GLOBAL X ETFs INSIGHTS

Powering Europe's Growth: How Infrastructure Investment can fuel Competitiveness

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From technology and decarbonisation to a shifting geopolitical landscape, it appears that the global economy is navigating a fundamental transformation, with industries and international trade dynamics being redefined. Europe is facing a challenging period, facing fierce competition in an extraordinarily dynamic global economy. One of the most impactful EU-focused reports on these issues over the past decade is Mario Draghi's study on Europe's competitiveness.[1] Commissioned by the European Commission, the former president of the European Central Bank was tasked with the challenging mission of delivering an impartial assessment of the continent's weaknesses and proposing ambitious recovery plans. Draghi's study outlines both the challenges and the vast opportunities for infrastructure spend – particularly in areas such as digitisation, decarbonisation and security.

Key Takeaways

- Mario Draghi's report highlights the critical need for significant investments in green initiatives, digital infrastructure, and defence capabilities to bridge Europe's annual €750 to €800 billion investment gap and sustain global competitiveness.[2]
- Investment in renewable energy, electric vehicle infrastructure, 5G networks, and cloud computing are aimed at accelerating Europe's decarbonisation and digitalisation efforts, potentially creating opportunities for both public and private infrastructure development sectors.[3]
- Updated regulations and the completion of the Capital Market Union (CMU) could facilitate greater capital flows into infrastructure projects, enabling startups and small and medium-sized enterprises (SMEs) to grow more efficiently, boosting innovation across the European Union (EU).[4]

Europe's Competitiveness: Navigating Challenges and Seizing Opportunities

Draghi's analysis reveals that Europe is falling behind its global competitors across important areas like innovation, technology adoption, and infrastructure development. While the U.S. and China are leading the way in artificial intelligence (AI), cloud computing, and advanced manufacturing, Europe's share of global research and development (R&D) in this space is decreasing. The EU's spending in R&D as a percentage of GDP was broadly stable over the past decade, only slightly rising from 2.08% in 2012 to 2.27% in 2022.[5] However, on a relative basis, the EU's R&D intensity over the same period remained well below its peers like South Korea (5.21%), the U.S. (3.59%), Japan (3.41%), and China (2.56%).[6] This widening gap is perhaps the primary reason for the stagnation in Europe's industrial activity, resulting in lower productivity growth compared to its global peers.[7]

One of the reasons for this shortfall, according to Draghi, is the lack of support for disruptive innovation. While Europe has arguably produced some of the best academics and innovators in the world, it appears to have struggled to convert new technologies into marketable successes. Consequently, innovation-oriented startups, hamstrung by burdensome regulation, fragmented markets and limited access to venture capital – often turn to the U.S. or Asia.

While the report appears somewhat concerning about the region's growth prospects, there remains hope. Strategic investments in infrastructure that target the drivers of the future economy, such as green energy, digital technologies and industrial innovation, could help to bridge Europe's annual investment gap of €750 to €800 billion which is needed to achieve the region's goal of carbon neutrality, full digitalisation and economic growth, the report confirms. Additionally, it would require the EU's investment share to increase from around "22% of GDP today to around 27%, reversing a multi-decade decline across most large EU economies," the report said.[5]

Infrastructure Investment as the Pathway to Recovery

In Draghi's report, it argued the case for increased investment in Europe's infrastructure to boost competitiveness, which includes both green and digital infrastructure, as the key to sustainable and resilient growth – and there are potentially many opportunities for public and private collaboration.

Green Infrastructure and Decarbonisation

The EU has pledged to become carbon neutral by 2050, meaning it needs to quickly and drastically cut its greenhouse gas emissions.[6] The continent's transition to carbon neutrality will be dependent on new investment in renewable energies, for example in wind, solar and hydro power, as well as in new and updated energy grids capable of storing and dispatching power when and where it is needed, making the whole energy ecosystem more efficient.

It promises to be an investment on a grand scale, but with equally large scope for public-private partnerships.[7] Through long-term contracts, tax incentives and simplified regulations, governments can offer private investment a credible and rewarding prospect. Alongside the European demand for renewable energy to spur, large-scale manufacturing, the need will continue to grow.

