bruegel

ANALYSIS

03 February 2025

Draghi on a shoestring: the European Commission's Competitiveness Compass

The proposed EU Competitiveness Compass would set up a conflict between industrial policy and the single market

Jeromin Zettelmeyer

In September 2024, former Italian prime minister and European Central Bank governor Mario Draghi delivered a major report to the European Commission containing a diagnosis of the European Union's competitiveness problems (Draghi, 2024[1]). The report set out three big ideas: (1) a big push, coordinated across member states, to improve the EU's business environment; (2) an expansive, centrally-steered industrial policy to promote clean tech, ensure minimum industrial capacity in security-sensitive sectors and subsidise the decarbonisation of energy-intensive industry; (3) a large, centrally-funded public-investment push, particularly in energy and digital infrastructure.

This vision is radical in three ways. First, it requires exceptional cooperation and coordination across EU countries. Second, it violates free-trade orthodoxy. Following the example of the US Inflation Reduction Act, Draghi made a pitch for subsidies based on local content (which are illegal under World Trade Organisation rules). Third, it promises to be very expensive. Even assuming a big role for privately financed investment, ideas 2 and 3 will cost a lot of public money, which Draghi wants to become available at the EU level, including through common borrowing.

The European Commission's initial answer[2] to Draghi's radical and potentially divisive vision appeared to be: yes, but with significant caveats. Grabbe and Zettelmeyer (2025) analysed this response in detail, and also answered the question of whether the Commission's policy platform is strong enough to deal with President Trump (answer: not quite).

The Commission's response to Draghi

The Commission's more definitive answer to Draghi is the Competitiveness Compass (European Commission, 2024), a plan issued on 29 January that covers the main areas covered by Draghi, albeit in much less depth. The Compass largely reiterates the Commission's initial response to Draghi. But it also ties some loose ends, offers more definitional detail and contains one genuine surprise.

In essence, the Compass is a low-cost version of Draghi's policy prescriptions. Unlike Draghi, it stops short of endorsing violations of international law (although it seems prepared to flirt with them). The Compass is at least as radical as Draghi in requiring exceptional EU-level coordination and cooperation, somewhat less radical on trade policy and far less so on public financing[3] .

This makes it fiscally and politically more realistic, increasing the chances that the plan will at least start to be implemented. But it also generates tensions between objectives and increases the risk that implementation might get stuck.

Major recommendations

The Compass's recommendations include an extensive catalogue of *"horizontal enablers of competitiveness"*: reforms benefitting productivity growth across all sectors[4] . They focus on improving and reducing regulation, breaking down single market barriers, improving skills and improving access to risk capital (including by building an EU capital markets union – or, as the Commission now calls it, a 'savings and investment union'). Like Draghi – and another substantial report by a former Italian prime minister, Enrico Letta (2024) – the 'enablers' include ambitious measures, such as introducing a 'twenty-eighth' regulatory regime that companies anywhere in the EU could opt into (hence opting out of their national regimes). The Compass also vows to lower regulatory burdens through an *"unprecedented simplification effort"*.

The second main prong of the Compass is industrial policy. The Commission wants to promote clean tech, support the decarbonisation of energy-intensive industry, help the automotive sector and support any 'strategic' sector essential to EU economic security. This approach has its own problems (see below). But these problems are inherited from Draghi's report, with which the Commission seeks to align itself – except

on financing. Private risk capital may help boost clean tech, but it does not support declining or under-threat industries.

So, where will the needed public financing come from? Mostly from EU governments – that is, via state aid. The Compass calls for a *"flexible and supportive"* (one might also say, permissive) state-aid framework. That is the main departure from Draghi, who did not want more state aid; he wanted more central funding.

What might go wrong

Consider next the tensions and risks. The first two are problems the Compass shares with Draghi's approach, while the remaining three are specific to the Compass.

The first risk is that the ambitious *"horizontal enablers of competitiveness"* will not be implemented (or will be implemented in watered-down form). The Commission has long tried to get at least some of these done. The lack of progress relates to commercial and bureaucratic special interests, and to national governments being accountable to their electorates and thus not automatically pursuing the collective EU interest. Perhaps there is a better chance now: because there is more urgency, or because the 'enablers' are more palatable when implemented as a package.

