The Corona pandemic exposes the strengths and weaknesses of the European Union (EU) as well as the differences in the resilience of the European economies. This study therefore looks at how the EU and its member states can emerge stronger and more competitive from the crisis. The ideas of the German and French governments and the European Commission suggest that the EU will move away from the model of a liberal and competitive social market economy towards a more state-controlled and protectionist economic system. Isolation, dirigisme, restriction of competition and an extended welfare state are supposed to protect the European population and economy from all those challenges in a changing world which are perceived as a threat.

In this analysis, the Kronberger Kreis, scientific advisory board of the Stiftung Marktwirtschaft, warns against a retreat into Fortress Europe. An isolated community of states would lose its innovative strength and productivity, weakening its competitive position. This strategy would further increase the economic divergence and the loss of competitiveness within the EU. The seemingly old-fashioned alternative remains a market economy that is based on competitiveness through more – not less – competition. Competition creates innovation, ensures choice, reduces dependency and safeguards jobs and prosperity. It is the fundamental principle for a free and humane economic order.

„More confidence in market processes“ is the motto of the Kronberger Kreis, scientific advisory board of the Stiftung Marktwirtschaft. Founded in 1982, the Kronberger Kreis develops concepts for market-oriented reforms aimed at improving the liberal order in Germany and Europe. The state is considered a rule-setter and referee but should neither play the game itself nor act overly paternalistically. Its proposals have a significant influence on economic and political discussion in Germany.

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STIFTUNG Marktwirtschaft

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No Retreat into Fortress Europe!

Kronberger Kreis

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Executive Summary

The Corona pandemic shows how great the differences in dealing with crisis situations in the European Union (EU) are. The resilience of the European economies is proving to be very unequal. This raises fears that economic divergence within the EU will increase and that Member States will be left behind. The pandemic coincides with already existing international challenges such as globalisation, digitisation, climate change and migration, which are perceived as a threat to jobs and prosperity. There is also widespread concern that Europe is falling behind in the systems competition with the United States and China.

This study looks at how the EU can emerge stronger and more competitive from the crisis. According to the ideas of Germany, France and the European Commission, a reconstruction plan ("Next Generation EU") with a budget of 750 billion euros is intended to mitigate the consequences of the Corona crisis and strengthen the resilience of the national economies. To master the structural change driven by ecological conditions and technological progress, the aim of this fund is to be an important instrument for the European Green Deal and support projects in the field of digitisation. In addition, targeted investments are planned to achieve strategic autonomy in important value chains. To finance these projects, the EU is expected to be given its own debt facility and new sources of funding, for example in the form of a digital services tax.

Moreover, an ambitious European industrial policy and a revision of EU competition law is supposed to ensure that so-called key technologies are developed in Europe and European champions are created. The reason behind this is to protect European companies and jobs from non-European investors and to provide workers with social security through a coordinated labour market and social policy, for example in the form of harmonised minimum wages. In short: Europe is supposed to be strengthened by protectionist measures, state subsidies and special tax advantages. The idea is that competitiveness in the EU can be, above all, increased through protection against competition.

According to the Kronberger Kreis, the scientific advisory board of the Stiftung Marktwirtschaft, such a retreat into Fortress Europe would be the wrong strategy: it would undermine the foundations of the European model of success. The European economic area is not isolated, but must prove itself in competition with the rest of the world. A Europe that seeks to protect its citizens should not protect businesses from competition. It is without basis in competition theory and practical experience that the creation of national or European monopolies strengthens innovation and international competitiveness. Protectionism would not prevent structural change, but at best delay it. The EU Member States would increasingly lose competitiveness in the process. Instead, it is competition itself that creates innovation, ensures choice, reduces dependency and safeguards jobs and prosperity. It ensures that the economic development is guided by the needs of market participants, and is thus the basis for a free and humane economic order.

The benchmark used to justify Member States' restrictions on the four freedoms should also apply to the EU: Restrictions on the fundamental freedoms should only be considered if they are appropriate, proportionate and necessary to achieve legitimate objectives with a high degree of evidence. The four freedoms do not only limit the sovereignty of Member States. They are also fundamental structural principles of the European order.

The key to overcoming the Corona crisis and other challenges is to increase the productivity of European economies. Sustainable economic growth cannot be achieved without corresponding growth in productivity. It can only be achieved if the paralysed processes of competition in Europe are revived. This includes developing high quality products and services at the lowest possible cost through technological leadership in certain areas. Essentially, the key factors of productivity growth via non-price competitiveness are determined by national labour market, social, tax and fiscal policies. These policy areas are mostly within the competence and sovereignty of the Member States. The EU can only offer some support and provide incentives for reform to increase competitiveness, but cannot replace national efforts.

The Kronberger Kreis argues for relying on the proven paradigm of "competitiveness through competition". This does not underestimate the importance of the strategic trade and industrial policies of China and the United States. However, the necessary instruments for an appropriate response are largely in place. Instead of protectionism, openness through new trade and investment agreements should be favoured. A strategy of external isolation is a burden on competitiveness and is unlikely to lead to greater resilience among Member States. It would be fatal if the EU were to head for the next crisis with less competitive countries that exhibit persistently weak growth and higher public debt ratios. This must be prevented.

I Background

1. The Corona pandemic poses enormous challenges for the European Union (EU). For the EU as a whole, it represents the most serious economic crisis since the end of World War II. Accordingly, some people resort to war metaphors, even though the Corona pandemic has not caused any destruction of, for example, capital stock or infrastructure in the Member States that would require any reconstruction. Nevertheless, the Member States adopted a so-called reconstruction plan ("Next Generation EU") on 21 July 2020, supporting the Member States whose economies were hit particularly hard by the pandemic.

2. The Corona crisis also exposes the strengths and weaknesses of the EU. After initial problems, such as the brief disruption of the European internal market for medical products, the efficiency of the internal market in supplying the European population with essential products quickly became apparent. Member States health systems helped each other, for example by admitting patients from other Member States. European institutions are providing substantial support for the Member States' measures aimed at countering the economic consequences of the pandemic, using direct aid from the EU budget and a European short-time working allowance for workers.The European Investment Banking (EIB) is offering additional loans for companies and the European Stability Mechanism (ESM) a precautionary credit line with minimum conditionality. The European Central Bank (ECB) is providing additional liquidity of up to EUR 1.35 trillion under the Pandemic Emergency Purchase Programme (PEPP). Temporarily and in special cases, the EU Commission allows Member States to help companies to overcome liquidity problems and protect jobs by providing direct aid, concessionary loans, guarantees and sureties or equity investments.[1]

1 See the Temporary Framework of the Commission for state aid measures to support the economy in the current COVID-19 outbreak of 19.3.2020, last amended on 29.6.2020, available at https://ec.europa.eu/competition/state_aid/what_is_new/TF_consolidated_version_amended_3_april_8_may_and_29_june_2020_en.pdf.

