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Abstract

The European Commission presented its Competitiveness Compass – its "rescue plan" to address the EU's lagging economic performance, innovation and productivity in the coming years. The initiative promises to coordinate industrial policy, decrease business regulation and boost investment. It focuses on closing the innovation gap to the USA; on addressing the static industrial structure and increasing the low private sector research and innovation spending. It seeks to close comparative disadvantages from high administrative and regulatory burden and high energy prices, while preserving the course to carbon neutrality. It also wants to accelerate the access to EU funds and repurpose them to sectors of strategic importance for Europe. This short briefing paper presents a summary of the main points of the Competitiveness Compass and analyses them.

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The European Commission Competitiveness Compass – a Roadmap for Europe

Gabriel Felbermayr and Atanas Pekanov

The European Commission presented its Competitiveness Compass – its „rescue plan" to address the EU's lagging economic performance, innovation and productivity in the coming years. The initiative promises to coordinate industrial policy, decrease business regulation and boost investment. It focuses on closing the innovation gap to the US; on addressing the static industrial structure and increasing the low private sector research and innovation spending. It seeks to close comparative disadvantages from high administrative and regulatory burden and high energy prices, while preserving the course to carbon neutrality. It also wants to accelerate the access to EU funds and repurpose them to sectors of strategic importance for Europe. This short briefing paper presents a summary of the main points of the Competitiveness Compass and analyses them.

On the 29 January 2025, the European Commission presented its Competitiveness Compass (European Commission, 2025). It proposes a set of regulatory steps and new policies to adopt in the coming years. They are meant to address the EU's lagging economic performance, innovation and productivity along the recommendations of the Draghi and Letta Report (Draghi, 2024; Letta, 2024). Highlighting the urgency of the matter, the Commission uses the term "rescue plan" to describe its initiative, which promises to coordinate **industrial policy, decrease business regulation and boost investment**. The Compass focuses on three factors to explain Europe's slow productivity dynamics and its lagging performance relative to the US: (i) **an innovation gap**, when compared to the US tech and digital sector; (ii) **a static industrial structure in Europe with fewer start-ups** and (iii) **low private sector research and innovation spending**. On innovation, the goal would be to catch up on the fronts where Europe is lagging through a combination of disruptive innovation brought about by new, dynamic start-ups challenging incumbents; large-scale innovation introduced by companies; and efficiency gains in mature traditional industries applying innovation.

The Competitiveness Compass summarises the new European Commission's strategy to achieve a Europe *"where tomorrow's technologies and clean products are invented, manufactured and marketed"*, while preserving the course to carbon neutrality. Furthermore, it seeks to ensure more European **cutting edge scientific and research innovation**, rewarding risk, entrepreneurship, and talents as well as providing quality jobs. To achieve that, the Commission proposes a combination of steps to **simplify the regulatory environment,** to **accelerate the access to EU funds, to repurpose those funds to strategic sectors of common importance**, and to **mobilise considerable private investments**. This short briefing paper presents a summary of the main points of the Competitiveness Compass and analyses them.

1. A focus on strategic sectors

The Commission sees **current industrial policies** as fragmented between the EU and Member States and across multiple, uncoordinated objectives. It therefore sees the need for **greater coordination** between EU and Member States and a **greater collaboration on cross border projects, in sectors deemed of strategic importance**. Therefore, it proposes intensified coordination for some areas with clear added value for EU Competitiveness such as such as **energy infrastructure (electricity grids and storage), digital infrastructure, AI, critical medicines**. Funding for the implementation of these plans should come from the EU budget, national funding, and private capital. In Felbermayr and Pekanov (2024) we argued for the need for more common action on these fronts, especially in relation to electricity grids, as well as significant backing by the EU budget. Such an increased focus would be particularly useful in the area of **cross border projects** – where the difficulties and costs of coordination between Member States often means governments just avoid pursuing cross-border projects. In Felbermayr and Pekanov (2024) we point out to the lagging coordination on cross-border projects and the insufficient use of EU funds for such projects, even after some mild measures to direct European funding through the RRF towards them. While worth pursuing in general however, **the idea of coordinated industrial policy is very hard to achieve** – EU Member States continue to have diverging opinions on even whether an active vertical industrial policy is overall a good thing or not, let alone a unified opinion in which sectors it should be used[1]).

