

Brussels, the 7th February 2024



To: Prof. Mario Draghi
former Italian Prime Minister
former President of the European Central Bank

Dear Prof. Draghi,

We have the honour to request a meeting with you, in the framework of your leading role in the drafting process of the report on the future of European competitiveness that the European Commission entrusted you with.

Climate Action Network (CAN) Europe is Europe's leading NGO coalition fighting dangerous climate change and brings together over 200 civil society organisations active in 40 European countries, representing over 1,700 NGOs and more than 40 million citizens. We understand that you have been meeting with policy makers and industry representatives and would find it important to bring in a perspective from the climate movement.

We would like to share our views on some of the challenges facing industry and companies in our Single Market, which resonate with our mandate, as well as our concerns on the EU's current approach to industrial policy, macroeconomic competitiveness, and associated public and private finance policies. Building on those concerns, we propose some key recommendations which you can find enclosed in a discussion note below.

As further elaborated in the latter, all the existing evidence suggests that improving the EU's competitiveness and productivity issues cannot be achieved without:

1. Ending the bloc's dependence on imported fossil fuels via an acceleration of the renewable energy transition, coupled with prioritisation of energy efficiency and consumption reduction;
2. Drastically reducing the EU's dependence on imported material resources through the introduction of a genuine circular economy model, demand reduction and associated material efficiency across all sectors of the economy;
3. Ensuring that industrial policies at both the EU and national levels are properly targeting the relevant sectors and actors via outcome-based conditionalities;
4. EU-wide policies that are geared to the diffusion of innovation, technologies and techniques across the entire EU to address productivity differentials between countries, within countries, and within sectors;

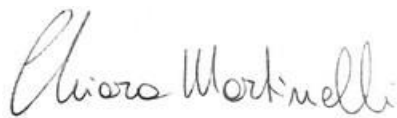
5. A properly resourced EU budget for addressing vast inequalities of access to finance, in particular green public and private finance;
6. Addressing the climate and nature related risks faced by both non-financial and financial corporations, notably for reducing risks of possible macro-financial instability.

Unfortunately, the EU's current policies on those crucial fronts are still not up to the task of responding to those major challenges - undermining both the EU's energy transition, environmental performance as well as socio-economic welfare.

As such, we hope to discuss those challenges, and possible responses, in a meeting as we are convinced that the report on the future of European competitiveness could represent a crucial contribution in the current European political debate and help shaping the policy priorities of the next EU legislative cycle.

We thank you for your attention and look forward to an opportunity for a more in-depth discussion with you.

Sincerely yours,



Chiara Martinelli

Director, Climate Action Network (CAN) Europe

Discussion note: The EU's competitiveness in an age of climate and nature breakdown

Reducing the EU's dependence on fossil fuels

The Russian invasion of Ukraine exposed the perils of the EU's dependence on imported fossil fuels, which still make up for a large proportion of the bloc's energy consumption. This dependence, due to the delays in the transition to renewable energy sources, is the root cause of the current energy crisis, which has heavily undermined European businesses and industry while bringing household energy poverty to unacceptably high levels. On a macroeconomic level, this dependence is also a drag on the EU's trade balance while shielding vulnerable households and businesses from the energy price increase was necessary, this severely impacted public finances in several member states.

Addressing this critical issue cannot consist in a mere shift of fossil fuel imports from other economic blocs. To take one example, shifting from Russian gas by importing more LNG instead of accelerating the transition to a fully renewable energy system is likely to result in a dependence on expensive LNG for decades to come – undermining the EU's competitiveness and macroeconomic conditions, and jeopardising Europe's commitment to decarbonise its economy and keep global temperature below 1.5C. It also opens the door to further weaponisation of Europe's dependency on imported energy, in a geo-political context that promises to remain extremely tense in the coming years.

Among others, our briefing on how to Repower the EUⁱ, based on our Paris Agreement Compatible model pathwayⁱⁱ, outlines the concrete policies and steps that should be taken for phasing out the EU's dependence on fossil fuels through an accelerated renewable energy transition. Our analysis suggests such a pathway would equally generate substantial co-benefits for the EU's economy and societyⁱⁱⁱ.