The second risk has to do with the proposed industrial policies. It is not just that industrial policy can end badly (as illustrated by the recent debacles involving Intel and Northvolt), but it is uncertain that it will raise productivity growth even if it achieves its industrial objectives. On this, both Draghi and the Compass leave important questions unaddressed. One question is how far the public sector should protect Europe's energy-intensive industry from foreign competition when this has costs for the rest of the economy in the form of higher energy prices, even if industrial decarbonisation succeeds. A related question is whether President Trump's attempt to gut US clean-tech subsidies weakens or modifies the case for subsidising EU clean tech (which was partly motivated by President Biden's Inflation Reduction Act, rather than the green transition *per se*). Perhaps these questions will be answered in the Commission's forthcoming Clean Industrial Deal (Tagliapietra and Trasi, 2024).

The third risk is that the Commission will reduce regulatory burdens with one hand and add new ones with the other. To its credit, the Commission's industrial policy is not just about money or trade measures. It's also about creating rules of the game – regulatory frameworks. The Compass proposes a new EU Cloud and AI Development Act, a

Quantum Act, a Biotech Act, an Advanced Materials Act and a Space Act. Hopefully these will reduce national-level regulatory barriers and create consistent standards. But they might also create new regulatory burdens. Could they do more harm than good? We will not know until we see them.

The fourth risk is that relying mostly on member state-based funding will not deliver the required volumes of public investment. Under the EU's fiscal rules, even countries without large deficits, such as Germany, have little room to raise spending. While the rules allow EU countries proposing higher investment a few more years to adjust, they do not exempt the financing of EU-approved investment programmes from the deficit limits (Darvas *et al*, 2024). EU level borrowing would not face such restrictions. Of course, it must be repaid, but the permanent fiscal adjustment required to pay for a temporary investment programme (even if large) is modest[5] .

The fifth and perhaps most worrying risk is the tension between member state-funded industrial policy and the single market. This is another case in which one policy effort might work against another. With horizontal enablers, the Commission would be levelling the playing field; with greater flexibility with respect to state aid in specific sectors, it would be tilting it towards countries with deeper pockets and the more effective lobbies. Consequently, industrial policy might do more harm than good.

A big idea that goes beyond Draghi

This leads to the final and most interesting Compass proposal: the *"competitiveness coordination tool"* (CCT), a forum comprising EU countries and the Commission, modelled on Draghi's Competitiveness Coordination Framework (CCF). The CCF according to Draghi was to agree and execute medium-term *"competitiveness action plans"* to implement Draghi's proposals to the extent that they required coordination.

The CCT occupies a more central role in the Commission's Compass than the CCF would have done. This reflects the fact that the Commission would give state aid more flexibility in key industrial areas (such as the promotion of clean tech). As a result, according to the Compass, there is a need to *"align industrial and research policies and investments at the EU and the national levels"*, at least in these areas, that would not exist if industrial policy were financed centrally.

The hope is clearly that the CCT would achieve most of the benefits of central industrial policy without requiring central funding. Is this likely? Probably not, for two

reasons.

First, the CCT will be hard to design and implement. Attempts to coordinate structural policy through the European Semester have been largely unsuccessful (Darvas, 2024; Darvas and Leandro, 2015). The problem is that EU-level coordination attempts must not only resolve a coordination failure in the game-theory sense (selecting an equilibrium that is self-enforcing once chosen), but must prod governments to deviate from industrial policies that they would want to implement in their national interest.

This requires incentives. According to the Compass, these would be financial, namely, redirected EU funds during the ongoing (2021-27) EU budget cycle and a future Competitiveness Fund during the next budget cycle (2028-34). Almost by definition, these funds are expected to be small (if not, the Commission would be embracing Draghi's approach of dispensing any aid centrally). An obvious additional incentive, not discussed in the Compass, would be the threat of a return to a stricter interpretation of the state-aid rules in the areas in which greater flexibility reinforces the need for coordination.

Second, even if successful, the CCT would not eliminate the distortions caused by state aid. It would just ensure that there are offsetting benefits. The maximum benefit would consist of, for example, a German industrial policy exactly aligned with the German portion of the optimal EU-level policy. But Germany would still only fund German companies. The competitive distortion would remain, except to the extent that EU-level co-funding can persuade other member states to fund some of their own companies.

Conclusion

As expected, the Commission is taking Draghi seriously. The Compass largely follows the aims and logic of his report. But it does so in a way that assumes that most industrial policy and investment decisions with EU-wide implications will be taken and funded by national governments. To ensure that that the result remains in the interests of the EU, it proposes the CCT.

The idea makes sense in theory but is unlikely to work.

The EU has two main instruments to coordinate member-state policies: regulation and the EU budget. The Draghi report implied a large expansion of the budget. The

Compass instead proposes a reallocation of existing funds and hopes for a modest increase in the future. But it also wishes to reduce regulation and it wishes to expand industrial policy beyond the level that could be financed by the expected increase in EU-level funds. This makes coordination both exceedingly important and extremely hard.

