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Delusions of competitiveness

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Why even Super Mario (Draghi) can't rescue the EU economy

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Delusions of competitiveness: Why even Super Mario (Draghi) can’t rescue the EU economy

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Executive summary

The European Union is sleepwalking into economic irrelevance, and its political elite are misdiagnosing the disease. Behind the choreographed unity and hollow rhetoric of recent summits, the EU is paralysed by a profound, three-decade-long structural productivity crisis. The narrative that Europe merely suffers from a 'competitiveness problem' that can be fixed with protectionist 'Buy European' clauses and minor bureaucratic tweaking is a fatal delusion.

Productivity problem

Hard data reveals a continent in decline. Labour productivity growth – the ultimate engine of societal prosperity – has flatlined across the continent. In the early 1970s, Western European economies enjoyed robust annual productivity growth of over five per cent; today, growth in the EU-27 has plummeted below 0.5 per cent. The reality in major Western member states is even more grim: between 2000 and 2023, productivity per hour worked completely stagnated in Italy and, since 2020, productivity in France has actually declined by 0.1 per cent.

The False Cure: Draghi-inspired industrial policy

The EU's flagship responses – Mario Draghi's landmark report, the Commission's 'Competitiveness Compass', omnibus 'simplification' packages, etc – are destined to fail because they double down on the policies that caused the crisis.

Rather than tackling the root causes, Draghi proposes a centrally planned €800 billion investment bonanza, including enormous subsidies mostly under the guise of a 'clean-tech' transition. This massive state intervention aims to compensate for competitive weakness by propping up uncompetitive firms. To make this mobilised private capital profitable, governments would need to artificially slash the cost of capital by 2.5 per cent through taxpayer-funded financial incentives. This is a subsidy drive to make up for the failures of fundamental economic reform.

The real root causes of Europe's paralysis

Europe's crisis is not due to a lack of state intervention, but rather an ideology of anti-growth and a pervasive culture of dependency.

- **An investment collapse**: Net corporate investment rates have collapsed from the highs of the 1960s to a stagnant two to three per cent of GDP following the 2008 financial crisis. Rather than investing in physical automation and transformative technology, companies have relied on cheap, low-wage migration to maintain margins without improving processes.
- **The deindustrialising Green Deal**: The EU's climate policy is driving devastating energy costs. Because of the forced transition away from fossil fuels to volatile renewable energy, industrial electricity prices in Europe are two to three times higher than in the US. This penalises any company attempting to introduce energy-intensive, productivity-boosting technologies like AI and advanced automation.
- **The precautionary stranglehold**: Driven by a risk-averse technocracy, the EU's adherence to the 'precautionary principle' prioritises banning potential risks over embracing disruptive innovation. Heavy-handed regulations, such as the AI Act and bans on green genetic engineering, inherently protect established global monopolies while blocking the market entry of dynamic new challengers.
- **The migration fallacy**: For years, European economies have been propped up by cheap labour via migration. But not only have successive waves of migration been less economically beneficial, the very addiction to low-wage migration has reduced productivity in itself. If labour is cheap, companies do not invest in productive changes or automations.

The verdict

The European Union cannot regulate, subsidise or protect its way to prosperity. To genuinely revive its economy, Brussels must embrace the painful but necessary process of 'creative destruction' – allowing uncompetitive zombie companies to fail so that innovative ones can thrive.

Unless the EU unwinds its anti-growth climate policies, abolishes protectionist non-tariff barriers, ends cheap money subsidies, and dismantles its innovation-choking regulatory tsunami, the current competitiveness agenda will amount to nothing more than managing Europe's own relative decline.

Introduction

In mid-February 2026, the motorcades of Europe's political elite wound their way through the Flemish countryside to the sixteenth-century Landcommandery of Alden Biesen. The choice of venue – a moated castle historically associated with the Teutonic Order – offered a visual metaphor almost too heavy-handed for the moment: shut away from the reality of the modern world in an ancient castle. Across the drawbridge walked French President Emmanuel Macron and German Chancellor Friedrich Merz, projecting a carefully choreographed image of unity that belied the deep, tectonic fractures threatening the European project's economic foundation. They were there to discuss 'competitiveness', the buzzword that has come to dominate the Brussels bubble with an intensity bordering on desperation.

The weeks leading up to this informal retreat saw an unprecedented flurry of bureaucratic and political activity. From the corridors of the Berlaymont to the industrial heartlands of the Ruhr, the narrative was consistent: Europe is falling behind, and only a radical intervention can arrest its slide into economic irrelevance. European Commission President Ursula von der Leyen, now well into her second term, had already signalled the urgency of the moment in January 2025 with the launch of the 'Competitiveness Compass', a strategic roadmap designed to operationalise the grim warnings delivered in Mario Draghi's landmark report on the future of European competitiveness. By February 2026, this roadmap had spawned a labyrinth of initiatives: a 'Clean Industrial Deal', an 'Industrial Accelerator Act',

and a sweeping ‘simplification’ agenda comprising 10 ‘omnibus’ packages that promised to slash the administrative Gordian knot binding European enterprise.

Yet, as the leaders debated late into the night at Alden Biesen, a sense of déjà vu hung over the proceedings. The rhetoric of ‘urgent strategic imperatives’ and ‘paradigm shifts’ echoed the hollow promises of the Lisbon Strategy of 2000, which had grandiosely vowed to make the EU ‘the most competitive and dynamic knowledge-based economy in the world’ within a decade. That decade came and went, leaving behind a legacy of stagnation rather than dynamism. Now, in 2026, the diagnosis remains terrifyingly similar, but the proposed cures – a mixture of subsidy-heavy industrial policy, selective deregulation and protectionist ‘Made in EU’ mandates – threaten to replicate the failures of the past.

The atmosphere at the summit was charged with the recognition of a ‘new geoeconomic context’, a polite euphemism for the reality that the European Union is being slowly crushed between the protectionist rock of the United States and the subsidised hard place of China. President von der Leyen, in her invitation letter to the leaders, framed the retreat as a critical juncture to ‘harness the full potential of Europe’s single market’. However, the unity on display was fragile. While Chancellor Merz and Italian Prime Minister Giorgia Meloni pushed for a ‘deregulation revolution’ to unleash market forces, Paris continued to advocate for state-led investment vehicles and strategic autonomy measures that Berlin views with deep suspicion.

This report posits that the frenetic activity witnessed in early 2026 – the summits, the leaked drafts and the high-profile declarations – is destined to fail. It will fail because it fundamentally misdiagnoses the patient. The European Union does not merely suffer from a ‘competitiveness problem’ that can be fixed with ‘Buy European’ clauses or a reduction in reporting

requirements. It is in the grip of a profound, structural productivity crisis that has been metastasizing for nearly three decades.

The narrative dominating the news cycle focuses on 'level playing fields' and 'strategic sovereignty', concepts that appeal to the political need for control and protection. Yet the data reveals a different story: a continent that has ceased to innovate at the technological frontier, where capital deepening has stalled, and where the 'creative destruction' necessary for growth is stifled by the very mechanisms designed to protect the status quo. The 'Competitiveness Compass' and its associated legislative vehicles are, in many respects, an attempt to compensate for this productivity failure through fiscal and regulatory engineering rather than addressing the root causes: the lack of technology diffusion, the refusal to allow natural economic restructuring such that uncompetitive companies may whither and new competitive ones be born, and energy costs that remain stubbornly high due to the transition to a far less productive (green) energy system.

The European elite have thus far offered only two solutions to the problem. The first is, essentially, a massive subsidy drive. This is clear in the Draghi Report, which advocates relief for companies through government aid in order to overcome economic stagnation. To stimulate innovation-driven productivity gains, Draghi recommends an EU-coordinated industrial strategy, including an investment offensive that, in addition to government investment, should primarily come from private capital. However, to mobilise the necessary capital, massive government aid and subsidies are needed as leverage so that private investments achieve sufficient profitability. To increase annual private investment by four per cent of the EU's gross domestic product, the cost of capital would have to be reduced by 2.5 per cent. Although the completion of the capital markets union, also called for in the Draghi report, could increase the efficiency of European capital

markets and contribute to lower capital costs, 'fiscal incentives to unlock private investment' are still necessary.[1]

The industrial strategy outlined in the Draghi Report is based on a massive subsidy program designed to compensate for the consequences of competitive weakness as much as possible without having to address its causes. However, this leads to a toxic mix of contradictory industrial-policy measures that are aimed at protecting competitively weakened companies and entire industries, while at the same time preventing competitors from gaining a competitive edge with better and cheaper products. This approach also allows industrial-policy measures that undermine competitiveness to continue, as fiscal and regulatory means can be used to mitigate or offset the consequences.

The second is the attempt to reduce the administrative/bureaucratic burden on companies. In response to the spiralling burden on businesses, Ursula von der Leyen reiterated, in a letter to the 27 EU heads of state and government ahead of the informal EU summit on the 10th and 11th of February 2026, that the Commission 'will sustain and deepen our unprecedented drive to simplify European legislation'. The Commission expects that the 10 omnibus packages now available to simplify previous laws will result in administrative cost savings of around €15 billion per year.

Although this represents almost 0.1 per cent of the EU's economic output, it is clearly not a significant contribution to improving the competitiveness of European companies. At the same time, the regulatory web is becoming thicker and thicker: last year saw a total of 1,456 legislative acts, more than at any time since 2010.[2]

The EU member states are finding it just as difficult as the EU Commission to reduce bureaucracy. Despite the grand words of Chancellor Merz, who declared the reduction of bureaucracy a 'top priority' last year,

neither the current federal government nor its predecessor has yet managed to achieve any significant reduction in bureaucratic burdens, despite repeated announcements. On the contrary, a large number of laws are in the pipeline in Germany that are likely to increase the burden even further.

Since the debate on the EU's legislative activity focuses almost exclusively on reducing bureaucracy – that is, bureaucratic efficiency – in many cases the much more problematic compliance costs, which can place a far greater burden on companies, remain largely untouched. Valdis Dombrovskis, the EU Commissioner responsible for simplification and productivity, has repeatedly made it clear that the content of EU legislation is not up for discussion when it comes to reducing bureaucracy. The EU is not moving away from 'high social or environmental standards. We are looking at how we can achieve our political goals more easily and cost-effectively'.[3]

A cycle of failed promises to reduce regulation, and an economic strategy geared around protectionism and subsidy – these are the two wings of the EU's 'competitiveness' drive. These will not address the underlying issue because they are not designed to. The underlying issue is the productivity stagnation – and addressing this would be far more painful and far-reaching than European elites have the stomach for. It would also require the slaying of EU idols – the green transition, addiction to low-wage migration, and the hostility to risk-taking which strangles the adoption of new technologies.

In this detailed analysis, we will demonstrate why, without a radical pivot toward genuine productivity-enhancing reforms – reforms that may be politically painful and economically disruptive – Europe's 'competitiveness' agenda will amount to little more than managing its own relative decline.

1 Where does productivity come from?

Classical economists like Adam Smith and David Ricardo saw human labour as the source of prosperity. But to achieve economic progress, the key was to get more work for the same amount of labour employed – in other words, improving labour productivity. There are two elements to this. First, the social division of labour, differentiating work into different trades and professions. Second, enhancing the division of labour within trades, resulting in the breaking down of tasks into discrete specialisms that can ultimately be mechanised and automated.

