



# TRADE, MONEY, POWER: A RECIPE FOR A GREEN AND COMPETITIVE EUROPE?

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**Filip Křenek** joined EUROPEUM Institute Green Europe team in May 2024 as an analyst in the areas of European economy, competition, competitiveness and climate. He also focuses on EU economic security in the areas of supply chains, sources of critical raw materials and foreign investment screening. He gained his experience in European affairs during his time in Brussels, where he has worked since 2018 in the European Commission in the Directorates General for Competition, International Trade and Regional Development. In 2023, he completed a James S. Denton Fellowship under the think tank CEPA (Centre for European Policy Analysis) in Washington DC, focusing on the development of security relations between the US and Central and Eastern European countries. He studied Economic Policy and Media Studies and Journalism at Masaryk University and worked briefly as a reporter for Czech Television during his studies.

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## Introduction: Climate policy and competitiveness go hand-in-hand

The EU is the largest trading block in the world in terms of goods and services combined, the largest provider of and second largest destination for foreign direct investment<sup>1</sup>. While the EU's open economy model has historically fostered its prosperity, its competitiveness is now under pressure. High energy prices, a lack of critical raw minerals, and limited spending on research and innovation leave the EU trailing behind USA and China. This lag is particularly evident in green technologies, such as renewable energy, batteries, and electric vehicles, which are essential for the decarbonization of the economy.

Central European countries, heavily industrialized and firmly embedded in global supply chains, benefit significantly from the EU's openness. In Czechia, the most industrialized EU country, manufacturing accounts for 23 % of gross added value<sup>2</sup>. With similar levels in neighbouring countries, foreign demand accounts for 75 % of the sector in Czechia, Slovakia and Hungary<sup>3</sup>. As export-oriented economies, central European countries are strong proponents of open trade and deeper Single Market integration. However, with rising geopolitical tensions, calls for protectionism, interventionist policies and the degradation of the multilateral order, this openness risks becoming a liability rather than an asset.

The 2024 European Parliament elections have renewed discussions around the EU's commitment to achieving net zero by 2050<sup>4</sup>. Between 2019-2023, EU public support for this goal has dropped by 3 percentage with Czechia and Slovakia recording the largest decreases of 14 and 11 percentage points<sup>5</sup>. Czech households experienced some of the highest electricity prices across Europe<sup>6</sup>, fueling public distrusts against EU clean energy policies<sup>7</sup>. As a result, pre-electoral discussions were framed in terms of reversing, stopping or recalibrating the Green Deal, not just in Czechia<sup>8</sup>, but across the continent<sup>9</sup>. In terms of priorities, climate

and environment still feature high on the agenda for EU citizens, but have been surpassed by security and defence and high costs of living<sup>10</sup>. Similarly, the new European Strategic Agenda for 2024-2029 puts more emphasis on security and economic prosperity<sup>11</sup>.

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But the rationale for the EU to maintain its leadership in climate policy has not changed. Europe is warming faster than any other continent<sup>12</sup> and faces severe economic and social impacts. Recent climate-related damages have cost the EU more than EUR 50 billion a year<sup>13</sup> and these can further escalate. The 2024 floods are a sad reminder of this fact with estimated costs of EUR 1,2 bn in Czechia<sup>14</sup>, EUR 1 bn in Austria, EUR 500 mil. in Poland and EUR 100 mil. in Romania<sup>15</sup>. According to estimates, climate change more than doubled the likelihood of such catastrophic flooding and increased its

severeness by 7 % and if temperatures rise above the 2°C threshold, this probability will further grow by 50 %. <sup>16</sup>The cost of non-action grows ever higher, notwithstanding related issues, such as climate migration.

Secondly, the EU has faced several crises, including the COVID pandemic, supply chain disruptions and the war against Ukraine, all of which have exposed its over-reliance on foreign suppliers and especially Russian gas. All these have underscored the need for a more resilient, integrated and self-sufficient Europe. The energy sector, where average electricity prices in Europe in 2023 were 2-3 times higher compared to the US with considerable variance between Member States<sup>17</sup>, makes a particularly strong case for ramping up domestic production using cheap clean energy resources. In doing so, however, the EU must avoid replacing a fossil fuel dependence on Russia with a clean tech dependence on

China, which would create a new critical vulnerability for the European economy. Lower costs of energy are also crucial to keep European industry competitive.

