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**Research Report**

## Future-proofing the EU's investment attractiveness: A bold reform agenda for competition enforcement, taxation and digital policy

ECIPE Occasional Paper, No. 04/2024

**Provided in Cooperation with:**

European Centre for International Political Economy (ECIPE), Brussels

*Suggested Citation:* Bauer, Matthias; Pandya, Dyuti; du Roy, Oscar (2024) : Future-proofing the EU's investment attractiveness: A bold reform agenda for competition enforcement, taxation and digital policy, ECIPE Occasional Paper, No. 04/2024, European Centre for International Political Economy (ECIPE), Brussels

This Version is available at:

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OCCASIONAL PAPER – No. 04/2024

# Future-proofing the EU's Investment Attractiveness: A Bold Reform Agenda for Competition Enforcement, Taxation and Digital Policy

By **Matthias Bauer** (*Director*), **Dyuti Pandya** (*Junior Analyst*),  
**Oscar du Roy** (*Junior Economist*).

## EXECUTIVE SUMMARY

Reducing the deterrent effects from EU and Member State laws in three key cross-sector policy areas – competition policy, business taxes and VAT, and digital policies – could significantly enhance the business environment within the Single Market and boost the EU's attractiveness to both domestic and foreign investors.

The EU's future competitiveness is at risk due to a significant disparity in investments, particularly in technological innovation, compared to the US. Despite having a larger population and labour force, the EU lags behind in large business activities, with US firms consistently outspending their European counterparts in key tech-intensive sectors such as software, computer services, pharmaceuticals, and biotechnology. Moreover, China and other emerging nations are rapidly catching up, dramatically diminishing the EU's relative economic and political influence on the global stage. The urgency for the EU to bridge these gaps is more critical than ever (**Section 2**).

The EU's profound investment gap highlights a systemic advantage for the US in fostering innovation and economic growth. The EU's regulatory complexity, largely driven by legal fragmentation in horizontal policies, further exacerbate the situation, deterring cross-border activities reducing the region's attractiveness to global investors (**Section 3**).

## EU Competition Policy in Support of Scale and Productivity

To enhance EU competition policy and reinforce productivity, the European Commission and national governments must distinguish between firms gaining market power through innovation versus firms engaging in anti-competitive practices, such as cartels. Harmonising competition enforcement across the EU will reduce compliance costs, foster a predictable business environment, and eliminate legal uncertainties, particularly critical for the digital economy's growth. A risk-based prioritisation framework should allocate resources to high-impact cases, such as cartels, ensuring timely and effective enforcement.

Strengthening institutional capabilities of the European Commission and courts is vital to maintain market fairness without stifling large enterprises. Additionally, a balanced, evidence-based approach to mergers accounting for global markets and competition could better promote consumer welfare and market efficiency. Reducing regulatory protectionism and compliance costs across sectors will free up resources for innovation, driving a more dynamic and competitive market environment (**Section 4**).

## Reassessing Taxation in Support of Economic and Technological Change

The EU's diverse VAT rates, labour income tax regimes, and social security rules create a complex legal environment that results in high compliance costs and administrative burdens, particularly for businesses operating across multiple Member States. This legal diversity encourages tax

evasion, undermines government revenues, and distorts economic activities. Simplifying and harmonising tax and social security regimes would significantly reduce these costs and legal risks, making the EU more attractive for investments by businesses of all sizes. It would facilitate smoother cross-border operations, enhance competition, and reduce opportunities for tax avoidance, thereby fostering a fairer economic environment.

Given the significant drawbacks of the current corporate income tax (CIT) systems, there is a strong case for abolishing corporate income taxes in the EU. This move would simplify tax code compliance, reduce administrative burdens, and enhance the EU's attractiveness for investment. To offset the relatively insignificant revenue loss, the EU could enhance other forms of taxation, such as taxes on capital income, labour income, and sales taxes. Additionally, direct support targeted at critical sectors like green technologies and R&D could replace opaque corporate tax incentives, ensuring funds reach intended sectors and promoting innovation and growth. This approach would support the EU's economic and environmental goals, while fostering a much more appealing investment climate (**Section 5**).

## **EU Digital and Technology Policy to Support Technology Adoption and Diffusion**

To navigate the digital economy, the EU must balance regulatory policies to foster innovation and growth, recognising digital policy as a key horizontal strategy essential for cross-sector advancement. Critical changes include reconsidering overly stringent data protection standards, promoting an innovation adoption-centric Digital Single Market, and actively engaging in global digital integration, especially with the US, to enhance competitiveness. Achieving a unified digital market requires broad policies to reduce cross-border barriers and regulatory costs.

Ensuring the free flow of data globally will remain vital for supporting innovation and technology diffusion. Well-drafted, evidence-based regulations are needed to protect consumer and human rights without stifling innovation. Encouraging advanced cloud computing and AI integration, including public services, would drive technological progress and foster a competitive, future-oriented European economy (**Section 6**).

## **Political Ambitions**

Implementing these reforms will demand significant political will, which may differ across the EU27. Coalitions of willing governments could initiate the process, showcasing the benefits and encouraging other Member States to follow. This phased approach would enable pioneering countries to lead by example, fostering broader acceptance and eventual adoption of the necessary reforms throughout the EU. Additionally, Member States could act independently on taxation, social insurance, and digital policies to achieve better economic governance and systemically enhance the competitiveness of their domestic economies.

# 1. INTRODUCTION

The European Union, once acclaimed for its principles of market economy, competition, and trade openness, faces significant challenges that threaten its foundational ideals and future economic vitality. Despite the core values enshrined in its legal framework, the EU's regulatory landscape has evolved in ways that increasingly reduces the competitiveness of EU-based companies and its attractiveness as a predictable investment destination.

Under the political leadership of Ursula von der Leyen, who took office as President of the European Commission in 2019, there has been a marked shift towards interventionist industrial, trade, and technology policies. This shift, exemplified by initiatives aimed at increasing the "EU's strategic autonomy" in the world, has introduced several complex and cumbersome regulations that often impede economic freedom and counteracts European industries' international competitiveness.<sup>1</sup>

Key economic and technological innovation indicators suggest that the EU is progressively falling behind when compared to major jurisdictions across the globe.<sup>2</sup> In our extensive research and analysis concerning the EU Single Market and trade policy, we have provided numerous recommendations aimed at enhancing the EU's long-term international competitiveness.<sup>3</sup>

In this paper, we concentrate on three central horizontal policies that urgently require reforms: EU competition policy, tax policies, and digital policies. We caution against political complacency, emphasising the necessity to make Europe significantly more attractive for private-sector investments which heavily rely on accommodating economic, trade, and technology policies, with benefits extending to large as well as smaller and growing enterprises. We consider these three policies as extremely important. Other policies to consider are capital market conditions and energy policies, which, however, fall outside the scope of this paper.

<sup>1</sup> See, e.g. ECIPE and Kearney (2022). Measuring the Impacts of the European Union's Approach to Open Strategic Autonomy. Available at <https://ecipe.org/wp-content/uploads/2022/11/Strategic-Autonomy-Impacts.pdf>. ECIPE (2022). The EU Digital Markets Act: Assessing the Quality of Regulation. Available at <https://ecipe.org/publications/the-eu-digital-markets-act/>. Bruegel (2024). A dataset on EU legislation for the digital world. Available at <https://www.bruegel.org/dataset/dataset-eu-legislation-digital-world>.

<sup>2</sup> See, e.g., McKinsey (2024). Accelerating Europe: Competitiveness for a new era. Available at <https://www.mckinsey.com/mgi/our-research/accelerating-europe-competitiveness-for-a-new-era#>. IMF (2024). Europe: Turning the Recovery into Enduring Growth. Available at <https://www.imf.org/en/News/Articles/2024/05/14/sp051424-alfred-kammer-at-the-ecb-house-of-the-euro-brussels>. McKinsey (2022). Securing Europe's competitiveness: Addressing its technology gap. Available at <https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/securing-europes-competitiveness-addressing-its-technology-gap>.

<sup>3</sup> See, e.g. ECIPE (2024). Reinventing Europe's Single Market: A Way Forward to Align Ideals and Action. Available at <https://ecipe.org/publications/reinventing-europes-single-market-align-ideals-and-action/>. ECIPE (2023). What is Wrong with Europe's Shattered Single Market? Lessons from Policy Fragmentation and Misdirected Approaches to EU Competition Policy. Available at [https://ecipe.org/wp-content/uploads/2023/04/ECI\\_23\\_OccasionalPaper\\_02-2023\\_LY04.pdf](https://ecipe.org/wp-content/uploads/2023/04/ECI_23_OccasionalPaper_02-2023_LY04.pdf). ECIPE (2022). The Impacts of EU Strategy Autonomy Policies – A Primer for Member States. Available at [https://ecipe.org/wp-content/uploads/2022/11/ECI\\_22\\_PolicyBrief\\_AutPol\\_09\\_2022\\_LY02.pdf](https://ecipe.org/wp-content/uploads/2022/11/ECI_22_PolicyBrief_AutPol_09_2022_LY02.pdf). ECIPE (2024). ICT Beyond Borders: The Integral Role of US Tech in Europe's Digital Economy. Available at <https://ecipe.org/publications/the-role-of-us-tech-in-europes-digital-economy/>. Also see ECIPE (2024). Openness as Strength: The Win-Win in EU-US Digital Services Trade. Available at [https://ecipe.org/wp-content/uploads/2024/03/ECI\\_24\\_PolicyBrief\\_05-2024\\_LY03.pdf](https://ecipe.org/wp-content/uploads/2024/03/ECI_24_PolicyBrief_05-2024_LY03.pdf).



Targeting these major horizontal policies, our analysis is guided by the following questions:

1. Is **EU competition policy** suitable for an era where innovation and productivity, driven by large enterprises, are paramount, or does it penalise its most productive, innovation-oriented and competitive industries?
2. Can the EU afford to maintain **complex and extremely cumbersome and costly business tax laws** that not only fail to ensure fair taxation but also discourage investment by innovative and productive technology companies?
3. How can the EU streamline **digital and technology policies** to enhance its appeal as a destination for technology-fuelled companies aiming to compete on a global scale?

While considerable political effort is often directed towards harmonising sector-specific policies, legal fragmentation remains a pervasive issue in horizontal policies affecting businesses across all sectors and technologies. Indeed, excessive regulation not only complicates business operations, but also builds barriers to commerce, hindering innovation and deterring investment. However, the imperative for regulatory reform extends beyond simply reducing regulatory red tape. It also encompasses the critical task of addressing policy fragmentation across the 27 EU Member States. In our recommendations, we underscore the urgency of reform and urge policymakers to act swiftly to harmonise horizontal policies to enhance Europe's competitiveness on the global stage.

The remainder of this paper is organised into several sections that delve deeper into specific regulatory areas: **Section 2** discusses the state of investment and implications for the EU's future competitiveness. **Section 3** provides an overview of determinants of a jurisdiction's investment attractiveness and discusses of the deterrent effect of regulation on investment decisions. **Sections 4, 5, and 6** are devoted to three key policy areas, where we see need for reform: EU competition policy, taxation policies, and digital policies respectively. Section 7 concludes.

## 2. THE STATE OF INVESTMENT AND IMPLICATIONS FOR THE EU'S FUTURE COMPETITIVENESS

In an increasingly interconnected and innovation-driven global economy, commercial investments in business operations (e.g., infrastructure and staff) and research and development (R&D) serve as the cornerstone for sustaining and enhancing future competitiveness. As industries evolve and technological advancements reshape global markets, the ability of firms to innovate becomes paramount for maintaining relevance and seizing new opportunities. Continuous investments not only foster product and process innovation but also cultivate a culture of adaptability and resilience, crucial qualities in navigating changing market environments. However, recent

analyses indicate a substantial disparity between the US and the EU in terms of commercial and technological R&D investments.<sup>4</sup>

While especially large US corporations demonstrate a proactive approach towards innovation, with firms consistently allocating significant resources to R&D activities, the EU businesses lag substantially behind. The relative attractiveness of the US in commercial R&D and capital investments becomes even more striking when considering the relative size of population and labour force between the two jurisdictions. As of 2023, the EU has a population of approximately 447 million and a labour force of about 220 million, compared to around 333 million people and a labour force of about 170 million in the US. Despite the EU's larger population and labour force, American firms consistently outstrip their European counterparts in R&D spending, highlighting a pronounced "systemic" advantage in corporate innovation and capital investment.<sup>5</sup>

## **2.1. Technology-intensive Investments: Benchmarking the EU against the US**

Recent data reveals that the cumulative R&D spending in the US in 2022 amounted to EUR 527 billion, significantly outpacing the EU's total of EUR 219 billion. For instance, the US corporations invested EUR 178 billion in Software & Computer Services and EUR 122 billion in Pharmaceuticals & Biotechnology, compared to the EU's EUR 14 billion and EUR 37 billion, respectively.

Furthermore, the cumulative capital expenditure (Capex) spending also highlights this disparity. In 2022, the US's total Capex spending was EUR 381 billion, compared to the EU's EUR 313 billion. These figures underscore a pronounced advantage for American firms in innovation investment, which is crucial for fostering long-term economic growth and competitiveness. This pronounced dichotomy underscores a pressing necessity for European policymakers and corporate stakeholders to pro-actively redress the prevailing asymmetry by devising and implementing strategies aimed at increasing R&D investments to ensure sustained competitiveness within the regional economic landscape (see Table 1 and Table 2).

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<sup>4</sup> ECIPE (2024) ICT Beyond Borders: The Integral Role of US Tech in Europe's Digital Economy. Available at: [https://ecipe.org/wp-content/uploads/2024/03/ECL\\_24\\_PolicyBrief\\_06-2024\\_LY03.pdf](https://ecipe.org/wp-content/uploads/2024/03/ECL_24_PolicyBrief_06-2024_LY03.pdf)

<sup>5</sup> World Bank data.

