

Improving economic policy



EU competitiveness challenges during the green transition

Briefing to the Eurogroup – January 15, 2024

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The challenges

1. Decarbonisation

- Ambitious 2030 goals require expanded carbon pricing, large-scale investment

2. Economic security

- Concerns about coercion by China (and potentially U.S., if Mr. Trump returns)

3. Economic nationalism in competitor countries

- Protectionist trade policy and discriminatory subsidies in both China and the U.S.

4. Lack of fiscal space

- Need to adjust after years of high deficits. Take new fiscal rules seriously

Need a strategy that preserves growth/competitiveness and social cohesion in the face of all four challenges

The reaction



The emerging strategy: a push for “vertical” industrial policy, more subsidies, reshoring

- Expensive, inefficient, potentially divisive
- Could undermine the foundations of EU prosperity: the single market and trade integration

A better strategy:

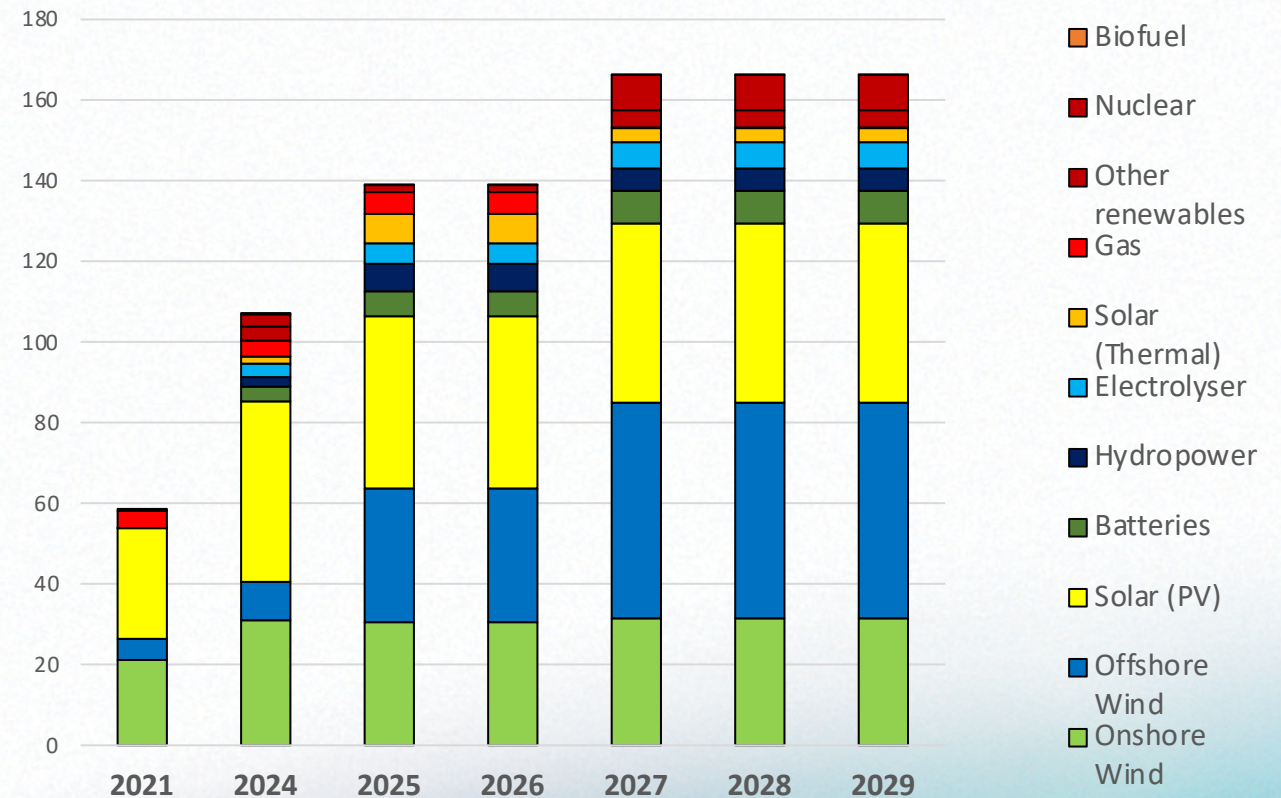
- Understand where there are trade-offs between objectives and where not
- Use subsidies sparingly, at the EU level or in a coordinated fashion, and in a manner that preserves competition
- Push policies that do not involve trade-offs
 - Prime example: consolidate the EU internal electricity market

The cost of European electricity supply will drive the EU's cost-competitiveness



- High energy costs is one of the main competitiveness impediments in the EU
- Meeting CO2 target and reducing energy costs requires large, coordinated investments across the EU
- Not investing implies 20-30% higher gas and coal consumption, higher CO₂ emissions, lower economic security, *and higher electricity prices*

EU Capital Investment Needs by Technology to 2030



Source: Bruegel based on ERRA and JRC.

