

# THE NEW EUROPEAN COMMISSION: BALANCING DECARBONIZATION AND COMPETITIVENESS

## — FINDINGS AND ISSUES HIGHLIGHTED IN THE DRAGHI REPORT —

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### SUMMARY

- One of the top priorities of the new European Commission, led by Ursula von der Leyen in her second term, is to strengthen EU competitiveness. The main challenge is finding a balance between this goal and the decarbonization efforts.
- The policy recommendations compiled by Mario Draghi, a former prime minister of Italy and former president of the European Central Bank, suggest that one of the challenges in pursuing both competitiveness and decarbonization includes lowering energy costs through decarbonization and responding to increased global competition in clean technologies.
- The EU needs to secure significant investment capital, develop coherent strategies and coordinate policies across a wide range of policy areas, including energy, industry, and trade to enhance competitiveness. This will challenge Ursula von der Leyen and the European Commissioners to implement effective policies while setting aside political differences.

## 1. PRIORITY ISSUES FOR THE NEW EUROPEAN COMMISSION

### 1-1. The challenges facing EU President Ursula von der Leyen’s second term

December 1, 2024, a new European Commission led by President Ursula von der Leyen took office. This is von der Leyen’s second 5-year term. The core policy of her first mandate was the “European Green Deal”, an ambitious decarbonization program. The political guidelines for her second term, entitled “Europe’s Choice,”<sup>1</sup> specify that the priority areas include climate change, competitiveness, and security (Figure 1). Regarding climate change, von

**Figure 1: Priorities identified in European Commission President Ursula von der Leyen’s political guidelines**

First term (2019-2024): A Union that strives for more	Second term (2024-2029): EUROPE’S CHOICE
● A European Green Deal	● A new plan for Europe’s <b>sustainable prosperity and competitiveness</b>
● An economy that works for people	● A new era for <b>European defense and security</b>
● A Europe fit for the digital age	● Supporting people, strengthening our societies and our social model
● Protecting our European way of life	● Sustaining our quality of life: food security, water and nature
● A stronger Europe in the world	● Protecting our democracy, upholding our values
● A new push for European democracy	● A global Europe: Leveraging our power and partnerships
	● Delivering together and preparing our Union for the future

Source: Compiled by MGSSI based on materials of the European Commission

<sup>1</sup> European Commission, “POLITICAL GUIDELINES FOR THE NEXT EUROPEAN COMMISSION 2024–2029”, [https://commission.europa.eu/document/download/e6cd4328-673c-4e7a-8683-f63ffb2cf648\\_en?filename=Political%20Guidelines%202024-2029\\_EN.pdf](https://commission.europa.eu/document/download/e6cd4328-673c-4e7a-8683-f63ffb2cf648_en?filename=Political%20Guidelines%202024-2029_EN.pdf) (accessed 31 October 2024)

der Leyen intends to implement the policies and legislations towards decarbonization set out under the European Green Deal, as well as adopt a legally-binding 2040 climate target.

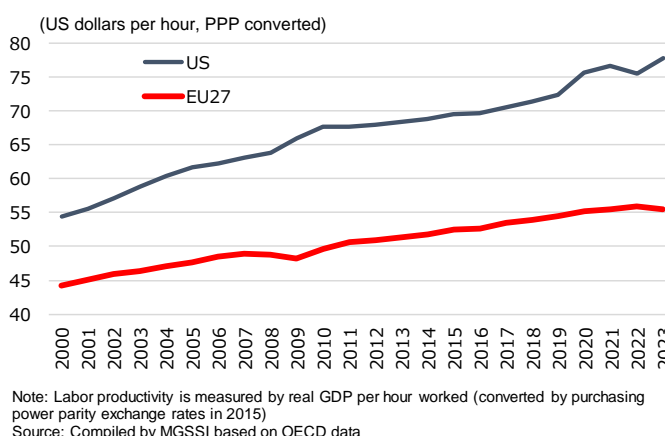
That said, there are growing concerns about the declining competitiveness of EU industries against the backdrop of high energy prices and intensifying technological competition with China and the US. For this reason, the political guidelines emphasize the importance of achieving both decarbonization and competitiveness.