Reducing the EU's dependence on imported material resources

Although the shift to a circular economy is part and parcel of the EU Green Deal, the EU's economy remains heavily dependent on the extraction of material resources, notably minerals, which are available in limited quantity and mostly sourced abroad. Along with negative environmental impacts, considerable economic vulnerabilities arise from the EU's heavy dependence on non-EU imports from a limited number of countries governed by authoritarian regimes. For example, 98% of the EU's rare earth elements supply comes from China^{iv}.

However, progress towards circularity and the reduction of the EU's resource footprint remains painfully slow and highly uneven across the Union^v.

Reducing the EU's material footprint is a *sine qua non* for (a) ensuring the EU's strategic autonomy, (b) reducing global pressures on natural resources and biodiversity, (c) achieving the Paris Agreement target and (d) boosting the EU's economy.

For example, all available evidence suggests that the transition from a “linear” to a “circular” economic model would create additional (net) employment, notably by boosting intra-EU supply chains. Evidence equally suggests that reducing the material footprint of key sectors would significantly improve business productivity, especially for SMEs^{vi}.

Table 1: Examples of studies on economy-wide impacts related to the circular economy

Study	Scope	Description	Employment impact
WRAP, 2015	UK	Ambitious scenario of reuse, recycling and material efficiency	102,000 (decrease in net unemployment)
Club of Rome, 2015	France, Finland, Sweden, Netherlands, Spain	Material efficiency scenario: 25% increase in resource efficiency 50% replacement of virgin material inputs with recycled inputs	France: 500,000 Finland: 75,000 Sweden: 100,000 Netherlands: 200,000 Spain: 400,000
ECOAP, 2014	EU	Resource productivity increase of 30%, leading to an 1% increase in the EU GDP	2,000,000
Meyer, 2011	EU	Increasing resource efficiency with 25%	2,600,000
European Commission, 2014	EU	3% increase of resource productivity per annum	2,000,000

Source: Cambridge Econometrics, Trinomics, and ICF^{vii}

As such, we consider that any strategy to improve the EU's “competitiveness” must entail an acceleration of a circular economy transition aiming to significantly reduce the EU's material footprint, from the design of products to the management of waste and directing support to business models integrating sufficiency in their approach. Among other measures, we consider that at minimum the following steps should be recommended:

1. Adopt an EU Directive to set a legal objective for the Union to reach sustainable levels of resource consumption in relation to its biocapacity. It will include a clear delineation of the EU's and each Member State's role in reducing material footprints (fossil fuels, biomass, metals, minerals).
2. Adopt binding reduction targets for EU material footprint (raw material consumption, as measured by Eurostat^{viii}) to 5 tonnes per capita by 2050 (a 66% reduction compared to 2022 levels of 14.8 tonnes per capita), with mid-term reduction targets of at least 20% by 2030 (11.8 tonnes per capita per year) and at least 50% by 2040 (7.4 tonnes per capita per year). National targets for each Member State to reach should subsequently be developed, indicated in tonnes per capita rather than a percentage reduction, and taking

into account specific Member State contexts, biocapacity, historical responsibility and more.

3. The Union and its Member States should commit to integrating sufficiency into the coming overall strategic document to guide the Union for the next five years, supported by national strategies, to support the achievement of the targets with a focus on reducing resource use in high-consumption sectors such as transport, construction and digital sectors and developing sector-specific roadmaps with binding sub-targets.

A green industrial policy that is fit-for-purpose

Shifting away from a carbon and material intensive economy requires a holistic industrial policy framework that can deliver a transformation of the EU's business models and economic structures. Unfortunately, the EU's Green Deal Industrial Plan and its legislative offsprings (Net Zero Industry Act and Strategic Technologies for Europe Platform) are inadequate for delivering this change as they largely rely on a crude approach of indiscriminate subsidies to large industries^x.