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The temptation to “go national”

- Higher energy prices and competitiveness challenges vs. China and the US lead to demand for energy/industry subsidies at home
 - National governments only want to spend on national industry/consumers (obviously)
 - On top of this, countries with relatively cheap energy sources are less interested in trading energy (since this raises prices at home)
- Result: a trend toward fragmentation
- Problem: counterproductive!
- Fragmentation has a huge efficiency cost that hurts everyone – even those that think that they stand to gain. This is true also in a fiscal sense

The case for much higher electricity market integration

Sources of efficiency gains:

1. Huge cross-EU difference in comparative advantage with respect to energy sources
 - Linked to weather (wind, solar) population density (nuclear), geology (geothermal, hydro)
2. Benefits of diversification with respect to shocks (weather-related, external, operational)

How efficiency gains show up:

- Lower fossil fuel use (\Rightarrow lower imports, less pollution)
- Lower renewable energy investment needs (for given emission reduction targets)
- Reduced price volatility
- Lower need for storage and backup capacity
- Enhanced system resilience (and economic security)

What integration requires:

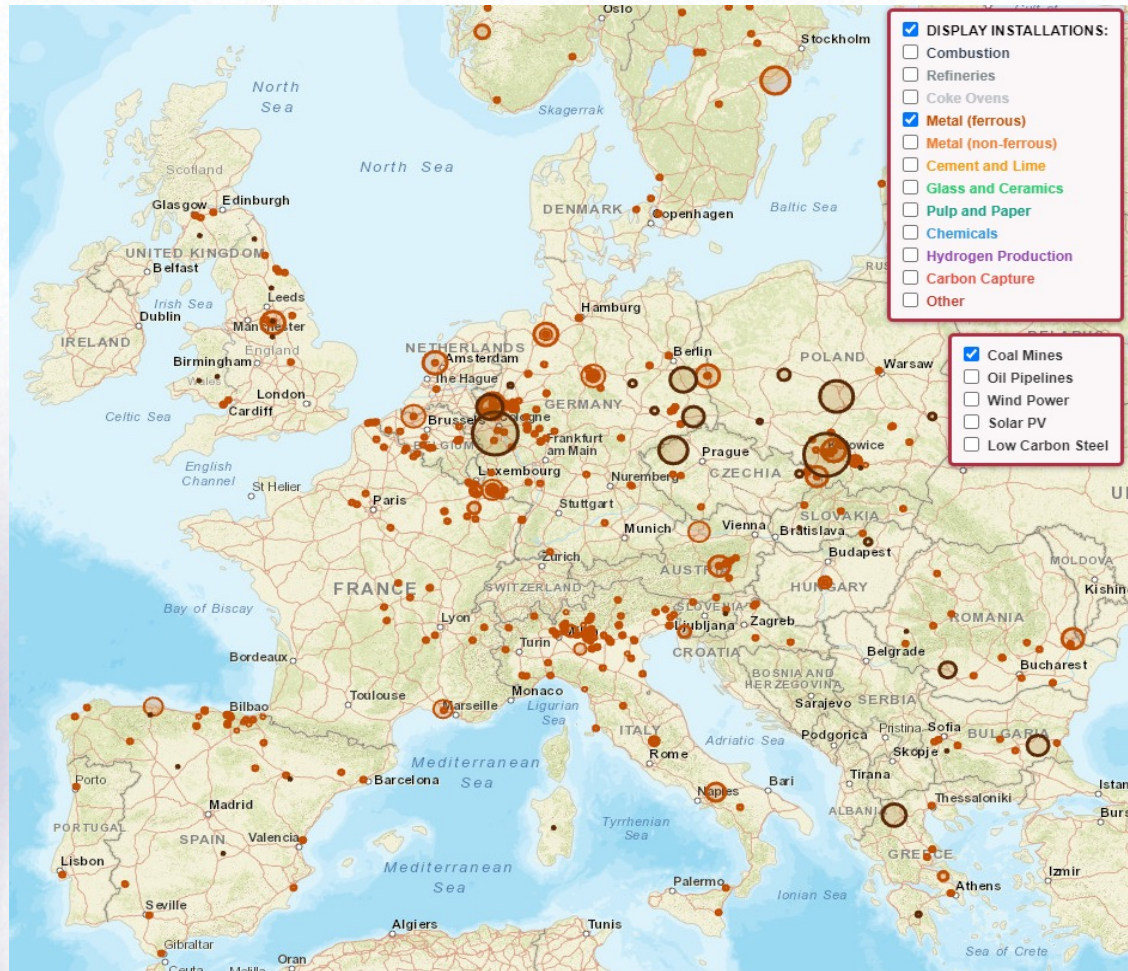
- Aligned electricity market rules
- Coordination of investment