Thirdly, the production of green technologies such as renewable energy sources, electric vehicles and batteries provides huge economic potential. By 2030, the global clean technology market should triple to about EUR 600 billion<sup>18</sup> and major economies around the world are trying to seize this opportunity. The US Inflation Reduction Act (IRA) aims to mobilize EUR 330 bn by 2032 to support domestic green tech industry, Japan is raising EUR 140 bn in “green bonds” to transform its economy and China is spending over EUR 260 bn in clean tech as part of its five-year plan and the Made in China strategy<sup>19</sup>. Similar plans are in motion in India, UK, Canada and other countries are quickly joining the race.

While climate will likely not be the central theme for new policy initiatives, decarbonization will remain a key underlying principle during the next Commission mandate. Developing, promoting and scaling up clean technologies and decarbonizing the industry are not only crucial for improving the wellbeing of European citizens, but also necessary preconditions for staying globally competitive in the 21<sup>st</sup> century. The longer EU companies are subject to high energy prices and the more the climate deteriorates, the higher the cost of inaction – especially for Europe, which bears a disproportionately high cost of climate change. To address these issues, this policy paper looks into three areas, which are necessary to safeguard EU’s competitiveness and climate ambitions: trade policy, capital markets union and energy. The topic of industrial policy, which also plays a crucial role, was addressed in a previous publication<sup>20</sup>.

## Trade policy for an age of geoeconomics

The EU is a strong proponent of a multilateral rules-based trading system under the steer of the World Trade Organization (WTO). As an open economy, the EU has greatly benefited from lowering trade barriers and opening new market for European exporters. For comparison, the EU has 730 thousand companies exporting outside the EU, 2.6x more than the United States. In 2022, EU's total trade as a percentage of GDP amounted to 51 % compared to 28 % for the US, marking a sharp divergence from the parity of 25% seen between the two blocs in 2000<sup>21</sup>. This divergence may be partly explained by Europe's economic growth, which has long relied on cheap energy from Russia, cheap goods from China and access to its large market<sup>22</sup>. Adding Europe's dependence on the US for defense and security<sup>23</sup>, digital technologies and services<sup>24</sup>, EU's "outsourced" growth is now bearing costs.

The EU lacks capacity to build up renewable energy sources on its own and relies heavily on imports. China dominates global clean tech markets with 80 % of global solar panel production<sup>25</sup>, 60 % of newly installed wind energy capacity<sup>26</sup>, 75 % of battery production and a 57% share of electric vehicle sales<sup>27</sup>. It also effectively controls the supply chains by processing critical raw materials necessary for clean technologies, such as nickel, lithium, cobalt and graphite<sup>28</sup>. Ramping up production of clean tech in Europe will require diversifying trade relations and finding alternative sources of these materials across the globe – from resource-rich countries in Africa and central Asia to South America and Australia.

Trade policy, once seen as a purely economic tool, has now become a powerful geopolitical instrument. This shift is evident in the unprecedented scale of trade restrictions imposed globally, with more than 3000 such measures adopted globally each year in 2022 and 2023 compared to just hundreds per year from 2009 to 2017<sup>29</sup>. This marks a change in global dynamics with growing fragmentation into regions of 'like-minded' countries, where intra-regional trade is on the rise, but extra-regional is on the decline. With growing exports of Chinese clean tech overcapacity abroad, the EU and the US, as competing economic blocs, have been implementing a growing number of trade restrictive measures themselves,<sup>30</sup> alongside subsidy programs to stimulate domestic production<sup>31</sup>.

For the EU, which traditionally champions open trade, this shift in mindset does not come naturally. When dealing with trade and competition distorting measures, Europe risks falling into a protectionist trap and impeding its own growth<sup>32</sup>. The EU needs to advocate more forcefully for a global trade system with subsidy transparency, penalties for breaches of WTO rules and a functioning dispute settlement<sup>33</sup>.

But to kick-start a functioning multilateral order and rebuild Europe's competitiveness, the EU must also act as a unified front on the global stage. Otherwise, it will face internal fragmentation, as evidenced by the divergent views regarding the countervailing duties on Chinese electric cars<sup>34</sup>. Member States should avoid politicising such measures, which can be used to divide European

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unity. Only jointly can the EU withstand economic and political pressures from countries like China. While politically tempting, solutions which only provide a temporary relief to a selected few Member States, industries or companies, but fail to address a long-term perspective, will ultimately lead to more distrust among Member States and Europe's decline.