3. However, the Corona crisis has also shown how large the differences between Member States in regard to their crisis management are. The health systems of the Member States revealed significant differences in dealing with the pandemic. The administrative and regulatory responses of Member States varied widely, from curfews in France, Italy and Spain to relatively mild restrictions in Sweden. Economic and financial policy also differed, with extensive measures taken in Germany and somewhat more restraint being shown in Spain. It soon became apparent that while some Member States seemed to have been reasonably well equipped for dealing with such crises, others struggled far more in areas such as the health sector, their administrations and, last but not least, in economic and fiscal policy terms. The resilience of the Member States varies significantly across countries.

4. These differences in competitiveness and performance have, of course, not only been known since Corona. From its outset, the process of European unification was accompanied by concerns about the economic convergence of the Member States and their regions. The internal market is linked with the expectation that the larger common market offers companies in all Member States greater opportunities for specialisation, thus realising income opportunities. It has, at the same time, been accompanied at European level by an increasing number of instruments, particularly the Structural Funds, which are intended to reduce existing weaknesses in the Member States or individual regions by building up infrastructure or providing direct support.

5. The impact of the crisis is fuelling fears of increasing divergence in the EU, not least because Member States such as Germany, the Netherlands or Austria are better prepared to deal with the crisis. Indeed, the European framework for COVID crisis aid could create tensions in the internal market if it exacerbated economic disparities and contributed to a further falling behind of those parts of the EU that are less competitive. The discussion about necessary measures at EU level to tackle the Corona crisis has therefore turned into a competition of ideas aimed at increasing the competitiveness of economically more severely affected Member States. The most prominent outcome of this struggle is the reconstruction plan. Crisis management and convergence objectives are linked to more far-reaching policy goals: The funds of the reconstruction plan are to be raised by the EU on capital markets and are supposed to support new technologies and structural change towards digitisation and climate protection (European Green Deal). The Commission's new debt competence is based on the compromise over the new EU multiannual

financial framework (2021-2027) reached on 21 July 2020, which also takes into account the UK's withdrawal from the EU and the different interests of the Member States in how these funds are to be distributed.

6. On top of that, the EU Member States are increasingly exposed to an international systems competition. On the one hand, the United States has an economic system that relies heavily on market principles, private property and competition on the merits. On the other hand, China pursues an economic system in which a dominant state directs market activities and follows a pronounced industrial and innovation policy. While these characterisations are somewhat simplified – particularly considering how large private enterprises and assets have been created at breath-taking speed and under tough competition in China – these alleged models have a pertinent effect on the debate on economic policy. In this systems competition, the EU sees itself as committed to the idea of the social market economy – characterised by a free and competitive market and, in contrast to the United States, a stronger welfare system, but without dominating the economic process by steering and planning, as is the case in China. The largely uniform or harmonised regulation in the European common market is attractive for investors and companies, thus securing jobs.

7. According to the German and French governments, this is no longer sufficient. Instead, a stronger protection from external competition is demanded. This entails protection against foreign direct investors[2] who want to take over European companies, a proactive industrial policy[3] which at least actively supports European champions, and ideally even helps developing them in order to ensure greater competitiveness on the world markets, and by special taxes on digital sales, which are in fact directed primarily against American companies. At the same time, European workers are to be safeguarded by extensive social protection. French President Macron describes this policy as a "*l'Europe qui protège*".

2 See EU Commission, Guidelines for Member States on Foreign Direct Investment, free movement of capital from third countries and protection of Europe's strategic assets in the run-up to the application of Regulation 2019/452 on the review of foreign direct investment, OJ 2020 No. C 99 I/01.

3 See Federal Ministry for Economic Affairs and Energy, National Industry Strategy 2030: Strategic Guidelines for a German and European Industrial Policy, 2019, available at https://www.bmwi.de/Redaktion/EN/Publikationen/Industry/national-industry-strategy-2030.html.

8. The German Federal Government supports these intentions, as demonstrated by the industrial policy visions of Peter Altmaier, the Federal Minister of Economic Affairs.[4] Those plans are no longer about open markets, but about market foreclosure and limiting competition. Until recently, Europe offered protection to its citizens not by protecting companies from competition, but rather by strengthening the European economy, its companies and its employees through an appropriate regulatory framework, enabling them to thrive in competition. Competition creates innovation, guarantees choice, reduces dependencies and thus safeguards jobs and prosperity. It ensures that economic development is controlled by decisions of the customers and is thus the basis for a free and humane economic order.

9. As a result, two contradicting views on the sources of the competitiveness of national economies and therefore also on the role of the state are increasingly coming into conflict. Some advocate for state protection through protectionist measures, subsidies and special tax advantages, both internally and externally, as well as industrial policy guidance that makes it easier for companies to take risky technological decisions. State assumption of risk and protection against competition are supposed to help European companies to succeed on world markets. The seemingly old-fashioned alternative to this remains a market economy based on competitiveness through competition. Companies and their employees prove themselves in competition. They are successful because they are efficient and innovative, in other words, because they offer interesting products at conditions that are attractive to customers.

10. For an economy this means, on the one hand, maintaining price competitiveness. If production is too expensive and thus prices rise, companies' offers become less attractive unless they compensate for cost disadvantages in other ways, for example by improving quality. This, however, is only possible to a certain extent because at some point, it will become difficult to justify higher prices through higher quality. In the highly developed European economies, on the other hand, non-price competitiveness, namely the framework conditions that determine economic activity in Europe, are therefore more important. A location's attractiveness depends on factors such as legal certainty, an efficient public administration and infrastructure as well as a well-trained workforce. Equally important are the fiscal conditions, the social system, efficient regulation of labour and product markets and, last but not least, competition law. Competitiveness, which is strengthened by competition, increases productivity as well as prosperity and enhances the resilience of an economy – in both general terms and crisis situations.

4 The Franco-German-Polish manifesto on the modernisation of EU competition policy of July 2019 is primarily aimed at revising merger control to take greater account of the effects of mergers, acquisitions and shareholdings on future potential competition.