Furthermore, the Compass proposes to introduce a new so-called **Competitiveness Coordination Tool** to facilitate pan-European projects and to encourage Member States to work together on the Commissions priorities. For the further development of this Competitiveness Coordination Tool, the report mentions the "*successful experience with the Strategic Technologies for Europe Platform (STEP), under which over EUR 6 billion have already been redirected from Member States' Cohesion Policy Funds to support strategic objectives*" (European Commission, 2025). However, STEP was introduced only in 2024 and with a small budget of 10 billion € and still in implementation, the question whether the experience with this instrument to stimulate specific investments in the EU is indeed positive is still open.

The Compass also plans a ***"wider use of Important Projects of Common European Interest (IPCEI) for innovative sectors"*** (European Commission, 2025). IPCEIs are consortia between different Member States and private firms from these Member States. The consortia pursue specific projects in a given sector (like semiconductors, batteries or others). Under the umbrella of IPCEI alliances, procedures to receive approval on state aid and other subsidies are fast-tracked. The EU budget, however, does not provide any funding for IPCEI alliances, leaving the funding for these projects to the private sector and national governments.

[1]) Some Member States want to help their national champions, others a more broader tax and incentives stimulus without a specific sector in mind.

2. How to fund this?

To achieve all of this, there is a wide consensus by now that **Europe will need significant investments** in the coming years and there is also wide acceptance that this will need to come **both from the public side (national and EU Budget) and the private sector**. The Draghi report assess the combined additional investment needs in Europe at 750-800 billion € per year by 2030 (Draghi, 2024). Our assessment in Felbermayr and Pekanov (2024) is similar – we propose an increase in the EU budget to up to 4% of the EU GDP in comparison to the current EU budget of around 1%.

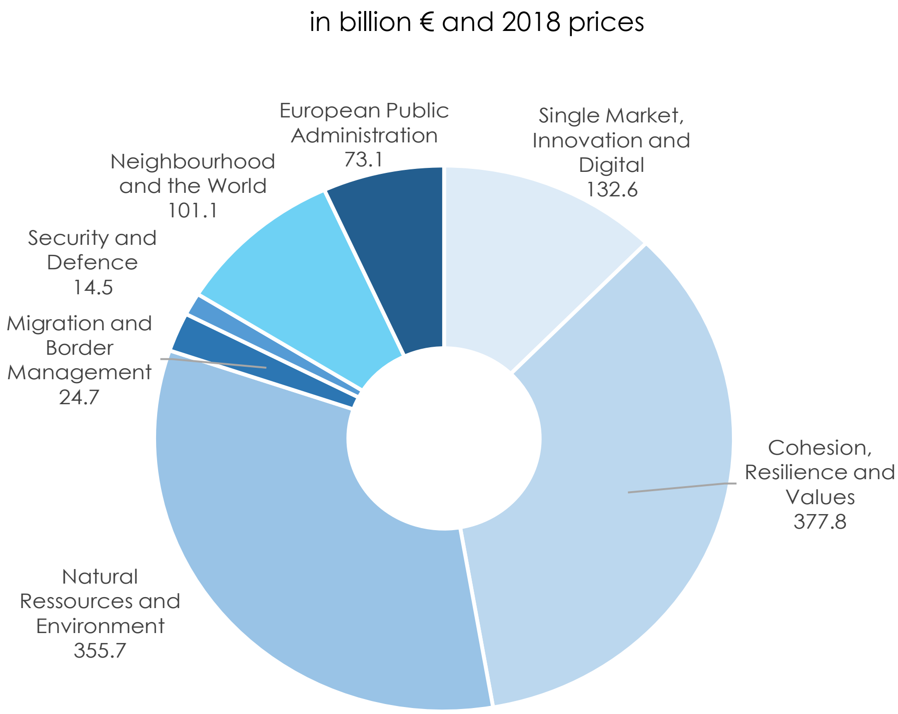
On the private sector side, funding is expected to come from a renewed push towards better usage of EU savings towards investments. To this end, the long-discussed goal of completing **the Capital Markets Union is now being rebranded into a Savings and Investment Union**. Changing the narrative can help show to European citizens the financial losses that they sustain due to the lacking harmonisation of European capital markets. "*The EU's household saving rates was 65% larger than in the US in 2022. Yet, the EU's financial sector does not channel them efficiently to productive investment or allocate sufficient capital to EU innovation. As a result, every year EUR 300 billion of savings from Europeans are invested in markets outside the EU*" (European Commission, 2025).