**TABLE 1: CUMULATIVE R&D SPENDING BY SECTOR IN EU AND US IN 2022, IN EUR BILLION**

EU		US	
Automobiles & Parts	72.8	Software & Computer Services	178.4
Pharma & Biotech.	37.0	Pharma & Biotech.	121.7
Tech. Hardware & Equipment	20.1	Technology Hardware & Equipment	109.2
Software & Computer Services	13.8	Automobiles & Parts	33.6
Electronic & Electrical Equip.	11.7	Health Care Equipment & Services	15.2
Aerospace & Defence	8.7	Electronic & Electrical Equipment	11.7
Industrial Engineering	7.1	Aerospace & Defence	9.4
Health Care Equipment & Services	7.1	General Industrials	6.3
Banks	6.5	General Retailers	5.6
Chemicals	5.5	Chemicals	5.0
Rest	28.8	Rest	30.5
<b>Total</b>	<b>219.2</b>	<b>Total</b>	<b>526.5</b>

Source: EU Industrial R&amp;D Investment Scoreboard 2023 (World 2,500)

**TABLE 2: CUMULATIVE CAPEX SPENDING BY SECTOR IN EU AND US IN 2022, IN EUR BILLION**

EU		US	
Automobiles & Parts	56.7	Software & Computer Services	104.1
Fixed Line Telecommunications	39.6	Technology Hardware & Equipment	71.3
Electricity	32.4	Automobiles & Parts	49.1
Oil & Gas Producers	28.7	Oil & Gas Producers	38.0
Gas, Water & Multiutilities	15.3	Pharmaceuticals & Biotechnology	24.0
Chemicals	14.8	Fixed Line Telecommunications	18.4
Travel & Leisure	14.6	Chemicals	10.8
Pharmaceuticals & Biotechnology	12.1	Health Care Equipment & Services	9.6
Electronic & Electrical Equipment	10.9	Food Producers	7.1
Technology Hardware & Equipment	9.9	Electronic & Electrical Equipment	6.9
Rest	77.8	Rest	42.0
<b>Total</b>	<b>312.7</b>	<b>Total</b>	<b>381.4</b>

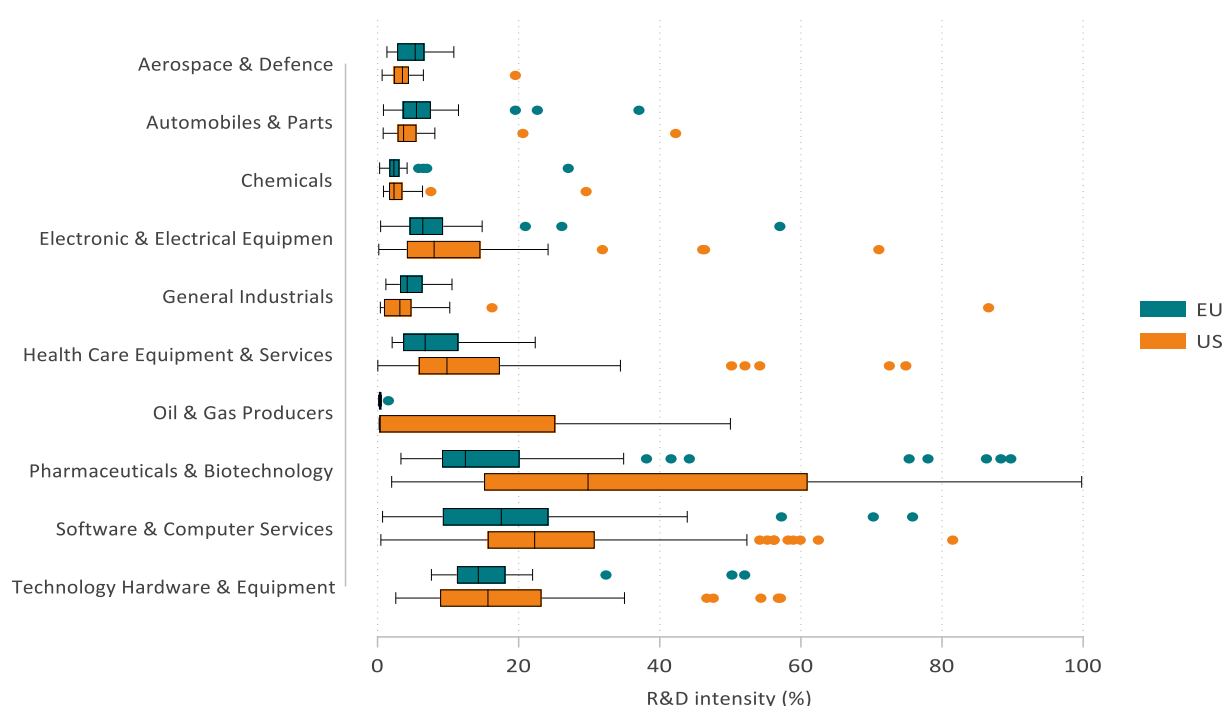
Source: EU Industrial R&amp;D Investment Scoreboard 2023 (World 2,500)



We also examine the metrics of Capital and R&D intensity (see Figure 1 and Figure 2), seeking insights into the investment performance of firms in both jurisdictions.<sup>6</sup> R&D intensity, a measure encompassing R&D and Capex spending relative to revenues, serves as a crucial indicator of the extent to which companies allocate resources towards innovation. This metric unveils the intricate interplay between risk-taking and innovation, as future-oriented companies typically channel earnings and external funds into research endeavours, anticipating solid returns in the future.<sup>7</sup>

The numbers also reveal a distinct disparity between the US and the EU regarding R&D intensity across various sectors. Specifically, sectors such as pharmaceuticals, biotechnology, software, ICT hardware, and healthcare exhibit markedly higher levels of R&D intensity in the US compared to their European counterparts. This discrepancy underscores a greater propensity among US firms to allocate a larger share of their revenues towards research and development activities. Consequently, sectoral averages for R&D intensity tend to be significantly higher in the US than in the EU. Similar patterns are found for capital intensity.

**FIGURE 1: R&D INTENSITY AMONG TEN MOST INNOVATIVE SECTORS IN EU AND US (5-YEAR AVERAGE, 2018-2022)**

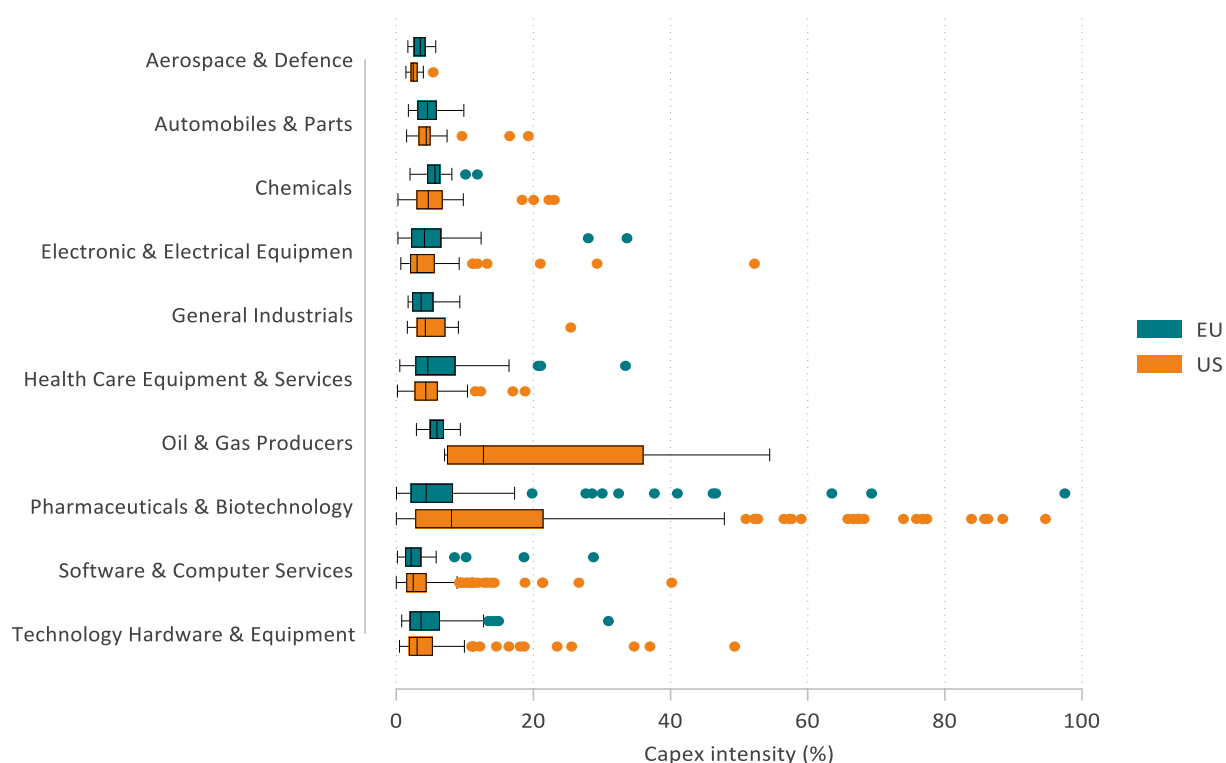


Source: authors' calculations based on the EU Industrial R&D Investment Scoreboard 2023 (World 2500). Note: For clarity reasons, the X-axis is capped at 100 percent, due to the presence of outliers. Less than 25 percent of the firms in the dataset have been omitted.

<sup>6</sup> Comparing the economic performance of the EU to the US provides a valuable means of evaluating the EU's economic development and competitiveness. Both regions share market economy principles and have a deep-rooted transatlantic relationship. By benchmarking against the US, policymakers can identify areas of strength and weakness within the EU's economy, helping to inform decisions aimed at improving competitiveness, attracting investment, and fostering economic growth and structural economic change.

<sup>7</sup> Our analysis encountered a notable challenge stemming from outliers, exemplified by companies such as Arena Pharmaceuticals, whose R&D intensity figures exhibit extreme values. These outliers, with their exceptionally high R&D intensity readings, significantly skew sector averages, rendering them unreliable as indicators of overall sectoral performance. To address this issue, we opted for a more nuanced approach, focusing on the distribution of R&D intensity across sectors. By employing visualisation techniques such as box plots, we were able to present a more accurate representation of sectoral performance, excluding outliers and thus providing a clearer understanding of prevailing investment trends.

**FIGURE 2: CAPEX INTENSITY AMONG TEN MOST INNOVATIVE SECTORS IN EU AND THE US (5-YEAR AVERAGE, 2018-2022)**



Source: authors' calculations based on the EU Industrial R&D Investment Scoreboard (World 2500). Note: For clarity reasons, the X-axis is capped at 100 percent, due to the presence of outliers. Less than 5 percent of the firms in the dataset are omitted.

## 2.2. The EU's Attractiveness to Foreign Investors

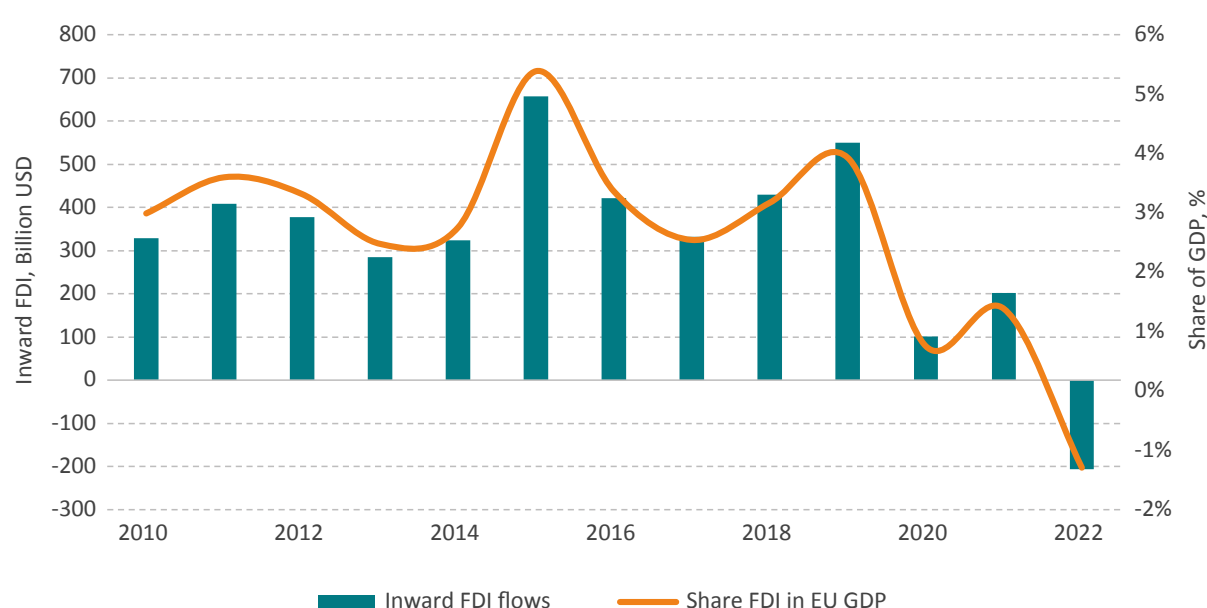
Foreign Direct Investment (FDI) is crucial for a jurisdiction's long-term competitiveness, positively impacting productivity growth by introducing new technologies, expertise, and capital, fostering a skilled workforce, and increasing competition.

Data on EU inward FDI from 2010 to 2022 reveals significant fluctuations, with notable spikes in 2015 and 2019, reaching USD 658 billion and USD 550 billion, respectively. However, recent years have shown a dramatic decline, with FDI dropping to USD 101 billion in 2020 (largely a reflection of the economic impacts of the COVID-19 pandemic) and EUR 203 billion in 2021, representing only 1 percent of GDP each year. Moreover, 2022 saw a net disinvestment of EUR 206 billion, equating to approx. 1 percent of GDP. This downward trend suggests increasing investment uncertainties, regulatory challenges, and, overall, a reduced attractiveness of the EU as an investment destination (see Figure 3).