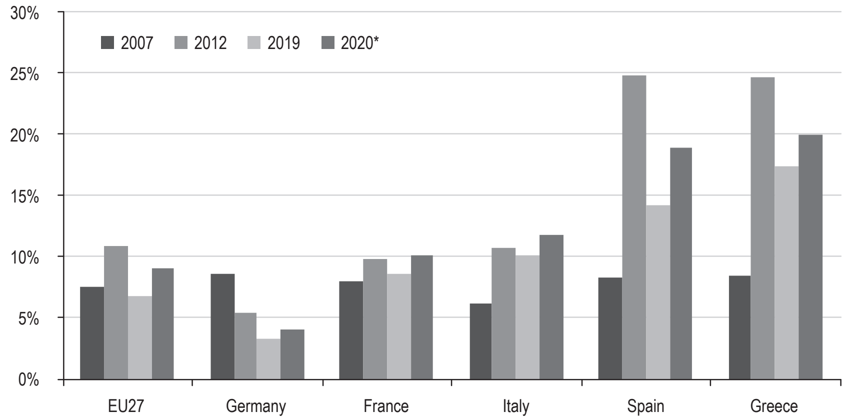
11. The dispute over the paths to competitiveness is not new. It has accompanied the EU from the very beginning. However, the increasingly perceived threat of systems competition with China has led to a shift which is likely to intensify due to the Corona crisis. Calls for greater external protection and a renationalisation of value chains are increasingly resonating. Production is to be brought back from abroad in a self-sufficient aberration, and competition between countries and regions is to be weakened. With the departure of the United Kingdom, the forces in this discussion at European level have shifted.

12. The retreat into Fortress Europe threatens to undermine the foundations of the European model of success. Indeed, Europe is facing fundamental challenges. It is precisely in this situation that the resilience of the European economy and of the national and European institutions in their interaction must be increased. Only the model of "competitiveness through competition" will contribute to this.

II Challenges Facing Europe

13. With the vision of a "l'Europe qui protège", the French President responded to citizens' concerns. Economic challenges for EU citizens do indeed arise in many different ways. They have intensified with the Corona crisis.

Figure 1: Unemployment rates in the EU over time



*Estimate.

Source: Eurostat; European Commission, European Economic Forecast, Spring 2020.

14. First, the consequences of excessive debt and persistently weak growth in past years are becoming apparent. Highly indebted Member States have too little fiscal leeway to mitigate the economic slump on their own. Without the massive bond purchases made by the ECB, risk premiums for some Member States would have most likely been significantly higher. Although the situation on the labour market had improved before the Corona crisis, there is now a threat of substantial unemployment again. Figure 1 shows the rise in unemployment in the wake of the financial and economic crisis, the subsequent recovery up to the eve of the Corona crisis and the projected increase

in unemployment that is likely to result from it. Figure 1 also shows significant differences between Member States, which indicate structural differences in national labour markets. In some countries, entrenched youth unemployment seemed to be weighing on the future of an entire generation even before the Corona crisis. Longer periods of unemployment at a young age can inflict lasting damages (Schmillen and Umkehrer, 2017). In this situation, the Corona crisis is hitting people in Europe severely, while hopes for a better future are fading.

15. Second, globalisation and, third, technological progress are perceived as a threat by many people in Europe. The fall of the Iron Curtain, the inclusion of China in the international division of labour, and an improved participation of other Asian states and South America in internationalisation have led to a significant reduction in absolute poverty in the world (Deaton, 2013). However, this has also led to increased competition for workers in the Western world, which threatens jobs, especially for low-skilled workers, in certain regions of the EU. As a result, these workers in high-wage countries are in competition with those in Romania, for example, who have lower productivity but at the same time receive significantly lower wages. Better-qualified workers in high-wage countries can justify their higher wages by corresponding productivity differentials, while low-skilled workers often cannot. This can lead to rising regional disparities and rising income inequality. Increased international competition tends to increase employment in the aggregate (GCEE, 2017). Nevertheless, there are some regions which have already been negatively affected by increasing globalisation in the past and which can expect further disadvantages. For them, ever-increasing globalisation in the EU appears to pose a threat to existing jobs.

16. Technological progress has a similar effect. It induces structural change, is often labour-saving, favours qualified workers and can lead to regional disparities and higher income inequality. Although, automation, robotization and digitisation have so far contributed to employment growth overall, especially in Germany (Elstner et al., 2018), technologically induced structural change is leading to job losses in some regions (GCEE, 2017). In addition, the EU is facing a new wave of digitisation, which many perceive as a particularly serious threat to their jobs. Predictions of artificial intelligence replacing existing jobs far into the middle qualification and income range are leading to debates about an unconditional basic income or a robot tax (Oberson, 2017; GCEE, 2019).

17. Fourth, technological progress interacts with a policy of climate protection aimed at mitigating further global warming to avoid the most harmful effects of climate change. Currently, the transport sector is particularly affected by such policies. The automotive industry does not only need to adapt to digitalisation (e.g. Industry 4.0 and autonomous driving), it must also meet the challenges of climate change for the internal combustion engine. In principle, this is independent from the policy instruments chosen, i.e., whether policymakers in Europe find the strength to introduce a comprehensive CO_2 pricing system or continue to use a costly combination of regulatory law and subsidies. In the first case, CO_2 emissions will become more expensive, and the automotive industry will have to meet the resulting increase in demand for other engines. In the second case, it must react to bans on certain engines and specifications for new engines. This entails considerable structural change, for which the government has not made any legislative or political preparations yet.

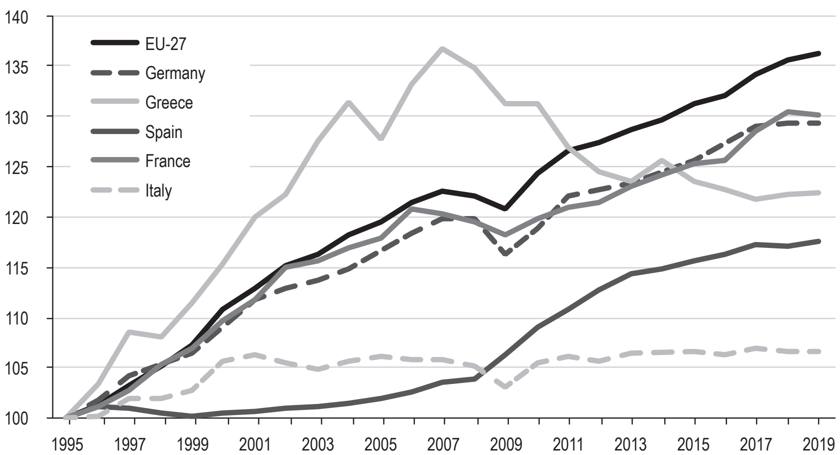
18. It must not be ignored that climate change in itself leads to considerable uncertainty and discontent among the population. Some people fear that states will fail to preserve the natural foundations of life. The protests of the Fridays for Future movement are symbolic for this part of the population. Another part of the population resists the additional burdens that are associated with climate protection measures. Climate protection does not come for free; it entails in particular distributional effects that can reinforce the trends in regional and personal income distribution described above. The French yellow vest protests are illustrative for this part of the population. Most importantly, however, these contrasts make it clear that credible climate policy must be resource-conserving.