At the bilateral and regional level, developing trade and investment agreements remains essential, opening new opportunities for EU companies while helping diversify supply chains. While the EU has made progress in concluding free trade agreements (FTAs) with Chile, New Zealand and Kenya, closing deals with major trading partners has stalled. The trade agreement with MERCOSUR has been in the making for two decades and remains divisive among Member State<sup>35</sup>. Finalising the negotiations would be a geostrategic success for the EU, because Europe has been struggling to get a foothold in the region and broader "Global South", where China is already heavily invested. However, its conclusion requires the right political constellation on both sides of the Atlantic as well as calming down the public discontent with the agreement<sup>36</sup>.

The EU's resources may be better spent on more narrow deals, which go largely under the radar, but may outweigh even large FTAs. For instance, each of the two mutual recognition agreements (MRAs) with the US in the clean tech and machinery sectors can impact trade flows of double the value of trade with MERCOSUR<sup>37</sup>. Such agreements may serve as powerful enablers for the EU clean tech sector by improving access to critical raw minerals and technologies. Establishing industrial partnerships and co-investment agreements with third country partners under the Global Gateway may also provide a viable option for securing the offtake of EU-made products<sup>38</sup>.

In terms of unilateral action, the EU has built up an impressive arsenal of trade defence instruments. Aside from traditional anti-dumping and anti-subsidy instruments, the EU has introduced the Anti-Coercion Instrument (ACI), the

International Procurement Instrument (IPI), the Foreign Subsidies Regulation (FSR) and proposed an enhanced FDI screening framework. These tools are designed to protect the EU from economic pressures and market distortions, while safeguarding critical sectors.

The Draghi report suggests using these tools to shield industries of strategic importance, innovative sectors with a high growth potential and areas, where the EU has a comparative advantage (e.g. wind turbines) and those important for maintaining employment (e.g. automotive)<sup>39</sup>. But they should be used alongside industrial and competition policy to also attract inward investments. In the automotive industry, for instance, some Chinese companies have decided to relocate their production into the EU to avoid tariffs<sup>40</sup>. However, it is questionable whether this also helps reduce strategic dependencies. Importing incomplete technologies, which are only assembled in Europe, lowers the added value of the industry and reduces the potential positive spillovers on R&D and the labour force<sup>41</sup>. The Carbon Border Adjustment Mechanism (CBAM) will also phase-in a carbon tax for imported goods, but will only cover basic materials, like steel or aluminium, and not assembled products, such as cars<sup>42</sup>.

When WTO and bilateral dispute settlement procedures do not offer an adequate and timely response to aggressive industrial policies in third countries, the EU should continue to pursue an assertive trade policy, making full use of its trade defence tools. It should use new formats of cooperation to diversify its trade relations and align its trade policy with other policy objectives.

The Czech Republic traditionally positions itself as a defender of free trade and investment policy in line with the goals of the EU,<sup>43</sup> but has been more reserved when it comes to the use of unilateral tools, such as the countervailing duties against the import of Chinese electric vehicles.<sup>44</sup> European businesses, including Czech representatives, however, call for a robust yet balanced response towards aggressive industrial policies of third countries.<sup>45</sup>

## A more integrated EU market to stimulate growth

The Letta report has revived the discussion on deepening the Single Market as a means to improve EU's competitiveness<sup>46</sup>. Praised as a 'reboot' of EU integration<sup>47</sup>, the report explains why deepening capital markets is crucial for boosting investments into decarbonization and ramping up EU's clean tech sector.

The Commission estimated the annual investment needed to deliver on the Green Deal, RepowerEU and Net Zero Industry Act at around EUR 710 billion<sup>48</sup>. Similarly, the Draghi report puts the investment gap at EUR 750-800 billion a year to safeguard Europe's future competitiveness, or about 5 % EU GDP increase from current 22 % to 27 %. One fifth of that should come from public finances to mobilise the remaining majority from private resources. And Europeans do have the necessary capital. But the EU lacks a Capital Markets Union (CMU) to ensure that the savings are used for investments that stimulate future growth. An integrated financial market would lower the cost of capital for European companies, allowing them to grow and scale, reduce the investment risks and attract foreign investors.