Globally, FDI totalled USD 1.3 trillion in 2022, which was 34 percent above 2020 levels, reflecting a robust post-COVID recovery. However, there was a year-on-year decrease of 14.3 percent compared to 2021. The EU27 significantly contributed to this global decline. Despite the overall

decline in FDI inflows, the cumulated number of foreign transactions into the EU27 displayed an increasing trend between 2015 and 2022, with an average yearly number of 2,200 foreign acquisitions and 3,200 greenfield investments.<sup>8</sup> However, the second half of 2022 saw a significant fall in deal-making due to economic slowdowns and rising financing costs driven by higher interest rates implemented by central banks to control inflation. Inflationary pressures, worsened by Russia's war against Ukraine and the resulting impact on energy and commodity prices, along with widespread supply chain disruptions, led investors to adopt a more prudent approach, waiting for more favourable conditions. These factors collectively contributed to the weakening confidence in the EU as an investment destination.<sup>9</sup>

**FIGURE 3: INWARD FDI FLOWS, ABSOLUTE TERMS AND SHARE IN % OF GDP**

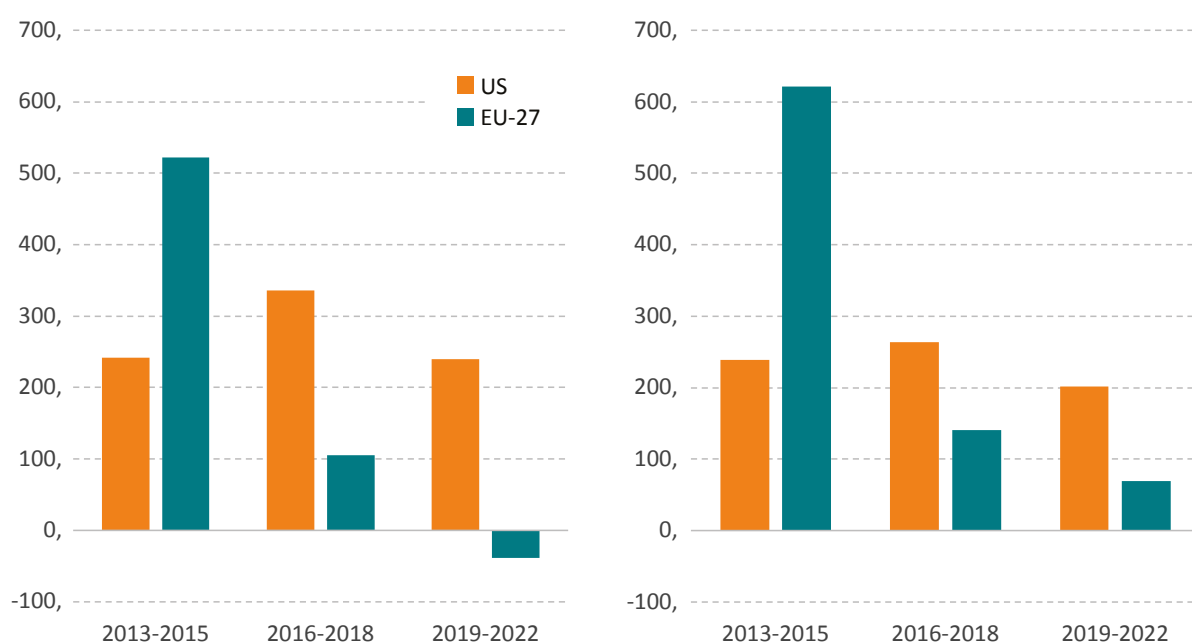


Source: OECD and Eurostat, ECIPE calculation.

Recent FDI data also reveals a stark contrast in investment flows between the EU and the US from 2013 to 2022 (see Figure 4). The EU experienced a dramatic decline in both inward and outward investments, with inward investments dropping from EUR 621 billion to EUR 69 billion, and outward investments plummeting from EUR 522 billion to a net disinvestment of some EUR 38 billion. In contrast, the US maintained relatively stable investment patterns, with inward investments peaking at EUR 264 billion and only slightly decreasing to EUR 202 billion, while outward investments peaked at EUR 336 billion and later settled at EUR 240 billion. This significant disparity also underscores potential economic or policy challenges within the EU, highlighting the need for a reconsideration of broader economic policies to enhance its investment attractiveness and the international competitiveness of EU-based corporations.

<sup>8</sup> Report from the Commission to the European Parliament and the Council : Third annual report on the screening of foreign direct investments into the Union. (2023) COM(2023) 590 final. Available at: <https://data.consilium.europa.eu/doc/document/ST-14427-2023-INIT/en/pdf>

<sup>9</sup> *ibid*

**FIGURE 4: INWARD AND OUTWARD (RIGHT) FDI FLOWS, THREE-YEAR AVERAGES, IN BILLION EUROS**

Source: Authors' calculations based on Eurostat.

While the EU aims to create a unified market, its regulatory complexity and legal fragmentation increase legal uncertainty, affecting investment decisions. Despite the EU's political ambitions to create a unified market, regulatory complexity and legal fragmentation often deter investments. Regulatory complexity, bureaucratic obstacles, and varying national policies impede investment and economic growth within the EU. Regulatory uncertainty introduces risks regarding the potential revenue from projects, which decreases their feasibility and thus dampens investment, private sector engagement, and innovation.

In contrast, emerging economies are becoming increasingly attractive to investors as they enhance their economic and technological capabilities and improve the quality of their institutions. These countries are implementing reforms to streamline business operations, reduce regulatory burdens, and foster a more conducive environment for investment, thus drawing attention away from the EU.

Generally, legally fragmented markets reduce the incentives for producers to invest by shrinking the potential size of the market, making substantial investments in research and development or new production facilities increasingly uncertain and risky<sup>10</sup> Based on feedback from corporations, several major business associations (EuroCommerce, Business Europe, ERT, DIGITALEUROPE, and Eurochambres) have voiced concerns about the European economy's downturn and the EU's failure to effectively deepen the Single Market over the last decade. They point out that the

<sup>10</sup> See, e.g., European Investment Bank (2024). Investment barriers in the European Union 2023 - A report by the European Investment Bank Group. Available at [https://www.eib.org/attachments/lucalli/20230330\\_investment\\_barriers\\_in\\_the\\_eu\\_2023\\_en.pdf](https://www.eib.org/attachments/lucalli/20230330_investment_barriers_in_the_eu_2023_en.pdf).

Single Market no longer functions as a true free trade area due to inconsistent implementation of EU laws across member states and obscured enforcement mechanisms against national regulations that lead to market fragmentation. This situation hinders companies' expansion and innovation capabilities, particularly affecting SMEs struggling with high compliance costs.<sup>11</sup>

A recent survey-based study by the European Investment Bank demonstrates the economic significance of uncertainty for investment decisions. European firms perceiving uncertainty as a major impediment are more likely to reduce investment and less likely to increase investment, with negative impacts on employment (growth).<sup>12</sup> Even though the measure of uncertainty goes beyond regulatory complexity and uncertainty about regulatory changes in the EU, the study findings indicate that prolonged uncertainty can have large very negative economic consequences.

### **2.3. EU Regulations Undermining Public R&D Incentives**

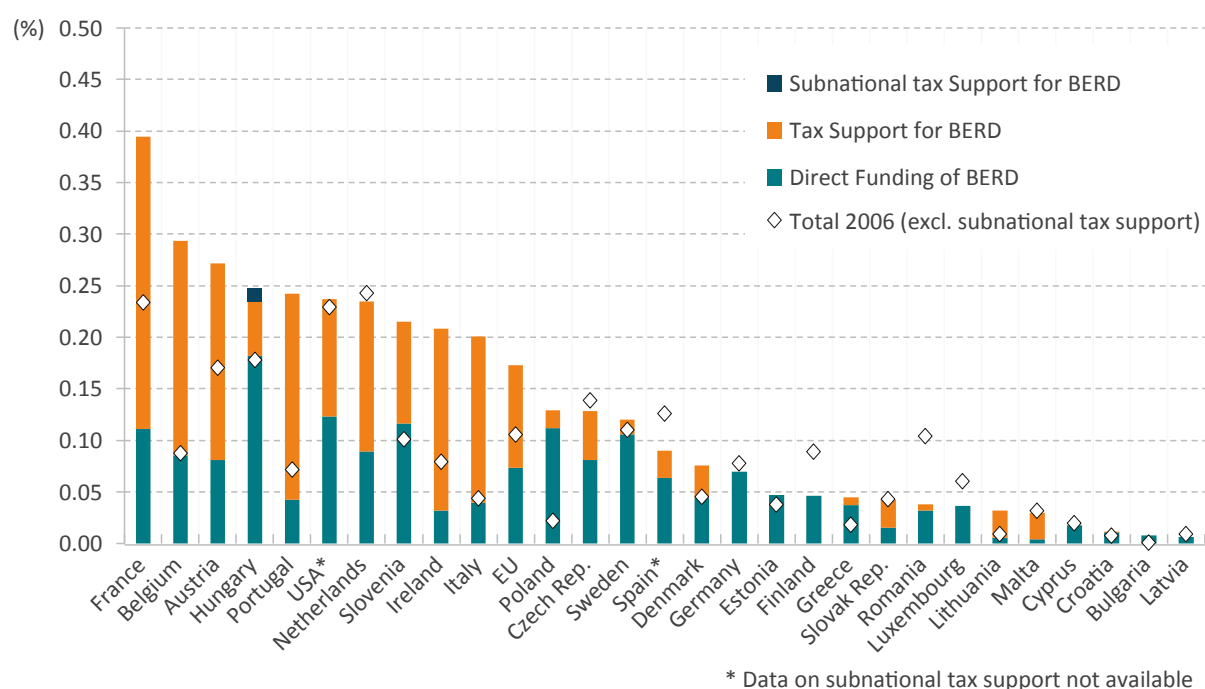
Despite substantial government support for R&D through tax incentives and direct funding, the EU continues to lag behind, raising concerns about the effectiveness of these incentives and suggesting that they may constitute a waste of taxpayers' money.

Between 2006 and 2019, government support for business R&D expenditure as a percentage of GDP increased in 19 EU countries and the US. This support is provided through two main channels: direct funding and tax incentives. The EU allocates a greater proportion of this support through tax incentives (EUR 13 billion) compared to direct funding (EUR 10 billion), while the US maintains a more balanced approach, with 52 percent of support coming from direct funding and the rest from tax incentives (see Figure 5). This indicates that both regions recognise the importance of R&D for economic growth, though they differ in their methods of support.

<sup>11</sup> See, e.g., EuroCommerce (2022). Fresh political engagement required to renew economic integration in the Single Market. For an overview of major barriers to the free movement of goods, services, capital and people in the Single Market, see ERT (2024). ERT Single Market Stories. Available at <https://ert.eu/single-market/stories/>; ERT (2024). Single Market Obstacles - Technical Study. Available at [https://ert.eu/wp-content/uploads/2024/02/ERT-Single-Market-Obstacles\\_Technical-Study\\_WEB.pdf](https://ert.eu/wp-content/uploads/2024/02/ERT-Single-Market-Obstacles_Technical-Study_WEB.pdf).

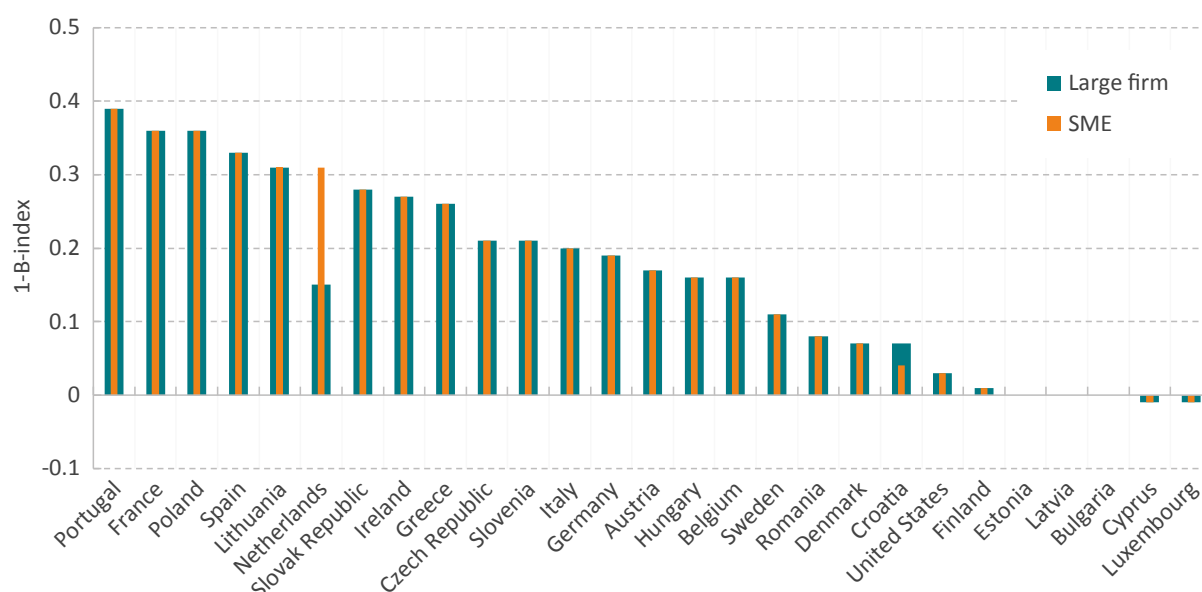
<sup>12</sup> European Investment Bank (2024). The effect of uncertainty on investment Evidence from EU survey data April 2024. Available at [https://www.eib.org/attachments/lucalli/20240131\\_economics\\_working\\_paper\\_2024\\_02\\_en.pdf](https://www.eib.org/attachments/lucalli/20240131_economics_working_paper_2024_02_en.pdf).

**FIGURE 5: DIRECT GOVERNMENT FUNDING AND GOVERNMENT TAX SUPPORT FOR BUSINESS R&D, 2019 AND 2006 (PERCENTAGE OF GDP)**



Source: OECD.

In 2022, the implied tax subsidy rate for R&D expenditure, measured by the B-Index, reveals the extent of preferential tax treatment for R&D investments (see Figure 6). A higher implied subsidy rate means more generous tax provisions, reducing the cost of R&D for businesses. For example, an implied subsidy rate of 0.1 indicates a 10 percent reduction in R&D investment costs due to tax incentives. These rates highlight how tax policies can significantly lower the financial barriers for businesses investing in R&D, promoting innovation and enhancing global competitiveness. Despite the higher implied tax subsidy rates for R&D expenditure in many EU Member States, including large countries such as France and Spain (with rates between 0.3 and 0.4), the US continues to see significantly more investment in R&D, even with a much lower rate of 0.1. This paradox highlights the limitations of relying solely on tax incentives to stimulate R&D investment.

**FIGURE 6: IMPLIED TAX SUBSIDY RATES ON R&D EXPENDITURE IN 2022 (1-B-INDEX, FOR PROFITABLE FIRMS)**

Source: OECD.