19. Fifth, migration poses major challenges to the EU. The focus of attention lies on the refugee crisis of 2015/2016, but it is in fact on the permanent handling of migration of people seeking protection. Internal migration within the EU also plays a latent role. It sparked the debate in the UK, which led to a desire to restrict the free movement of people and greatly contributed to the outcome of the Brexit referendum. In Germany, France and Austria, migration to stronger social security systems is receiving a lot of attention. Even if immigration does not lead to a financial burden on welfare systems, there are fears that it could lead to renewed wage pressures, not least for low-skilled workers, as migration creates increased competition on regional labour markets.

20. These structural challenges are exacerbated by the Corona crisis and the differing capability of Member States to cope with it. While Germany is combining massive investments in climate protection and digitisation with its extensive economic stimulus packages, Italy is struggling to mitigate the consequences of the threat of unemployment. Reforms aimed at managing structural change are in danger of being neglected.

21. The key to overcoming the Corona crisis is the productivity of the European economies. Figure 2 shows the development of overall labour productivity, measured per hour worked, for the EU-27 and for selected Member States over time. The differences are striking. In Greece, credit-driven productivity growth was evident prior to the financial crisis, but this was corrected by the Greek debt crisis. While productivity in Germany and France has developed almost identically, albeit with considerable differences in unemployment (see Figure 1), the trend in Italy has been a sideward movement since 2000, i.e., it has stagnated for 20 years. Without productivity growth, however, sustainable economic growth is impossible to achieve. In order to realize it, the competitive processes need to be revived.

Figure 2: Total economic productivity per hour worked in the EU over time



Source: Eurostat.

III (Economic) Policy Responses and Mismanagement

22. The belief that competitiveness can be increased through less competition is proliferating not only in Europe, but worldwide. The election of Donald Trump as President of the United States, which is facing similar challenges, represents in any case a turn to increasingly protectionist policies. Although the focus of this policy is on Sino-American trade relations, it also affects other countries, such as the EU Member States. The Trump administration's "America First" strategy is explicitly designed to protect jobs in the US and to mitigate the pressure of globalisation and technological progress on the manufacturing sector through customs duties, new trade agreements, tax policy, withdrawal from the Paris Climate Change Agreement, etc. With Trump's re-election increasingly becoming less likely in the wake of the Corona crisis, he is resorting more and more to these protectionist means. For example, the US has recently withdrawn from the negotiations on the taxation of digital services at OECD level and is threatening European states in particular, which want to introduce or have already introduced unilaterally digital taxes, with considerable retaliatory measures.

23. The EU has so far not followed such a strategy but is counting on the conclusion of further trade agreements, for example with Canada (CETA), Japan or Mercosur. Negotiations with the US on a new trade agreement are proving tough but are continuing. However, politicians in the EU Member States are increasingly open-minded towards protectionist policies, as indicated by the reluctance to ratify CETA or the questioning of the trade agreement with Mercosur due to Brazilian policy in the Amazon region.

24. This is accompanied by the tightening of foreign trade law in the EU and in Germany. In the future, the Federal Ministry of Economic Affairs and Energy (BMWi) will not only be able to intervene in a restrictive manner to guarantee the public security of the Federal Republic of Germany, but also that of other EU Member States. The same applies to ensuring public security regarding projects or programmes of EU interest. In addition to that, it will be sufficient if public security is likely to be threatened. The main threshold for taking action has thus been significantly lowered and is now more difficult to assess for parties concerned. In addition, the term "public security" is explicitly to be interpreted generously. Previously, a "real and sufficiently serious threat" had to be proven. Additionally, the lists of notifiable transactions of the Foreign Trade

and Payments Ordinance (AWV) will be extended. An intervention is already possible if an acquisition increases the buyer's share to 10 percent instead of the previous 25 percent. In the first instance, companies in the sectors of services for securing communication infrastructure, certain medical devices, essential medicines and protective equipment are affected by the widened scope. The next step is expected to be an expansion into the fields of artificial intelligence, robotics, semiconductors, biotechnology and quantum technology in the course of this year.

25. The industrial policy visions of Peter Altmaier, the Federal Minister of Economic Affairs, go beyond these measures:[5] Closed value-added chains in an economic area should be preserved and the state should identify key technologies in order to participate in basic innovations. This culminates in demands for investments in the field of artificial intelligence or battery cell production. In order to achieve greater competitiveness on the world market, mergers should be made easier so that national or European champions can be created, even if this leads to the creation of quasi-monopolies on European markets. This is to be made possible through a correspondingly generous and politicised delineation of relevant markets. Finally, a facility for state ownership is to be set up to make it easier for the state to acquire company shares to fend off takeover attempts aimed at technology and innovation leadership in sectors deemed important. Recently, the Federal Minister of Economic Affairs announced the acquisition of stakes in a Tübingen-based pharmaceutical company that is working on the development of a vaccine against the Corona virus. This is aimed at deterring potential American investors but first of all illustrates the extent to which symbolic politics are used in the Corona crisis.

26. The concept of an industrial policy strategy can be found in a similar form in a Franco-German manifesto for a European industrial policy in the 21st century and in a Franco-German-Polish proposal to modernise EU competition policy.[6] The Franco-German manifesto, following Altmaier's visions, calls for a more ambitious European industrial policy and a revision of competition

5 See Federal Ministry for Economic Affairs and Energy, National Industry Strategy 2030: Strategic Guidelines for a German and European Industrial Policy, 2019, available at https://www.bmwi.de/Redaktion/EN/Publikationen/Industry/national-industry-strategy-2030.html.

6 See BMWi, Ministère de l'Économie et des Finances, MinisterstwoPrzedsiebiorczosci I Technologii, Modernising EU Competition Policy, available at https://www.bmwi.de/Redaktion/DE/Downloads/M-O/modernising-eu-competition-policy.pdf?__blob=publicationFile&v=4.