In 2022, EU household savings were EUR 1390 billion compared to EUR 840 billion in the US, but despite the higher savings rate, EU households have lower wealth than US ones<sup>49</sup>. European investors are more risk-averse compared to their US counterparts<sup>50</sup>, but the US financial markets also provide higher yields. Due to higher returns on investments, about EUR 300 billion of EU savings are diverted to the US each year<sup>51</sup>. Aside from countries like the Netherlands, Luxembourg and Ireland, capital markets in Europe are much less developed and the architecture of the EU's financial system relies much more on banks. In the US, stock markets meet up to 75 % of the companies' capital needs, whereas in the EU, banks provide up to 70 %, resulting in far less companies listed on the stock exchange<sup>52</sup>.

**Deeper integration of the capital markets will help reduce costs and incentivize investments, mobilising private savings to finance the green transition of existing carbon-intensive sectors and the scaling up of domestic clean tech industries. A more integrated Single Market will also allow bigger economies of scale, making it easier for EU companies to expand and compete globally.**

Taking inspiration from the US, where pension funds play a prominent role, the Letta report suggests a Pan-European Pension Product (PEPP), a welcomed step by the financial sector<sup>53</sup>. But Europe cannot simply replicate the US pension model. Most Europeans still pay into pay-as-you-go social security systems and 62 % of all pension assets are held in the Netherlands, Denmark and Sweden. Instead, the EU solution has to be tailor-made. A strong role of banks should be maintained with the European Investment Bank (EIB) at the center, a significant capital at its disposal and more leeway in its spending, a proposal which may be acceptable

to countries reluctant to issue more common European debt<sup>54</sup>. However, any capital market ultimately needs a 'safe asset' and common European bonds, like those issued to finance the NextGenerationEU, could provide that liquid and risk-free product<sup>55</sup>.

After ten years of unsuccessful attempts to fully develop the Capital Markets Union, largely due to institutional inertia and protection of special interest groups, both public and private,<sup>56</sup> the EU may also have to reopen issues like taxation, insolvency and governance to fully reap its benefits. Fragmented and punitive bankruptcy laws are holding back innovation in Europe<sup>57</sup>. And a more integrated system of supervision would help transform national capital markets into a European one<sup>58</sup>.

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Czechia has a particularly high share of savings in current accounts and deposits,<sup>59</sup> which do not translate into productive investments. In addition, it is also facing a continuous outflow of capital with regard to major foreign-owned companies, whose profits are largely paid out abroad instead of being reinvested locally,<sup>60</sup> resulting in lower levels of R&D spending. Czech Republic could therefore benefit from improved functioning of financial markets, but needs to retain the mobilised capital domestically.

## Clean energy to power the economy

Integrating energy markets is key for EU's climate ambitions. Energy prices in the EU are 158 % higher compared to the US and natural gas prices are 345 % higher<sup>61</sup>. Driving down the costs for households and companies is therefore crucial to allow the industry to remain competitive. Both Draghi and Letta agree that the EU should undertake a massive rollout of renewables. But while Draghi advocates for the continued use of nuclear power with a low marginal cost, Letta warns of possible fuel dependency. New measures will also be needed, including easier permitting, support for investments into energy infrastructure, grid, interconnections, electrification or storage<sup>62</sup>. Varying patterns in renewable energy generation across Europe will help stabilise the integrated grid, reducing the costs.

Following Russia's full-scale attack on Ukraine, the impact of the energy crisis was felt very differently across EU Member States. The Netherlands, Czechia and Poland were among the worst hit recording electricity price increases of 86 %, 82 % and 27 % respectively between 2022-2023<sup>63</sup>. Lithuania, Poland and Slovakia were the most impacted by the increase of natural gas prices by 68 %, 24 % and

22 %<sup>64</sup>. As a result of the EU's fragmented energy markets, the prices for electricity and gas regularly differ by a factor of three between the cheapest and most expensive Member States.

For lack of natural resources, the EU is the largest global gas and LNG importer. Since 2022, the EU has added 50 billion cubic meters of LNG capacity, mostly in Germany, the Netherlands, Italy, France and Finland, with the United States providing the bulk of the liquified gas<sup>65</sup>. However, with the incoming US presidential elections, the political landscape may quickly turn and affect the supply of US-produced LNG to Europe. And with looming threats in the Middle East<sup>66</sup> and the South China Sea,<sup>67</sup> the global LNG supply chains risk being disrupted. The EU should aim to diversify its sources of gas and fully leverage its size in joint procurement purchases, securing long-term contracts at stable prices. At the height of the energy crisis, instead, intra-EU competition for gas drove prices even higher.