The pronounced advantage of US-based firms in both R&D and capital expenditure underscores the urgent need for European policymakers to re-evaluate accompanying policy strategies. The EU's recent decline in FDI and the lower R&D intensity across key sectors highlights systemic issues that current policies have failed to address. Rather than continuing with ineffective R&D incentives that do not translate into competitive investment levels, the EU should focus on creating a more conducive environment for innovation and investment through streamlined regulations, harmonised tax codes, and enhanced digital policies. Only by addressing these fundamental challenges can the EU hope to close the gap with the US and ensure long-term economic dynamism and international competitiveness.

### 3. REGULATION AND THE DETERRENT EFFECTS ON INVESTMENTS

Under the von der Leyen Commission, the EU has emphasised strategic autonomy and industrial policy initiatives, shifting focus away from legal harmonisation and structural reforms to improve the international competitiveness of Member State economies.<sup>13</sup> This shift towards increasing legal intervention reduces the EU's long-term investment attractiveness, especially as global economic, trade, and technological capabilities rapidly advance, increasing economic gravity for global investment flows. Over the past decade, emerging market economies have significantly improved their technological and economic capabilities. Key factors driving this

<sup>13</sup> See, e.g. ECIPE (2024). Reinventing Europe's Single Market: A Way Forward to Align Ideals and Action. Available at <https://ecipe.org/publications/reinventing-europes-single-market-align-ideals-and-action/>. ECIPE (2023). What is Wrong with Europe's Shattered Single Market? Lessons from Policy Fragmentation and Misdirected Approaches to EU Competition Policy. Available at [https://ecipe.org/wp-content/uploads/2023/04/ECI\\_23\\_OccasionalPaper\\_02-2023\\_LY04.pdf](https://ecipe.org/wp-content/uploads/2023/04/ECI_23_OccasionalPaper_02-2023_LY04.pdf).



growth include substantial investments in technology, enhanced economic policies, and the increasing global competitiveness of large companies within these markets.<sup>14</sup>

The EU's comprehensive regulatory framework and ambition to influence global trade and technology standards often result in legal uncertainty for businesses, impacting capital risk in several ways:

- Ambiguous or frequently changing regulations in the EU increase compliance costs and diminish profitability, as businesses must allocate significant resources to navigate complex and varying rules across Member States, which is especially burdensome for companies operating in multiple countries. The ERT survey, titled "ERT Single Market Stories," offers numerous clear examples, ranging from plastic production and standards for new medicines to regulations for elevators.<sup>15</sup>
- Regulations also cause operational delays by creating bureaucratic obstacles and necessitating legal clarifications, adversely affecting time-sensitive business opportunities and reducing competitiveness. For example, biopharmaceutical manufacturers introducing the same new medicine in different EU countries face time and financial losses due to inconsistent evidence requests, leading to higher costs. Ultimately, this undermines the EU's competitiveness and attractiveness for pharmaceutical innovation.<sup>16</sup>
- An unpredictable regulatory environment makes investors cautious, leading to reduced investment inflows as businesses and investors prefer more stable and predictable settings.<sup>17</sup>

Overall, the EU faces substantial challenges with complex, often vague regulations and legal fragmentation across Member States, amplified by linguistic diversity. This necessitates additional resources for legal counsel, translation, and compliance management, further increasing operational costs. Meanwhile, companies in the US benefit from clearer regulations, which, despite some state-level differences, are easier to navigate due to the common language. The EU, with its 27 countries and 24 official languages, faces significant trade and business challenges due to its linguistic diversity.<sup>18</sup> Unlike the US, where English potentially mitigates the negative impacts of internal regulatory barriers, the EU's linguistic diversity and legal fragmentation require additional resources for translation, legal counsel, and compliance

<sup>14</sup> See, e.g., McKinsey (2018). Outperformers: High-growth emerging economies and the companies that propel them. Available at <https://www.mckinsey.com/featured-insights/innovation-and-growth/Outperformers-high-growth-emerging-economies-and-the-companies-that-propel-them>.

<sup>15</sup> ERT (2024). ERT Single Market Stories. Available at <https://ert.eu/single-market/stories/>; ERT (2024). Single Market Obstacles - Technical Study. Available at [https://ert.eu/wp-content/uploads/2024/02/ERT-Single-Market-Obstacles\\_Technical-Study\\_WEB.pdf](https://ert.eu/wp-content/uploads/2024/02/ERT-Single-Market-Obstacles_Technical-Study_WEB.pdf).

<sup>16</sup> See, e.g., ERT (2024). What's in a pill? Why the EU needs a single approach to assessing innovative medicines. Available at <https://ert.eu/single-market/stories/whats-in-a-pill/>.

<sup>17</sup> See, e.g., European Investment Bank (2024). The effect of uncertainty on investment Evidence from EU survey data April 2024. Available at [https://www.eib.org/attachments/lucalli/20240131\\_economics\\_working\\_paper\\_2024\\_02\\_en.pdf](https://www.eib.org/attachments/lucalli/20240131_economics_working_paper_2024_02_en.pdf).

<sup>18</sup> See, e.g., EPRS (2018). Languages and the Digital Single Market. Available at [https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/625197/EPRS\\_BRI\(2018\)625197\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/625197/EPRS_BRI(2018)625197_EN.pdf).

management. This results in higher operational costs and complexities, impacting business efficiency and trust in the Single Market.<sup>19</sup>

Moreover, the EU's regulatory approach, emphasising preventive action to avoid harm – embodied in the precautionary principle – can result in over-regulation and stifle innovation, particularly in areas like GMOs, chemicals, and AI. By contrast, US policymakers have historically placed less emphasis on the precautionary principle, allowing for faster innovation and business churn.<sup>20</sup> A general overview of determinants of investment risks for globalised businesses and differences between the EU and the US is provided in Table 3.

**TABLE 3: OVERVIEW OF DETERMINANTS OF MAJOR INVESTMENT RISKS FOR GLOBALISED BUSINESSES**

Determinant	Description	Potential Weaknesses in the EU	United States Performance
<b>Regulatory Framework</b>	The extent and clarity of regulations governing business operations, financial markets, and investor protections.	Complex and often vague regulations, frequent changes in EU and national policies, high compliance costs, especially driven by legal fragmentation across Member States.	Less regulatory restrictiveness, but heavy regulation in some sectors (e.g., healthcare, finance); state-level differences can create fragmentation but mitigated due to common language across US Federal States.
<b>Legal Environment</b>	The strength and predictability of a country's legal system, including property rights and contract enforcement.	Variability in legal enforcement across Member States, lengthy judicial processes (e.g., delays in Italy and Greece), legal fragmentation across the EU.	Stronger legal protections and contract enforcement, but complex regulatory landscape can pose challenges; state-level legal differences, even though less deterrent due to common language.
<b>Political Stability</b>	The likelihood of political events such as elections, government changes, or civil unrest affecting investment returns.	Rise of populist movements, political fragmentation, and Brexit-like events.	Stable overall, but political polarisation and recent events (e.g., government shutdowns, Capitol riot) cause concerns.
<b>Economic Development (sometimes referred to as Stability)</b>	The overall health of a country's economy, including factors like GDP growth, inflation rates, and employment levels.	Slow GDP growth in some member states (e.g., Italy), high unemployment rates in certain regions (e.g., Spain).	Generally strong GDP growth, but susceptible to cyclical recessions (e.g., 2008 financial crisis, COVID-19 pandemic impacts).
<b>Currency Risk</b>	The potential for losses due to fluctuations in exchange rates.	Weakening Euro due to economic disparities among member states, concerns over ECB policies.	US Dollar is a global reserve currency, generally stable, but trade imbalances and Fed policies can impact strength.
<b>Credit Risk</b>	The risk that a borrower will default on their financial obligations to investors.	High levels of public and private debt in some member states (e.g., Greece's sovereign debt crisis).	Generally lower credit risk, but high national debt and budget deficits pose long-term risks.

<sup>19</sup> ERT (2021) Renewing the dynamic of European integration: Single Market Stories by Business Leaders. Available at: [https://ert.eu/wp-content/uploads/2021/12/ERT-Single-Market-Stories\\_WEB-low-res.pdf](https://ert.eu/wp-content/uploads/2021/12/ERT-Single-Market-Stories_WEB-low-res.pdf)

<sup>20</sup> In the US, bipartisan hesitation to regulate has often been a notable feature of the policy landscape. While the US approach to regulation has fostered a robust innovation ecosystem, it has also highlighted the need for a balanced regulatory framework that can mitigate the risks associated with rapid technological and market changes.

Determinant	Description	Potential Weaknesses in the EU	United States Performance
<b>Corporate Tax</b>	The tax rate imposed on the income or profit of corporations, and the complexity of tax code.	High corporate tax rates in some countries (e.g., France) and tax code complexity and fragmentation, which can deter investment, tax rate differences and legal fragmentation across member states.	Complex tax codes, but lower corporate tax rates after the 2017 Tax Cuts and Jobs Act, and ongoing debate about tax reforms; differences in state corporate tax rates.
<b>Labour Tax</b>	Taxes imposed on wages and salaries, including payroll taxes.	High labour taxes and social security contributions in many member states (e.g., Germany, Belgium), and significant legal fragmentation across the EU.	Moderate labour taxes, but significant differences across states; social security taxes can be substantial.
<b>Sales Taxes</b>	Taxes imposed on the sale of goods and services, including VAT and excise duties.	High VAT rates in many countries (e.g., Sweden, Denmark), legal fragmentation in VAT policies across the EU.	Generally lower sales taxes compared to the EU, but varies by state; no national VAT.
<b>Social Security Law</b>	Laws and regulations related to social security benefits, pensions, and welfare programs.	Generous social security benefits, but high associated costs for employers and employees (e.g., in France, Italy), substantial legal fragmentation in social security systems across the EU.	Social security system is substantial but easier to navigate due to common language.
<b>Competition Policy and Mergers</b>	Regulations aimed at promoting competition and regulating mergers and acquisitions.	Strict competition policies, sometimes leading to long approval processes for mergers (e.g., EU antitrust cases). Less emphasis on consumer welfare standard and bias against large businesses and merges respectively.	Strong antitrust enforcement based on consumer welfare standard.
<b>Innovation and Technology Diffusion</b>	The ability of a country to foster innovation and spread new technologies throughout the economy.	Variability in innovation capacity across member states; bureaucratic hurdles can slow technology adoption, legal fragmentation across the EU.	Strong innovation ecosystem, leading in many tech sectors, but faces challenges from global competition. Political hesitance to impose new obligations on innovative industries.
<b>Precautionary Principle in Regulation</b>	Regulatory approach that emphasises preventive action in the face of uncertainty, to avoid harm to health or the environment.	Can lead to over-regulation and stifle innovation (e.g., restrictions on GMOs, chemicals, AI), legal fragmentation in applying the precautionary principle, e.g., in environmental policies and environmental standards.	Less emphasis on the precautionary principle, potentially allowing for faster innovation but with higher risk.
<b>Professional Qualifications</b>	Standards and requirements for professional certifications and qualifications.	Diverse and often non-harmonised professional qualification standards across member states, leading to legal fragmentation.	Generally less restrictive professional standards, but high standards in critical professions, supporting higher level of labour mobility.
<b>General Incentives to Work</b>	Overall incentives for workforce participation, including wages, benefits, and work conditions.	High taxation and generous welfare benefits can reduce incentives to work.	Competitive wages and benefits, but some regulatory disparities exist; some states have minimum wages and labour market policies, which are easier to navigate for workers due to common language.

Source: compilation by ECIPE.

Considering the above, much needs to be done policy-wise in the EU to enhance Member States' investment attractiveness and foster economic growth. Below, we focus on areas where meaningful changes in EU and Member State legislation could benefit industries across all Member States and all sizes of corporations.

Reducing the deterrent effect from EU and Member State laws in three key horizontal (cross-sector) EU policy areas – competition policy, business taxes and VAT, and digital policies – could significantly enhance the business environment within the Single Market and increase the EU's attractiveness to both domestic and foreign investors.

Streamlining competition policies would support the growth of large, competitive firms, and their ability to innovate and compete on global markets. Simplifying and harmonising the tax framework would create a more predictable investment climate. Revisiting digital policies to balance protection with innovation would foster a favourable environment for high-tech investments. Overall, material changes to existing legal regimes in these areas would drive economic growth and innovation, and thereby increase the economic competitiveness of EU Member States.

Table 4 provides a summary of key issues and the expected benefits of reducing regulatory deterrents in major EU horizontal policy areas. A more detailed discussion is provided in the following sections.

**TABLE 4: KEY ISSUES AND EXPECTED BENEFITS OF REDUCING REGULATORY DETERRENTS IN MAJOR EU HORIZONTAL POLICY AREAS**

<b>Competition policy</b>	
<p><b>Current issues:</b></p> <p>The EU's strict competition policies, particularly those aimed at preventing anti-competitive mergers, often result in lengthy approval processes for mergers and acquisitions. This regulatory environment, while intended to maintain market fairness, can stifle the growth and scalability of European companies. The emphasis on preventing large enterprise formations, even when such mergers could enhance global competitiveness, creates a bias against big businesses. This is counterproductive given the evidence that large companies drive innovation, create high-quality jobs, and enhance overall productivity.</p>	<p><b>Expected Benefits</b></p> <p>By streamlining national competition policies and focusing more on global competitiveness rather than just intra-EU competition, the EU can facilitate the growth of large firms capable of competing on the international stage. Prioritising the creation of a level playing field, while abstaining from protectionism and discrimination based on foreign origin, ensures fair competition and enhances the EU's attractiveness for global business.</p>
<b>Business and sales taxes</b>	
<p><b>Current issues:</b></p> <p>The EU's complex and fragmented tax framework, characterised by high corporate tax rates and diverse VAT regulations across member states, imposes significant compliance costs and operational challenges. This complexity leads to high administrative burdens, which diminish profitability and deter both domestic and foreign investment. The variability in tax rates and regulations creates an unpredictable business environment, further discouraging investment.</p>	<p><b>Expected Benefits:</b></p> <p>Simplifying and harmonising business taxes and VAT across the EU would create a more predictable and attractive investment climate. A more competitive and uniform tax regime would lower compliance costs and administrative burdens, making it easier for businesses to operate across multiple member states. This would not only attract more foreign direct investment but also encourage domestic firms to reinvest their earnings into growth and innovation, stimulating economic activity and enhancing the EU's global competitiveness.</p>
<b>Digital policies</b>	
<p><b>Current issues:</b></p> <p>The EU's digital regulatory environment, while aiming to protect consumers, often inadvertently stifles innovation. Regulations like the General Data Protection Regulation (GDPR) and the Digital Markets Act (DMA), although essential for ensuring data privacy and fair competition, can impose significant compliance costs and operational challenges on businesses, particularly in dynamic and fast-evolving sectors.</p>	<p><b>Expected benefits:</b></p> <p>Revisiting and adjusting digital policies to better balance protection with innovation is crucial. Enhancing digital infrastructure, aligning data protection standards with global norms, and investing in digital skills would create a more favourable environment for high-tech investments. Reducing the regulatory burden on digital businesses would empower EU companies to lead in digital transformation, enhancing their competitiveness and attracting significant investment in technology sectors. This would ensure that the EU remains at the forefront of the global digital economy, driving long-term growth and innovation.</p>

Source: compilation by ECIPE.