The driver for such improvements is competition: if an individual or company can find a process or invention that improves productivity, they can produce goods at lower cost, improving profit margins and selling more than their competitors. As innovations spread across a particular industry (or laggards go out of business), the result is higher productivity and lower prices.

In turn, one of the best ways to improve productivity is by reorganising production away from being powered by human labour to being powered by externally produced energy. This applies not only to physical labour, which has been true since the first industrial revolution, but also to mental labour, particularly thanks to developments in computing.

However, advances in productivity have all but ground to a halt. In the 1950s, 1960s and up to the early 1970s, the economies of Western Europe achieved historically unparalleled annual increases in labour productivity of five per cent and sometimes even significantly more, driven by high corporate investment. Since then, however, productivity growth has been in a continuous and so far unchecked decline, which has now reached the point where the EU-27 countries are barely achieving any productivity gains at all.

This is a serious problem for the living standards of everyone in the EU. The president of the German ifo Institute, Clemens Fuest, believes that the decline in labour productivity growth is currently 'probably the most important issue for economic policy and economics'. Yet policymakers have, at best, paid lip service to the problem.

Even where there appears to be a concerted effort to tackle the problem, the policies envisaged mistakenly see the US as a model to copy. In fact, the main drivers to declining productivity growth appear right across developed countries, including Western Europe, the US and Japan.

The root causes are the lack of productive investment in new capital and the unwillingness to rethink production methods and processes. Even the digitalisation of firms has, all too often, been bolted on to existing ways of doing things rather revolutionising production.

Moreover, the most dynamic enterprises are held back by policies that defend the status quo – with the political aim of stabilising what already exists – rather than encouraging risk-taking and innovation. These policies include low interest rates, subsidies for existing industries and protectionist measures against outside competition. Immigration has been encouraged to fill labour shortages caused by the failure to automate. Big firms have shifted production to newer member states in Eastern Europe to take advantage of lower wage rates.

In addition, environmental concerns have created an atmosphere in which economic growth is treated with scepticism, with the result that concerns about greenhouse-gas emissions take precedence over the provision of the cheap, reliable energy that is essential to transforming production and raising productivity. The decarbonisation of energy has led to lower energy consumption, higher prices and the export of production to other countries and regions with lower energy costs, such as the US and China.

The result of all these policies is the ‘zombification’ of the economy, stagnant economic growth and flat-lining (or even falling) living standards. This is the exact opposite of what is in the interests of EU citizens.

Even if there are commonalities in the developed world in relation to declining productivity growth, the EU is the world leader in what are, literally, counter-productive measures. Until politicians and EU bureaucrats in the Commission and the ECB are willing to reduce regulation and protectionism in all its forms, including shifting away from Net Zero orthodoxies, the people of Europe will continue to suffer a steady decline in their living conditions.

1.1 Prosperity through labour productivity

Classical economists – including their most outstanding representatives, Adam Smith and David Ricardo – recognised that human labour is the ‘source of prosperity’.[4] In his 1776 work on the nature and causes of the ‘wealth of nations’, Smith explains that ‘the annual labour of every nation is the fund which originally supplies it with all the necessaries and conveniences of life which it annually consumes’.[5] Therefore, Smith continues, social prosperity can only be increased either by increasing the ratio of productive workers to the total population or by increasing the ‘skill, dexterity and judgment with which its labour is generally applied’.[6]

Smith wrote his work at the height of the manufactory period and immediately before the Industrial Revolution began in England and Scotland in the last third of the eighteenth century. He identified the division of labour as the main driver of prosperity, arguing that it was likely to lead to ‘the greatest improvements in the productive powers of labour and the greater part of the skill, dexterity and judgment with which it is anywhere directed or applied’.[7] As soon as the division of labour became possible in a trade,

it led to ‘a proportionable increase of the productive powers of labour’, an ‘advantage’ that was probably also the reason why ‘the separation of different trades and employments from one another seems to have taken place’.[8]

The productivity-enhancing effects of the division of labour thus result in two ways. First, from the social division of labour, in that the division of labour, which originally arose naturally, became increasingly differentiated into a wide variety of trades and professions. Second, from the advancement of the division of labour within individual trades, which had reached its highest level at that time within manufactories.

Smith uses a pin manufactury as an example to illustrate how the division of labour within a manufactury increases productivity. The steps required to manufacture pins were divided among individual workers, so that each worker no longer performed all the tasks, as was previously customary in the craft, but only a single step. This specialisation leads to greater dexterity on the part of the individual worker and less time lost due to changing tools or work location when changing tasks.

Workers cooperating in this way can produce significantly more high-quality needles in the same amount of time than the same number of workers would if each performed all the tasks themselves. Smith observed a more than hundredfold increase in productivity through this form of division of labour. Instead of only about 20 needles that a single worker could produce per day, the 10 cooperating workers produced a total of 48,000 needles per day.

1.2 Revolutionising the production method

The division of labour driven forward in manufactories laid the foundations for the subsequent industrial revolution, in which it was no longer the

organisation of workers and the optimisation of their work processes that became the linchpin of productivity gains, but rather the tools and the automation of processes that had previously been carried out manually. Further improvements and targeted adjustments to the tools enabled the use of machine tools that could perform the same operations through mechanisation that had previously been carried out by workers. By transferring the work previously done by humans to machines, it became possible to replace workers on a large scale, revolutionising production methods and enabling enormous increases in productivity.

Now, the energy contributed to the manufacturing process in the form of human labour could also be completely replaced by other natural energy sources. The steam engine, further developed by James Watt, was used in cotton spinning from 1786 and in weaving from 1789. It enabled the use of inexhaustible natural forces, as it converted combustion heat into mechanical work.

Due to the productivity gains now achievable in textile factories, the prices of industrially manufactured textiles fell dramatically – both in comparison to traditionally manufactured fabrics and in relation to all other goods that were not yet subject to this revolutionary production method. Starting from the earliest machines in the eighteenth century, by the 1960s, further improvements made it possible to produce three thousand times more yarn per hour than before the start of the Industrial Revolution.[9]

1.3 Competition boosts labour productivity

However, this view of productivity gains ignores the human labour that was additionally expended to manufacture the spinning machines and to generate the energy required to power them. The production of a good

or the provision of a service only becomes more productive if the total human labour expended across the entire value chain decreases on balance.

Thanks to steady improvements in automation and the application of external energy – and provided that competition is functioning properly – the total amount of labour expended in an economy to produce a given quantity of goods will decrease, on balance, thereby increasing overall labour productivity in society. In a competitive environment, companies are constantly forced to reduce costs in order to remain competitive, which they achieve primarily by improving their own value-added processes. This will be profitable if the additional human labour expended in the form of increased investment and operating costs is less than the labour saved by the new technology.

The competitive pressure that companies have been under since the beginning of industrialisation, which began somewhat later in other developed economies than in England and Scotland, has driven them to achieve productivity gains far beyond anything achieved in previous human history. The development of overall labour productivity in Germany is typical of the increase in prosperity achieved over the past 200 years or so. Since the mid-nineteenth century, when industrialisation was just getting underway in Germany, labour productivity per employee has risen by an average of about 1.5 to two per cent per year, reaching 12 times its previous level today.[10]

Nor are these developments happening solely at the enterprise level. For example, the science sector, which has grown rapidly over more than two centuries due to the rapid advancement of the division of labour, is also playing an increasingly important role in the development of labour productivity in companies through new scientific findings, basic research and technological development.

1.4 Organising and optimising work: Henry Ford

A key driver of productivity gains over the past two centuries has been the ongoing reduction and elimination of non-value-adding human activities in work processes.

Henry Ford, the pioneer of automobile production, drew on this technique at the beginning of the twentieth century after being inspired by the industrially organised working methods in Chicago's slaughterhouses.[11] Even back then, the animals were stunned, hung on hooks and moved from workstation to workstation by a ceiling conveyor system. Ford himself developed a production system in which the entire automobile manufacturing process was divided into individual production steps based on standardised parts so that these could be carried out in synchronisation. This enabled – as is common in automotive production today – a perfected flow production system in which there were neither waiting times nor inventories, as prefabricated parts and car bodies were moved from one workstation to the next at a fixed cycle time, as on an assembly line.

Using the methods applied to improve production flow and production technology, Ford achieved extremely short lead times even by today's standards. The delivered iron ore went through the entire production process, from raw steel production to final assembly, in less than five days.

With this focus on process excellence and the simultaneous reduction of manufacturing complexity through the exclusive production of absolutely identical vehicles, Ford achieved sustained high increases in labour productivity, which enabled above-average wage increases, but above all contributed to a continued decline in car prices and created the basis for the emergence of a mass market. This not only revolutionised automobile production, but also contributed decisively to the second industrial revolution between the

end of the nineteenth and the beginning of the twentieth century, thanks to the superior production methods he developed – to which, in particular, electricity, the telegraph, the telephone and the combustion engine also contributed.

1.5 Automating work

The greatest productivity gains since industrialisation have been achieved in value-creating processes where human activity has been successfully replaced by automated processes. Automation requires an advanced division of labour, as the associated specialisation reduces the complexity of value-creating processes. This enables a more productive organisation of work. The specialisation of entire value-creation processes and the differentiation of task distribution within the value chain also facilitate the continuous improvement of work processes and work equipment. This lays the foundation for the partial or complete transfer of work execution to machines through the technical means of mechanisation, electrification and digitalisation.

Historically, automation has initially succeeded in replacing *physical* human labour. Since the invention of the computer in the 1940s, *mental* work has also been increasingly replaced, either partially or completely, with the help of digital information processing.

Entire work areas, such as order processing or warehouse logistics, are now automated in many companies. In many sectors of the economy, value-creation processes are fully automated – for example, in financial services, in the chemical, pharmaceutical, food, pulp, paper, glass, steel and chip industries, as well as in the energy sector. The unmanned factory, in which machines, computers and robots take over the entire value-creation

process and human activity is largely limited to maintenance and servicing, is no longer a vision, but is becoming a reality in more and more areas.

Process automation has cumulative productivity-enhancing effects. As soon as cost-reducing automation becomes established in the manufacture of machines, computers and robots, these become increasingly affordable.[12] This makes their use increasingly attractive in areas where automation was previously not profitable. Technical progress thus has a domino effect, because the manufacture of machines is carried out by other machines, reducing the overall amount of human labour required for their manufacture.

The transfer of previously human tasks – such as weaving to machines, calculating to computers, or gripping and loading to robots – is an indispensable technical prerequisite for automation. However, this technical progress only unfolds its full potential when work machines are no longer powered by humans, as was still common in the Middle Ages and in the early stages of the industrial revolution, but by power machines that use other natural energy sources. Advancing automation has meant that the human energy originally expended in physical or mental work in value-added processes has gradually been replaced by much cheaper energy sources, primarily fossil fuels and nuclear energy.

The total energy now used in production and service processes far exceeds the use of human energy. In Germany, for example, final energy consumption in industry, trade and services totals around 1,000 terawatt hours (TWh) per year.[13] This is about 10 times more than the amount of energy that the approximately 45million people in employment consume annually through their food and thus contribute to value-creation processes.

The reason for the increasing share of primary energy in value-added processes compared to human labour is the productivity gains achieved in the energy industry. This has made energy comparatively cheap. The almost

complete automation of energy production and supply has brought about such an enormous improvement in labour productivity that 1,500 kilowatt-hours (kWh) of energy, which corresponds to the annual energy consumption of a physically hard-working person, costs only €150, based on a typical electricity price of 10 cents/kWh for large industrial consumers in the EU.