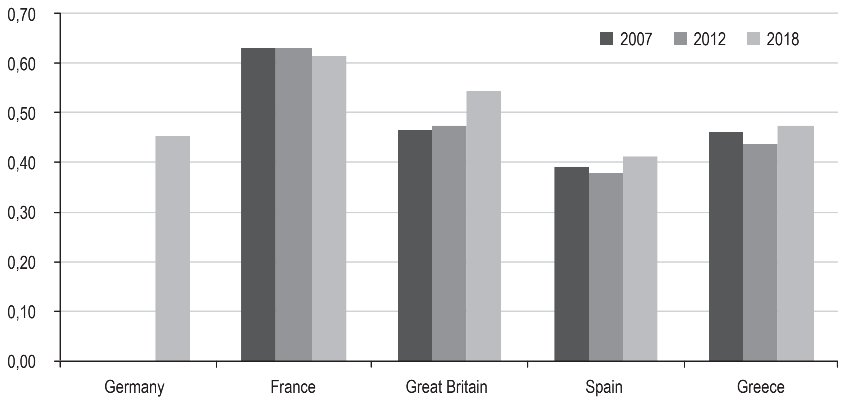
law. With a similar aim, the Franco-German-Polish proposal aims to politicise merger control whenever a merger is likely to increase the international competitiveness of European companies, or conversely whenever non-EU countries are shareholders of the companies involved or provide subsidies to these companies.

27. The reactions of the Member States in the field of labour market and social policy are also problematic. Under pressure from France, for example, EU law on the posting of workers has been tightened and restrictions on the freedom to provide services in the EU have been accepted.[7] The old law on the posting of workers already allowed France to push back competition from German companies by imposing bureaucratic hurdles. The new law on the posting of workers worsens the situation.

28. Attempting to protect workers against market forces, calls have been made for EU-wide coordinated labour market and social policies, including a European minimum wage. Essentially, this is about harmonising minimum wages to 60 percent of the median wage. As Figure 3 illustrates, this would lead to a substantial increase in statutory minimum wages in Spain, Greece and Germany. In some regions this would affect a lot of workers with a corresponding threat to jobs. The statutory minimum wage thus loses its function as a corrective to monopsonistic structures on regional labour markets. Instead, a European harmonisation of the minimum wage leads to wages that are not covered by the productivity of workers in the poorer Member States. This poses the threat of higher unemployment there, which is likely to lead to calls for transfers from the rich to the poor Member States in the sense of financial redistribution. The disparities in the competitiveness of the Member States would widen.

7 See Directive (EU) 2018/957 of the European Parliament and of the Council of 28 June 2018 amending Directive 96/71/EC concerning the posting of workers in the framework of the provision of services, Brussels, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L0957&from=DE.

Figure 3: Ratio of minimum wage to median wage in selected Member States



Source: OECD.

29. The European Economic Area is not isolated but must prove itself in competition with the rest of the world. This includes achieving a high quality of products and services at the lowest possible cost through technological leadership in certain areas. Price and non-price competitiveness are of great importance in this respect. In international competition, unit labour costs are just as important as the fiscal, financial and regulatory conditions for investors.

IV Competitiveness as a Model for Europe

30. The orientation towards competitiveness through competition has so far been a core element of the European economic constitution. The regulatory framework is set in such a way that companies operating in the internal market are encouraged to prove their competitiveness by competing with other enterprises. Suppliers are therefore guided by the interests of customers, and ultimately offer goods and services according to their wishes, ideas and willingness to pay. Entrepreneurial pricing is appropriate and requires efficient production. Even more important is the dynamic role of competition. Companies achieve advantages if they succeed in gaining an edge over their competitors through product and process innovations. Competition serves as a discovery process for such innovations. Ultimately, the customer preferences are decisive for prevailing in competition.

Competition Law

31. Competition law is designed to protect this mode of competition by preventing the abuse of dominant positions and cartel agreements. In addition, merger control should ensure that effective competition is not significantly impeded.

32. With these rules, European competition law sets the direction for national competition policies. It has undergone various changes in the last 20 years. The so-called More Economic Approach, meaning the strict orientation of European competition rules towards the protection of consumer welfare, is increasingly being questioned. The EU Commission is now devoting more attention to the dynamic effects of competition.

33. Despite intensive discussions on the objectives and interpretation of the competition rules in detail, the success of European competition law is indisputable. The European competition authorities have uncovered cartel agreements and handed out heavy fines. They have recently conducted various proceedings for abuse of dominant market positions and put an end to anti-competitive practices. Prominent examples are the Microsoft and Google cases. Lastly, the EU Commission has protected effective competition in the EU within the framework of merger control with few prohibitions but many conditions.

State Aid Control, Internal Market Legislation and Trade Policy

34. However, competition policy is not sufficient on its own. It must be complemented by internal market and external economic policy, which aim for free trade. For companies in the internal market this means that they cannot rely on protection through subsidies or other special advantages. This applies equally to trade in goods and services, but also to cross-border capital movements and migration within the EU.

35. State aid control aims at identifying and then limiting unjustified special advantages granted to corporations by a Member State. This is not an easy task. Overt and covert subsidies can be found in many different ways. The Member States are quite resourceful when it comes to granting aid to "their" companies. They do so, for example, to cushion the effects of structural change, to improve the development of structurally weak regions or in applied research. In each case, the EU sets framework conditions within which distortions of competition can be kept relatively low.

36. State aid control in the EU solves prisoner's dilemmas. If Member States are free to support their economies with aid, they run the risk of a subsidy race (Brander and Spencer, 1985). Each Member State may be in a better position if other Member States do not provide subsidies and they themselves grant aid. This can lead to a situation in which all provide subsidies, but no one obtains a competitive advantage, and each Member State is thus worse off. State aid control is a mechanism to prevent such unfavourable situations caused by uncoordinated behaviour by Member States.

37. Nevertheless, the EU is accused of extending its competence in the area of state aid control (Mause and Gröteke, 2017), for example by intervening in a harmonising manner in the tax policy of the Member States. To a certain extent, however, such "encroachments" are inherent in a state aid control that establishes general criteria for the approval of aid. Nevertheless, a tension remains that is difficult to resolve (Advisory Board to the Federal Ministry of Finance 2017, Monopolies Commission 2008). In the case of decentralised regulation, regulatory competition between local authorities also makes it possible to limit excessive regulation.

38. The EU is going one step further with its internal market legislation. Wherever existing or planned regulations in the Member States impede trade between countries, it sets uniform framework conditions for companies and consumers. The criticism of detailed regulation is abundant. At the same time, technical standardisation is repeatedly called for by companies, giving European companies economies of scale and competitive advantages on world markets while the EU gains influence on the design of international conditions for production and competition (Bradford, 2020). In certain areas, however, the EU explicitly allows Member States to restrict fundamental freedoms. For example, the freedom to provide services can be restricted on the grounds of the law on the posting of workers for social policy reasons, while security reasons may allow for restricting the freedom of capital movement.