## 4. EU COMPETITION POLICY

The traditional approach of the EU to competition policy has addressed anti-competitive behaviour through case-by-case investigations, merger reviews, and legal proceedings, ensuring targeted enforcement. This approach allowed for tailored responses to specific market conditions and behaviours, maintaining competitive markets effectively without over-regulation.

At the same time, the EU's stringent merger policies have been criticised for being too restrictive, potentially hindering the competitiveness and innovation of European firms compared to their global counterparts. Overly stringent merger policies can also deter investors from supporting small tech companies due to the perceived risks and limitations associated with potential mergers and acquisitions. Investors may be reluctant to provide funding to start-ups and smaller firms if they believe that future growth opportunities through mergers or acquisitions will be stifled by regulatory hurdles. This is important as investments and acquisitions by large technology companies have a positive impact on initial seed funding and, generally, venture capital investments (worldwide).<sup>21</sup> A lack of investment support can hinder the development and scaling of innovative tech companies, ultimately preventing the emergence of a dynamic and thriving tech ecosystem akin to "Silicon Valley in Europe". Without the ability to grow and consolidate, small tech firms may struggle to compete on a global scale, hindering the overall advancement and competitiveness of the European tech sector.

With the introduction of the Digital Markets Act (DMA) in 2022, the EU imposed broad though untested ex-ante regulations on large technology companies. While the DMA formally aims to enhance competition, its broad and prescriptive approach has been criticised for stifling innovation and imposing disproportionate burdens on designated "gatekeepers" and less choice for European users of digital services.

Rapidly evolving global markets and technological advancements necessitate a reassessment and enhancement of EU merger policies and the DMA to ensure that access to new technologies remains conducive to economic growth. With respect to mergers and acquisitions, Enrico Letta and Mario Draghi have recently called for a re-thinking on the EU competition enforcement which should allow for market consolidation and creation of European Champions. Previously, in a joint paper, the governments of Germany and France had proposed new objectives to enhance EU's competitiveness. The underlying ambitions include making Europe an industrial and technological powerhouse by removing unjustified

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<sup>21</sup> See, e.g., Prado and Bauer (2022). Big Tech platform acquisitions of start-ups and venture capital funding for innovation. Available at <https://www.sciencedirect.com/science/article/pii/S0167624522000129>. Also see American Bar Association (2023). Merger Enforcement Considerations – Implications for Venture Capital Markets and Innovation. June 2023. Available at [https://www.americanbar.org/groups/antitrust\\_law/resources/source/2023-june/merger-enforcement-considerations/](https://www.americanbar.org/groups/antitrust_law/resources/source/2023-june/merger-enforcement-considerations/).

barriers, promoting industrialisation, and increasing investments.<sup>22 23</sup> However, the EU and Member State authorities should avoid redesigning merger policies solely to benefit EU-headquartered companies. Instead, competition policies should be crafted to allow for mergers and acquisitions involving EU companies and those based in non-EU market economies, ensuring a level playing field. Asymmetric regulations that privilege companies with an EU passport could lead to protectionism, limiting the potential for beneficial international collaborations and innovation.

## 4.1. How Large Firms Drive Innovation and Productivity in the EU

The EU's competition policy must acknowledge the significant role that large companies play in driving economic growth and delivering societal benefits (see Table 5). An excessively stringent antitrust approach can inadvertently stifle the economic and technological advantages these firms provide.<sup>24</sup> One major benefit is the positive productivity spillovers that large firms confer on smaller enterprises.<sup>25</sup> For instance, a recent study indicates that when a supplier engages with a larger firm, its Total Factor Productivity (TFP) increases by 7 to 9 percent, and its sales grow by 25 percent within four years of the partnership.<sup>26</sup> These benefits are unique to relationships with large companies, highlighting their critical role in enhancing economic productivity and fostering growth. Consequently, it is imperative for governments to support large enterprises or minimise barriers to grow organically rather than excessively regulate their business practices. Against this background, it should also be noted that the EU has a gap in the number of large companies relative to the US. In 2021, this gap amounted to 19 percent when adjusted for the size of the US and EU27 populations (see Figure 7).

<sup>22</sup> A new agenda to boost competitiveness and growth in the European Union. Available: <https://www.bundesregierung.de/resource/blob/975226/2288870/c080323912f0e4229d1dbb5ae8333879/2024-05-28-deu-fra-papier-eng-data.pdf?download=1>

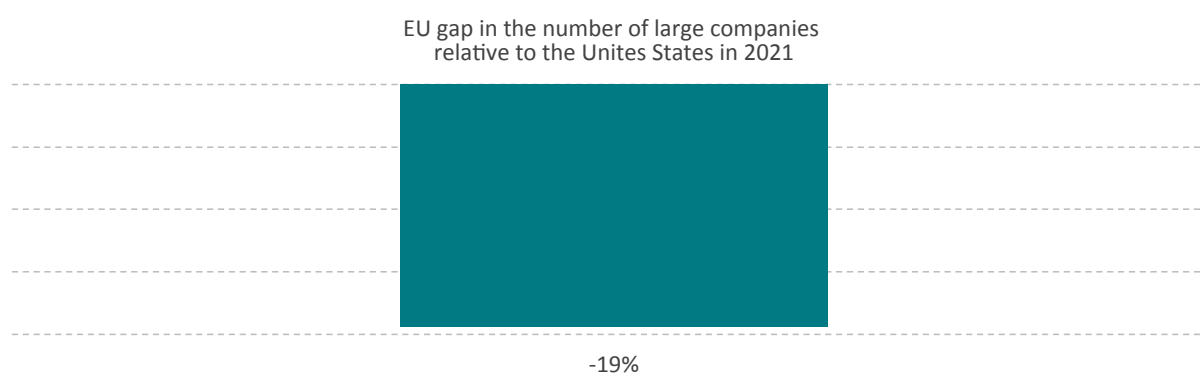
<sup>23</sup> Over the last fifteen years, EU's portion of global capital markets dropped from 18 percent to 10 percent. Its share of global GDP declined by 27 percent from 2006 to 2022, Breen, C. et al. (2023) EU Capital Markets: A New Call to Action. New Financial. Available at: <https://newfinancial.org/wp-content/uploads/2023.09-EU-capital-markets-a-new-call-to-action-New-Financial.pdf>; Within the past seven years, the EU's representation in the market capitalisation of the top 100 global companies decreased from 11 percent to 5 percent, Demarigny, F. (2024, January 11). L'autonomie stratégique passe par l'Union des marchés de capitaux. Le Grand Continent. Available at: <https://legrandcontinent.eu/fr/2024/01/11/lautonomie-strategie-par-union-des-marches-de-capitaux/>

<sup>24</sup> Long, T. (2024, April 12). Large Firms Generate Positive Productivity and Non-Productivity Spillovers for Their Suppliers. ITIF. Available at: <https://itif.org/publications/2024/04/12/large-firms-generate-positive-productivity-non-productivity-spillovers-for-suppliers/>

<sup>25</sup> Amiti, M., Duprez, C., Konings, J., & Van Reenen, J. (2023). FDI and superstar spillovers: Evidence from firm-to-firm transactions (No. w31128). National Bureau of Economic Research.

<sup>26</sup> Long, T. (2024, April 12). (see note: 24)



**FIGURE 7: THE EU'S LARGE BUSINESS GAP (2021)**

Source: Eurostat and BLS for number of enterprises and World Bank population statistics.

Against this background, it is important to consider how "superstar firms" invest and contribute to innovation and productivity growth. The rapid growth of very large global companies, often referred to as "superstar" companies, has fuelled widespread debate about their impact. These companies, which include global banks, manufacturing giants, and fast-growing tech firms, capture a disproportionate share of economic profit. The top 10 percent of these firms account for 80 percent of positive economic profit, with the top 1 percent alone generating 36 percent of this profit. This concentration highlights the significant role these firms play in the global economy.<sup>27</sup> Superstar firms are distinguished by their substantial investment in intangible assets such as R&D, software, data, brands, and supply-chain partnerships. On average, they spend two to three times more on R&D than their peers, accounting for 70 percent of total R&D spending among the largest companies. This investment strategy results in higher productivity and innovation, as evidenced by the market value of their patents.

Importantly, in Europe, the gap in intangible investment between high- and low-growth companies is notably large. European low-growth companies invest only 1.4 percent of revenues in intangibles, below global and North American rates. In contrast, high-growth European companies invest 6.2 percent of revenues in intangibles, which is 4.4 times more. These data suggest that many European low-growth companies would benefit from allocating more revenue to intangible investments.<sup>28</sup>

Additionally, superstar companies utilise their significant capital investments in intangible assets to achieve increasing returns to scale. This results in higher return on invested capital over time, as intangible investments can easily scale and complement other intangible assets. These companies also engage more in mergers and acquisitions, further boosting their growth and market position. However, while superstar firms may have higher markups, these are typically established early in their life cycle and persist due to their superior

<sup>27</sup> See McKinsey (2019). What every CEO needs to know about 'superstar' companies. Available at <https://www.mckinsey.com/featured-insights/innovation-and-growth/what-every-ceo-needs-to-know-about-superstar-companies>.

<sup>28</sup> See, e.g., McKinsey (2022). Why intangibles are the key to faster growth in Europe. Available at <https://www.mckinsey.com/capabilities/growth-marketing-and-sales/our-insights/why-intangibles-are-the-key-to-faster-growth-in-europe>.

productivity and innovation capabilities. There is no indication that star firms use market power to reduce output for supernormal returns. Instead, they maximise value by increasing output, investment, and R&D.<sup>29</sup>

Moreover, the R&D activities of large firms have substantial spillover effects, enhancing the innovation capabilities of smaller firms. This interaction is particularly evident in business-to-business (B2B) sectors, where companies closely collaborate within supply chains.<sup>30</sup> In key sectors such as construction, ICT, manufacturing, trade, and transportation, the productivity gap between larger companies and micro, small, and medium enterprises (MSMEs) is narrower due to these collaborative relationships.<sup>31</sup> Approximately 66 percent of MSMEs and larger companies operate synergistically, particularly in 45 sectors where their close cooperation results in an overall productivity level of USD 163,000 (in purchasing power parity terms). This figure is 1.5 times higher than in domains where only small or only large businesses excel.<sup>32</sup>

Multiple industry cases underscore the political importance of fostering a balanced regulatory environment that supports the growth and innovation potential of both large and small enterprises. The networks and links between MSMEs and large companies tend to benefit the growth and performance of both. Large companies are also dependent on smaller companies for development to supply, production, service delivery, distribution and sales, and there exists an incentive to raise smaller firms' capabilities (R&D, workforce) and achieve network efficiencies. For example, German wholesalers gain spill over benefits from being part of a larger ecosystem. They operate as legally independent subsidiaries which remain integrated with upstream purchasers or distributors for large manufacturers for the EU.<sup>33</sup> The ability of firms to have a large-scaled operations which has a substantial customer base can also help the suppliers to extend their supply networks and reach scale economies, which has an effect on the overall economy. Large firms also provide significant development of new technologies, contributing to knowledge diffusion and allowing smaller firms to conduct follow-on innovation.<sup>34</sup>

<sup>29</sup> See Center for Global Development (2022). The Rise of Star Firms: Intangible Capital and Competition. Available at <https://www.cgdev.org/sites/default/files/rise-star-firms-intangible-capital-and-competition.pdf>.

<sup>30</sup> McKinsey. (2024). A microscope on small businesses. Available at: <https://www.mckinsey.com/-/media/mckinsey/mckinsey%20global%20institute/our%20research/a%20microscope%20on%20small%20businesses%20spotting%20opportunities%20to%20boost%20productivity/a-microscope-on-small-businesses-spotting-opportunities-to-boost-productivity.pdf?shouldIndex=false>

<sup>31</sup> Ibid

<sup>32</sup> Ibid

<sup>33</sup> Bernhard Dachs et al., EU wholesale trade: Analysis of the sector and value chains, European Commission, June 2016.

<sup>34</sup> Braguinsky, S., Choi, J., Ding, Y., Jo, K., & Kim, S. (2023). Mega firms and recent trends in the us innovation: Empirical evidence from the us patent data (No. w31460). National Bureau of Economic Research.

**TABLE 5: OVERVIEW OF KEY ECONOMIC BENEFITS OF LARGE COMPANIES IN VARIOUS DOMAINS**

<b>Economic Benefit</b>	<b>Description</b>
<b>Consumer Welfare</b>	Large companies often provide goods and services at lower prices due to economies of scale. They also offer a wider variety of products, enhancing consumer choice.
<b>Technology Development &amp; Innovation</b>	Large firms invest significantly in research and development (R&D), driving technological advancements and innovation. They often lead in bringing new technologies to market.
<b>Trade and Exports</b>	Large companies are major players in international trade, contributing significantly to exports and improving the trade balance. Their global reach helps them access new markets and expand the EU's economic influence.
<b>Professional Skills Development</b>	Large firms provide extensive training and professional development opportunities, enhancing the skill levels of their workforce. They often have the resources to invest in continuous learning and development programs.
<b>Employment</b>	Large companies create numerous job opportunities, both directly and indirectly through their supply chains. They often offer higher wages and better benefits compared to smaller firms.
<b>Economic Stability</b>	Large firms contribute to economic stability by providing stable employment and being less vulnerable to market fluctuations due to their diversified operations and financial strength.
<b>Infrastructure Development</b>	Large companies often invest in infrastructure projects, such as logistics, transportation, and utilities, benefiting the broader economy.
<b>Corporate Social Responsibility</b>	Large firms often engage in corporate social responsibility (CSR) initiatives, contributing to community development, environmental sustainability, and social welfare programs.