Today, one third of the EU's LNG contracts are based on spot prices, adding to price volatility<sup>68</sup>. More integrated energy markets would not only curb volatility, but also help dissipate higher costs. Gas will likely remain part of Europe's energy mix to power cogeneration units or back-up gas-powered plants, but it also poses a problem. Due to the set-up of the energy-pricing system, gas was the price-setter for electricity 63 % of the time despite only contributing around 20 % to the electricity mix<sup>69</sup>. To ensure that the rollout of renewables delivers lower electricity prices, the price setting mechanisms needs to be adjusted. Draghi suggests using Power Purchase Agreement (PPA)

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or Contracts for Differences (CfDs) to dissociate the cost of energy for end-consumers from the marginal price-setter, which is usually gas.

However, the price difference will continue to distort the level playing field between EU Member States and threaten the competitiveness of certain industries. Economies heavily reliant on manufacturing, like Czechia and other central European countries are among the most energy intensive in the EU<sup>70</sup>. Only about 2 % of gross added value in the EU is generated by industries, where electricity accounts for a considerable part of the total cost<sup>71</sup>. In the Czech Republic, employment in the energy-intensive industries is at 7.4 % of total employment, more than double the EU average<sup>72</sup>. But with current energy prices, the prices of metals, cement and chemicals are unlikely to remain competitive. Speeding up energy market integration and massive rollout of renewables is therefore absolutely necessary to reduce the risk of these sectors going out of business.

However, even clean energy will not be able to meet the demand from these industries and higher energy costs will continue to pressure companies to relocate closer to cheaper energy sources. The EU and especially Member States like Czechia will therefore face a difficult trade-off between investing in keeping these industries afloat and financing nascent, but prospective clean technologies.

## Conclusion

As Europe grapples with global political, economic and climate challenges, it finds itself at a juncture. All strands of EU policy need to work together to help secure EU's competitiveness while leading the charge in decarbonization. The EU's open economic model, once its greatest strength, has revealed vulnerabilities in the face of geopolitical tensions and shifting global trade dynamics. By advocating for a rules-based global trading system, diversifying critical supply chains, and strategically employing trade defense mechanisms, the EU can navigate these challenges without falling into the trap of protectionism. Czechia, as a champion of open trade, should continue to pursue its role as a strong advocate for multilateralism in the EU, while taking a pragmatic stance on the use of trade defense measures and various forms of narrower, yet effective, trade and investment partnerships.

In parallel, the EU's greatest asset, the Single Market will be key in unlocking Europe's savings and channeling them into the green technologies that will power future growth. To maintain leadership in the green technology race, the EU must speed up its work on the Capital Markets Union to ensure that investments can flow freely across borders to finance the innovations needed for decarbonization. However, reducing capital markets barriers must not lead to a flight of capital out of countries like Czechia, which are already facing a similar situation with regard to major foreign-owned companies, whose profits are largely repatriated abroad rather than reinvested locally, exacerbating the challenge of retaining financial resources for domestic development and innovation. To advocate for such a solution, which does not further increase regional discrepancies, Czechia should align itself with other CEE countries to escape the so-called 'middle-income trap'.

Lastly, transforming the EU's energy markets is imperative for both climate goals and competitiveness. Energy prices, if left unchecked, threaten to erode Europe's manufacturing base, particularly in energy-intensive sectors. A unified and

resilient energy market, powered by renewable energy and bolstered by infrastructure investments, will reduce volatility, lower costs, and maintain Europe's edge in an increasingly competitive global market. Renewables can provide a reliable source of energy in all geographic conditions on the continent, including central Europe. And the resilience of the European energy grids will only increase with more integration as clean energy sources can more easily balance out each other. Accordingly, Czechia should diversify its energy portfolio and speed up the rollout of renewable energy resources, which can be easily scaled and can quickly bring down energy prices, which are still among the highest in Europe. If energy-intensive industries in Czechia are to survive, they must be supported by renewables in the short run. In that regard, Czechia should partner up with other heavily-industrialized Member States and jointly advocate for (and implement) easier and faster permitting procedures as well as streamlined access to financing clean energy projects.

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