Moreover, there is also substantial investment potential in electric vehicle (EV) infrastructure. As part of the broader decarbonisation initiative, Europe is advocating for the widespread use of EVs, which will require significant investment in charging stations, battery technology and related infrastructure.[8]

Digital Infrastructure and Technological Innovation

Draghi's report also highlights the vital role of digital infrastructure in ensuring Europe's future competitiveness. While the digital transformation story continues to permeate all sectors of the economy, Europe has fallen behind its peers in adopting game-changing technologies such as 5G, cloud computing and AI. To close the gap on the technological sophistication of the U.S. and China, the EU will need to make sustained large-scale investments across these areas.

The fragmented nature of Europe's markets, making it difficult for tech companies to scale up, is another factor hindering Europe's digital competitiveness. To address this, Draghi suggests implementing a "28th regime", enabling startups to operate under a consistent set of regulations throughout the EU. This approach would allow Europe's tech capabilities to grow within the EU without having to move to the U.S. or China.[9]

The rollout of 5G infrastructure brings with it a wealth of potentially exciting opportunities. As 5G networks take shape in Europe, businesses may stand to gain from lightning-fast internet speeds, minimal lag times, and enhanced connectivity. These advantages could help fuel the next wave of technological innovation, powering advancements in the Internet of Things (IoT) and smart cities. Companies that invest in building out this infrastructure may potentially benefit as the demand for 5G-enabled services progress.

Meanwhile, Europe's cloud computing sector may expand as firms shift their operations to digital. Draghi's report speaks to the need for Europe to carve out its position in this market, stressing the importance of building data centres, developing cloud services and improving cybersecurity infrastructure which offer long-term growth potential, particularly as the demand for digital services continues to grow.

Capital Markets and Funding Innovation

A key aspect of Draghi's recommendations is the need to create a more unified capital market throughout the EU with the completion of the Capital Markets Union (CMU). By lowering regulatory barriers and simplifying investment rules among member states, the CMU could facilitate the flow of larger and more diversified sources of capital into infrastructure projects. This unification may also foster institutional investors, such as pension funds and insurance companies, to invest in long-term infrastructure development projects, particularly those that align with Europe's climate and sustainability goals.

Regulatory Simplification and Innovation Funding

Draghi points to over-regulation as a key hindrance to Europe's competitiveness. He calls for measures to simplify compliance, especially in the fast-growing sectors of digital technology and renewable energy, where new high-potential firms operate. A drive to harmonise EU regulation could make it easier for the companies to innovate, and for investors to commit capital to new start-ups.

Further, Draghi argues that more funding for innovation should continue to be managed at the EU level. The EU should build on the model of the Next Generation EU funds and issue common debt instruments that allow resources to be allocated to high-profitability projects, irrespective of where they are in Europe.[10] Investors may benefit from a more transparent and consistent funding mechanism, making it easier to identify and invest in the most promising infrastructure developments.

Investing in Europe's Future

Mario Draghi's report is unequivocal in calling for Europe to invest in its infrastructure to address competitiveness challenges over the next decade. Opportunities may exist across clean energy, digital infrastructure, and industrial innovation which have the potential to boost the region's economic prospects, especially given Europe's ambitious decarbonisation and digitalisation goals. European infrastructure development offers opportunities for long-term growth, supported by public and private initiatives. Prudent investments enabling Europe to upgrade its infrastructure can enable it to remain competitive on a global basis.

Footnotes

[1] Centre for European Reform . Draghi's Plan to rescure the European Economy. 17 September 2024.
[2] The Draghi Report: Future of EU's Industrial Strategy | BCG
[3] Ibid.
[4] Ibid.
[5] R&D expenditure - Statistics Explained (europa.eu)
[6] European Comission. 2050 long-term strategy. Accessed 29 September 2024.
[7] European Investment Bank, March 2024.
[8] Important decision ahead in EU's push for cleaner EV batteries.
[9] Parsing Europe's productivity stagnation (ft.com)
[10] Draghi's report on EU competitiveness: Five key takeaways | Euronews

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