Additional gains are possible by locating demand closer to energy sources



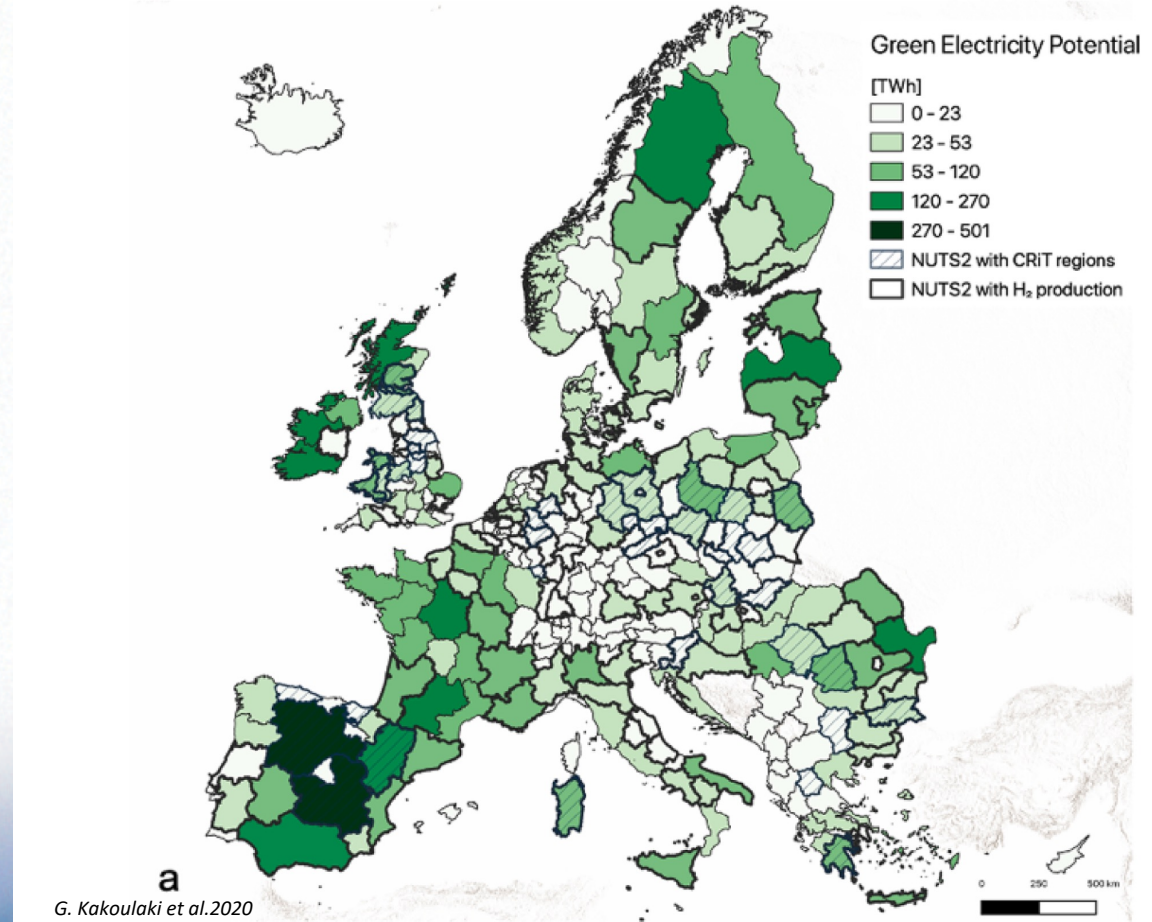
Regional challenges

Example: current sites of ferrous metal production



Regional opportunities

Example: green electricity potential estimate



Conclusions



1. The EU faces a huge challenge in reconciling competitiveness, economic security, decarbonisation, social cohesion, and fiscal consolidation
2. The national incentive is to respond to these challenges by seeking national solutions (quite naturally!)
3. This leads to fragmented policies that are collectively suboptimal
4. This is true particularly in the energy area, where the efficiency gains of an integrated electricity market are huge
5. Realising these gains requires strong coordination and cooperation between Member states



Thank you!