The CCT is an attempt to create a new process in which the Commission can use what incentives it has to maximum effect. If this process operates like an informal institution, it may work. But previous attempts to coordinate structural policy in the EU are not encouraging. By offering coordination of state aid as a substitute, the Commission is giving up the fight for central investment and industrial policy too easily.

I am grateful for the comments of Marco Buti, Zsolt Darvas, Hans Geeroms, Heather Grabbe, Jacob Funk Kirkegaard, Lucio Pench, David Pinkus, Fiona Scott Morton, André Sapir, Simone Tagliapietra, Niels Thygesen and Reinhilde Veugelers.

References

Darvas, Z. (2024) 'Countries are still slow to follow European Union policy recommendations', *Analysis*, 11 July, Bruegel, available at https://www.bruegel.org/analysis/countries-are-still-slow-follow-european-union-policy-recommendations

Darvas, Z. and A. Leandro (2015) 'The limitations of policy coordination in the euro area under the European Semester', *Policy Contribution* 2015/19, Bruegel, available at https://www.bruegel.org/policy-brief/limitations-policy-coordination-euro-area-under-european-semester

Darvas, Z., L. Welslau and J. Zettelmeyer (2024) 'The implications of the European Union's new fiscal rules', *Policy Brief* 10/2024, Bruegel, available at https://www.bruegel.org/policy-brief/implications-european-unions-new-fiscal-rules

Draghi, M. (2024) *The future of European competitiveness*. *Part A: A competitiveness strategy for Europe*, available at https://commission.europa.eu/document/download/97e481fd-2dc3-412d-be4c-f152a8232961_en

European Commission (2025) 'A Competitiveness Compass for the EU', COM(2025) 30 final, available at https://commission.europa.eu/document/download/10017eb1-4722-

4333-add2-e0ed18105a34_en

Grabbe, H. and J. Zettelmeyer (2025) 'Not yet Trump-proof: an evaluation of the European Commission's emerging policy platform', *Policy Brief* 03/25, Bruegel, available at https://www.bruegel.org/policy-brief/not-yet-trump-proof-evaluation-european-commissions-emerging-policy-platform

Letta, E. (2024) *Much More Than a Market*, available at https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf

Scott Morton, F., S. Tagliapietra and J. Zettelmeyer (2025) 'Internal market, industrial policy and competition', Annex D in H. Grabbe and J. Zettelmeyer (2025) 'Not yet Trump-proof: an evaluation of the European Commission's emerging policy platform', *Policy Brief* 03/25, Bruegel, available at https://www.bruegel.org/policy-brief/not-yet-trump-proof-evaluation-european-commissions-emerging-policy-platform

Scott Morton, F. (2024) 'A fork in the road for EU competition policy', *Analysis*, 6 November, Bruegel, available at https://www.bruegel.org/analysis/fork-road-eu-competition-policy

Tagliapietra, S. and C. Trasi (2024) 'Northvolt's struggles: a cautionary tale for the EU Clean Industrial Deal', Analysis, 11 December, Bruegel, available at https://www.bruegel.org/analysis/northvolts-struggles-cautionary-tale-eu-clean-industrial-deal

Endnotes

1. Throughout this analysis we refer to Draghi as shorthand for Draghi (2024).
2. As expressed through Commission President von der Leyen's September 2024 mission letters to incoming European Commissioners; see https://commission.europa.eu/about/commission-2024-2029/commissioners-designate-2024-2029_en.
3. While more orthodox on trade policy, the Compass also appears more willing than Draghi to loosen merger rules to support the creation of European 'champions'. See Scott Morton (2024), Grabbe and Zettelmeyer (2025) and Scott Morton et al (2025).
4. These are the counterparts of Draghi's chapter 2 ('Closing the innovation gap') and of the private investment sections of chapter 5 ('Financing investments').
5. For example, with long-term interest rates perhaps 1-2 percentage points above growth rates, bending down the debt curve after a rise of 15 percent of GDP requires a permanently higher fiscal balance of 0.15-0.3 percent of GDP.

Bruegel
Rue de la Charité 33,
B-1210 Brussels
(+32) 2 227 4210
info@bruegel.org

Bruegel.org

© Bruegel 2025. All rights reserved. Short sections, not to exceed two paragraphs, may be quoted in the original language without explicit permission provided that the source is acknowledged. Opinions expressed in this publication are those of the author(s) alone.