Market Regulation and the REMIT Regulation for the supervision of the wholesale energy market. In view of the soaring rise in energy prices, which began as early as 2021 and was exacerbated by the Russian attack on Ukraine in February 2022, the reform aims to help reduce the dependence of electricity prices on the cost of fossil fuels, such as natural gas, accelerate the expansion of renewables, and improve the transparency, monitoring and integrity of the electricity market. Overall, the Commission wants to press ahead with the decarbonisation of the electricity sector, protect private households and businesses from short-term price spikes on wholesale electricity markets and, most notably, strengthen the international competitiveness of energy-intensive industries.

While many EU Member States are calling for fundamental reform, particularly of the price-setting mechanism on the short-term spot markets ("merit order") as well as the partial continuation of the EU emergency measures adopted in 2022, the Commission instead wants to focus on increasing price stability for electricity consumers and planning certainty for players in the EU internal electricity market - in particular electricity consumers, electricity producers, technology manufacturers and investors - by way of long-term measures to accelerate decarbonisation of the electricity sector and strengthen the international competitiveness of European industry.

In order to give European industry better protection against volatile electricity prices, and to strengthen its international competitiveness, the Commission is proposing the increased use of long-term civil-law power purchase agreements (PPAs). At the same time, in the Commission's view, stable revenues for electricity producers and protection of the industry from price volatility require that any government support for new investments in renewable and nuclear power generation must take the form of two-way contracts for difference (CfDs) while Member States will have to channel "excess profits" to electricity consumers. CfDs provide stable revenues for the power producer but limit revenues when electricity prices are high.

With an increasing proportion of electricity coming from volatile renewable energies, incentives for market-stabilising behaviour are becoming more and more important. Consequently, producer prices must reflect the temporary supply situation. The Commission rightly therefore wants to retain the merit order principle as the established core of EU electricity market design as its short-term price signals provide reliable orientation. At the same time, it is an important instrument for the long-term efficient phase-out of fossil-based energy sources and, in this respect, an incentive mechanism for private investment in renewable energies. In order to protect consumers from short-term price shocks whilst also providing planning security for investors, the increased use of long-term instruments such as PPAs may be an important element in the continued development of electricity market design.

1.4 Communication on the EU's long-term competitiveness: Looking beyond the year 2030

In the **Communication on the long-term competitiveness of the EU: looking beyond 2030**, the Commission provides details about the competitiveness of the European economy today. It cites the successes achieved in transforming the European economy into a green economy but it also points out that average productivity growth in the EU since the mid-1990s has been lower than in other major economies.

The EU has identified nine mutually reinforcing factors with which it aims to increase the future competitiveness of the European economy. These nine factors are:

1. A functioning Single Market. This will be achieved by
    a. ensuring fair competition, both within the internal market and with companies from third countries, as well as
    b. simplifying administrative procedures.
2. Improved access to private capital and investment. This will be achieved by
    a. deepening the Capital Markets Union and completing the Banking Union,
    b. developing a business-friendly EU regulatory framework, including by removing tax barriers to cross-border investment, and
    c. creating a European Sovereignty Fund.

3. More public investment and improved infrastructure. This will be achieved by
    a. reforming European fiscal rules to take greater account of reforms and public investment, as well as
    b. modernising European transport infrastructure.
4. Better research and faster innovation. This will be achieved by
    a. tax incentives from the Member States,
    b. public-private partnerships and
    c. strengthening innovative capacity, especially in the areas of clean technology, biotechnology and digitalisation.
5. Secure and affordable energy. This will be achieved by
    a. the rapid roll-out of renewables,
    b. the digitalisation of energy systems and
    c. energy storage.
6. A better circular economy. This will be achieved by
    a. stronger incentives for recycling (15% of European demand should come from recycled critical raw materials) and
    b. ecodesign rules for sustainable products.
7. More comprehensive digitalisation. This will be achieved by
    a. improved cybersecurity and
    b. support for the development of key digital technology, such as artificial intelligence, digital twins, Web 4.0 and quantum computing.
8. Better education. This will be achieved by
    a. improving the mutual recognition of qualifications,
    b. increasing the participation of women, young people and third-country nationals in the labour market, and
    c. promoting vocational education and training.
9. Open trade and strategic autonomy. This will be achieved by
    a. deepening ties with allies and
    b. developing new trading partnerships.

The Commission also wants to

- give new regulations a competitiveness check in advance,
- reduce company reporting requirements by 25% and
- design new regulation in an innovation-friendly way.

The Commission has rightly recognised that the competitiveness of European companies is key to achieving the desired policy goals, most notably the transformation towards a green and digital economy. However, the measures which the Commission sets out lack ambition. In many cases, it has simply listed measures and programmes that already exist and will either just be continued or only adapted slightly. Thus, the measures envisaged in the field of energy are unlikely to lead to competitive energy prices in the EU. Nor will the aforementioned measures in the field of education eliminate the shortage of skilled workers which exists in many Member States. Even the small number of new measures, such as the promised reduction in bureaucracy for reporting requirements, do not go far enough because not only are companies groaning under the weight of reporting requirements but also under auditing and documentation obligations, such as those contained in the planned Supply Chain Act and the General Data Protection Regulation. Both pieces of legislation pursue correct and important goals but they also hamper entrepreneurial action because companies now have to fulfil a whole range of obligations before they can even start producing their goods or services. In short, the measures set out in the Communication will not be enough to ensure the competitiveness of European companies beyond 2030.

5. Strategically over-defensive and in regulatory terms limited in scale: Why the Commission falls short

One thing is clear: by submitting these four EU projects, the Commission is taking important steps and picking up the pace. This is good and necessary because strategic deficits and one-sided dependencies have formed in many areas, which could jeopardise the EU's competitiveness, sovereignty and resilience in the medium term. Nevertheless, the geopolitical conflicts and industrial transformation processes - above all digitalisation and climate neutrality - demand a higher level of initiative and strategic foresight.

The Commission is on the right path with the four EU proposals and pushing things along but its approach is very small scale and, in some cases, interventionist, while considerably increasing the bureaucratic burden on companies. cep advocates an approach that places reliance on innovation skills and entrepreneurial freedom to strengthen competitiveness. Geostrategic sovereignty has always hinged on the ability to develop leading-edge technologies, produce on an industrial scale and tap into international markets. Resilience will not be increased by moving industries and value creation back to the EU - this will be detrimental to welfare and reduce diversification of supply chain risks – but, most notably, by way of open markets and strategic partnerships. Competitiveness, sovereignty and resilience must be thought of in terms of an integrated strategy (cf. Figure 2).

Figure 2: An integrated strategy

Source: own diagram

Two main areas of criticism have been identified:

1. The Commission’s response is strategically defensive: It focuses to a large degree on the EU's weaknesses without adequately developing the EU's potential strengths with regard to geopolitical systemic competition and industrial transformation processes. Furthermore, the EU is structured differently to the USA and China and must therefore move systemic competition onto a different playing field. An EU strategy must be derived from shared interests which, with 27 Member States, are diverse. The measures have to strengthen EU competitiveness, sovereignty and resilience without fragmenting the single market, which is now 30 years old.
2. The measures proposed by the Commission are small-scale and bureaucratic. The regulatory approach is based on detailed specifications. A lot of potential lies in strengthening individual economic responsibility and ability to take the initiative. An "emergent" regulatory approach is therefore needed. This would have the advantage that the Commission would not have to encroach further upon national competences and approval procedures, which is one of the possible areas of conflict with the present drafts. The express intention to reduce the burden of bureaucracy is illogical given that the drafts are likely to produce even more of it.

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