Source: compilation by ECIPE.

It is crucial to establish an ecosystem that allows the presence of larger firms and smaller firms to exist together (see Table 6). MSMEs grow fast into large companies and can add to the dynamism of the economies they operate in. Therefore, there exists a cyclic process which if allowed, can promote innovation, and competition among companies and can enhance the overall economy wide participation. About 1 in 5 large companies scaled up from being MSMEs since 2000.<sup>35</sup> There are unique factors which contribute to this, but an overall picture suggests that – availability in resources that can allow expansion of growth opportunities, prioritising technological advancement and reliance on profits to fund their growth can allow companies to scale up. The size of smaller companies plays an important role in their productivity which is relative to large companies. The overall productivity gap increases when the ratio of MSME productivity to large company productivity is brought closer to fuller potential. Narrowing the productivity gap is equivalent to 5 to 10 percent of GDP.

<sup>35</sup> McKinsey. (2024). (see note: 27)

**TABLE 6: OVERVIEW OF KEY ECONOMIC BENEFITS DERIVED BY SMALLER FIRMS FROM LARGE COMPANIES**

<b>Economic Benefits derived by small firms from larger firms</b>	<b>Description</b>
<b>Access to Larger Markets</b>	Larger firms often have extensive distribution networks and reach a broader customer base. By collaborating with or supplying to larger firms, SMEs can gain access to these larger markets, expanding their customer base and increasing their sales potential.
<b>Subcontracting and Outsourcing Opportunities</b>	Large companies frequently outsource or subcontract certain processes, services, or components to SMEs. This arrangement provides SMEs with a steady stream of work and revenue, enabling them to leverage their specialised expertise and capabilities.
<b>Knowledge Transfer and Capacity Building</b>	Larger firms often have advanced technologies, efficient processes, and experienced personnel. By working with these firms, SMEs can benefit from knowledge transfer, learning best practices, and improving their own operational capabilities and competitiveness.
<b>Technology Development &amp; Innovation</b>	Large firms invest significantly in research and development (R&D), driving technological advancements and innovation. They often lead in bringing new technologies to market.
<b>Digital Transformation and Industry 4.0</b>	Larger firms are increasingly investing in digital technologies, automation, and Industry 4.0 solutions to enhance their operations and stay competitive. SMEs can collaborate with these larger firms to gain access to cutting-edge digital tools, data analytics, and advanced manufacturing technologies, enabling them to streamline processes, optimise supply chains, and improve overall efficiency.
<b>Economies of Scale</b>	Through their collaboration with larger firms, SMEs can benefit from economies of scale. For example, they may be able to negotiate better prices for raw materials or inputs by leveraging the purchasing power of the larger firm.
<b>Risk Sharing and Diversification</b>	By collaborating with larger firms, SMEs can share risks and diversify their customer base or product portfolio. This risk diversification can help SMEs weather economic downturns or market fluctuations more effectively, reducing their overall vulnerability.
<b>Cross-Country Collaborations and Global Expansion</b>	Multinational corporations with a global presence can serve as valuable partners for SMEs seeking to expand their operations across borders. SMEs can leverage the established supply chains, distribution networks, and local partnerships of larger firms, facilitating their entry into new markets and regions.

Source: compilation by ECIPE.

## 4.2. The Need for Policy Re-Evaluation

EU merger regulation effectively limits the ability of Member States to interfere and gives an exclusive competence to the Commission to intervene and block the ones they think would impede competition in the market, and the test for merger review is based on competition considerations only.<sup>36</sup> While it is generally beneficial to have merger competence at the EU level, ensuring a consistent and fair approach across all EU Member States, the European Commission should broaden its assessment criteria to include global competition, especially imports and investments from non-EU countries, and dynamic competition. This would provide a more comprehensive understanding of how mergers impact the competitive landscape beyond the EU.

<sup>36</sup> See Council Regulation 4064/89, on the Control of Concentrations Between Undertakings, 1989 O.J. (L 395) 1–12 (EC) [hereinafter Merger Regulation 1989], and Council Regulation 139/2004, on the Control of Concentrations Between Undertakings, 2004 O.J. (L 24) 1–22 (EC) [hereinafter Merger Regulation 2004].

The European Commission's decision to block the merger between Siemens and Alstom in February 2019, based on the EU Merger Regulation, has sparked significant political controversy. The prohibition, which aimed to prevent a significant impediment to effective competition (SIEC), has been criticised for not sufficiently considering the global competitiveness of European enterprises. Critics argue that this decision hindered the creation of a "European champion" capable of competing with global giants like the state-owned China Railway Rolling Stock Corporation (CRRC). Despite the political outcry and calls for mechanisms to overturn such decisions, akin to Germany's "Ministererlaubnis," the Commission's role as an enforcer of legislation limits its political discretion in these matters.<sup>37</sup>

Despite the Commission's detailed appraisal, which included a global market analysis for high-speed trains, the prohibition highlighted a critical need to re-evaluate the EU's merger assessment criteria, which may not actually require legal revisions. While the SIEC test ensures competition within the EU by considering both foreign and local companies in the market definitions it establishes, it may not always fully capture the broader global context in which companies operate. The European Commission already considers competitive pressures from both EU and non-EU companies in its assessments, aiming to level the playing field for all companies, regardless of origin. However, the European Commission could, as it has in the past, show greater flexibility in its assessment of potential competition by considering longer time frames. Extending this assessment period may not require new legislation but rather an adjustment in the Commission's approach, thereby better supporting the strategic interests of European firms.<sup>38</sup>

The application of the SIEC test is inherently prone to interpretation and is heavily dependent on assumptions about future market conditions. This subjectivity can lead to differing conclusions on the potential longer-term impacts of mergers.<sup>39</sup> In the context of the railway industry, which operates as a network industry with significant public procurement, the dynamics differ markedly from many other sectors of the economy. Indeed, public procurement plays a crucial role in shaping competition and market structure in the railway sector, adding an additional layer of complexity to merger assessments. However, the EU utilises various tools to address state-supported foreign firms, including Trade Defence Instruments (TDI) to counter unfair trade practices, which can be made more effective with increased transparency and stricter

<sup>37</sup> See, e.g., FWP (2019). Why the Siemens – Alstom rail merger was prohibited by law. Available at <https://www.fwp.at/en/news/blog/why-the-siemens-alstom-rail-merger-was-prohibited-by-law>.

<sup>38</sup> France, Germany, and other critics of current EU merger rules argue that these rules cause the Commission to adopt an overly rigid stance when assessing potential competition. Specifically, they contend that the time frame for evaluating potential future market entry should be extended. Currently, Commission guidelines state that market entry is generally considered timely only if it occurs "within two years." See, e.g., Amory et al. (2019). Beyond Alstom-Siemens: Is there a need to revise competition law goals? EU policy after Siemens/Alstom: A look into the right tools to preserve the EU industry's competitiveness at global level. Available at <https://www.concurrences.com/en/review/issues/no-4-2019/conferences/beyond-alstom-siemens-is-there-a-need-to-revise-competition-law-goals-new>.

<sup>39</sup> Stockhaus (2015) outlined that the SIEC test relies heavily on the definition of the relevant market. This dependence can lead to arbitrary decisions and may not fully capture the competitive dynamics involving substitutes outside the narrowly defined market. See Stockhaus (2015). How Forceful is EU Merger Control? – the SIEC test meets the five forces. Available at <http://www.diva-portal.org/smash/get/diva2:855682/FULLTEXT01.pdf>. Roeller and de la Mano (2006) highlight the difficulty in providing conclusive evidence of the test's effectiveness, given the limited number of cases and challenges in establishing a clear counterfactual. They also criticise the negligible role that efficiency claims play in practical merger assessments, which undermines the potential benefits of the SIEC test. Despite the shift towards evaluating competitive effects, dominance still plays a significant role in assessments, sometimes overshadowing the intended effects-based approach. Additionally, the transition to the new test requires significant adaptation and expertise in industrial economics, leading to potential initial inconsistencies and application challenges. See Roeller and de la Mano (2006). The Impact of the New Substantive Test in European Merger Control. European Competition Journal. Available at [https://ec.europa.eu/dgs/competition/economist/merger\\_control\\_test.pdf](https://ec.europa.eu/dgs/competition/economist/merger_control_test.pdf).

enforcement. Public procurement rules, including the International Procurement Instrument (IPI) and the new the Foreign Subsidies Regulation (FSR) aim to prevent such firms from gaining unfair advantages and ensure reciprocity in public procurement access, enhancing the EU's ability to maintain fair competition in the internal market, e.g., by scrutinising and addressing financial contributions from non-EU countries.

Beyond these issues, in the application of the SIEC test, the European Commission may omit certain factors related to the price sensitivity of buyers, such as the impact on quality/performance and buyer profits. Such omissions, however, can become significant in the context of assessing competitive constraints in industries where business-to-business (B2B) and business-to-government (B2G) transactions are prevalent.<sup>40</sup> This specificity necessitates a nuanced approach that recognises the unique challenges and opportunities within such network industries, ensuring that regulatory decisions foster a competitive yet globally resilient market environment.

More generally, EU competition policy faces significant challenges in balancing the prevention of anti-competitive practices with fostering innovation and growth, particularly regarding large companies and mergers. Influenced by neo-Brandeisian and anti-corporate ideologies, there is a push for stringent antitrust enforcement to dismantle large firms perceived as market-dominating. This approach, evident in recent actions against major tech companies, aims to address the "market power problem" but may overlook the broader economic benefits these firms provide, such as productivity boosts to their suppliers, and innovation and productivity effects, especially for vertical mergers.<sup>41</sup> Generally, research indicates that the increase in market power often correlates with a firm's productivity rather than purely anti-competitive measures.

At the core of the competitive process is the principle that market actors should be free to make their own economic choices within a framework supervised by public bodies. Antitrust agencies play a crucial role by preventing anti-competitive conduct that harms the development of level playing field, such as cartels or predatory exclusion.<sup>42</sup> A vital aspect of competition is allowing firms with market power to charge prices that reflect their scale of production. This dynamic is essential for promoting innovation and efficiency within the market.

An effective antitrust policy should enable firms to capture the surplus generated by their investments, innovation, and foresight. Policies that prioritise static efficiency at the expense of dynamic efficiency, or those that aim to protect competitors instead of consumers, risk impeding long-term economic growth and welfare. Therefore, it is critical to strike a balance that fosters competitive markets while also recognising the substantial contributions of large firms to the broader economy. As noted, "[a]n essential element of appropriate antitrust policy is to allow a firm to capture as much of the surplus that, by its own investment, innovation, industry, or

<sup>40</sup> Stockhaus (2015). How Forceful is EU Merger Control? – the SIEC test meets the five forces. Available at <http://www.diva-portal.org/smash/get/diva2:855682/FULLTEXT01.pdf>.

<sup>41</sup> See, e.g., ITIF (2023). Why Merger Guidelines Must Do More to Support Productivity, Innovation, and Global Competitiveness. Available at <https://itif.org/publications/2023/05/03/merger-guidelines-must-do-more-to-support-productivity-innovation-global-competitiveness/>.

<sup>42</sup> Ibid

foresight, the firm has itself brought into existence.”<sup>43</sup> This relaxed approach to competition enforcement in the EU would ensure that antitrust policies support overall economic welfare and sustainable growth.

### **4.3. The Need to Introduce Urgency and Proportionality Checks**

The European Commission's efforts to regulate large tech companies, particularly through the DMA, have raised concerns about potentially stifling innovation and harming consumer benefits. For example, the DMA's obligations under Articles 5 and 6, which include rules on self-preferencing, data access, and interoperability, aim to prevent anti-competitive practices. However, these rules may often overlook the broader and dynamic benefits that large companies and their online platforms provide, such as enhanced-quality services, innovation, and significant productivity growth. In fact, the EU's strict regulatory stance, as seen in the DMA's enforcement against several major tech companies, seeks to address “market power problems” but does not consider and weight all the economic advantages these firms offer.

There is also a need for proportionality in the assessment of mergers, which means evaluating not only the ability and incentives of companies to engage in anti-competitive practices post-merger, such as foreclosure of competitors, but also the actual probability and broader economic impact of mergers. It is thus crucial to consider the broader economic benefits that mergers can bring. Mergers often drive innovation, improve service quality, and enhance productivity growth. Overly stringent regulations would stifle these positive contributions, leading to unintended longer-term consequences for consumers and the economy at large. Therefore, proportional measures should be implemented to ensure that merger enforcement rules are not excessively burdensome and are adaptable to dynamic market developments, ultimately supporting both competition and economic dynamism.

To ensure that EU competition policy effectively balances the need to prevent anti-competitive practices with fostering innovation and growth, the EU should introduce urgency and proportionality checks. These checks would help the Commission target genuinely harmful practices without impeding the positive contributions of large firms. This approach would focus regulatory efforts on clear-cut violations, such as cartels, that have much more obvious negative impacts on consumers, while allowing beneficial business practices to continue (see Table 7 comparing alleged harm of self-preferencing and harm by cartels).

By implementing urgency and proportionality checks, the EU can ensure its competition policy effectively targets abusive practices that harm consumers without stifling the beneficial contributions of large firms. This balanced approach would support innovation, protect consumer welfare, and maintain fair competition across the market.

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<sup>43</sup> Dennis W. Carlton & Ken Heyer, *Extraction vs. Extension: The Basis For Formulating Antitrust Policy Towards Single-Firm Conduct*, 4 Competition Pol’y Int’l 285, 285–86 (2008).