The rapid advancement of the division of labour over the past two centuries, in contrast to previous human history, has enabled enormous increases in prosperity as a result of the improvements in labour productivity achieved. In Western Europe and the USA, real per capita incomes and real wages have risen in line with productivity growth by a factor of between 13 and 18 since the first half of the nineteenth century.[14]

1.6 More prosperity with less work

The close link between the development of real income and labour productivity stems from the fact that, as labour productivity increases, those working together in an economy produce a greater quantity of goods in the same total working time, or alternatively produce the same quantity of goods in less total working time. When goods or services are produced more efficiently, the total amount of human labour required to produce them decreases, so that the goods in question become cheaper to the same extent.

As soon as pioneering companies succeed in reducing production costs by introducing productivity-enhancing technology, they achieve higher margins than their competitors, enabling them to generate above-average returns on capital. However, in a functioning competitive environment, these companies lose their higher profitability as soon as the more productive technology becomes established throughout the industry. This is because

competitive pressure then causes sales prices to fall to a level that corresponds to the increase in labour productivity.

The enormous wealth-enhancing effect of rising labour productivity can also be illustrated by the production of artificial light visible to humans. While people in pre-Christian times had to work around 50 hours to produce 1,000 lumen-hours of light using sandstone lamps and animal fat as fuel,[15] which is equivalent to the output of a 75-watt light bulb or a modern LED of around eight watts in one hour, today's average income earners have to work less than a second to achieve the same result. Artificial light is now, in a sense, cost-free, and has also improved dramatically in quality and safety.

Although more productive lighting is an extreme example of the technical and technological progress achieved over the past two centuries, even areas less affected by industrial revolutions, such as food production,[16] have achieved such significant productivity gains that even the less affluent classes have benefited from enormous increases in prosperity. In contrast to the 1850s, when well over half of private household consumption expenditure was spent on food, this share has fallen to less than 15 per cent today, with an enormous improvement in the quality of these foods.[17]

Increasing labour productivity has opened up new opportunities for individuals and society, reflected, among other things, in the fact that only around 880,000 people are now employed in German agriculture, including only around 250,000 full-time workers,[18] whereas around 1900, there were about 10million people still working in agriculture.[19] During this period, the total number of people employed in the German healthcare industry has grown to just under eight million.[20] This impressively demonstrates that humanity, driven by the eternal desire to improve its own living conditions, is constantly developing new fields of activity, provided that these yield such great material benefits that the desire for more leisure time takes a back seat.

2 Origins of EU productivity decline

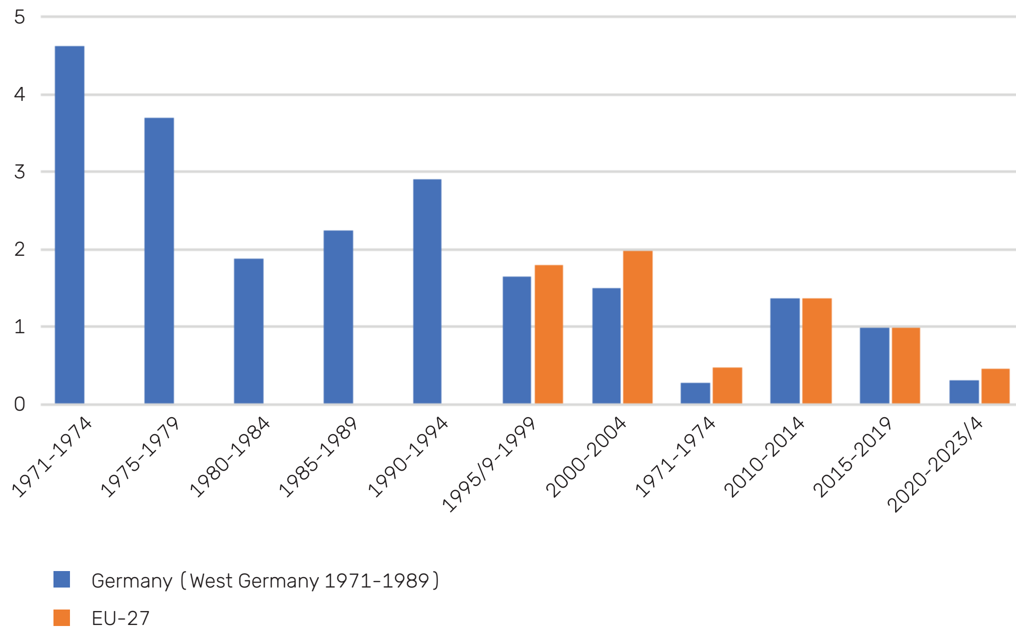
2.1 Productivity in decline

In the 1950s, 1960s and up to the early 1970s, the economies of Western Europe achieved historically unparalleled annual increases in labour productivity of five per cent and sometimes even significantly more, driven by high corporate investment.[21] Since then, however, productivity growth has been in a continuous and so far unchecked decline, which has now reached the point where the EU-27 countries are barely achieving any productivity gains at all.

The trend in Germany, as shown in the following chart, is typical of Western Europe. As recently as the early 1970s, West Germany was achieving an annual increase in labour productivity of 4.5 per cent per hour worked. Thereafter, as in the other Western European countries,[22] productivity growth slowed to around two per cent per year by the 1990s.[23] Even with the inclusion of the Eastern European countries that are now part of the EU-27, which have achieved significantly higher productivity growth than Western European countries since the early 1990s, productivity growth in the EU-27 collapsed from the mid-2000s.[24] Since then, it has been well below one per cent on an annual average, and continues to fall. In the 2020s, it fell below 0.5 per cent.

Labour productivity in Germany and EU-27, average growth in % per year

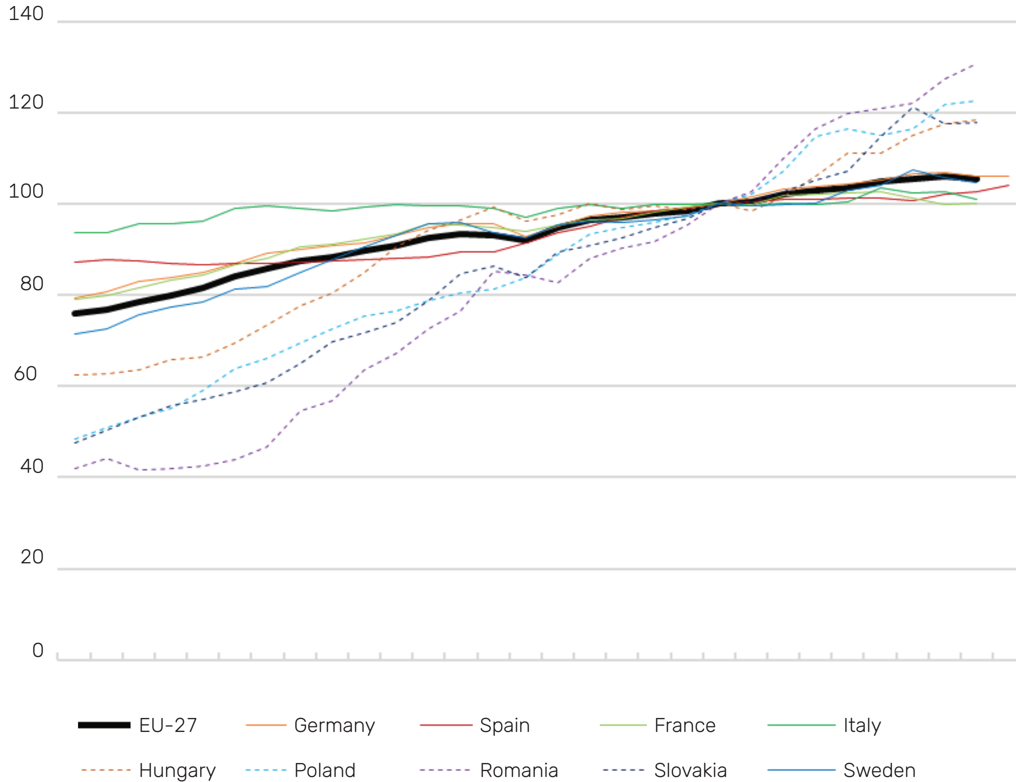
Source: Statistiches Bundesamt, Genesis and Fachserie 18, Reihe 1.5, 2022, Eurostat Data Browser Code tipsna70



The EU-27 average masks the fact that productivity growth in the Western European EU countries has now virtually come to a standstill and is even threatening to turn negative. Between 2000 and 2023/2024, average annual productivity growth in the four largest EU countries fell to below one per cent. Germany reached 0.9 per cent, France 0.8 per cent, Spain 0.7 per cent, and in Italy, labour productivity per hour worked stagnated throughout the entire period.[25] Since 2020, Western European EU countries have effectively not achieved any productivity growth. Although Spain was still able to achieve an annual average productivity growth of 0.5 per cent and Germany managed 0.3 per cent, France's productivity actually declined by 0.6 per cent. The remaining Western European EU countries are also moving at this level, as the following graphic shows.

Labour productivity per hour worked, Index 2015=100

Source: Eurostat Data Browser Code tipsna70



It is thanks to the comparatively strong economic and productivity growth of the Eastern European member states that productivity growth in the EU-27 has not fallen even further since the mid-1990s. Between 2000 and 2023/2024, Hungary achieved an average labour productivity growth rate of 2.4 per cent per hour worked, Poland and Slovakia 3.1 per cent and Romania as much as 4.8 per cent.[26] This is due to the fact that the productivity level of these countries in the early 1990s was significantly lower than that of the Western European EU countries and that, despite the catch-up process of recent decades, it is still about one-third lower.[27]

But since the economic weight of the Eastern European countries is low – in 2023, the Polish economy, the largest of these, only accounted for

4.4 per cent of the EU's gross domestic product (GDP)[28] – the statistics are dominated by the particularly pronounced productivity weakness of the Western European countries.[29]

2.2 The productivity crises ignored

Since the mid-2000s, productivity growth in the EU has been well below the long-term historical average of around 1.5 to two per cent per year achieved in Europe since industrialisation began some 200 years ago.[30] The long-lasting decline in productivity in the EU has turned into stagnation in recent years, which now threatens to become entrenched. Yet policy-makers have, at best, paid lip service to the problem – despite the concerns of economists, particularly since the 2008 financial crisis. For example, the president of the German ifo Institute, Clemens Fuest, believes that the decline in labour productivity growth is currently 'probably the most important issue for economic policy and economics'.[31]

When the economy in the EU was only growing at a modest rate after overcoming the financial crisis of 2008 and the escalating euro crisis of 2012, the EU Commission put productivity weakness on its agenda for the first time. As a result of its initiative, a recommendation was issued by the Council of the EU to the EU states in 2016. The EU member states were encouraged to establish permanent national productivity boards to diagnose and analyse the development of productivity and competitiveness at the national level.[32] The recommendation addressed the issue of the significant slowdown in potential growth in the euro area, the weakening of economic growth due to the decline in investment since 2008, and the fact that a return to economic growth 'will depend on an increase in productivity'. In addition, the Council of the EU declared its intention – without, however, adopting any specific measures – to improve productivity and competitiveness, not least because

this could increase resilience to macroeconomic imbalances in both the eurozone and the EU.