The Commission envisions such a push to the consolidation of capital markets in the EU with ambitious measures for "***much more unified supervision***" and by **removing *"barriers to market-driven consolidation of infrastructure"*** including for stock markets, exchanges, and funds, which will result in a reduction of the numbers of stock exchanges in Europe, as proposed also in Pekanov (2024). The European Commission also plans the introduction of an **EU single, low-cost savings and investment product**, to be presented in Q2 2025, as well as the necessary steps to finally **improve the regulatory framework for pension and investment funds to invest in Europe**. Without putting too much focus on it, the Compass also mentions the lacking risk appetite and the resulting low profits that European savers accumulate on their savings and hints to the wish to **address the broader financial literacy and investment culture in Europe**. Finally, the very challenging issues of harmonising insolvency and other financial sector related laws to align capital markets across the EU are mentioned. For a summary of the different necessary steps to make practical progress on CMU, see Pekanov (2024).

In terms of public funding, the Compass suggests some of the **current existing spending can be repurposed** – **from Cohesion Policy**, a traditional tool used for infrastructure, healthcare and educational purposes in laggard regions**, to specific sectors of EU strategic importance**. A similar idea is floating around on the RRF funding, but details are scarce. Introducing some flexibility to repurpose funds from the RRF however could be essential, since Member States are lagging in receiving these funds and implementing their national reforms and investments before the final deadline of using the funds by the summer of 2026. The Report also talks about a "*European Investment Bank-led investment program to bridge a financing gap "to support disruptive innovation, strengthen Europe's industrial capacity and scale up companies in innovative technologies.*"

For the next EU budget – the Multi-Annual Financial Framework (MFR) 2028 – 2034, the Commission will present its first proposal in the summer of 2025, which will be followed by a long process of negotiations between the Commission, Council, Parliament and Member States of around two years. The Commission **sees an opportunity to rethink the structure and allocation of the EU budget *"in support of competitiveness priorities"***. The Commission considers **relocating some of the current priorities such as regional development and cohesion policy towards sectors ensuring the EU competitiveness**. *"A new **European Competitiveness Fund** should respond to these needs…, by **financing investments in strategic technologies and manufacturing – from AI to space, from clean tech to bio-tech** – and helping to leverage and de-risk private investments and support R&D."* The new European Competitiveness Fund would replace the idea of the never realised EU Sovereignty Fund with the aim to finance investments in strategic sectors and therefore implement **industrial policy at the EU level**. On the other hand, the Compass mentions that in line with the recommendations of the Draghi Report, "*the successor to the EIC should be structured like an ARPA-type agency for increased risk taking*". In Felbermayr and Pekanov (2024) we also discuss the need for a considerable boost to EU research and development spending, combined with a new governance framework. For us, this should revolve around creating EU-wide academic and research institutions, an enhanced environment for researchers, and improvements in the selection process of top scientific ideas.

Figure 1: **EU Budget 2021 – 2027 without NGEU**



Source: Council of the European Union (2024).

The Compass also correctly identifies that **the current EU budget is too fragmented** – it includes tens of different programmes with different rules and application frameworks, making it very difficult for businesses, households, NGOs and other organisations to have a transparent and clear view. The Compass therefore recommends focusing the future disbursement of EU funding to follow "*commonly agreed funding priorities in the form of EU public goods and multi-country investment projects, to be defined through strengthened policy coordination tools*". While this sounds reasonable, simplifying the next MFF is no easy feature as the different programmes so far have had different goals, traditions, histories, and approaches. Initial reports have pointed towards an increased interest by the Commission to take the so-called performance-based approach of the Recovery and Resilience Mechanism/NextGenEU as the new approach to disbursing European funding, instead of the traditional approach based on costs incurred.