As pointed by both international evidence^x and academic literature^{xi}, any successful industrial policy must rely on conditionalities, and systems of incentives and disincentives to deliver positive economic, social and environmental outcomes. Yet, the financial leg of the Green Deal Industrial Plan fails this critical test. Based on our previous assessments^{xii}, we consequently recommend among others:

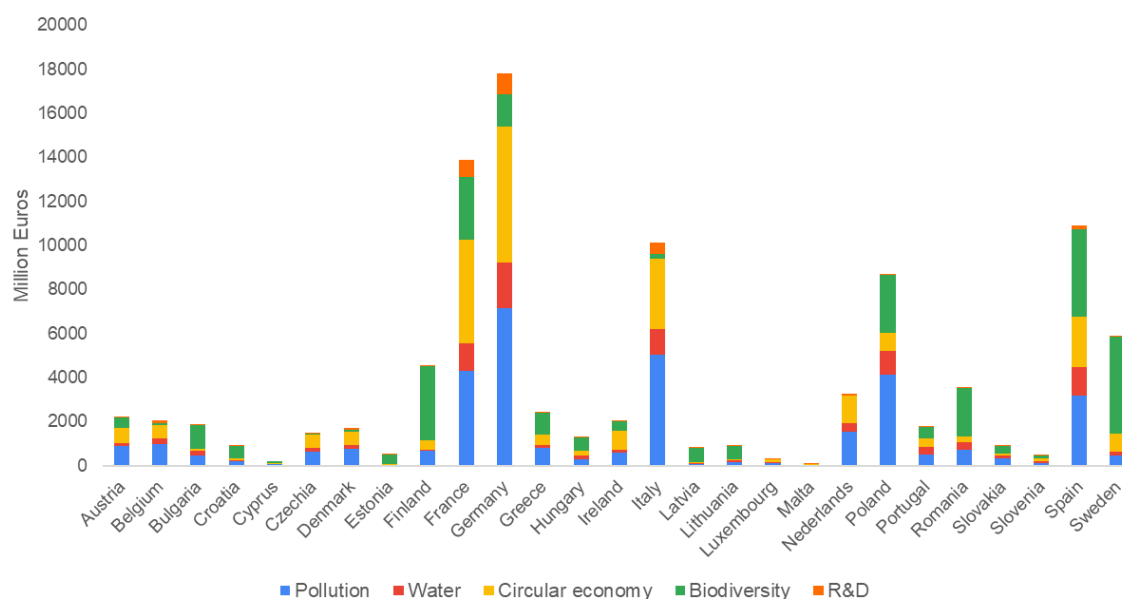
1. **Green conditionalities:** Public and private companies benefitting from public subsidies, whether via State Aid or EU funding, should divest from climate and environmentally harmful activities, which includes accelerating the shift to renewable energy sources. This requires significant regulatory reforms at the macro level as well as robust prerequisites at the micro level. Among others, governments should end both explicit and implicit (e.g. free ETS allowances) fossil fuel subsidies for these companies as a precondition for accessing more public funds.
2. **Social conditionalities:** Conditions such as gender equality in recipients' operations, respect for collective bargaining, participation of workers as shareholders to move towards alternative business models, prioritisation of social and environmental goals in companies' operations, a ban on dividend payments while a company is in receipt of state aid, and a requirement that a proportion of the profits should be distributed to workers and reinvested in greening the company's operations.
3. That the provision of subsidies to private sector companies should **differentiate between large corporations and SMEs**; indeed, while the former do not have a problem of access to finance (no "market failure" except for specific expenditures e.g. R&D) the latter often do. An indiscriminate channelling of resources would risk wasting scarce public resources in investments with little additionality (investments that could have happened anyway without public support); these are resources that are desperately needed for closing the "green public investment gap"^{xiii}.

- Addressing within-Union inequalities. An EU-wide green industrial policy should consist in “lifting all boats”, not simply reinforce “champions” in rich EU Member States while others are lagging behind. Indeed, there are vast inequalities in the Green Complexity Index of production across Member States^{xiv}. Likewise, it should ensure that technological and technique capabilities are broadly diffused across the economic tissue within Member States, notably SMEs.