In Germany, where the role of national productivity committee has been assigned to the Sachverständigenrat,[33] the analyses and diagnoses produced by these bodies have fallen on deaf ears in politics and the EU technocracy for years. Committees in other EU countries have suffered a similar fate. In its 2019/2020 productivity report, for example, the Sachverständigenrat emphasised the 'need for economic policy action', because although the decline in productivity growth is an international phenomenon, no economy is 'well advised to simply accept the slowdown in productivity growth by referring to the common trend'.[34] According to the German Council of Economic Experts, productivity growth is 'in the long term the decisive factor for material prosperity' and for 'individual opportunities for development' of citizens.

Despite all the warnings, neither national politicians nor the EU technocracy have so far reacted in a manner appropriate to the problem. As early as 2017, the German Federal Ministry of Finance (BMF) had reacted in a dismissive manner to the 2015/2016 Annual Report of the German Council of Economic Experts, in which this low productivity was discussed in detail.

The declining growth in labour productivity was considered 'justifiable in view of the historically low unemployment rate'.[35] The BMF did not view the low productivity gains as one-sidedly negative, since a 'job miracle' emerged in Germany after the 2008 financial crisis despite low economic growth. This supposed miracle was due precisely to the fact that companies were barely achieving any productivity gains. With only small increases in turnover, they had to hire more staff, which pushed up the number of people in employment. Over the years, this led to the problem of a shortage of skilled and unskilled

labour in Germany, as in many other EU countries, which was exacerbated by the demographically induced decline in the working-age population.

Meanwhile, the European Commission has taken up the issue of the European economy's productivity weakness and made overcoming it a priority on its agenda. This effort is to be based on the 'competitiveness strategy'[36] presented in September 2024 by the former president of the European Central Bank, Mario Draghi, commissioned by the Commission president, Ursula von der Leyen.[37] To implement this strategy, the EU Commission presented the 'Competitiveness Compass' in January 2025, which, according to von der Leyen, 'transforms the excellent recommendations of the Draghi report into a roadmap' and defines the fields of action identified as central in the report – innovation, decarbonisation and security – as core tasks. She claimed that the EU now has a plan for how it can 'become competitive again'.[38]

The linchpin of the Draghi report is overcoming the decline in productivity growth. According to the report, the 'resulting' and ever-declining economic growth in Europe has been seen as unfortunate since the beginning of this century, but not as a threat.[39] Various strategies have been implemented to increase growth, but the negative growth trend has not changed. Now, however, Europe is facing 'existential challenges' and the weakness in growth and competitiveness can no longer be ignored. The EU must become more productive to be able to grow at all in the face of a shrinking working-age population, because otherwise the current challenges cannot be met, Draghi continued. 'If Europe cannot become more productive, we will have to choose. We will not be able to become, at once, a leader in new technologies, a beacon of climate responsibility and an independent player on the world stage. We will not be able to finance our social model. We will have to scale back some, if not all, of our ambitions.'[40]

2.3 Draghi is jumping to conclusions

In his analysis of the productivity weakness, Draghi draws on an economic policy narrative that has since become established, according to which the European economies performed well until the turn of the millennium, but have since fallen behind, particularly in comparison to the US and, more recently, China. The report uses a wide range of indicators – including investment, economic growth and productivity trends – to show a growing gap between Europe and the US. According to Draghi, a 'wide gap has emerged between the US and the EU, mainly due to the more pronounced decline in productivity growth in Europe'.[41] Due to deficits in the entire innovation life cycle, the EU's ability to innovate is severely impaired, which has a significant impact on productivity development, since 'research and innovation are the main drivers of productivity growth and human well-being'.[42]

The analysis of the EU's productivity weakness presented in the Draghi report is completely fixated on the supposedly existing and widening gap in relation to the US. Draghi's researchers imply that productivity development in Europe was adequate until the end of the 1990s and that the US, in contrast to Europe, has managed to continue with an overall positive development. Due to this selective perspective, the study remains superficial and falls victim to the trap it has set for itself. Instead of penetrating to the causes of the productivity weakness from the many correctly identified problems, the report jumps directly to the economic policy solutions supposedly found in the US and advocates that the EU copies them.

In fact, the analyses in the Draghi report do not substantiate the narrative of a supposedly more dynamic or even qualitatively different economic and productivity development in the US, although in some cases the discrepancy between the two economic areas is accentuated by clever data selection.

To show that the slowdown in productivity growth in the EU has held back economic growth, the researchers point out that the US economy has grown faster than the EU economy since the early 2000s. In fact, the US has since achieved average annual growth in GDP of around 2.5 per cent,[43] while the growth rate in the EU has only been around 1.5 per cent. However, as the authors themselves explain, the US had significantly stronger population growth than the EU during this period, so the greater increase in economic output in the US is not primarily due to productivity improvements, but mainly to the increase in the total number of hours worked.

Even so, the researchers claim to be able to discern a widening 'gap' between the two economic areas as a result of the better productivity development in the US, even if the changes they identify are marginal. As evidence, they cite the fact that the difference in GDP per capita, which was already 31 per cent in 2002, had risen to 34 per cent by 2023. The 'gap' thus increased – but only by 0.1 per cent per year. On top of that, they put this finding into perspective by pointing out that, according to their analyses, only 70 per cent of this difference is actually due to the different productivity trends in the two economic areas.[44]

According to the Draghi report, the digital transformation is the decisive factor behind the growing productivity gap between the EU and the US. Unlike the US, where the 'internet-led first digital revolution' emerged from the mid-1990s, Europe has not succeeded in benefiting from it.[45] According to the report, the EU and US would have had roughly the same productivity development since the early 2000s if the tech sector – IT services, finance and insurance, and professional services – had been excluded.

Although the Draghi researchers interpret this as evidence of the particular dynamism of the tech sector in the US, the opposite can also be seen: in all other sectors in the US – and in the EU as a whole – there is no

evidence of a successful introduction of digital innovations that boost productivity since the early 2000s. [46] In the USA, this has been clearly apparent in industry since 2010, which, with almost a fifth of economic output, still plays a significant role in the development of prosperity. Since then, labour productivity per hour worked has fallen significantly there, by an average of 0.5 per cent per year.[47] So far, there are no signs of a turnaround.[48]

In order to make the effects of the 'digital revolution' clear, the Draghi report shows that in Europe, in a decades-long catch-up process since the 1950s, labour productivity had gradually approached the initially much higher level in the USA. In the mid-1990s, Europe finally reached 95 per cent of the US productivity level. However, due to the lack of a tech revolution, labour productivity in Europe grew significantly more slowly than in the US from 1995 onwards, causing the gap between the two economic areas to widen again.[49] The researchers estimate that the resulting productivity gap between 2000 and 2019 was around 0.5 per cent per year, because while the EU only achieved an average annual labour productivity growth rate of just under 0.7 per cent per hour worked, the USA achieved 1.2 per cent.[50]

However, they can only show this discrepancy of around 0.5 per cent per year because they do not take into account the strong-growth Eastern European countries that are now part of the EU during this period (see chart above). In addition, they have excluded from their calculations those EU countries that experienced particularly weak growth during this period, such as Greece and Portugal, thereby deliberately understating productivity growth in the EU.

Moreover, the exclusive consideration of the period from 1995 or 2000 onwards obscures the fact that, both in the US and in the EU, productivity growth has been on a downward trend for decades and that annual growth rates in both economic areas are well below the average achieved since indus-

trialisation. While growth in labour productivity per hour worked in Europe has shrunk from over five per cent annually in the 1950s to just 0.5 per cent now, it has shrunk from around 2.5 per cent to around one per cent in the US over the same period.[51]

Moreover, the undifferentiating view of the period since the turn of the millennium obscures the fact that productivity growth in the US actually weakened more than in the EU after the 2008 financial crisis, which is diametrically opposed to the central claim of superior productivity development in the US. The US failed to sustain the somewhat more dynamic productivity development achieved between 1995 and 2010. It was only during this relatively short phase that the US achieved higher productivity growth than Europe or the current EU-27 countries, at an average of around 2.5 per cent per year.[52] From the beginning of the 2010s, it fell to an average of less than one per cent per year and was thus even lower than in the EU.[53] It is only since productivity growth in the EU has come to a complete standstill at the beginning of this decade that the US has been ahead in the snail race of the past 15 years.[54]

In short: the Draghi report is based on a huge overestimation of the dynamics of the US economy and particularly of productivity development, both in relation to the EU and with regard to historical development in the US. Differences undoubtedly exist, but those that are often emphasised, such as the supposedly much better innovative capacity and the resulting productivity development of America, have actually led to relatively small superiority in economic outcomes.

In reality, both the US and the EU are sliding deeper and deeper into an economic depression, which has not yet been overcome on either side of the Atlantic despite escalating government spending and debt, increasing protectionism and subsidies, and cheap central bank money. Labour

productivity is stagnating or even declining in many sectors. As a result, real incomes are now falling in both economic areas.

The fact that the US economy often seems to outshine the EU economy is due to an important difference that is not mentioned in the Draghi report. The US economy has a much greater resilience to global shocks, which it has demonstrated in the 2008 financial crisis, the Covid crisis and as a result of the war in Ukraine. To a large extent, this is due to the strong support provided by the unbroken global role of the US dollar.[55] This is because global crises, even if they are triggered by the US – as is currently the case with the Trump administration's trade protectionism – have so far always strengthened the demand for US dollars, which facilitates borrowing and makes the extraordinarily loose fiscal policy of recent decades possible. This is the case even though the US budget deficit has exceeded seven per cent of GDP in each of the past two years[56] and the national debt now stands at 120 per cent of GDP.[57]

The unfounded claim of a dynamic productivity development in the USA leads to seriously flawed conclusions. Nonetheless, both the report and the European Commission, which is now basing its entire economic strategy on the report,[58] are drawing far-reaching economic policy conclusions for the EU.

In a momentous overestimation of the US economy, the authors of the Draghi report propose a broad copying of American economic policy to overcome the European productivity crisis – with more debt, more protectionism, less competition and, above all, power over industrial policy for the EU institutions. This economic policy approach reflects a blatant underestimation of the productivity crisis in the EU, but also in other developed economies such as the US. This is because the supposed way out, in the eyes of the European Commission, is to pursue the economic policy of

the past decades even more consistently – the very policy that has led to this plight.