While the performance-based approach can be helpful in pushing the implementation of important reforms, it is already showing **significant weaknesses** that can be observed through the **slow disbursement of funds and major delays in the receipt of payments** by Member States. For example, until now, **Austria and Bulgaria have received only one payment from their Recovery and Resilience Funds, although according to their initial plans they should have received more than four by now to receive all the eight tranches by 2026.** The delay in the implementation of National Recovery and Resilience Plans is due to a mixture of factors including the energy and inflation shock, the inability of Member States to find Parliamentary majorities for unpopular reforms, or the changes of governments with different reform priorities. Some of these delays are due to the inability of the Member States, others to the **embedded inflexibility** of the European Commission in the distribution of RRF funds. The performance-based approach of the RRF currently thus can result in **uncertainty on the exact amount of EU funds to be received by Member States and therefore in uncertainty for final beneficiaries, which also results in a laggard performance of the investment projects these funds should finance**. **The current performance-based approach needs a re-thinking and its one-to-one implementation as a general rule for the next MFF will be rather risky**.

3. Competitiveness through regulatory simplification and decreasing costs

The Competitiveness Compass emphasizes the need to reduce **bureaucracy and administrative burden and to simplify the complicated** set of rules in Europe. This will start with the presentation in February of the so-called Omnibus package, with the goal to speed up and improve administrational processes and to reduce the reporting burden for businesses, especially for smaller and mid-cap companies. Permitting and administrative procedures should be streamlined, also as part of the Clean Industrial Deal Plan.

The Compass also addresses Europe's substantial competitive disadvantage due to high energy prices, a central topic also of the Draghi Report. The European Commission will therefore propose new measures to "*de-risk long-term power contracts for businesses, more evenly share the costs of running energy networks in the bloc by redesigning tariffs, and incentivize industries to use, store and sell excess energy to the grid more efficiently*". The **Affordable Energy Action Plan** will aim to ensure access to low-cost electricity for households and industrial customers by further market integration, use of guarantees and risk reduction instruments to facilitate long-term power purchase agreements, incentivise industrial customers to provide demand flexibility services and encourage a fair allocation of energy system costs through better designed tariff methodologies.

4. Horizontal measures, further policies and missing pieces

The Compass also mentions further important topics such as:

- The setting up of a Union of Skills to include a STEM Education Strategic Plan, a Basic Skills Action Plan on school education, and a European Strategy for Vocational Education and Training;
- An industry platform for buying strategic raw materials;
- Review of **public procurement rules**, which could also favor **Made-in-Europe** products;
- **A 28th (EU-level) legal regime** for incorporating a firm to simplify applicable rules and reduce the cost of failure, including aspects of insolvency, labour law, and tax law;
- **EU Start-up and Scale-up Strategy** to address *"bottlenecks to market entry and scale-up, including relations between universities and business, cross-border mobility of talent and skilled workers, access to risk finance, barriers within the Single market, infrastructure constraints, insufficiently targeted innovation support.";*
- The **Apply AI Strategy** to boost new industrial uses of AI in sectors, such as manufacturing, automotive, energy, robotics, pharmaceutical and aeronautics, public services and healthcare;
- The Commission also envisions **a substantial increase in the level of defence cooperation** between Member States as discussed in Felbermayr and Pekanov (2024). This will include using **joint defence procurement to use aggregated demand to achieve cost efficiencies through economies of scale**, as well as industrial cooperation on joint R&D and pooling resources through Defence Projects of Common European Interest;
- **The future EU research budget**, with a more strategic and less bureaucratic approach to supporting the transition from applied research to the scale-up phase, will provide targeted support to industrial competitiveness.;
- **A flexible and more supportive state aid regime** to better help companies, especially energy intensive ones, in their effort to switch to clean technologies as part of the Clean Industrial Deal. Specific attention here will be paid to **industries such as steel and metals, chemical or cement**, which are the most vulnerable in the transition;
- On mergers and acquisitions and therefore a more flexible anti-trust policy, the Compass mentions briefly the need for a reconsideration and to be "*more supportive of companies scaling up in European and global markets*", while will be "*reflected in new guidance for assessing mergers so that innovation, resilience and the investment intensity of competition in certain strategic sectors are fully taken into account.*".