A transformative EU budget

Despite the adoption of Next Generation EU, large investment gaps remain for delivering both climate and other EU Green Deal targets^{xv xvi}. These investment gaps notably entail crucial public infrastructure that cannot be financed through private capital and are intimately linked to the private sector’s transition to a decarbonized, less material intensive economic model. To take but two examples, it is impossible to envisage the transition to a more circular economy without the associated public infrastructure for waste recycling. Similarly, the decarbonisation of the transport fleet requires extensive public infrastructural investments for creating the “demand base” for a public and private electric fleet.

Figure 1: Annual investment gap for achieving selected Green Deal target on top of climate investment gaps (2021-30)



Source: European Semester reports 2023

The EU will likely face a “crunch point” in 2026 when Next Generation EU ends, dividing almost in half the finance available especially to periphery Member States that are fiscally constrained both by high interest rates as well as the Stability and Growth Pact. The ongoing reform of the EU fiscal rules is not expected to significantly improve the situation.

As such, any strategy to address competitiveness in the EU must include proposals for the post-2026 period, providing Member States with the necessary resources to finance those investments. Such proposals must entail financing options such as sources for EU new own resources^{xvii}. It is also crucial to give households and companies the long term perspective that they need to plan their own investments.

Finally, in line with both International Monetary Fund recommendations and previous EU commitments, fossil fuel subsidies (in the form of investment support) should be permanently excluded in the totality of EU funds^{xviii}.

A regulatory “race to the top”

There is a strong positive correlation between productivity and strict social and environmental standards^{xix}. The latter provide the necessary incentives for capital investments that can both improve labour productivity while delivering on reducing emissions and enhance resource productivity and material footprint reduction. Any strategy to enhance the EU’s competitiveness must be based on a regulatory “race to the top” as opposed to the simplistic “cost competitiveness” approach that were prevalent during the debt crisis period and was based on an undermining of social rights and environmental regulation in several Member States^{xx}.

On this front, there have been important legislative initiatives under the current European Commission’s mandate to ensure that products and goods put on the EU market meet certain social and environmental requirements, wherever they are produced and whoever puts them on the market (Deforestation regulation, Forced labour regulation (in progress), Corporate sustainability due diligence Directive (in progress), eco-design regulation (in progress), and the Carbon border adjustment mechanism). These are important initiatives to avoid a “competitiveness” that is based on labour dumping, human rights abuses and environmental degradation, notably when sourcing raw materials.

However further regulatory efforts are needed for transitioning from a carbon intensive and resource wasteful “linear” economy that depends on the permanent extraction of material resources, notably minerals, which are available in limited quantity and mostly sourced abroad. Those efforts should take into account possible impacts on third developing countries.