39. In external relations, the requirement of competition applies accordingly. Here, the dismantling of trade barriers is an essential objective too. Since this is difficult to achieve multilaterally within the framework of the global trade order, regional preferential and free trade agreements can lead to a gradual opening of markets. For some time now, the EU has increasingly been relying on such free trade agreements, which must be comprehensive in order to be WTO-compliant. This can be achieved by taking into account all the markets of the countries involved or even by making more diverse adjustments to technical or political standards. In contrast to internal market legislation, external relations are not concerned with the four fundamental freedoms. In particular, the free movement of people is not the subject of trade policy. However, questions of the free movement of capital certainly are. So far, the EU has, largely in line with WTO rules, aimed at reciprocity in international trade, for example by imposing protective tariffs in the case of high subsidies from other states, as in the case of steel tariffs directed against China. Restrictions on the free movement of capital have so far been relatively restrained: Investments in European companies can be prohibited mostly for security reasons.

40. In its recently published "White Paper on ensuring fair conditions of competition with regard to subsidies from third countries", the EU Commission proposes new instruments against, among other things, state-subsidised foreign companies seeking to acquire shareholdings in Europe. It also takes a look at award procedures in public procurement. In future, the EU wants to determine the influence of the foreign state in the case of shareholdings that allow an investor to exercise a significant influence on company decisions, or if an investor acquires more than 35 percent of the shares, in companies with

annual sales of at least €100 million or potentially important companies with (still) limited sales. There will be an obligation to notify an acquisition if the foreign company has received more than 20 million euros in subsidies or subsidies amounting to 5 - 10 percent of the purchase price in the past three years. If this results in a distortion of competition, the participation can be prohibited or subjected to conditions. The review can also be carried out retrospectively, but at a lower threshold for subsidies of 200,000 euros in three years.

41. In practice, these instruments are likely to be difficult to implement. If foreign states do not exert their influence overtly but covertly – as is regularly to be expected – this will be difficult to prove. The new instrument then becomes either blunt or a gateway for discretionary defensive measures. Especially when the influence of the foreign state is difficult to prove, the assertion of state influence is conversely difficult to refute. The supposed protection of a "level playing field" then quickly becomes a further means of industrial policy and, in the worst case, economic war.

Research and Innovation, Regional and Cohesion Policy

42. Despite the restrictions and political currents mentioned above, the EU has so far flanked its policy, which is oriented towards competition and openness, with research and innovation policy on the one hand and regional and cohesion policy on the other. In addition, there is agricultural policy, which also contains regional policy elements.

43. In research policy, the EU aims to complement national research policies by promoting European networking and research activities characterised by significant externalities. In this way, the EU focuses on the transformation of money (research funds) into knowledge (research results and patents). Innovation policy is about transforming knowledge into money by transforming research results and patents into new products and processes. The EU's innovation policy is primarily concerned with the financing side, for example through loans from the European Investment Bank (EIB) or in connection with European regional or cohesion policy.

44. In the discussions on the architecture of the European Monetary Union, the Capital Market Union plays an important role in cushioning the effects of shocks that have regionally different effects. The Capital Market Union is

intended to create a common capital market in the EU by removing regulatory barriers to the common market. This is a prerequisite for a larger and deeper capital market in Europe, which should facilitate access to risk capital (venture capital) beyond bank financing for young companies, especially in the growth phase. On the one hand, this is an internal market project. On the other hand, however, cross-border credit relations and capital flows offer an opportunity to compensate to a certain extent for regional shocks. The capital market union is therefore an important contribution to strengthening the resilience of the European Monetary Union.

45. Regional and cohesion policy with the help of the EU's so-called Structural Funds was originally intended to support the catching-up process of poorer regions and to compensate regions disadvantaged by lower competitiveness for the negative economic consequences of integration, for example if domestic firms are displaced by more competitive suppliers from other regions. In practice, the Structural Funds have mainly been used to finance public infrastructure projects and other public investments. In agricultural policy, however, it was mainly about income compensating for farmers, most recently with an environmental policy connotation. The extent to which EU regional and cohesion policy has promoted economic convergence in the EU is disputed in the literature. While there are empirical studies that prove convergence-increasing effects (Becker, Egger and von Ehrlich, 2010), there are analyses that cannot identify convergence (Breidenbach, Mitze and Schmidt, 2019).

46. With their reconstruction plan, the Member States and the European Commission aim to strengthen the convergence process in the EU after the Corona crisis. The reconstruction plan provides for a volume of 750 billion euros, consisting of 390 billion euros in non-repayable grants and 360 billion euros in the form of loans. It authorises the Commission to raise funds on the capital markets on behalf of the EU. The powers conferred on the Commission to borrow jointly are limited in terms of amount, duration and scope: EU borrowings will be guaranteed by the Member States in proportion to their share of GDP, new net borrowing will cease by the end of 2026 at the latest, and repayment of the debt should be completed by the end of 2058 at the latest. The use of the funds is largely geared (for the 672.5 billion euros of the so-called reconstruction and resilience facility) towards national reconstruction and resilience plans to be drawn up, which set out the reform and investment agenda for the Member State concerned for the years 2021-2023. These must be

assessed by the Commission and approved by the European Council by qualified majority. A positive assessment of payment requests is subject to the satisfactory fulfilment of relevant milestones and targets. In order to refinance the common debt, the EU is moving closer to having its own taxation competence. As a first step, a new source of own resources based on a non-recycled plastic waste tax will be introduced starting in 2021. In addition, in the first half of 2021, the Commission is to present proposals for a Carbon Border Adjustment Mechanism (CBAM) and a digital levy, to be introduced from 2023. It is also planned to work towards the introduction of other own funds, such as a financial transaction tax, during the next multiannual financial framework. The EU is thus taking a further step towards a fiscal union.

47. With regard to the convergence of the Member States, however, the question arises as to how far the support provided by the reconstruction plan can achieve a better result than the previous EU Structural Funds. In essence, the main drivers of productivity growth via non-price competitiveness are determined by national labour market, social, tax and fiscal policies. The EU can offer some support to increase competitiveness, for example by promoting infrastructure investment. However, such support cannot replace fundamental reforms, for example of the education system or labour market regulation. It may even happen that financial support for investment from EU funds leads to a reduction in national investment expenditure or to wage and price increases in the recipient regions, which would undermine their competitiveness and thus cement their dependence on aid.