2.4 The lack of productive investment

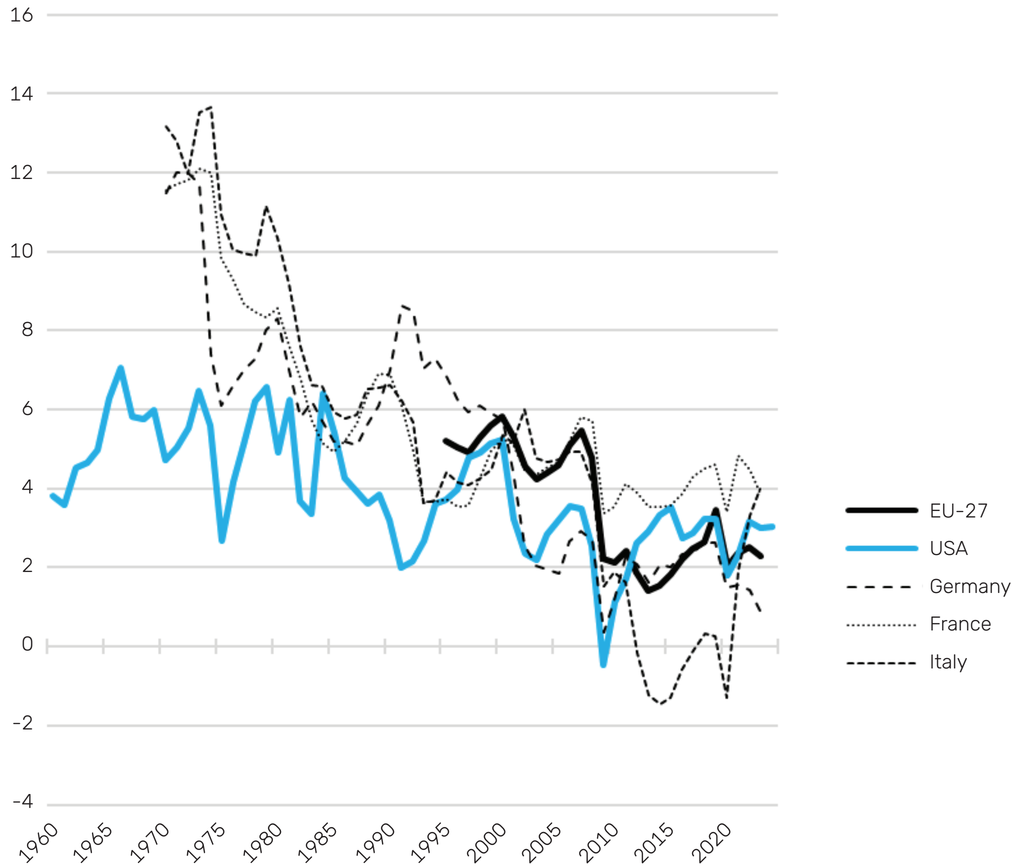
The Draghi Report rightly identifies the stagnation of labour productivity as the biggest economic policy problem in the EU. But the issue is only taken up and instrumentalised to lend weight to the European Commission's agenda, without addressing the roots of the productivity crisis. The authors of the Draghi report ignore the fact that the decline in productivity and economic growth in Europe, North America and Japan follows the same economic pattern and that this decline is also accompanied by a similar economic policy orientation in all developed economies. Economic policy measures have not been able to stop or even reverse the trend of declining productivity growth that has been unbroken since the mid-1970s.

The main reason for the decline in productivity growth and a defining component of the common economic pattern is the declining propensity of companies to invest in all developed economies. This negative trend is very clearly evident from net fixed capital formation, which, in contrast to gross fixed capital formation, deducts annual depreciation and thus takes into account the loss in value of the capital stock built up in the past.

To show the development trend of net fixed capital formation with a potential impact on productivity, the following chart only takes into account non-governmental investment, which is mainly made by companies, because government investment is mainly in infrastructure and defence and therefore has only a limited and indirect impact on productivity development. The share of net fixed capital formation in GDP shown in the chart provides an indication of the investment momentum, as it shows whether investment is rising or falling in relation to economic output.

Net business (private) investment, share of GDP in %

Source: Federal Reserve Bank of St Louis, BEA Code W709RC, A362RC; European Commission AMECO Database tables 3.4 and 6.1, BMWI Jahreswirtschaftsbericht 2006



The development of corporate net investment rates in the largest EU economies shows that the high investment momentum in Europe in the 1960s was lost from the mid-1970s onwards.[59] Within about 10 years, the corporate net investment rate in what was then Western Europe had fallen to roughly the same level as in the US. Since then, investment rates in both economic areas have continued to fall in waves. Since the financial crisis of 2008, they have fluctuated within a range of about two to three per cent of GDP. If we were to disregard the investments made by companies in residential construction, which, like public-sector investments, have little

impact on the productivity of the capital stock, the net investment rate of companies would be significantly lower.

Since net investments are now very low in relation to economic performance, companies are finding it increasingly difficult to turn new research findings and technical innovations into successful process and product innovations. At the same time, the diffusion[60]– that is, the ‘dissemination of new processes and products in the economy’ – of innovations that usually originate with technology leaders to other companies, has weakened[61] or economic penetration has even failed to materialise,[62] as the companies following the technology leaders are also investing less and less.

In a highly competitive environment, such low net investment rates would not be expected, since companies would be under considerable pressure to repeatedly create competitive advantages for themselves or to compensate for competitive disadvantages that have arisen by improving their value-added processes and developing new products in order to remain profitable. It is often possible to achieve significant process improvements with little effort, for example, through better organisation or avoiding non-value-adding activities in work processes with the help of innovative tricks, self-developed special tools or improved raw materials and other materials. Cost-cutting programmes can also increase profitability in the short term.

However, investments in the value-creation processes are crucial for maintaining competitiveness in the long term, because only these have a transformative effect. It is the introduction of innovative efficiency- and productivity-enhancing value-creation methods and processes, along with the necessary investments in tangible assets such as machinery, hardware and software, buildings and equipment, that lay the foundation for the production of completely new, higher-quality and also more cost-effective

goods and services. The truly significant productivity-boosting effects come from the automation of processes that were previously carried out by people.

In all developed economies, however, companies are not only avoiding this challenge by investing little in relation to their value added. They are also spending an ever-smaller share of their investments on improving their value-creating processes and an increasing share on intellectual property instead.[63] This includes research and development (R&D) expenditure, which accounts for the lion's share of these investments, as well as expenditure on software, databases and copyrights. Although R&D and copyright expenses are often a necessary condition and prerequisite for product or process innovations, they do not have any direct transformative effect on the value-creation processes. They only have a productivity-boosting effect if production and service processes are actually changed by follow-up investments in tangible assets or software and databases.

For example, the very low net investment rates in the long-term historical comparison since 1850 conceal the fact[64] that productive investment in recent decades has declined even more sharply in all developed economies. In Germany, the share of gross fixed capital formation attributable to investment in equipment has fallen from around 40 per cent at the beginning of the 1990s to below 30 per cent today, while the share of investment in non-residential construction has fallen from just under 30 per cent at the time to just 20 per cent today.[65] As a result, the share of investment in equipment and non-residential buildings has fallen from over 15 per cent of GDP at the time to around 10 per cent now.

The shift away from investment in tangible assets in industry is even more pronounced than in the economy as a whole. In Germany, significantly less than half of gross fixed capital formation in industry is now accounted for by

investment in equipment and construction, while more than half of investment goes into intellectual property – mainly R&D.[66]

Weak investment in equipment is increasingly out of line with the capital tied up in companies. This is because technical and technological progress, which has been advancing for more than 200 years, has led to fixed assets becoming increasingly important for productive value creation and the capital stock invested per workplace has grown sharply. Typical for developed economies is the capital investment in Germany per employee, where the gross fixed assets used by the company are valued at replacement prices – that is, without taking into account age or degree of wear and tear. In Germany in 2023, the capital stock per employed person in the manufacturing sector (excluding construction) was worth €448,400 at replacement value. In trade, transport and hospitality, the figure was €215,400, in agriculture (excluding land) €815,600, and in water and energy supply, well over €2million is invested per employee.[67]

The stakes are therefore high for companies, which need to be sufficiently profitable, because gigantic investments have to be mobilised when functioning equipment has to be replaced – in whole or in part – by new equipment, facilities, buildings and software when technical innovations are introduced.

2.5 Technologies that flop

The decline in investment means that the productivity-enhancing potential of new technologies and technical applications is being exploited less and less, and their further development is also being hampered. This is particularly evident in the use of digital information and communication technology, which dates back to the invention of the computer in the 1940s and the third industrial revolution that began around that time.

The rapid advancement of digital technology revolutionised information processing by bringing forth innovative products such as mainframe computers, plant and robot control systems, PCs, satellite-based communication, the internet and mobile devices. It also greatly increased user benefits by increasing the processing speed of ever-growing amounts of data while simultaneously miniaturising devices. The rapid pace of technological progress is symbolised by Moore's Law, which has been in effect since the 1960s. It states that the number of circuit components on an integrated circuit, or the number of transistors per unit area, doubles approximately every two years.[68]

Above-average productivity gains have been achieved in the manufacture of data processing and communications equipment, due to very high levels of investment in relation to gross value added in some areas, such as chip manufacturing.[69] However, companies that use digital technology in industrial and service sectors have so far achieved hardly any noticeable productivity improvements. This discrepancy between the technological and technical development of digitalisation and the lack of productivity effects in companies that use it[70] was summed up by the German industry association BDI in an industrial policy dossier in the mid-2010s: 'Information and communication technologies and productivity: manufacturers top, but users flop.'[71]

Back in the 1980s, Robert Solow, who received the Nobel Prize for his research on technological progress, pointed out the paradoxical productivity trend in the context of the digital revolution, which he summed up with the words: 'You can see the computer age everywhere but in the productivity statistics.' Since then, at least in the US, there was a noticeable productivity effect from high IT investments in the late 1990s and early 2000s, but this subsequently subsided. In other developed countries, including the EU, such an effect, if it occurred at all, was only marginal. Today, the contradic-

tion between increased IT investment and the lack of a productivity effect is known as the 'productivity paradox'.

When it comes to digitalisation, a particular challenge in terms of productivity improvements is that production and service processes are typically based on the physical movement and alteration of goods. The transmission and processing of information – for example, for process control or quality and process documentation – generally accounts for only a minor part of value creation. In most cases, the value-adding share of information processing predominates in only a very few process stages, such as order processing, customer-specific adaptation of construction and design, or the transmission of delivery and invoice data to customers. To date, only a relatively small number of services are based exclusively on information processing. Examples include internet and streaming services, financial services, and the services of tax consultants, certified public consultants, lawyers, brokers, property managers and insurance companies.

In order to tap into the productivity potential offered by digitalisation in production and service processes involving the movement or modification of physical goods, significant adjustments to the physical process environment are usually required, ranging from changes to equipment to buildings and infrastructure. For example, the digitalisation of warehouse management in well-organised and structured warehouses hardly leads to any improvement in work productivity, because such optimised warehouses with a manageable range of parts can also be managed manually without any search effort using simple tools. On top of that, the use of software to manually record storage and retrieval transactions instead of previously manual entries can even lead to an overall increase in workload.

Only when the physical world, in this case the warehouse itself, is automated – when labour-intensive warehouse movements are carried out

partially or completely by machines and robots – can the potential offered by digitalised warehouse management be exploited. However, the investment required for such a transformation of the physical world is considerable. The introduction of fully automated warehouses usually requires the complete replacement of existing warehouse facilities, including the construction of new buildings, and thus far exceeds the investment required for digitalisation alone.

Productivity gains based exclusively on digitalisation can generally only be achieved in production and service processes in which physical goods are moved or modified through the most complete digitalisation of value-creation processes possible. In logistics, this can be achieved by fully digitising the entire booking process, from the physical creation of a product – including transport and, if necessary, intermediate storage – to its final consumption. However, the necessary use of radio scanners and barcode labels or RFID tags, as well as radio coverage of all booking areas, requires investments in infrastructure and equipment.

Investment costs increase further if the further productivity potential of digitalisation is to be tapped by going beyond the individual company. For example, if standardised digital incoming goods recording is to be implemented, all direct suppliers in the usually widely branched value chains must be integrated, so that often many hundreds or even tens of thousands of suppliers must digitise production and logistics processes to the extent that they can make shipping and material data available digitally.