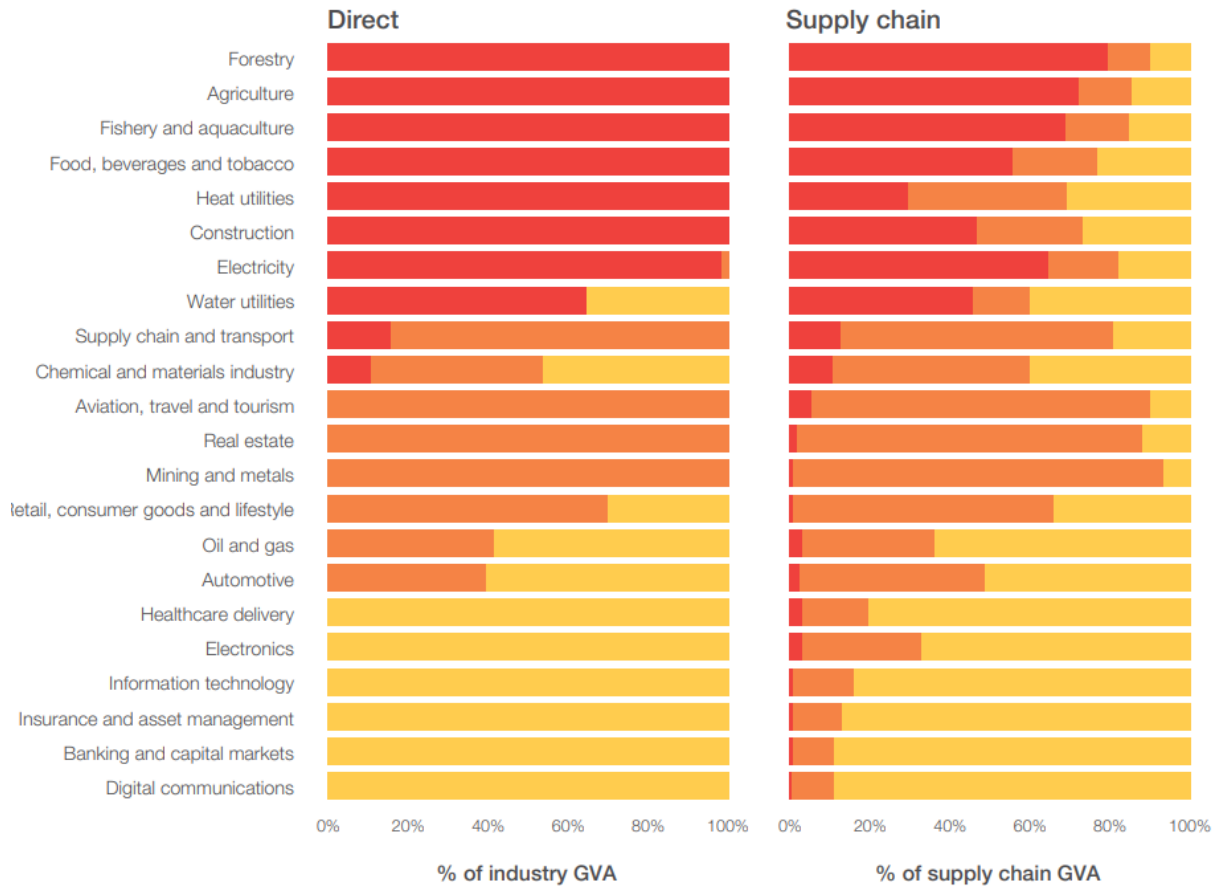
Addressing climate and nature-related risks

Finally, there is ample evidence the EU financial and non-financial corporations are exposed to significant climate^{xxi} and nature related risks^{xxii} not least due to strong sectorial dependencies on nature (Figure 2) ^{xxiii}. These risks could become systemic and undermine the EU’s financial and economic stability.

Although the European Central Bank has been integrating exposure to climate related risks into micro and macro prudential supervision, more regulatory steps should be taken to prevent climate impacts morphing into significant economic crises. Among many others, adaptation objectives could be integrated into the totality of new infrastructure projects and companies’ capital investments at a micro level, along with requirements to reduce businesses’ environmental and resource pressures.

However, it should be acknowledged that climate and nature related risks cannot be addressed without dealing the root cause by significantly halting climate change and biodiversity loss. As such, climate and environmental policy are inextricably tied to any economic policy or, indeed, “competitiveness” strategy.

Figure 2: Percentage of direct and supply chain GVA with high, medium and low nature dependency, by industry