Increasing Intervention Intensity

48. More recently, there has been a renaissance of industrial policy in both the Member States and at the European level. Once a proponent of an active competition policy, Germany has now become a driver of industrial policy ideas and moved closer to the French idea of a more interventionist state. The United Kingdom is missing as a counterweight in European politics. The Corona crisis is intensifying fantasies about the ability to steer economic outcomes.

49. With state aid control and internal market legislation, the EU is gradually acquiring further powers and is thus increasingly determining legislation in the Member States. In doing so, it is losing sight of interstate competition as

the motor of economic development, which the four fundamental freedoms are supposed to promote. Convergence in regional prosperity can hardly be achieved through permanent transfers that are not sustainable in the long term. Convergence can be achieved by ensuring that state activities prove their worth in competition between local authorities. Regulations are put to the test, and interventions that inhibit economic development and are contrary to the market are uncovered through competition. This allows Member States to focus on what the state should be doing, namely correcting market failures.

50. The importance of competition in and for Europe is therefore not limited to competition policy and related policy areas. Each Member State offers different policy solutions to existing problems. The four fundamental freedoms, in particular the free movement of people and capital between Member States, allow citizens and businesses to choose local authorities that provide them with a sufficiently acceptable set of public goods and services and their financing according to their preferences. Inter-state competition through the diversity of such solutions is the key to Europe's success to date. Regulatory competition can be beneficial or detrimental to the internal market. This depends on the scope of application and on whether the characteristics of this competition ultimately prevent the correction of market failures by the state (Feld, 2007 and the overview in Feld et al., 2017). However, it is hardly to be expected that the elimination of competition between Member States is the optimal solution.

51. One mechanism for this competition is the mobility of labour and capital between Member States. The European rules on free movement, however, neglect the consequences of promoting mobility between states whose welfare systems are developed to different degrees. This creates incentives to migrate to states with more generous transfer systems. In the long run this threatens to undermine the financial viability of these welfare states (Sinn, 2003 and the overview in Feld et al., 2017). The possibility of restricting and delaying migrants' eligibility for welfare benefits is therefore being discussed in the EU, but no solutions have yet been found. This does not aim to weaken the welfare state. Rather, it is a matter of striking a balance. Freedom of movement ensures a more efficient use of labour in the EU; in contrast, migration motivated purely by the welfare state provides the wrong incentives, which ultimately lead to an erosion of the welfare state.

V Retreat into Fortress Europe

52. The discussions of the past years threaten the core identity of the EU: the creation of competitiveness through competition. The Franco-German advances for an industrial policy that seeks to promote specific technologies and sectors in a targeted manner, for a competition policy that relies on national or European champions and thus increasingly on instruments that restrict competition to increase the competitiveness of European companies abroad, and for a foreign trade policy that is more strongly shielded from foreign direct investment, mean nothing more than a retreat into "Fortress Europe".

53. Internally, the EU is trying to achieve greater harmonisation in various regulatory areas and to transfer competences to the EU level. The aim is to reduce differences between the Member States in the fiscal and regulatory area and in labour market and social policy significantly. At the same time, restrictions of the four fundamental freedoms, especially the freedom to provide services, are accepted. EU harmonisation and regulatory efforts in labour market policy, for example the introduction of minimum standards for national minimum wages, or in social policy, for example the entitlement of EU citizens to social benefits in all Member States, not only restrict the political sovereignty of the Member States and competition between them, but also reduce the competitiveness of European companies and thus lead to employment losses.

54. Globalisation poses challenges for EU Member States, their workers and citizens. Yet on balance, it has contributed to an increased prosperity in the EU. It is therefore wrong to respond to these challenges with protectionism. Protectionism will not prevent structural change but delay it at best. The EU Member States will, however, increasingly lose competitiveness in the process of it. The EU Commission would therefore do well to continue to focus on expanding international trade. With a World Trade Organization (WTO) weakened by the US, regional trade agreements are the only remaining option, which the EU should continue to pursue consistently. As a first step, this requires ratification of the most recent agreements (CETA and the agreement with Mercosur) by the Member States. The Commission should also intensify negotiations with the US for an American-European trade agreement, not least to avert the threat of a trade conflict, but above all to safeguard the enormous further trade potential between the US and the EU.

55. In order to survive in the systems competition with the US and China, sealing off is the wrong way to go. Although discussions about restricting foreign direct investment are directed at China, they also affect American investors. They are thus potentially causing considerable damage. The tightening of foreign trade law – lower intervention thresholds for equity investments and a broader definition of security relevance – gives policy-makers significant leeway to deny foreign investors access to the European market. The security relevance should be narrowly defined and relate to areas of internal and external security or critical infrastructure.

56. Nevertheless, it must be recognised that systems competition with China poses other challenges for the EU. Chinese companies often enjoy significant support of the Chinese state. Direct investment made possible by subsidies is not problematic in principle, as Chinese taxpayers preserve European jobs by subsidising Chinese investors investing in the EU. Even technology transfer facilitated by this is not harmful per se. In the long term, European companies can only remain competitive, if they constantly innovate, operate at the technological frontier and maintain technological leadership. Chinese direct investment is particularly problematic in those areas where there is a real impact on public security. In addition to the classic security areas, these include critical infrastructures, such as the digital infrastructure.

57. The changed legal situation in foreign trade law must not be used as a pretext for further sealing off Europe. The security relevance must be interpreted narrowly and must not be extended on a discretionary basis. This would unduly restrict the private owners' rights of disposal, who could obtain higher prices by selling shares to foreign investors, and be susceptible to the influence of interest groups. This applies first and foremost to a state ownership motivated by the desire to repulse foreign investors. From an ordoliberal perspective, state participation in industrial undertakings are rarely justified. As long as the direct state influence of Member States only replaces the indirect influence of the Chinese state on European companies, little is gained. Nevertheless, the problem here is that foreign companies strategically fostered by state aid are used for takeovers in a targeted manner and under state influence. Although this does pose problems from an ordoliberal perspective, it is more doubtful that it constitutes a serious problem in practice justifying the creation of such a far-reaching and potentially dangerous instrument of foreign ownership control as proposed in the White Paper.

58. Finally, European policy must address concerns about China's future development. The Chinese market is of considerable importance to European companies. The Chinese economy is in danger of falling into the trap of middle-income countries which, having undergone a certain process of convergence, are no longer able to move forward and remain at their level of development. China is technologically and economically less strong than is feared in this country. Böing and Müller (2016, 2019), for example, show that Chinese patents are only about one-third of the quality of patents in an international comparison. Although China's increased innovative efforts allow for an increasing decoupling from the international innovation system through increased innovation activities, it rarely succeeds inleaving a genuine footprint. Due to insufficient quality, the Chinese economy is unable to convert the high output of patents (innovation output) into productivity growth. Many fears are therefore exaggerated. This does not imply that the EU Member States should simply accept violations of intellectual property rights, nor should Chinese restrictions on European investors in China be tolerated. Both can be addressed and regulated best in a Sino-European investment agreement.