**TABLE 7: COMPARING ONLINE PLATFORM “SELF-PREFERENCING” AND CARTEL HARM TO CONSUMERS**

Aspect	Digital companies self-preferencing Harm	Cement or Steel Cartel Harm	Pharmaceutical Cartel Harm	Emissions Cartel Harm
<b>Type of Harm</b>	Digital market anti-competitive behaviour	Traditional market anti-competitive behaviour	Health sector anti-competitive behaviour	Environmental harm through excess emissions, consumer deception
<b>Affected Parties</b>	Online consumers, competing online retailers	Consumers, construction industry, government entities, and broader economy	Patients, healthcare providers, insurance companies, and governments	Consumers who purchased vehicles, regulatory authorities, and public health from excess emissions
<b>Impact</b>	Reduced visibility and sales for competing online retailers, potential increase in online prices	Higher prices for cement and steel, increased costs for construction projects, increased public expenditure	Higher drug prices, reduced access to essential medications and financial strain on healthcare systems	Pollutants like NOx emitted more than the permissible limited, violation of environmental regulations and emissions standards
<b>Consumer Impact</b>	Limited choice in online products, potential higher online prices	Higher prices for construction-related products, increased costs for housing and infrastructure	Higher out-of-pocket costs for medications, reduced access to treatment	Overpaid costs for vehicles marked as environmental friendly, re-sale values of affected vehicles dropped, health impacts increased, Market distortion for automobiles that are actually environmentally friendly
<b>Consumer Alternatives</b>	Consumers can turn to alternative shopping platforms or search engines, or they can turn to bricks-and-mortar shops	Consumers and businesses have limited alternatives due to the essential nature of cement and steel	Limited alternatives for essential medications, leading to unavoidable high costs	Regulatory backlash, increased costs for emissions testing and compliance rules – passes down to consumers, lesser choices from reduced competition, and limited availabilities and undermined trust in newer technologies, increase in product liabilities

Aspect	Digital companies self-preferencing Harm	Cement or Steel Cartel Harm	Pharmaceutical Cartel Harm	Emissions Cartel Harm
<b>Case study</b>	The General Court confirmed EC's imposition of EUR 2.42 billion on Google for providing favourable treatment to its shopping service, which does not reflect consumer harm. <sup>44</sup>	In a pre-stressing steel case Commission fined EUR 269 million for a two-decade long price fixing and market sharing cartel. The producers violated EU's ban on cartel and restrictive business practices. <sup>45</sup>	Commission fined pharma companies EUR 13.4 million for participating in a cartel concerning a pharmaceutical ingredient used to produce the abdominal anti-spasmodic drug Buscopan and its generic versions. The companies fixed the sale prices to consumers and exchanged commercially sensitive information. <sup>46</sup>	Commission fined EUR 875 million for breaching antitrust rules for avoiding competition on emissions cleaning. <sup>47</sup>
<b>Conclusion</b>	<p>When users are allowed to have choices, consumers are inclined towards platforms that favour certain sellers over others, which helps in expanding the customer base.</p> <p>In contrast, cartels constitute an extreme form of collusion where competitors agree collaboratively to fix prices or restrict output to inflate profits artificially. This behaviour leads to diminished economic growth, reduced innovation, and limited consumer choices. Cartels also exploit market power to create shortages, and supply low-quality goods to consumers.</p> <p>The enforcement measures against digital companies appear disproportionate when considering the relative scope and impact of harm. The fines imposed on digital companies for self-referencing practices do not align with the comparatively less severe consumer and societal impact. In contrast, cartels in traditional markets, pharmaceuticals, and emissions sectors can cause severe economic, health, and environmental harm. Therefore, enforcement measures and penalties should be more targeted to cases of severe consumer harm and accurately reflect the varying degrees of consumer harm and broader societal and economic impacts, including productivity and innovation considerations.</p>			

Source: compilation by ECIPE.

## 4.4. Proportionality in EU Merger Policy

The EU's stringent stance on large companies, particularly in the technology sector, undermines the competitive edge of European companies on a global scale. While mergers between companies can significantly increase innovation by boosting R&D productivity and generating spillovers from R&D spending,<sup>48</sup> recent merger cases and the adoption of ex-ante regulations

<sup>44</sup> General Court of EU. The General Court largely dismisses Google's action against the decision of the Commission finding that Google abused its dominant position by favouring its own comparison shopping service over competing comparison-shopping services Available at: <https://curia.europa.eu/jcms/upload/docs/application/pdf/2021-11/cp210197en.pdf>

<sup>45</sup> Pre-stressing steel includes long curled steel wires that is used to make foundations, bridges and balconies. The companies fixed individual prices and quotas and exchanged sensitive commercial information and monitored price and quota arrangements through national coordinators and contracts, which is a breach of Article 101 of TFEU. see: Antitrust: Commission fines prestressing steel producers € 269 million for two-decades long price-fixing and market-sharing cartel (2011). Available at: [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_11\\_403](https://ec.europa.eu/commission/presscorner/detail/en/IP_11_403)

<sup>46</sup> Commission fines pharma companies €13.4 million in antitrust cartel settlement (2023) Available at: [https://ec.europa.eu/commission/presscorner/api/files/document/print/en/ip\\_23\\_5104/IP\\_23\\_5104\\_EN.pdf](https://ec.europa.eu/commission/presscorner/api/files/document/print/en/ip_23_5104/IP_23_5104_EN.pdf)

<sup>47</sup> Antitrust: Commission fines car manufacturers €875 million for restricting competition in emission cleaning for new diesel passenger cars (2021). Available at: [https://ec.europa.eu/commission/presscorner/api/files/document/print/en/ip\\_21\\_3581/IP\\_21\\_3581\\_EN.pdf](https://ec.europa.eu/commission/presscorner/api/files/document/print/en/ip_21_3581/IP_21_3581_EN.pdf)

<sup>48</sup> Suominen, K., (2020, October 26). On the Rise: Europe's Competition Policy Challenges to Technology Companies. CSIS. Available at: <https://www.csis.org/analysis/rise-europes-competition-policy-challenges-technology-companies>

demonstrate the EU's rigorous approach to preventing the formation of large enterprises, thereby undermining productivity gains and impeding the development of innovative products and services.

For instance, in 2012, the European Commission prohibited a merger between Deutsche Boerse and NYSE Euronext, citing concerns that the merger would result in a quasi-monopoly in exchange-traded European financial derivatives. Deutsche Boerse in its appeal pointed that European Commission's prohibition of the merger on grounds that merging the parties will constrain innovation competition was incorrect. The company's claim was dismissed.<sup>49</sup>

The European Commission has continued to pursue investigations into mergers and acquisitions made by American technology companies. In 2020, the Commission opened an investigation against Apple on the grounds whether Apple discriminated its rivals like Spotify on its app store and "how other competitors were treated on its mobile payment service app."<sup>50</sup> In the Commission report, "Icompetition policy for the digital era," the report pointed that dominant digital firms are likely to have "strong incentives to engage in anti-competitive behaviour" and "require vigorous competition policy enforcement and justify adjustments to the way competition law is applied."<sup>51</sup> The report also highlights a significant shift in the burden of proof, requiring companies to demonstrate that their actions are not anti-competitive in nature. Specifically in some cases if a company introduces a new product or a service which can potentially restrict competition, it must now prove that the product actually benefits the consumers.<sup>52</sup>

As outlined above, the debate about urgency and proportionality in EU competition policy thus extends to the merger enforcement. An overly restrictive approach to mergers and acquisitions will ultimately hinder European firms from achieving the scale necessary to compete globally, particularly against larger US and Chinese competitors. Restrictive merger regulations can limit the ability of EU companies to expand and integrate across borders, imposing high compliance costs and creating legal uncertainties that discourage investment and innovation.<sup>53 54</sup>

<sup>49</sup> European Commission, Case M. 6166, DEUTSCHE BÖRSE/NYSE EURONEXT, Commission Decision of February 1, 2012. Available at: [https://ec.europa.eu/commission/presscorner/api/files/document/print/en/ip\\_12\\_94/IP\\_12\\_94\\_EN.pdf](https://ec.europa.eu/commission/presscorner/api/files/document/print/en/ip_12_94/IP_12_94_EN.pdf); also see: General Court of European Union. The General Court confirms the Commission's decision prohibiting the proposed merger between Deutsche Börse and NYSE Euronext. Available at: <https://curia.europa.eu/jcms/upload/docs/application/pdf/2015-03/cp150032en.pdf>

<sup>50</sup> Adam Howorth, the company spokesman, said, "It's disappointing the European Commission is advancing baseless complaints from a handful of companies who simply want a free ride, and don't want to play by the same rules as everyone else," in Scott, M., and Dorpe, V., (2020, June 16). Apple thrust into EU antitrust spotlight. Politico. Available at: <https://www.politico.eu/article/eu-opens-two-antitrust-probes-into-apple/>

<sup>51</sup> European Union. (2019). Competition policy for the digital era. Publications for the Digital Era. Available at: <https://op.europa.eu/en/publication-detail/-/publication/21dc175c-7b76-11e9-9f05-01aa75ed71a1/language-en>; also see: Suominen, K., (2020, October 26). (See note: 48)

<sup>52</sup> Ibid

<sup>53</sup> These practices are addressed under Article 102 of the Treaty on the Functioning of the European Union (TFEU) and are a highly contested area of European competition policy. For example, the Commission has taken the stance that offering low prices in the form of loyalty rebates may be deemed anti-competitive behaviour.

<sup>54</sup> In contrast to the US, which views loyalty rebates as a pro-competitive business practice, European authorities are concerned that dominant companies may exploit their market position by offering discounts that prevent equally efficient competitors from competing for consumer demand. This debate came to a head in 2009 when the European Commission ruled that Intel had abused its market dominance through loyalty rebates, a decision later overturned by the Court of Justice of the European Union (CJEU). However, the case highlighted the European perspective that loyalty rebates can harm competition and consumers, primarily serving to shield less efficient competitors from their own competitive shortcomings. See, e.g., Suominen, K. (2020) (see note: 48); Intel Corp. v European Commission. Appeal — Article 102 TFEU — Abuse of a dominant position — Loyalty rebates — Commission's jurisdiction — Regulation (EC) No 1/2003 — Article 19. Case C-413/14 P.

In 2019, the French and the German governments adopted a manifesto for a European industrial policy fit for 21st century (the Franco-German Manifesto, see Table 8). The manifesto called for a redefined distribution of authority through a centralised decision-making concerning competition policy. It urged the Member States to also adopt a more interventionist approach in shaping their industrial policies.<sup>55</sup> Following the 2019 Commission's dismissal of the merger of Alstom and Siemens, the governments of France and Germany presented a manifesto with a set of far-reaching proposals designed to reshape EU industrial and competition policy.<sup>56</sup>

The manifesto is a follow up call from 19 EU governments to update EU antitrust rules to facilitate the presence of European industrial firms to compete against China and US.<sup>57</sup> The proposal to veto European Commission decisions on competition policy, is defended by the overall claim that Europe's competitiveness in manufacturing is in decline. The manifesto's goal was increase political and advance an ideological shift in how the European Commission implements competition policy in the future.<sup>58</sup>

**TABLE 8: RE-FORMING THE COMPETITION POLICY UNDER INDUSTRIAL PRE-TEXT<sup>59</sup>**

Joint statement by France, Austria, Croatia, Czech Republic, Estonia, Finland, Germany, Greece, Hungary, Italy, Latvia, Luxembourg, Malta, Netherlands, Poland, Romania, Slovakia, Spain	A Franco-German Manifesto for a European industrial policy fit for the 21st Century
<ol style="list-style-type: none"> <li>1. The 19 countries call for a comprehensive approach to EU industrial policy to strengthen its strategic autonomy.</li> <li>2. The strategy should consider the need for re-industrialisation and differences in industrial base development among Member States through an indicator-based monitoring mechanism</li> <li>3. There is a need to mobilise all European policies that contribute to industrial competitiveness and to also develop dedicated action plans for each identifiable strategic value chain</li> <li>4. The strategy includes a strong industrial dimension in the Horizon Europe programme and calls for a focus on financing industrial deployments, sustainability and key enabling technologies.</li> </ol>	<ol style="list-style-type: none"> <li>1. The manifesto states that Europe's economic strength is dependent on its ability to remain global manufacturing and industrial power.</li> <li>2. The manifesto highlights that there is a requirement of a genuine European led industrial policy for sustainable and inclusive growth to give Europe economic sovereignty and independence</li> <li>3. The manifesto considers that a right of appeal of the Council with the possibility of overriding Commission decisions when it comes to existing competition rules will be appropriate in well-defined cases.</li> <li>4. The manifesto states that EU should monitor and adapt to new reforms relevant to trade policy as a means to defend strategic autonomy.</li> </ol>

Guided under the pretext of national/economic security, countries within the EU may very likely proceed to form a coalition to advocate for protectionist policies which will undermine competition. For instance, in the "Friends of an Effective Digital Markets Act" coalition,

<sup>55</sup> A Franco-German Manifesto for a European industrial policy fit for the 21st Century.(2019) Available at: <https://presse.economie.gouv.fr/wp-content/uploads/2020/11/fd32d63828617cc973af75261e66209d.pdf>

<sup>56</sup> European Commission (2019). Mergers: Commission prohibits Siemens' proposed acquisition of Alstom. 6 February 2019. Available at [https://ec.europa.eu/commission/presscorner/detail/it/IP\\_19\\_881](https://ec.europa.eu/commission/presscorner/detail/it/IP_19_881). The European Commission has prohibited Siemens' proposed acquisition of Alstom under the EU Merger Regulation. The merger would have harmed competition in markets for railway signalling systems and very high-speed trains.

<sup>57</sup> The joint statement reads "Competition and state aid: the identification of possible evolutions of the antitrust rules to better take into account international markets and competition in merger analysis" Friends of Industry (2018). Joint Statement. Available at: <https://presse.economie.gouv.fr/wp-content/uploads/2020/11/1ffc051c389ad6d40bc3abe53414ab50.pdf>

<sup>58</sup> From an Interview with official, French Ministry of the Economy, in person, 16 December 2019 in Bora, S. I. (2023). 'A Sovereign Europe'? Strategic Use of Discourse at the Service of French Economic Interests in EU Politics (2017–2022). *JCMS: Journal of Common Market Studies*, 61(5), 1281–1297.

<sup>59</sup> Ibid, also see Franco-German Manifesto (see note: 55)

which includes Germany, France, and the Netherlands, the trio introduced a position paper "Strengthening the Digital Markets Act and Its Enforcement" which said that Member States should have the discretion to set and enforce national rules around competition law because the "importance of the digital markets for our economies is too high to rely on one single pillar of enforcement only." The coalition paper also mentioned that "a larger role should be played by national authorities in supporting the European Commission,"<sup>60</sup> an underlying base for targeting the big tech, and non-EU companies.

## **4.5. Key Changes to Consider for a Pro-Productivity EU Competition Policy**

To address pressing issues in EU competition policy, the European Commission and national governments should more clearly differentiate between firms that gain market power through anti-competitive practices and those that can become market leaders through genuine productivity and innovation. This differentiation is crucial for ensuring that competition policies effectively target and penalise companies engaging in unfair practices, while simultaneously fostering an environment that encourages and rewards innovation and efficiency.