## 1-2. Draghi Report: Policy recommendations to boost competitiveness

In September 2024, the European Commission issued a report entitled “The Future of European Competitiveness”.<sup>2</sup> The report, requested by the European Commission and written by Mario Draghi, former prime minister of Italy and former president of the European Central Bank, lays out recommendations for strengthening competitiveness. Within 100 days of taking office, the European Commission is slated to announce the “Clean Industrial Deal,” a policy aimed at enhancing the EU’s competitiveness and decarbonization of industries in the EU, and the Draghi Report serves as the foundation of this policy.

Draghi warns that the EU will face an existential threat, citing concerns over the EU’s economic growth lagging behind the US and the EU’s sluggish labor productivity growth (Figure 2). Weak productivity growth is attributed to the slow pace of digitalization and lack of investment, reflecting Europe’s structural problems. These problems include financing difficulties due to the fragmentation of the EU’s single market and regulations, lack of policy coordination between the EU and its member states, and increasing regulatory costs.

**Figure 2: Labor productivity**



Changes in the external environment have also had a profound effect. In the past, growth in global trade, cheap energy supplies from Russia, and stable geopolitics formed the foundation of the EU’s economic growth. However, these factors have been disrupted in recent years. Draghi also pointed out that extensive government subsidy programs in China and the US have distorted competition and weakened Europe’s competitiveness.

## 2. A PRESCRIPTION FOR STRENGTHENING COMPETITIVENESS

### 2-1. Three key issues to bolster competitiveness

The Draghi Report highlights the need to address three key issues: increasing productivity by closing the innovation gap with the US and China, achieving both decarbonization and enhanced competitiveness, and ensuring economic security by reducing external dependence. The following section of the report focuses on the second issue: the need to achieve both decarbonization and competitiveness, which will shape the direction of the EU’s future energy and industrial policies.

<sup>2</sup> European Commission, Report by Mario Draghi, “The future of European competitiveness – A competitiveness strategy for Europe”, [https://commission.europa.eu/document/download/97e481fd-2dc3-412d-be4c-f152a8232961\\_en?filename=The%20future%20of%20European%20competitiveness%20-%20A%20competitiveness%20strategy%20for%20Europe.pdf](https://commission.europa.eu/document/download/97e481fd-2dc3-412d-be4c-f152a8232961_en?filename=The%20future%20of%20European%20competitiveness%20-%20A%20competitiveness%20strategy%20for%20Europe.pdf) (accessed 31 October 2024)

## 2.2. The need to pursue decarbonization

Draghi asserts that decarbonization is crucial for Europe's competitiveness, particularly emphasizing the need to decarbonize the energy system. High energy costs in the EU significantly undermine competitiveness; gas prices are 3-5 times higher than in the US, and electricity prices are 2-3 times higher than in the US and China. These elevated energy costs are especially detrimental to energy-intensive industries such as chemicals and steel.

Draghi argues that the EU's lack of natural resources to meet demand leaves decarbonization of the energy system as the only viable solution to high energy prices. Accelerated decarbonization using cost-effective, technology-neutral approaches—such as renewable, nuclear, hydrogen, and bio energy, along with carbon capture, utilization, and storage [CCUS]—can provide Europe with security of supply, lower and more stable prices, and reduced external dependence through increased self-sufficiency. He also emphasizes that the EU must prioritize the decarbonization of hard-to-abate industries.

Regarding specific recommendations, the report suggests faster deployment of clean energy and power grid, including cross-border grid connections and expediting permit approval processes (Figure 3).