The productivity-enhancing effects of digitalisation therefore remain extremely limited or can even be negative if only isolated solutions are created in the value chains in an otherwise analogue world or if the physical processes underlying the digitised information flow are not also transformed.

2.6 The imaginary productivity paradox

For decades, however, there has been a growing lack of the necessary corporate investment to enable saving human labour through digitalisation and accompanying automation. While corporate investment in equipment for digitalisation has increased since the 1970s, this growth has steadily slowed since the early 2000s.[72] For example, the share of investment in equipment for information and communication (ICT) in total gross value added in the EU reached its highest level in the 1990s – in Germany, the share was approximately 2.5 per cent – but since then, the share has declined across the EU; in Germany, it has remained below two per cent ever since.[73]

Although companies invest a considerable amount in ICT, at around two per cent of their total value added, other equipment investments have developed so weakly in recent decades that the share of total equipment investments (including ICT) in value added is continuously declining.[74] A typical example of this is the German mechanical engineering sector, where the share was still more than 10 per cent in the early 1990s, remained at an average of eight percent until the end of the 2000s, plummeted to six per cent in the 2010s, and now stands at just five per cent.[75]

Since companies have been investing an ever-decreasing share of their value added in new equipment for decades, including digitalisation expenditures, the adoption of digital and automation technology is limited even among pioneering companies, and the diffusion of productivity-enhancing technology is severely hampered in many economic sectors and value chains. Although the declining productivity growth is therefore easily explained, it is considered a 'paradox' that, while companies have been investing more and more in ICT for decades, and these investments even account for a growing share of total equipment investment, productivity growth is getting weaker.

The paradox arises from the fact that digitalisation is still seen as a supposedly simple solution and, above all, as a capital-saving option for increasing labour productivity and reducing costs,[76] largely eliminating the need for capital-intensive and risky restructuring of value-creation processes. Instead of seeing the new technical possibilities of digitalisation as an opportunity for the comprehensive transformation of existing processes, companies aim to avoid the investment costs associated with this transformation by introducing new software. Consequently, digitalisation aims to preserve existing processes as much as possible. Investment in equipment declines – and so does productivity.

Economic researchers see this approach as a critical shortcoming in the development of labour productivity. Companies rely too heavily on IT solutions, even though productivity gains are primarily based on process improvements. The digitalisation of production does not necessarily lead to productivity gains; rather, 'the digitalisation of inefficient processes leads to inefficient digital processes'.[77]

That said, productivity gains are often not the motivation for digitalisation. In many cases, other concerns prevail, such as documenting compliance with and monitoring regulatory requirements regarding quality, safety, the environment, data protection or working conditions.

3 The ideology of anti-growth

Despite the now glaring weakness in innovation and productivity, companies are apparently still doing well and even better at asserting themselves economically. For decades,[78] corporate failures and insolvencies, as well as the rates of annual job losses in relation to the total workforce, have been declining in all developed economies. A stabilised economy has emerged in which more and more companies are enabled to survive in the long term and remain profitable, even though they are hardly achieving any competition-enhancing efficiency and productivity improvements. The main reason for this stabilisation is the economic framework conditions, established by the states decades ago, within which companies operate.

After overcoming the global economic crisis of 1929 and the economic depression of the early 1930s, there was a subsequent, postwar expansion that was relatively crisis-free. But the cyclical economic crises which had shaped capitalist development reemerged at the end of the 1960s. Until the early 1980s, the reaction of political leaders and state institutions to these crises and the destabilising effect they had was ambivalent.

After the experiences of the 1930s depression, unlimited economic growth seemed desirable. In 1946, the US Congress committed the government 'to promote maximum employment, production and purchasing power', which was maintained until the 1977 Reform Act. However, in view of emerging crises, economic stabilisation to mitigate or even avoid crises became an increasingly important priority. This ambivalence in the state's

orientation was further accentuated by the fact that a causal connection between crisis and growth was seen.

In the late 1960s, for example, the then West German chancellor, Ludwig Erhard, viewed the Federal Republic's first looming economic crisis as a necessary 'cleansing crisis' – that is, as an opportunity for economic restructuring. According to this view, a hard recession should help to eliminate uncompetitive and less-profitable businesses from the market. It was thought that better-positioned and sufficiently profitable companies could then drive structural change in two ways. Firstly, by investing in new and more productive technologies in anticipation of strong economic growth and expanding markets, and secondly, by taking over resources that have been freed up, such as the labour forces of companies that are going under or restructuring, or of entire sectors, and thus raising the overall economic productivity level. In order to favour this restructuring, the German Federal Bank raised the key interest rates and the German government's economic policy acted to exacerbate the crisis.

Although the recession only caused a contraction of 0.2 per cent of GDP and the unemployment rate only rose from 0.7 to 2.2 per cent in 1966/67, the political reaction showed a clear change of mood, which led to the passing of the Stability Act. The de-prioritisation of growth remained a defining feature for the Federal Republic, because the Stability Act henceforth obliged the federal and state governments to ensure economic stability. The 'requirements of overall economic equilibrium' – according to the law, the stability of the price level, a high level of employment, external equilibrium and 'steady and appropriate' economic growth – were to be given equal consideration in future economic policy measures.[79]

In the United States, it was only in 1979 that the US Federal Reserve, under its then chairman Paul Volcker, raised interest rates drastically with the

same intention and in the face of fierce resistance from politicians and business leaders, in order to send the US economy into a sharp recession. Volcker wanted to end the phase of recurring high inflation coupled with weak economic growth that had persisted since the late 1960s. As a result of the interest-rate hikes, the US economy suffered a severe crisis, with the unemployment rate rising to 10.8 per cent by the end of 1982. However, economic growth quickly returned and inflation fell significantly.[80]

Overcoming the inflation that emerged in the 1970s gave the US Federal Reserve (Fed), like other central banks, greater room for manoeuvre from the mid-1980s onwards. But as in Germany, a monetary policy geared towards economic stabilisation has since been adopted in the US and in all other developed economies. After Alan Greenspan took over as chairman, the Fed aimed to cushion or avoid cyclical economic crises and financial-market crises, such as the stock-market crash in October 1987, with the help of interest-rate cuts and the provision of liquidity, and to support and extend the economic upturns, which have been weakening ever since, through monetary policy.[81]

Under the leadership of the Fed, Western central banks have established an asymmetric monetary policy: they lower interest rates and provide liquidity when crises approach, in order to mitigate them, but they do not restore either interest rates or liquidity to their previous levels during the subsequent recovery phases.

Since then, economic restructuring has been avoided across all state institutions because of its uncertain outcome, the associated risks and the accompanying economically and politically destabilising effects. Governments and politicians opt for economic stabilisation over restructuring to avoid crises, although this is at the expense of long-term economic growth. The dominance of this one-sided focus on economic stabilisation is further

reinforced by the fact that economic growth is increasingly viewed with scepticism for ecological reasons and because of climate change.

As early as the 1970s, growth-sceptical views were already gaining widespread traction. This was demonstrated by the popularity of *The Limits to Growth*, a report written by Dennis and Donella Meadows for the Club of Rome and published in 1972, in which the authors claimed that economic growth was reaching its natural limits due to the increasing consumption of resources and that it must therefore be limited.

The doubts underlying this assessment regarding humanity's ability to repeatedly overcome supposedly natural limits through social and, above all, technological progress have become a dominant view over the decades. On the basis of this premise, the EU introduced a cap on energy consumption for the year 2020 for the first time in the 2012 Energy Efficiency Directive,[82] in order to gradually reduce greenhouse-gas emissions to a pre-industrial, 'natural' level.[83]

However, the binding agreement with the member states to reduce energy consumption also directly implied capping economic growth. That's because economic growth leads to an increase in energy consumption due to the increased use of labour-saving technologies such as machines, robots, digitalisation and AI – despite improvements in energy efficiency.

3.1 Alternatives to growth: stimulus, protectionism, migration

The increasing focus of central banks and governments on economic stabilisation, which has prevented the necessary restructuring to restore the growth achieved in the 1950s to 1970s, has led to a loss of the previous investment momentum. Financial crises, which would have led to the bursting of bubbles, were dampened or even permanently prevented, as were economic crises, which would have led to the collapse of less productive and competitive

companies. In Western Europe, the gross and net investment rates of companies had already collapsed in the 1970s, while in the US there was a noticeable decline in the 1980s that continues to this day in all developed economies in a series of waves.

3.2 Stimulus

Because they are investing less, the financing needs of companies have gradually fallen. By the early 2000s, non-financial corporations in developed economies had already mutated from former net borrowers to net savers.[84] After the 2008 financial crisis, their financing surpluses even increased, massively.[85] In Germany alone, non-financial corporations have been generating financial surpluses of two per cent of GDP per year on average since 2010, which now amounts to almost €100 billion annually.[86] Although companies are reducing their financial surpluses by using large-scale share buyback programmes and dividend distributions, they are still flooding the financial markets with many hundreds of billions of euros every year.[87] They are awash with money and apparently see hardly any profitable investment opportunities. Despite the gradual fall in interest rates for long-term capital, which they themselves have caused with the glut of capital on the capital markets, they are increasingly unwilling to invest in new technologies.

The falling interest-rate level and the increasing glut of money have opened up new avenues for states to avoid having to address the underlying investment weakness and to evade this problem. A crucial role was played here by the deregulation of the financial markets, which started in the US and the UK in the 1980s and was then pushed forward in all developed economies, as well as the central banks' monetary policy, which has since been geared one-sidedly towards crisis avoidance and stabilisation. The constant flow of capital into the financial markets and the resulting asset-price bubble opened

up new opportunities for companies to generate profits, beyond optimising their value creation.

The continuous flow of ever-cheaper money has also opened up further possibilities for states to stabilise the economy despite weakening investment and even to revive investment activity at times. Falling interest rates have further improved credit financing for states, private households and companies. This stimulated aggregate demand, including increasing consumer spending, with falling interest rates reducing the annual debt burden despite rising public debt. The artificial stimulation of demand also helped to stave off economic crises. Declining interest rates on borrowed capital have helped many companies improve their profitability and even contributed to turning previously unprofitable companies into profit makers.

In addition, there is an ever more extensive network of regulatory and fiscal measures, with which governments are setting framework conditions that preserve structures in order to protect companies and their profitability, but which weaken competition. All this opens up alternative paths for companies to secure their profitability while avoiding the risky introduction of new technologies.

3.3 The EU turn towards protectionism

These conserving state measures range from competition between states to reduce corporate taxes to reduced creditor protection to rescue insolvent companies,[88] to a colourful bouquet of ever-more extensive subsidies. Particularly striking is the growing trend towards protectionism in developed economies since the 2008 financial crisis,[89] often in conjunction with industrial-policy interventions in favour of individual sectors, technologies or companies.[90]

Due to historically low and relatively stable tariffs, the G20 countries maintained the 'diplomatic fiction' that protectionism had been tamed until the end of the 2010s, according to Global Trade Alert (GTA), an organisation specialising in monitoring world trade.[91] According to the authors of a GTA study, the states 'have only shifted their activities to other policy areas'.[92] Import tariffs were responsible for less than 10 per cent of trade distortions in 2016, according to GTA, because 'state financial aid, not import restrictions' is the main area of activity for protecting the domestic economy.[93]

Increasing protectionism has taken the form of so-called 'non-tariff trade barriers'. It is based primarily on measures that directly affect the domestic economy – that is, only have an effect 'behind the border'. These include technical and product standards, climate and environmental protection,[94] health-and-safety regulations, protection against foreign takeovers, taxes or levies on foreign companies and, above all, subsidies (such as financial aid and tax relief) for domestic companies.