Source: World Economic Forum^{xxiv}

Endnotes

- ⁱ CAN Europe (2022). Repower for the people. <https://caneurope.org/content/uploads/2022/05/Repower-for-the-People-Briefing-2.pdf>
- ⁱⁱ CAN Europe (2023). The Paris-Agreement-Compatible (PAC) scenario for the energy transition. <https://caneurope.org/civil-society-europe-climate-neutrality-2040-scenario/>
- ⁱⁱⁱ CAN Europe (2024). Paris pact payoff: speeding up the transition for socio-economic benefits. https://caneurope.org/content/uploads/2024/01/CAN-Europe-co-benefits-of-climate-action_REPORT.pdf
- ^{iv} Roland Gauß, Carlo Burkhardt, Frédéric Carencotte, Massimo Gasparon, Oliver Gutfleisch, Ian Higgins, Milana Karajić, Andreas Klossek, Maija Mäkinen, Bernd Schäfer, Reinhold Schindler, Badrinath Veluri (2021). Rare Earth Magnets and Motors: A European Call for Action. A report by the Rare Earth Magnets and Motors Cluster of the European Raw Materials Alliance. <https://eitrawmaterials.eu/wp-content/uploads/2021/09/ERMA-Action-Plan-2021-A-European-Call-for-Action.pdf>
- ^v Eurostat material flow accounts statistic. https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Material_flow_accounts_statistics_-_material_footprints
- ^{vi} RPA (2015): Assessing the Potential Cost Savings and Resource Savings of Investments in 4 SME sectors, report for DG Environment, February 2015, Loddon, Norfolk, UK
- ^{vii} Cambridge Econometrics, Trinomics, and ICF (2018). Impacts of circular economy policies on the labour market. Final report to the European Commission.
- ^{viii} Eurostat material flow accounts statistic. https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Material_flow_accounts_statistics_-_material_footprints
- ^{ix} CAN Europe (2023). The STEP proposal. <https://caneurope.org/the-step-proposal-recovery-funds/>
- ^x Wade, R. (1990) Governing the Market Economic Theory and the Role of the Government in East Asia Industrialization. Princeton University Press, Princeton.
- ^{xi} Mazzucato, M. and Rodrik, D. (2023). Industrial Policy with Conditionality: A Taxonomy and Sample Cases. UCL Institute for Innovation and Public Purpose, Working Paper Series (IIPP WP 2023-07). Available at: <https://www.ucl.ac.uk/bartlett/publicpurpose/wp2023-07>
- ^{xii} CAN Europe (2023). The proposal for a new sovereignty fund: a bogus good idea? https://caneurope.org/content/uploads/2023/01/proposal_for_a_sovereignty_fund.docx.pdf
- ^{xiii} Claudio Baccianti (2023). EU climate funding tracker. https://www.agora-energiewende.org/fileadmin/Projekte/2023/2023-07_EU_MacroNext/A-EW_EU-ClimateFundingTracker-documentation_WEB.pdf
- ^{xiv} Andres, P and Mealy, P (2023) Green Transition Navigator. www.green-transition-navigator.org.
- ^{xv} CAN Europe (2022). The contribution of EU funds to ambitious National Energy and Climate Plans. Unify project. https://caneurope.org/content/uploads/2022/08/Final-report_UNIFY_EU-FUNDS.pdf
- ^{xvi} Claudio Baccianti (2023). Op. Cit.
- ^{xvii} European Commission (2023). Working staff document accompanying the document Amended Proposal for a Council Decision amending Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union https://commission.europa.eu/system/files/2023-06/SWD_2023_331_1_EN_autre_document_travail_service_part1_v4.pdf

^{xviii} CAN Europe (2023). Fossil fuel subsidies in the EU.

<https://caneurope.org/content/uploads/2023/03/Fossil-Fuels-Subsidies-Report.pdf>

^{xix} European Environment Agency. (2019). Demanding environmental policy is associated with greater competitiveness and more eco-innovation in EEA member countries.

<https://www.eea.europa.eu/data-and-maps/figures/demanding-environmentalpolicy-is-associated>

^{xx} Felipe, Jesus and Kumar, Utsav, Unit Labor Costs in the Eurozone: The Competitiveness Debate Again (2011). Levy Economics Institute of Bard College Working Paper No. 651,

^{xxi} Alogoskoufis, Spyros & Dunz, Nepomuk & Emambakhsh, Tina & Hennig, Tristan & Kaijser, Michiel & Kouratzoglou, Charalampos & Muñoz, Manuel A. & Parisi, Laura & Salleo, Carmelo (2021) ECB's economy-wide climate stress test. Occasional Paper Series 281, European Central Bank.

^{xxii} Abdelli, Maud & Mugglin, Ivo & Vardakoulias, Olivier & Pacheco, Pablo & Elliot, Wendy & Church, Rebekah & Schmitt, Susanne & Morgan, Alexis. (2021). Nature's next stewards: Why central bankers need to take action on biodiversity risk. WWF Switzerland.

https://wwfint.awsassets.panda.org/downloads/wwf_report_nature_s_next_stewards_14_july_2021.pdf

^{xxiii} PWC and World Economic Forum (2019). Nature Risk Rising: Why the Crisis Engulfing Nature Matters for Business and the Economy.

http://www3.weforum.org/docs/WEF_New_Nature_Economy_Report_2020.pdf

^{xxiv} PWC and World Economic Forum (2019). Op. Cit.