**Figure 3: Electricity proposals in the Draghi Report**

	Proposals	Time Horizon
1	Simplify and streamline permitting and administrative processes to accelerate renewables, flexibility infrastructures and grids deployment.	Short/medium term
2	Foster network upgrades and investments in grids to address the electrification of the economy and avoid bottlenecks.	Short/medium /long term
3	Decouple the remuneration of RES and nuclear from fossil-fuel generation through long-term Contracts (PPAs and 2-way CfDs) to limit the impact of natural gas on electricity prices.	Short/medium term
4	Support PPAs for industrial users.	Short term
5	Encourage self-generation by energy-intensive users	Short term
6	Reinforce system integration, storage and demand flexibility to keep total system costs in check with a competitive uptake of renewables.	Short /medium term
7	Facilitate industry exposed to international competition to get access to competitive EU energy sources.	Short term
8	Maintain nuclear supply and accelerate the development of 'new nuclear' (including the domestic supply chain).	Short/medium /long term
9	Promote the role of carbon capture, utilisation and storage (CCUS) technologies as one of the tools needed to accelerate the EU's green transition.	Medium/long term

Source: Compiled by MGSSI based on materials of the European Commission

Moreover, it is essential to pass on the benefits of decarbonization to consumers. In the European wholesale electricity market, while supply-side priority is given to power sources with a lower marginal cost (e.g., power generation cost like fuel expenses), prices are determined based on the successful bid price of the power source with the highest marginal cost<sup>3</sup>. Generally, renewable energy has the lowest marginal cost, while natural gas tends to have a high marginal cost; thus, gas prices are more likely to be closely linked to electricity prices. This makes it difficult to pass on the benefits of increased renewable energy to end users. Draghi emphasizes the need to decouple natural gas prices from clean energy prices by utilizing long-term trading tools such as Power Purchase Agreements (PPA) and two-way Contracts for Difference (CfD)<sup>4</sup>, which were included in the 2023 proposal for revising the electricity market design<sup>5</sup>. Both tools are being extended to nuclear energy in addition to renewable energy.

<sup>3</sup> Council of the European Union, "Infographics: How is EU electricity produced and sold?",

<https://www.consilium.europa.eu/en/infographics/how-is-eu-electricity-produced-and-sold/> (accessed 31 October 2024)

<sup>4</sup> PPA refers to Power Purchase Agreement, and Two-Way CfD refers to Two-way Contract for Difference. Under a two-way CfD, a ceiling price and floor price are set, and if the market price falls below the floor, the government compensates the power producer, and if the market price exceeds the ceiling, the power producer returns the amount in excess of the ceiling price to the government.

<sup>5</sup> In March 2023, a reform of the electricity market was proposed to improve the design of the electricity market, consisting of amendments to electricity market regulations and the renewable energy directive, and was approved by the European Parliament and the Council of the European Union and officially entered into force in June 2024.

The report also advocates for the use of nuclear energy. In Europe, there has been a notable push for small modular reactors (SMRs), and in February 2024 the European Commission launched the “European Industry Alliance on SMRs”<sup>6</sup>. This alliance comprises more than 300 organizations and companies, including research institutes, SMR designers and developers, and electricity companies. It aims to address issues such as establishing supply networks, financing, and human resource development with the aim of introducing SMRs in the early 2030s. In addition, nuclear energy is designated as a net-zero technology alongside renewable energy in the Net-Zero Industry Act, which came into effect in June 2024 to support the expansion of European manufacturing capacity for clean technologies. Furthermore, in October 2024, (then-incoming) Commissioner Dan Jørgensen, who is in charge of energy policy in the new European Commission, stated in his response to a questionnaire from the European Parliament<sup>7</sup> that “Small Modular Reactors have the potential to provide low-carbon electricity and heat and contribute to decarbonizing not only power generation, but also sectors with hard-to-abate emissions such as transport, the chemical and steel industry”, expressing his intention to support the development and introduction of SMRs.

Stabilizing gas prices also remains a focal point. According to the IEA<sup>8</sup>, by 2035, demand for natural gas in the EU is expected to decline by 20% to almost 50% compared to the 2023 level (Figure 4). However, since the use of natural gas will continue in the medium term, it is recommended that the EU promote LNG joint procurement and long-term contracts to reduce exposure to the spot market and stabilize prices.