59. At the Member State level, systems competition with China has become a central argument for softening and politicising national and European competition law (see above). However, believing that dominant positions of European champions in European markets strengthen international innovation and competitiveness is contradicted by competition theory findings and practical experience. The necessary economies of scale can be ensured more effectively by technical harmonisation in the internal market, which has manifold spill over effects on international markets.

60. The efforts of the European Commission to strengthen the control of abusive practices under cartel law at the European level, however, are to be assessed positively. With the consultation for a Digital Services Act, the European Commission has initiated a reform process aimed at containing the market power of the dominant digital companies more effectively. Strengthening abuse control is particularly important in this sector, not least because tighter merger control could have quite ambivalent effects. On the one hand, stricter merger control could help preventing so-called "killer acquisitions" better, where large digital corporations buy small competitors in order to strangle potential competition. On the other hand, however, the prospect of being able to sell a start-up to a digital company at some point in time creates incentives for start-ups and innovations. Moreover, it is much more difficult

to predict which companies could eventually become competitors, especially in the digital economy, because – unlike in the pharmaceutical industry, where the phenomenon of killer acquisitions is well known – there are no long research pipelines that can be used to predict potential competition with a certain degree of reliability long before it happens. Preventing companies from abusing their dominant position is therefore crucial to protect competition.

61. Finally, the idea of safeguarding collective interests in competition law is problematic as long as it is not possible to define what the collective interest is. This allows politicisation. Moreover, in a democracy, the weighing of different political objectives should not be shifted to the level of the executive but should take place in the political sphere.

62. Climate protection requires considerable efforts by the Member States in order to significantly reduce CO_2 emissions and comply with the climate agreements. There is a possibility that climate targets might have to be tightened, if climate neutrality is to be achieved by 2050. With the EU Emissions Trading Scheme (EU ETS), the EU has a suitable instrument for efficient CO_2 reduction. Rising certificate prices over time make saving CO_2 worthwhile. So far, however, the EU ETS only covers around 40 percent of CO_2 emissions in the EU, primarily in the energy sector and industry. The primary objective of EU climate policy must therefore be to extend the EU ETS to sectors not covered by it so far. However, this will require a comprehensive restructuring of production in the Member States, which means that their willingness to undertake such extensive efforts still remains limited. With its Green Deal, the EU Commission is therefore aiming to take suitable support measures to promote the energy-efficient restructuring of European economies towards climate neutrality. These include infrastructure measures, for example to expand the use of electromobility, as well as the promotion of battery cells.

63. The reconstruction plan adopted in response to the Corona crisis offers a way of facilitating the transition to such a climate policy for Member States. According to the Commission's ideas, the reconstruction plan should be an important instrument for the Green Deal. In addition, it is intended to support projects in the field of digitisation to alleviate the challenge of managing the structural changes associated with it. However, Member States have no choice but to increase their competitiveness through appropriate economic and financial policy reforms under national responsibility. The reconstruction plan can help to achieve this if structural reforms, for example of the labour

and product markets, are implemented in the Member States most economically affected by the Corona pandemic in exchange for subsidies. This would ultimately make the location more attractive for investors and has the potential to significantly increase resilience in regard to future crises. However, it should be borne in mind that conditionality in the recipient countries is often equated with externally imposed austerity policies.[8] In this respect, it will have to be seen whether the recipient countries use the funds from the reconstruction plan productively. According to the Council agreement of 21 July 2020, the national reconstruction and resilience plans that will have to be attached to a payment application should be based on the country-specific recommendations of the European Semester. This could possibly lead to productivity-enhancing reforms. However, the status of implementation of the European Semester to date suggests that the Member States have so far been somewhat sceptical about the country-specific recommendations (König, 2020). The success of the reconstruction plan and the establishment of competitiveness will inevitably remain linked to the Member States' own responsibility and willingness to undertake reforms.

8 For example, the Greek Prime Minister Kyriakos Mitsotakis has explicitly rejected linking EU aid to conditions, see https://www.reuters.com/article/us-health-coronavirus-greece-pm/greece-pm-says-wont-accept-strict-eu-conditions-on-covid-19-aid-ft-idUSKBN24604W.

VI Competitiveness through Competition

64. In the systems competition between the US and China, the EU relies on the model of the social market economy. It was previously agreed upon, that economic conditions should be created in such a way that the Member States can achieve competitiveness through competition in the common market and through openness to the outside world. This view has come under increasing pressure. There is a threat that the previous paradigm of European economic policy will be replaced by the idea of increased competitiveness through less competition, protection against competition from outside and state control through industrial policy at home. The retreat into Fortress Europe is looming.

65. The Kronberger Kreis advocates adhering to the proven paradigm of competitiveness through competition. This does not mean that the strategic trade and industrial policy of China and the United States should be dismissed or even negated. However, the instruments that can be used to counter the tactics involved are largely available. Above all, instead of trying to isolate, it is better to focus on openness through new trade and investment agreements.

66. Exercising its competences, the EU enforces the four fundamental freedoms of the European internal market in relation to the Member States. However, it is unclear to what extent the EU itself is bound by this. There is an increasingly dominant impression that the EU has the competence to restrict the application of the four fundamental freedoms to itself when this seems politically expedient. A high degree of evidence is therefore required to show that restrictions of the fundamental freedoms by the EU are appropriate, proportionate and necessary. Otherwise, such restrictions should not be allowed. The paradigm of freedom as an overreaching right also applies to the EU.

67. Following the guiding principle of competitiveness through competition entails the risk of Member States falling behind, ending up in less favourable conditions. In political terms, this means that centrifugal forces can be triggered, as was the case when the United Kingdom left the EU. The EU's reconstruction plan – although there is nothing to rebuild after the Corona crisis – aims to prevent this and to promote convergence between Member States.

68. Essentially, strengthening competitiveness means increasing overall economic productivity. In the developed economies of the EU, productivity gains can be achieved primarily through increases in non-price competitiveness, i.e., the regulatory framework set by labour market, social, tax and fiscal policy. However, these policy areas are essentially within the national competence and sovereignty of the Member States. Therefore, the responsibility for increasing the competitiveness of their economies lies predominantly with the Member States themselves.

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