The EU Supply Chain Directive is typical of the many variants of modern protectionism.[95] Not only does it directly link the import of goods to compliance with predefined EU product standards – such as CO2 emissions for cars or genetically modified plants, food and feed, as is currently the case – but it also intervenes in production methods by imposing EU environmental and social standards that producers in other countries must comply with.[96] The potential competitive advantages of these foreign producers resulting from production methods that do not comply with EU regulations are reduced or even eliminated by these requirements. Accordingly, the competitive position of companies that already produce comparable goods in the EU improves.

Protectionism is no longer merely being pursued covertly by developed economies. Protectionist trade-policy instruments, including tariffs, are now

considered effective and legitimate means of pursuing economic goals as well as geopolitical interests. As early as 2015, the EU Commission published a trade-policy strategy titled 'Trade for All'.[97] It proposes 'using trade agreements and trade-preference programs as leverage to promote global values such as sustainable development, human rights, fair and ethical trade, and the fight against corruption'.

In spring 2021, the EU Commission established new trade-policy guidelines aimed at 'open strategic autonomy'.[98] To this end, it is now explicitly committed to an 'assertive'[99] trade policy to improve economic resilience, openly aiming to leverage its position as the world's largest economic area and the most important trading partner for many countries even more effectively than before. In recent years, it has underpinned this with a multitude of unilateral regulations that have a protectionist effect and interfere with the sovereignty of trading partners, such as the Deforestation-Free Products Regulation (EUDR), the Carbon Offsetting Mechanism (CBAM), the ban on products produced using forced labour (EUFL) and the aforementioned EU Supply Chain Directive (CSDDD).

Protectionist measures aim – usually out of fear of the economic, social and political consequences of economic restructuring – to economically stabilise the benefiting companies by improving their competitive position relative to rivals. This offers them the opportunity to avoid competitive pressure, so that they do not have to respond to it through investments in product and process innovations.

However, increasing protectionism is also dampening the investment willingness of a growing number of companies whose market access is made difficult or even denied by protectionist measures, or which must expect that this could be the case in the future. They must assume – as highly productive,

innovative and particularly competitive competitors – they will be deliberately prevented from exploiting their hard-won market position.

Such protectionist interventions do not necessarily have to originate from countries intending to protect domestic companies. This is demonstrated, for example, by the export tariff imposed by the US on the American companies Nvidia and AMD in 2025 for AI chips delivered to China, which lifted the export ban that had been in place until then,[100] or the export ban pushed through by the US and also applicable to China since 2023 on the high-performance chip-manufacturing machines equipped with EUV lithography from the Dutch global market leader ASML.[101]

Industrial policy – which, in line with Anglo-American usage, encompasses not only the manufacturing industry but all sectors of the economy – aims to 'support certain domestic companies, industries, technologies or economic activities through targeted state intervention'.[102] Since the 2010s, it has experienced a renaissance in developed economies and has now gained enormously in importance.[103] Formally, these state interventions aim to address market imperfections. They are motivated by the pursuit of both economic and political goals, such as improving strategic competitiveness, resilience, national security or even climate neutrality. Tariffs, subsidies and local-content requirements, which are typically protectionist measures, play a major role in achieving these goals.

The Next Generation EU (NGEU) economic stimulus programme launched by the EU in 2020 in response to the Covid crisis was aimed in this direction. It comprises a total of up to €750 billion, with financial aid and loans each accounting for about half.[104] Thus, the subsidies that can be disbursed through the fund alone comprise an annual volume of almost 0.5 per cent of EU GDP for the project period 2021 to 2026.

About 40 per cent of the total is earmarked for loans and subsidies for the green transformation, and another 20 per cent for the digital economy.

After the US, under President Biden, passed the Inflation Reduction Act (IRA) in 2022, which is estimated to provide a total of between $370 billion and $900 billion in subsidies for climate-friendly products and technologies over the period 2023 to 2032, the European Commission responded with the Green Deal Industrial Plan in 2023.[105] As part of this, the EU Commission has increased the REPowerEU fund[106] that was launched in May 2022. This now provides a further €310 billion climate and industrial subsidy programme for the period from 2023 to 2030.[107]

The US and EU are pursuing massive subsidy programmes to increase their shares of global chip production to 30 per cent and 20 per cent respectively.[108] As part of the Chips and Sciences Act, the USA launched a $52 billion funding programme in 2022 with research and, above all, investment grants for the semiconductor industry.[109] The EU, for its part, adopted the European Chips Act in 2023. This is to provide subsidies of €43 billion, which will be provided primarily by the member states.

Subsidies are playing an increasingly important role in the developed economies, especially when it comes to maintaining the profitability of existing business models and protecting domestic companies from the pressure of foreign competitors. Entrepreneurial success and even the fate of entire industries depend less and less on the creation of excellent and, compared to those of competitors, favourably priced goods and services. Instead, what has grown in importance is the ability to navigate the increasingly comprehensive and fragmented regulations in a direction that is favourable for one's own company or industry, or to access the funding pots of national or EU governments.

The state subsidies alone, which flow directly or indirectly to companies – for example through purchase premiums – often exceed profits.[110] In Germany, the share of subsidies provided by the federal and state governments has been more than five per cent of GDP since the early 2000s. After some rises and slight falls after various crises, this share has risen to 6.6 per cent in 2022 and is expected to reach as much as 7.7 per cent of GDP in 2023 (final figures not yet available).[111] The lion's share of the subsidies, which now amount to around €300 billion per year – in 2023, this is expected to have been over €3800 per capita – is used to support companies. A smaller share – about 20 per cent in 2022 – benefits private and state non-profit organisations.

3.4 The fictitious growth from migration

The focus of labour market and migration policies in the EU on higher labour force participation and increased immigration also reduces the pressure on companies to improve their competitiveness through productivity-enhancing investments.[112] Since the mid-2010s, more access to labour has kept wage costs down, improving profitability without the need for improving productivity.

Despite the high EU unemployment rate, immigrants managed to integrate quickly into Western labour markets, so that their share of the total workforce in some of the EU-15 countries reached low single-digit percentages by the end of the 2000s[113] and even mid-single-digit percentages in the 2010s.[114] The combination of increased immigration, the relocation of labour-intensive value creation to Eastern Europe and unemployment – which was already very high in the early 1990s and continued to rise until 2013 – exerted considerable pressure on wages and salaries in Western Europe. From the mid-1990s onwards, labour income growth in the EU-15 countries

was so weak that real wages – contrary to the historical trend – increased less than labour productivity.[115]

The overall increase in labour productivity usually results in a roughly equal percentage reduction in real goods prices, which translates into an increase in real wages. But from the 1990s onwards, only a portion of the productivity gains were passed on to the working population and were instead used to reduce labour costs. This primarily affected low-wage earners and less-skilled workers.[116] Across all EU countries, real wage increases were weaker the lower the wages. According to calculations by the DIW economic research institute, in Germany, for example, between 1996 and 2016, real household income in the decile of the highest earners rose by a good 30 per cent, that of the second decile by as much as 15 per cent, while real household income in the last decile actually fell by around 10 per cent.[117]

Since the mid-2010s, however, the outlook on the labour market has reversed. Due to ever-weaker productivity increases and the declining number of people of working age since the early 2010s due to demographic developments, a shortage of skilled workers and labour is now evident in many sectors and countries – despite increasing labour immigration. Since 2013, when the EU unemployment rate reached a historic high of 12 per cent, it has fallen continuously – with a brief interruption during the Covid crisis – and is now below six per cent.[118]

The labour shortage is driven by the failure to raise productivity. Between 2012 and 2024, the GDP of the EU-27 grew by a total of almost 20 per cent, but labour productivity per hour worked only grew by around 10 per cent. As a result, the working population in the EU had to work almost 10 per cent more hours in 2024 to generate the higher GDP.[119] In the previous period, 2000-2012, productivity growth roughly matched economic growth, meaning

that the increased economic output was achieved in the same total working hours.

To prevent the resulting labour shortage from leading to real wage increases that exceed productivity increases – as has already happened in many regions and sectors – the EU's labour market and migration policy aims to expand the labour supply as much as possible. In doing so, it alleviates the pressure on companies to counteract the shortage of skilled workers and labour, as well as rising labour costs, through the introduction of labour-saving technology. Therefore, among other things, it has set itself the goal of raising the employment rate of the population aged 20 to 64 to at least 78 per cent by 2030 and is also promoting 'legal migration ... to address labour shortages, close skills gaps and stimulate economic growth'.[120]

With this strategy of circumventing the skilled labour and labour shortages caused primarily by weak productivity, the EU is rejecting the core message of Adam Smith's *The Wealth of Nations*. Smith recognised that social prosperity is based on increasing the 'productivity of labour', which only developed rapidly within the framework of capitalist development. But the EU apparently strives to increase social prosperity – as was common in pre-capitalist times – through more work and believes that it simply has to manage the level of prosperity achieved to date while labour productivity stagnates.

The increasing productivity weakness in recent decades is the result of increasingly one-sided focus of government and EU institutions on economic stabilisation and the associated tendency to protect companies from competition. What should have been done is to help the most innovative and productive business models break through by providing the appropriate economic policy framework.

4 A culture of dependency instead of creative destruction

Over the decades, the developed economies reacted to the slowdown in economic momentum with increasingly one-sided measures to achieve economic stabilisation and to avoid, or least to mitigate, economic crises. This approach did succeed in stemming the typical consequences of crises, such as company collapses and the associated destabilising economic, social and political effects of job losses and capital destruction. On the other hand, however, it also undermined the market economy mechanisms that typically come into play during economic crises and that enable the crisis to be overcome. The decisive factor in overcoming the crisis is the elimination of unproductive and less profitable companies, whose capital assets are usually devalued as a result, so that the profitability of the remaining companies increases.[121]

When competition intensifies due to crises in the industry or the economy as a whole, or due to the emergence of new competitors, companies are forced to improve their competitiveness. As a rule, not all companies succeed in doing so, so that the intensified competitive situation makes it easier for the more profitable and innovative companies to accelerate the demise of their competitors by investing in product or process innovations. If this strategy – which is generally associated with high risks – works, they can benefit from high profit margins as their market share increases and the remaining competitors have not caught up with their technological advantage.

This process of 'creative destruction' described by Joseph Schumpeter, a contemporary of John Maynard Keynes, means that innovative firms

'enforce new combinations' and keep the economic dynamic going by triggering 'liquidation processes that occur from time to time'. Undermining the process of creative destruction has led to widespread zombification – that is, a massively weakened productivity development that has affected the entire economy. The introduction of innovative products or processes is limited to an ever-smaller number of usually highly profitable market leaders, while the diffusion of new technologies into the broad mass of comparatively strong companies is hardly successful and achieved only with a great deal of delay.

As discussed earlier, companies are becoming increasingly dependent on the creation of favourable and often competition-reducing framework conditions by governments. They offer companies alternative ways of maintaining profitability that they can achieve without improving their value-creation processes.