**Figure 4: Outlook for fossil fuel demand in the EU**

		Natural gas (bcm)	Coal (Mtce)	Oil (mb/d)
Actual	2010	446	361	10.3
	2022	358	238	9.3
	2023	331	188	9.0
STEPS (Stated Policies Scenario)	2030	296	94	7.8
	2035	257	61	6.3
	2050	166	36	3.0
APS (Announced Pledges Scenario)	2030	264	62	6.9
	2035	167	28	4.9
	2050	29	9	1.4

Source: Compiled by MGSSI based on the IEA's World Energy Outlook 2024 report

### 2-3. How to compete with the US and China in clean technologies

Demand for clean technologies is expected to grow as the decarbonization of the industry and transportation sectors progresses, along with the accelerated deployment of clean energy as described above. The EU's additional investment needs for the green transition are estimated at 450 billion euros per year between 2025 and 2030.

However, Draghi points out there is no guarantee that Europe will be able to meet this demand. While Europe has the potential for technological innovation, financing for scaling up, such as commercialization of emerging technologies, is challenging. The EU's industrial policies and financial support are also insufficient to compete with the US and China. China's subsidies for its clean technology industry are twice that of the EU's as a percentage of GDP, and support for US companies under the US Inflation-Reduction Act (IRA) amounts to US\$250 billion. The EU's countermeasure for the US IRA, the Net-Zero Industry Act, promotes domestic manufacturing by simplifying the permitting process for establishing manufacturing sites, but it does not provide new funding. Additionally, the EU's financial assistance programs are fragmented and complex to access.

Moreover, cheap clean-tech products subsidized by China are flooding the European market. While utilizing inexpensive Chinese products can advance decarbonization, it could also lead to a hollowing out of European industries. Conversely, adopting the US government's approach of systematically excluding Chinese technology could potentially hinder the energy transition in the EU.

<sup>6</sup> European Commission, “European Industrial Alliance on SMRs”, [https://single-market-economy.ec.europa.eu/industry/industrial-alliances/european-industrial-alliance-small-modular-reactors\\_en](https://single-market-economy.ec.europa.eu/industry/industrial-alliances/european-industrial-alliance-small-modular-reactors_en) (accessed 31 October 2024)

<sup>7</sup> European Commission, “QUESTIONNAIRE TO THE COMMISSIONER-DESIGNATE, Dan JØRGENSEN, Energy and Housing”, [https://hearings.elections.europa.eu/documents/jorgensen/jorgensen\\_writtenquestionsandanswers\\_en.pdf](https://hearings.elections.europa.eu/documents/jorgensen/jorgensen_writtenquestionsandanswers_en.pdf) (accessed 31 October 2024)

<sup>8</sup> IEA, “World Energy Outlook 2024”, <https://www.iea.org/reports/world-energy-outlook-2024> (accessed 31 October 2024)

Draghi acknowledges that there is no simple black-and-white solution and calls for the immediate implementation of the Net-Zero Industry Act, along with further fine-tuning of net-zero technology production targets.

He also calls for deploying different policies for different technologies. For example, in areas where Europe cannot compete with countries such as China, he suggests a pragmatic approach: procuring cheaper products from countries outside of the EU where subsidies are provided effectively, i.e. making foreign taxpayers bear the costs, which makes economic sense. An example is solar panels, where the EU has already lost almost all of its market share to Chinese products<sup>9</sup> (Figure 5). In cases where the technological know-how needs to be imported but production must remain in the EU to protect employment, import tariffs may be considered, while encouraging inward direct investment for production in the EU.

**Figure 5: Draghi Report's assessment of the EU's current competitiveness in clean technologies**

Solar PVs	The EU has lost considerable market shares in solar PV production over the years and has a now negligible presence in solar PV production manufacturing
Wind turbines	While retaining primacy in turbine assembly (serving 85% of domestic demand and acting as a net exporter), the EU has lost significant market shares to China in just a few years (declining from 58% in 2017, to just 30% in 2022) While the EU claims the second largest global market share for various wind turbine components, a massive gap has emerged with China (e.g. the EU produces 10% of the world's gearboxes and power converters, while China produces 66% and 77% respectively)
Heat pumps	While the EU's industry delivers 60%-70% of domestic demand for heat pumps, it has become a net importer in the past three years.
Batteries	Despite legacy strength in lead-acid battery production, the EU has achieved only marginal manufacturing capacity for lithium-ion batteries (a 65% share of the global production of battery cells), and components – including processing capacity With investment more than tripling in 2023, committed projects suggest the potential for the EU to achieve in the coming years self-reliance for the production of battery cells There would, however, be strong competition from Chinese producers, while the undersupply of components would continue to be a challenge
Electrolysers	The EU holds technological leadership in this segment, but, contrary to China, does not yet produce at Giga scale.
CO2 capture technologies	The EU is a global frontrunner in carbon capture technologies (over half of global investment in 2023). Yet, it is confronted by barriers hindering the actual expansion of this segment This is due, at least in part, to the need to secure CO2 storage sites and transport infrastructure.
Sustainable renewable/low carbon fuels	The EU holds technology leadership but has limited installed capacity and planned production.