5. Critical assessment

The Compass has some missing pieces. It rightly points that legislation is important and it needs to be improved and streamlined. At the same time, what matters both for short-term economic dynamics and for expanding the long-term economic potential of the EU, there is a need to ensure and mobilise investments, for which sometimes governments or the EU are responsible and must deliver more rapidly and decisively.

The Compass promises to do a lot for SMEs and for mid-size companies. It wants to create a new definition of mid-caps, so that more companies would benefit from relaxed regulation and reporting requirements. Yet it misses to comment anything on the state and performance of large companies in Europe. The Draghi Report and especially the Letta Report make the case that there are areas where we need consolidations to reach the scale, size and innovation spending potential of the biggest companies in the US, especially in tech and energy (Draghi, 2024; Letta, 2024). Beyond the plans to work on the framework for assessing mergers and acquisitions, the Competitiveness Compass does not delve much on that. Yet competition policy is crucial and the path it takes should be communicated more clearly. On the one hand, regaining international competitiveness is crucial, but on the other hand, this must not lead to higher prices for consumers in the EU.

Another missing piece is a discussion on euro denominated safe assets. The successful issuance of euro denominated assets is at the core of having a complete EMU and a strong, important international currency. The ESM recently pointed to some important milestones in regard to their own issuance of euro denominated asset[2]) – e.g. only Germany, the Netherlands, Ireland and Luxembourg borrow at cheaper rates than the ESM. This means 16 euro area countries pay more than the ESM in the market, which makes ESM issued assets a true safe asset. In 2024, Europe surpassed € 1 trillion of outstanding European safe assets, combining the ESM, the European Union and the European Investment Bank. **The completion of a true Capital Markets Union requires a true euro denominated safe asset** and common borrowing. The NextGenEU bond issuances have shown a quite positive experience on that. The coming years will require further steps to deepen the market for such assets. There are also some signs of an increased common EU borrowing, as even so-called frugal Member States, which have normally been opposing this, now see an argument for common EU borrowing to fund common defence spending.

The Compass also fails to mention the importance of the Schengen area as a crucial factor in enabling trade across the Single Market. The Schengen area brings economic benefits by enabling trade and reducing physical trade barriers, waiting times and the related costs. Yet the system has been under attack in recent years, with significant calls to improve or reform it and impediments to its normal functioning. A prolonged malfunctioning of the Schengen area will further fragment the EU single market.

Furthermore, more details are necessary on research and development, as it is an area which is central to addressing the innovation and productivity challenge of Europe. Designing innovation agencies such as the US ARPA and DARPA is a good direction, but it will also include resolving important trade-offs between the role of project officers in deciding which areas of innovation to pursue and the balance of R&D funding between the national and the EU levels.

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[2]) See: https://www.esm.europa.eu/speeches/remarks-kalin-anev-janse-omfiflbbw-euro-ssa-roundtable.

Furthermore, while regulation and investments are essential, Europe has taken a unique path to carbon neutrality. If this means competitive disadvantages in terms of costs, appropriate border adjustment mechanisms must be improved, given that the CBAM is currently a largely insufficient instrument.

6. Conclusions

The Competitiveness Compass is an important step towards a European reform programme that can only be welcomed. The use of the term "rescue package" highlights the urgency of action. The Compass touches on many of the pieces that the EU is currently missing to strengthen its economic performance and give a boost to its lagging productivity and innovation potential. It provides a piece-by-piece approach to improvement and progress in numerous avenues via different strategies, action plans and specific policy reconsiderations. At the same time, it does not provide for any revolutionary progress and can therefore also be seen as "more of the same". Nevertheless, the proposed policies are much needed and vital and it will be up to the Member States to find consensus on them quickly enough and move forward.

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