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| From: | General Secretariat of the Council |
| To: | Delegations |
| Subject: | Background note - R&I for Europe's competitiveness |

European Research and Innovation Area Committee (ERAC) delegations will find attached a background note on 'R&I for Europe's competitiveness', prepared by the Commission, with a view to the ERAC plenary meeting on 26 June 2024.

ERAC Plenary – 26 June

## Background paper – R&I for Europe's competitiveness

**Over the past 30 years, the average productivity growth in the EU has been weaker than in other major economies, leading to a growing gap in productivity levels, in particular vis-à-vis the United States**. Since the mid-1990s, total factor productivity growth in the EU has been less than half of that in the United States[1]. Coupled with demographic challenges, which are profoundly impacting Member States' economic and social structures, this decline in productivity growth is weighing heavily on Europe's growth potential.

**Persistent productivity gaps may also affect the EU's ability to respond adequately to societal needs.** Many Member States currently outperform the US and China in their progress towards achieving all 17 UN Sustainable Development Goals[2]. In particular, the OECD Better Life Initiative demonstrates the high level of well-being in many Member States compared to the US[3]. De-coupling societal objectives for well-being from economic productivity would put the European way of life into question.

**Lower R&D investments in the EU are underpinning this productivity gap. Despite improvement in R&D investments over the last decades, Europe is trailing behind its global peers on R&I and significant disparities in terms of R&I performance persist across the continent.** Investment in R&D has increased in Europe from 1.8% of GDP in 2000 to 2.2% of GDP today. However, it remains significantly below the investment levels of international competitors such as the US (3.5% of GDP) and China (2.4%) and is unevenly distributed across the EU. Only four Member States individually exceed the 3% target, while many Member States fall well below.

**In the United States, out of a total budget of 820 billion US $ for US defense spending in 2023, about 15% relates to R&D[4].** It accounts for almost half of the federal budget dedicated to R&D, twice as high as investments in health research, which is the largest civilian objective for public R&D[5]. Against the backdrop of growing "securitisation" in technology[6], the EU potentially follows the US into a new era of increasing deployment of military and/or dual use technologies based on higher investments in defense-related R&D.

**With regards to technological leadership, while the EU remains strong on green technologies, its position in areas linked to strategic, productivity-enhancing technologies in the digital domain is weaker than that of the US and China.** This is clearly visible when looking at the EU's patenting activity or the (more modest) number of new global technology leaders in Europe compared to the US or China, demonstrating the need for more resolute action to boost Europe's R&I performance.

[1] https://single-market-economy.ec.europa.eu/publications/2024-annual-single-market-and-competitiveness-report_en
[2] Sustainable Development Report 2023 (sdgindex.org)
[3] How's Life? 2020: Measuring Well-being | en | OECD
[4] The United States Spends More on Defense than the Next 9 Countries Combined (pgpf.org)
[5] US National Center for Science and Engineering Statistics: ncses24204.pdf
[6] Growing securitisation in technology risks co-operation on responses to global crises - OECD

**In an increasingly challenging geopolitical context, existing long-term productivity and demographic trends have led the European Council to call for a 'new European Competitiveness Deal', anchored in a fully integrated Single Market and with R&I as one of its key pillars.** In their Conclusions of 17-18 April, EU leaders notably reaffirmed the need to foster a more innovation-friendly environment based on excellent science, while increasing investment in research and development to reach the 3% of GDP investment target[7]. In the same vein, the highly anticipated Draghi report on the competitiveness of the EU, expected by July 2024, is likely to place special attention on R&I, emphasising its key role as one of most important drivers of productivity and economic growth.

**Research and innovation are essential ingredients of a 'deepened' Single Market, fit for the 21st century.** In his high-level report on the future of the Single Market, delivered in April 2024, Enrico Letta calls for the fulfillment of a fifth freedom on research, innovation, and education (in addition to the existing four)[8]. Beyond the mere circulation of research and innovation outputs, the fifth freedom would entail embedding the drivers of R&I at the heart of the Single Market. This requires addressing Europe's shortcomings in R&I by stepping up our R&D investment efforts and tackling the fragmentation of the R&I landscape in Europe. These priorities are at the core of our recently renewed EU R&I policy framework, as embodied in the revitalised European Research Area (ERA) and its ERA Policy Agenda[9], and the New European Innovation Agenda[10].

**Our ability to enhance the EU's R&I performance and build a well-functioning European Research Area enabling the fifth freedom will rely to a large extent on the deployment of stronger R&I investment and reform efforts across the EU**. The 2024 Annual Sustainable Growth Survey, published as part of the European Semester Autumn Package, highlights that securing Europe's competitive sustainability will require decisive policy action to strengthen R&I in Europe[11]. The Spring Package, expected to be published on 19 June, will contain a country-specific analysis of the key challenges weighing on Member States' competitive sustainability[12]. In that context, the need to boost R&I through enhanced investment and, in some cases, reforms, is expected to be recognised as a key priority ahead for a large majority of Member States.

[7] https://www.consilium.europa.eu/en/press/press-releases/2024/04/18/european-council-conclusions-17-and-18-april-2024/

[8] https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf

[9] ERA Policy Agenda 2022-2024 | European Research Area Platform (europa.eu)

[10] https://research-and-innovation.ec.europa.eu/strategy/support-policy-making/shaping-eu-research-and-innovation-policy/new-european-innovation-agenda_en

[11] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52023DC0901

[12] The concept of competitive sustainability has been introduced in the EU policy context in the Annual Sustainable Growth Survey and the European Semester as a recognition of the need to secure economic competitiveness that is aligned and supportive of meeting our sustainability commitments as laid out in the EU Green Deal Strategy and supports the inclusiveness and cohesion of our territories. While there are many possible definitions, one that is widely used is provided by the University of Cambridge Institute for Sustainable Leadership that defines it as "the ability of an economy, its companies and industrial ecosystems to excel
relative to international competitors in their transition to sustainable development (with climate neutrality at its core) through investment in the necessary innovation"

Beyond subdued investment levels in many Member States, the Semester analysis shows that, despite the efforts deployed under the Recovery and Resilience Facility and Cohesion Policy in particular, structural weaknesses hindering the functioning of many national (and regional) R&I systems remain[13]. Without tackling these shortcomings, building a strong ERA and implementing the fifth freedom is likely to remain an elusive goal, thus preventing R&I to fully play its role at the service of Europe's long-term competitiveness.

**Against this backdrop, ERAC delegations are invited to reflect on the three following questions:**

- Achieving the fifth freedom and the new European Competitiveness Deal will require actions at EU and Member State levels to address the current shortcomings in terms of R&D investments in Europe, both public and private. What measures have been effective to secure higher national public R&D budgets (e.g. definition of investment targets, mobilization of EU funding for R&D). And what measures seem to have been most effective to support stronger private R&D investments (e.g. provision of grants, tax incentives, financial instruments for business R&D, structural reforms)
- At EU level, how can the ERA Policy Agenda and New European Innovation Agenda contribute to boost competitiveness and fulfill the fifth freedom?
- How can the Commission help/support Member States in the process towards competitiveness and the fifth freedom?

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[13] These structural weaknesses are mainly linked to i) a lack of efficiency of the public science base, often characterised by a high degree of institutional fragmentation, ii) limited science-business linkages, iii) low business innovation, iv) an uncoordinated R&I governance.