Source: Compiled by MGSSI based on materials of the European Commission

For technologies where Europe has the technical know-how and production capacity, local content requirements should be applied, and foreign companies wishing to produce in the EU should be mandated to enter into joint ventures with local EU companies. For emerging technologies where the EU has an innovative advantage and

<sup>9</sup> In an address to the European Parliament on September 17, 2024, Mario Draghi said, "...for some technologies, like solar panels, where foreign producers are too far ahead, attempting to capture production in Europe will only set back decarbonization. Even if those countries are using subsidies, we should let foreign taxpayers finance cheaper installation of clean energy in Europe". Meanwhile, the Net-Zero Industry Act sets the goal of meeting 40% of the EU's demand for net-zero technologies in the region, and solar panels are also designated as a net-zero technology. In response to the Draghi Report, SolarPower Europe, the leading European association of solar power producers, issued a statement calling for increased support for the return of solar panel production to the region.

European Commission, "Address by Mr. Draghi - Presentation of the report on the Future of European competitiveness – European Parliament – Strasbourg – 17 September 2024", [https://commission.europa.eu/document/download/fcbc7ada-213b-4679-83f7-69a4c2127a25\\_en?filename=Address%20by%20Mario%20Draghi%20at%20the%20Presentation%20of%20the%20report%20on%20the%20future%20of%20European%20competitiveness.pdf](https://commission.europa.eu/document/download/fcbc7ada-213b-4679-83f7-69a4c2127a25_en?filename=Address%20by%20Mario%20Draghi%20at%20the%20Presentation%20of%20the%20report%20on%20the%20future%20of%20European%20competitiveness.pdf) (accessed 31 October 2024)

SolarPower Europe, "Draghi report on EU Competitiveness; SolarPower Europe Statement", <https://www.solarpowereurope.org/press-releases/statement-draghi-report-on-eu-competitiveness> (accessed 31 October 2024)



growth potential, protective measures should be taken until they are sufficiently scaled up. These approaches will require consistent and comprehensive policy coordination across multiple fronts, including industrial policy, competition law, and trade policy, he added.

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### 3. CHALLENGES AHEAD

The biggest challenge is securing the enormous amount of investment funds. Draghi estimates that up to 800 billion euros of additional annual investment will be required to strengthen competitiveness and proposes the issuance of joint EU debt to finance public support, which he identifies as the key to this initiative. The urgency of the need to strengthen competitiveness is shared among EU member states, and the contents of the Draghi Report are generally supported. The idea of joint debt issuance, however, has long been a divisive issue. Member countries with limited fiscal capacity, such as those in southern Europe, support the issuance of joint debt, while member countries that favor fiscal austerity, such as Germany, oppose the idea.

Additionally, as noted earlier, strengthening competitiveness requires the development of cross-sectoral and coherent strategies across various policy areas. The preparation of the Clean Industrial Deal, a policy aimed at achieving both competitiveness and decarbonization, which will be published within the first 100 days of the new Commission taking office, requires broad collaboration among numerous European Commissioners responsible for competition policy, trade, energy, industry, climate change, and other areas. Translating these strategies into national policies in cooperation with member countries and effectively engaging the private sector is challenging. Furthermore, similar to the issue of securing investment funding, the economic interests and political agendas of member countries are also entwined. Forming political consensus can be challenging, as seen in cases such as the zero emissions target for new cars by 2035 and trade policies against China.

Under Ursula von der Leyen's leadership, the EU executives and member states will be tested on their ability to unite in strengthening competitiveness and setting effective, realistic policies that can engage businesses.