These state framework settings block the process of creative destruction in two ways: by aiming to preserve the weakest competitors, they hinder companies that rely on investments in their value-creation processes to secure or increase their profitability. Zombification is further exacerbated by the existence of a growing number of zombie companies, which tie up resources such as skilled and unskilled labour, making it more difficult for more productive competitors or even companies in other sectors to grow – a situation that slows down structural change. The ability of companies to increase labour productivity and prosperity through competition-enhancing investment is severely impaired.

4.1 Stifled creative drive

However, state institutions not only paralyse the destructive side of creative destruction, but also its creative side. This is reflected, among other things,

in the enormous discrepancy between state funds used to support existing companies and their business models on the one hand, and those used to build up new knowledge and develop new technologies on the other.

According to EU data, the 27 EU member states have paid out around €2.5 trillion in subsidies directly to companies over the past 10 years.[122] In relation to economic output, Belgium received the highest direct subsidies, with an annual average of four per cent of GDP. France came in second with an average of 2.7 per cent of GDP. However, direct subsidies provide only a small insight into the universe of state-funding programmes, because the sum of all state aid is much higher – indirect subsidies, tax breaks, investment grants and equity investments are not included in EU statistics. In Germany, according to calculations by the Kiel Institute for the World Economy, total direct and indirect subsidies are many times higher than the EU figures.[123]

Comparatively little government money is spent on the development of new technologies that are an important basis for the emergence of new companies with disruptive business models and increasing social prosperity. This is shown by the German federal government's expenditure on research in 2024, including basic research, which reached a total of €18.6 billion – just 0.43 per cent of GDP.[124] On average, government spending in EU countries is even lower and has remained at around 0.25 per cent of GDP since the early 2000s.[125] Yet government funding is vital. Basic research makes a decisive contribution to technological progress and companies rarely conduct basic research due to the high costs and very long-term research projects involved, as well as the uncertain usability of the results.

No less problematic than the use of state funds is the risk aversion that dominates in Europe and is anchored in its institutions. In 1992, the precautionary principle was introduced as a constituent element into the Treaty on European Union. The underlying premise is to avoid possible risks by

prohibiting techniques, procedures and behaviours when in doubt, rather than taking calculated risks in order to exploit their potential benefits. This characterises legislation and jurisdiction in the EU in all areas of society and is probably the biggest trigger for the swelling of the regulation tsunami, which hinders innovation and directly reduces labour productivity due to increasing bureaucratic burdens. In the EU institutions, the precautionary principle is particularly pronounced because of their uniquely depoliticised form, because EU technocrats are not under pressure to change things like elected politicians. They are expected to manage and administer things with technocratic expertise, assessing and managing possible risks; this is where they derive their legitimacy.[126]

Perhaps the most prominent and possibly even the most far-reaching regulations are the EU's general ban on green genetic engineering – which was extended to include genome-edited plants by a ruling of the European Court of Justice in 2018[127] – and the EU's AI regulation, which was only adopted in 2024. The regulatory requirements of the AI regulation, according to Jörg Bienert, president of the KI Bundesverband, are so far-reaching that they protect the established American and Chinese incumbents, which have already consolidated their markets, while blocking the market entry of new companies. These large tech companies 'will cope with any regulation and will even ask for further regulation, as it creates additional barriers to entry and a defensible moat'.[128] The German Electrical and Digital Industries Association is calling for the complete removal of all industrial AI applications from the EU's AI regulation.[129]

The fear of disruptive market changes and crises, which determines policy, and the dominant scepticism towards growth are the decisive reasons why zombification has reached today's extreme levels. The state proves to be too business-friendly when it comes to maintaining existing business models

and too business-hostile when technological progress and growth are needed in conjunction with economic adjustment processes. The focus on stability therefore forms an objective barrier to overcoming the zombie economy.

4.2 Zombification through industrial policy

However, the Draghi report and the European Commission's 'Compass for a competitive EU', which is based on it, do not focus on reducing these competition-reducing framework conditions, despite ever-lower productivity growth and the resulting increase in competitive weakness. Instead, they focus on expanding stabilisation policy through industrial policy. In the foreword to the report, Draghi states that 'the aim of this report is to formulate a new industrial policy' that would better coordinate, focus and centralise industrial policies at the EU level, which are already on the rise at the national level.[130]

Ironically, with the transfer of more industrial policy power to the change- and risk-averse EU technocracy, Draghi said, 'the barriers will be overcome' that prevent Europe from 'radically changing to become more productive'.[131] As early as November last year, EU heads of state and government committed to the agenda set out in the Draghi report at a special summit. To ensure 'industrial renewal and decarbonisation', 'a European industrial policy' is to be developed 'to ensure the growth of tomorrow's key technologies, with a particular focus on traditional industries' that are undergoing change.[132]

With the help of massive subsidies, at least €750-€800 billion of additional private and public investment should be mobilised annually[133] so that growth is 'revived', according to Draghi.[134] If this were to succeed, gross fixed capital formation, which currently stands at around 22 per cent of EU GDP, would then rise to around 27 per cent. The declining net

investment rate would then also rise to around six or seven per cent, reaching the level of the late 1970s.

To achieve this, the new EU industrial policy must address three key areas of action. Firstly, the EU must close the innovation gap that has emerged between the US and China, which is particularly evident in the area of digitalisation. Secondly, a plan must be implemented to achieve decarbonisation and competitiveness at the same time. Thirdly, the EU must hedge against geopolitical risks by improving security and reducing dependencies.

By focusing on these three industrial-policy transformations, Draghi's industrial-policy concept aims to achieve structural change towards increased digitalisation. In particular, however, the area of climate technologies is to develop into an innovation-driven, highly productive and thus particularly competitive growth sector, because with the more mature technologies in which EU companies specialise, only a few technical breakthroughs are still possible, which limits growth.

In order to make the potential of the 'clean-tech sector' as an engine for growth and competitiveness seem plausible, the Draghi report cites the comparatively high energy prices in Europe, which are the 'main driver of the competitiveness gap' compared to other world regions. Natural gas prices are three to five times higher than in the US, and industrial electricity prices in Europe are two to three times higher. Since Europe does not have cheap fossil fuels, the 'decarbonisation of the energy system is an opportunity for the EU to ensure its competitiveness by reducing its dependence on fossil fuels'.[135] Competitiveness would be strengthened in two ways. Firstly, by reducing dependence on imports; secondly, 'it could promote the massive deployment of clean energy sources with low marginal generation costs'.[136]

In the Clean Industrial Deal, one of the building blocks of the compass, the European Commission reaffirms the potential of the clean-tech sector

identified in the Draghi report, because 'Europe's dependence on fossil fuel imports is the main reason for higher and more volatile energy prices' in Europe, it claims. The deal includes concrete measures to turn the CO_2 phase-out into a growth engine for the European economy, for example by introducing the 'Made in Europe criterion into public and private procurement to increase demand for clean products from the EU'.[137]

Contrary to such claims, it has long been apparent that the climate policy pursued in the EU – with the virtually complete phase-out of fossil fuels, their replacement mainly by renewable wind and solar energy and the goal of significant energy savings to achieve climate neutrality by 2050 – is an immensely costly undertaking. This is evident, on the one hand, from the rise in electricity prices in EU countries where volatile wind and solar power accounts for a significant share of electricity consumption. On the other hand, the difference between electricity prices and the comparatively low prices of fossil fuels is growing in these EU countries, even though electricity prices are now subsidised in many countries and significant carbon taxes and levies are imposed on fossil fuels.

Under the burden of rising energy prices and the increasing costs of avoiding CO_2 emissions, deindustrialisation has begun in the EU, particularly in energy-intensive industries, with declining investment, falling production and plant closures. Rising energy prices in the EU are not only affecting energy-intensive clean-tech industries such as solar-cell manufacturing, wind-turbine construction and battery production. Rising prices also affect all companies that want to introduce energy-intensive products, such as AI, or that invest in productivity-enhancing automation and digitisation, because the introduction of labour-saving technologies typically leads to more energy-intensive value-creating processes.

The Draghi report makes it clear that the development of the clean-tech industry is an extremely costly industrial-policy manoeuvre that devours huge subsidies. Simulation calculations by the IMF and the EU Commission apparently showed that the additional mobilisation of investments of more than €750 billion per year, four-fifths of which is private capital, would require a reduction in the cost of capital of around 2.5 per cent – even if the interest-lowering effect of the completion of the EU capital-market union called for in the report were already taken into account. In other words, since private investors must be able to achieve an additional annual return of 2.5 per cent on average (otherwise these investments would not appear profitable to them), substantial state subsidies are to be provided. The Draghi report succinctly states: 'Financial incentives to unlock private investment therefore appear necessary to finance the investment plan beyond direct public investment.'[138]

The need for permanent subsidies is economically a misincentive and clear evidence that the projects financed in this way do not pay off for investors. Such policies also result in a less productive and more expensive energy supply and energy use, which permanently impairs the competitiveness of EU companies.

The president of the ifo Institute, Clemens Fuest, had already pointed out this problem some time ago in the context of German climate policy. The planned transformation of the economy towards climate neutrality would, in the best case, simply result in the old capital stock being replaced by a new one. However, additional, cheaper energy generation capacities would not be created, and the forecast is therefore 'more sweat and tears than a major boom'.[139] In a less favourable case – which Fuest only implied – this climate-neutral capital stock is significantly less productive than the previous capital

stock. The result is not just an extremely expensive replacement of the capital stock, but also significantly higher energy costs in the long term.

With its industrial-policy concept, the Draghi report avoids the challenge it has set itself of overcoming productivity stagnation. It aims to generate growth by seeking to mobilise investment in projects that would not be profitable without subsidies. However, it is becoming apparent, particularly in the clean-tech sector, that the transformation towards climate neutrality does not lead to a more productive and cost-effective energy supply. Instead, it weakens the competitiveness of the economy as a whole and makes it even more receptive and dependent than before on cheap money, anti-competitive regulation, protectionism and industrial policy.

Conclusions

Increasing productivity is the key to increasing living standards and EU economic competitiveness. However, while EU institutions have for some time worried about the decline in productivity, the response to the problem has been feeble. Even with the much-vaunted Draghi report and the various proposals to tackle the problem, like the 'Competitiveness compass', the EU's institutions have been found wanting.

The causes of declining competitiveness have been misdiagnosed. Fundamentally, it is the failure to invest in new technologies and processes that has led productivity to stagnate. Rather than emphasising growth, EU institutions and national governments have, for decades, promoted stability and protection rather than risk-taking and innovation.

The solution to the productivity crisis is, therefore, conceptually simple and politically difficult: to unwind all the measures that have held back investment. These include:

- Ending protections on incumbent companies, like state subsidies and non-tariff trade barriers
- Breaking from 'cheap money' policies that allow poorly performing companies to stay in business at the expense of more dynamic firms
- Rejecting anti-growth policies, particularly in relation to climate and energy policy, but that also afflict many other areas under the influence of the 'precautionary principle'
- Doing more not simply to make regulation more efficient but to abolish it altogether, making existing firms more efficient and focused on value creation, but also lowering the barriers to new challengers.

Unfortunately, the EU's tendency to see every problem as an opportunity to centralise more and more power and influence in Brussels – such as through industrial policy or the doling out of ever more subsidies – means that such radical action is unlikely to happen.

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