### **Harmonising the Enforcement of Competition Policies**

Harmonising competition and merger enforcement across the EU would create a more predictable business environment, reducing compliance costs and fostering a healthier market for investment and productive economic activity. At the same time, the need to keep competition policy independent from political interference and European industrial policy ambitions and goals need to be prioritised.

To reduce legal uncertainties and support scaling and cross-border investments, the EU must harmonise competition enforcement. Currently, differences in national enforcement creates unnecessary legal uncertainties and compliance burdens for businesses operating across multiple Member States. Harmonising procedural laws and encouraging the establishment of specialised competition courts across Member States can create a more consistent judicial framework. Promoting uniform economic assessments with standardised tools and conducting joint market studies can help align the economic context for enforcement decisions. Continuous monitoring, performance metrics, and regular reporting from National Competent Authorities (NCAs) to the European Commission could ensure ongoing alignment and effectiveness of competition law enforcement across the EU.

A much more unified approach would reduce these burdens, provide a predictable legal environment, and eliminate the uneven playing field that currently exists. This alignment is particularly crucial as the EU faces the rapid growth and importance of the digital economy.

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<sup>60</sup> Friends of an Effective Digital Markets Act, (2021) "Strengthening the Digital Markets Act and Its Enforcement. <https://www.permanentrepresentations.nl/documents/publications/2021/05/27/strengthening-the-digital-marketsact-and-its-enforcement>

## **Investigations and Enhanced Institutional Capabilities**

A clear prioritisation framework shall be established to identify and allocate resources to cases with the highest potential for consumer harm or market impact. This risk-based approach will ensure that critical cases receive timely attention and resolution. Existing investigative and judicial processes shall be reviewed and optimised to eliminate redundancies, improve coordination between relevant authorities, and expedite decision-making without compromising due process or the quality of assessments.

Improving the capabilities of the European Commission and the courts to enforce competition laws effectively is vital. Well-resourced institutions capable of responding swiftly to market abuses are essential for maintaining market fairness without overly constraining large enterprises. Recent antitrust cases against major tech companies underline the EU's commitment to competitive markets, but there is a delicate balance to maintain—policies must not stifle the growth and scaling of European tech firms. Moreover, negative merger decisions can have a harmful impact on the startup ecosystem and the investability of Europe, as they may discourage investment in innovative ventures due to perceived regulatory hurdles. When startups and investors perceive the regulatory environment as overly restrictive, it can lead to reduced venture capital inflows and hinder the ability of new businesses to scale effectively (see discussion above). Ensuring that competition policies are balanced and do not disproportionately affect the dynamism and attractiveness of the European tech landscape is crucial for fostering a robust and investable startup ecosystem.

## **Urgency and Proportionality Checks**

In addressing mergers and compliance with ex-ante policies, as in the case of the DMA, competition authorities shall always adopt a balanced and evidence-based approach. Investigations shall be conducted impartially, considering both the potential pro-competitive benefits and anti-competitive risks of such activities. Decisions shall be based on sound economic analysis, transparency and aimed at promoting consumer welfare and market efficiency.

## **5. TAXATION OF SALES, LABOUR AND CORPORATE INCOME**

EU tax policy is marked by a complex mix of national regulations and supranational directives, impacting everything from sales taxes (VAT), corporate income taxes (CIT) to labour income taxes (income tax and social security contributions). Despite EU and OECD initiatives, the corporate income tax landscape has become more complex, negatively affecting the EU's investment attractiveness and conditions for competition and economic growth.

Tax code complexity and legal fragmentation poses significant challenges for businesses of all sizes and also impacts the attractiveness of the EU for investment. Simplifying and harmonising national tax laws could spur economic growth by creating a more predictable

and simplified system. It is important to note that this is not about actual tax rates. To retain national sovereignty over taxation, Member States should maintain the flexibility to choose their own rates for any tax.

## **5.1. Complex and Legally Fragmented Taxes on Sales and Labour**

The EU's diverse VAT rates and exemptions, along with varied income tax brackets and social security contributions, have create an extremely complicated legal environment, which leads to high compliance costs and administrative burdens, especially for businesses operating and investing in multiple Member States. Tax code diversity can also encourage tax evasion and avoidance, undermine government revenues, and create an uneven playing field, distorting labour mobility and consumption patterns. In the EU27 it is estimated that EUR 189 billion are paid in various compliance costs for CIT, VAT, and wage-related contributions. That is the equivalent of 1.3 percent of GDP annually.<sup>61</sup>

Harmonising and simplifying tax codes would enhance the EU's attractiveness for investment by reducing compliance costs and legal risks, which often deter companies from operating across national borders. This would ease the administrative burden on businesses and facilitate smoother cross-border operations, attracting foreign investment and encouraging domestic expansion within the EU. Additionally, it would create a fairer and more competitive economic environment by eliminating tax disparities and reducing opportunities for tax avoidance.

## **Sales Tax Complexity and Legal Fragmentation**

For small companies, VAT compliance costs create significant barriers to competition compared to larger firms. SMEs face higher administrative costs due to their smaller scale, while larger companies benefit from economies of scale. The differences in VAT regimes across EU countries further exacerbate the burden on SMEs engaged in cross-border activities.

According to a recent EU impact assessment, Tax complexity has several direct and indirect negative consequences for SMEs operating across-borders, creating significant barriers to their expansion within the internal market. Despite expectations, tax compliance costs have not declined over time; instead, they have increased by 114 percent from 2014 to 2019. These costs are regressive, placing a disproportionately higher burden on small businesses compared to large enterprises. SMEs spend approximately 2.5 percent of their turnover on tax compliance (covering CIT, VAT, and income taxes), while large enterprises spend only 0.7 percent. The study specifically examines the cost of compliance with corporate income taxation (CIT) among a population of around 16 million SMEs in the EU, of which 14.5 million do not yet engage in cross-border activities. The total CIT-related compliance costs in the EU could amount to EUR 54 billion, with very small enterprises (less than 10 employees) bearing 90 percent of this cost. While this represents only 0.004 percent of EU GDP, the

<sup>61</sup> D'Andria, D., & Heinemann, M. (2023). Overview on the tax compliance costs faced by European enterprises – with a focus on SMEs. European Parliament: Policy Department for Economic, Scientific and Quality of Life Policies.



financial burden on individual SMEs is significant and poses a substantial barrier to their growth and cross-border expansion.<sup>62</sup>

The EU VAT reform, aiming to exempt small businesses from being required to charge VAT, set to take effect on 1 January 2025 introduces a more complex landscape for small businesses and their interactions with VAT.<sup>63</sup> One main criticism is the administrative burden this reform places on businesses, especially those dealing with small vendors. By allowing small business exemptions to apply across borders within the EU, companies must rigorously track and update vendor data to ensure compliance. Changes in a vendor's VAT status or inadvertent payments to exempt vendors could lead to cash flow issues. This situation is further complicated by anticipated gradual increases in national thresholds, requiring continuous monitoring and system adjustments.<sup>64</sup>

The reform could create significant ambiguities and operational challenges for businesses engaged in cross-border transactions and digital services. The distinction between B2B and B2C transactions may become blurred, as tax authorities might classify small businesses as B2C customers if they fail to register for VAT. This misclassification could unfairly impose VAT collection responsibilities on non-resident service providers, increasing compliance costs and operational risks. Additionally, businesses selling to small enterprises across the EU will need to re-evaluate their customer bases to determine their VAT obligations accurately. This requirement could lead to increased compliance burdens and potential liabilities, particularly as EU tax authorities heighten enforcement actions against businesses in the digital economy.

These complexities undermine the intended simplification of the VAT system for small businesses, creating a challenging regulatory environment that could stifle small business operations and cross-border trade within the EU. Not only are compliance costs proportionally higher for SMEs, but they bear the largest share of total tax compliance costs (97 percent), creating significant barriers to competition with larger firms.<sup>65</sup> Table 9 below provides examples illustrating the case in point.

<sup>62</sup> European Commission (2023). Impact Assessment Report: Accompanying the document Proposal for a COUNCIL DIRECTIVE establishing a Head Office Tax system for micro, small and medium sized enterprises, and amending Directive 2011/16/EU. Available at <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SWD:2023:0302:FIN:EN:PDF>.

<sup>63</sup> See, e.g., Taxually (2024). The New SME Scheme: Implications for EU VAT Compliance. Available at <https://www.taxually.com/blog/the-new-sme-scheme-implications-for-eu-vat-compliance>.

<sup>64</sup> KPMG. (2023, October 3). KPMG report: Effect of EU small business VAT reform on nonresidents and large businesses. KPMG. <https://kpmg.com/us/en/home/insights/2023/10/tmf-kpmg-report-eu-small-business-vat-reform-nonresidents-large-businesses.html>

<sup>65</sup> D'Andria, D., & Heinemann, M. (2023). Overview on the tax compliance costs faced by European enterprises – with a focus on SMEs. European Parliament: Policy Department for Economic, Scientific and Quality of Life Policies.

**TABLE 9: EXAMPLES OF BURDENSOME EU VAT REQUIREMENTS HAMPERING CROSS-BORDER ECONOMIC ACTIVITY:<sup>66</sup>**

Sector	Instances where VAT requirements hamper cross border activity
International transport by coach	A Swedish bus company planning a trip to Munich must calculate VAT and register according to each country's regulations on its journey. This requirement for separate VAT registration in each country imposes a significant administrative burden, especially on SMEs. They often resort to using intermediaries, which increases costs.
Online selling goods	Online goods sellers face similar issues, spending around EUR 8,000 annually per country on VAT compliance, requiring an average of 13 documents per registration, and waiting approximately 100 days for a national VAT number. These high costs hinder intra-EU trade and economic growth.

Source: ERT.

Recent EU initiatives, such as the VAT in the Digital Age proposal, aim to modernise VAT for digital platforms and reduce administrative burdens, reflecting ongoing efforts to adapt tax systems to the digital economy. However, achieving harmonisation faces challenges due to differing political interests and national legacy tax policies.<sup>67</sup> Notably, these initiatives do not relate to the recent EU VAT in the Digital Age (ViDA) proposal for tax simplification for SMEs, which specifically targets streamlining procedures and reducing compliance costs for smaller enterprises in the EU. The ViDA proposal is designed to address the unique challenges faced by SMEs in the internal market, separate from the broader digital VAT modernisation efforts.<sup>68</sup>

## Legal Fragmentation and Complexity of EU Social Security and Labour Tax Laws

The fragmentation in EU social security laws, such as differing rules for unemployment and retirement insurance, creates substantial barriers that impact business and labour mobility. Harmonising these laws would encourage cross-border trade and investment in the EU, and contribute to a more fluid labour market. Similarly, the fragmentation in labour income tax codes across Member States presents significant challenges to businesses, workers, and economic integration. Harmonising labour income tax codes would reduce compliance costs and legal uncertainties, facilitating smoother cross-border employment and investment.

<sup>66</sup> ERT. (2024). Single Market Obstacles: Compendium. ERT. <https://ert.eu/wp-content/uploads/2024/02/Single-Market-Compendium-of-obstacles-13-Feb-2024.pdf>

<sup>67</sup> Mengden, A. (2024, January 30). 2024 VAT Rates in Europe. Tax Foundation. <https://taxfoundation.org/data/all/eu/value-added-tax-2024-vat-rates-europe/>

<sup>68</sup> The VAT in the Digital Age (ViDA) proposal by the European Commission aims to modernize VAT for digital platforms and reduce administrative burdens, reflecting efforts to adapt tax systems to the digital economy. The ViDA initiative includes measures such as real-time digital reporting based on e-invoicing, updated VAT rules for the platform economy, and a single VAT registration for businesses selling to consumers across the EU. However, these initiatives are separate from the recent EU proposal for tax simplification specifically for SMEs, which focuses on streamlining procedures and reducing compliance costs for smaller enterprises operating in the internal market. The tax simplification proposal introduces a head office tax system for SMEs, allowing them to interact with only one tax administration instead of multiple, which is designed to increase tax certainty, reduce compliance costs, and foster investment and cross-border expansion for SMEs. See European Commission (2024). VAT in the Digital Age. Available at [https://taxation-customs.ec.europa.eu/taxation/value-added-tax-vat/vat-digital-age\\_en](https://taxation-customs.ec.europa.eu/taxation/value-added-tax-vat/vat-digital-age_en).

Harmonisation of national social security regimes and labour income tax codes would make the EU more attractive for both domestic and foreign investments, allowing businesses to leverage the entire EU market to achieve economies of scale and compete globally. A streamlined regulatory environment would also foster innovation and development, particularly in critical sectors like health and technology.

Member States should still be allowed to charge their own social security contributions, such as a percentage of income, and maintain control over their labour income tax rates. This flexibility would enable them to address specific national needs and economic conditions. Ensuring that the overall framework is harmonised while allowing individual countries to tailor their contributions and tax rates to their unique social and economic landscapes would promote a balanced approach to integration. This would support both national sovereignty and the broader goals of EU economic cohesion and growth.

## 5.2. Corporate Tax Code Complexity

Corporate tax policy within the EU continues to face significant challenges, with its complex matrix of national regulations and overarching supranational directives adding layers of administrative and financial burden.<sup>69</sup> Despite ongoing efforts, such as the OECD/G20 "Base Erosion and Profit Shifting" (BEPS) initiative and EU-specific directives like the Anti-Tax Avoidance Directives (ATAD I and II), the corporate income tax landscape has become increasingly convoluted, detrimentally impacting the EU's attractiveness for investments and broader conditions for competition and economic growth.<sup>70 71</sup>

The attempts to curb tax avoidance and increase transparency have, paradoxically, complicated the fiscal environment. Companies now encounter formidable compliance demands, with businesses spending billions annually on tax-related filings (see above). This is particularly burdensome for SMEs, which face disproportionately higher costs relative to their larger counterparts. Moreover, empirical evidence suggests a negative relationship between high tax rates and FDI, indicating that the current corporate income tax regime is reducing economic activity rather than fostering it.<sup>72</sup>

It is widely recognised that corporate investment decisions are highly sensitive to tax rates, as companies carefully consider where to allocate their investment in infrastructure and R&D activities. Empirical studies consistently reveal a negative correlation between FDI and tax rates. One comprehensive study spanning multiple sectors found a tax rate elasticity of nearly -0.7, indicating that a one percent increase in tax rates corresponds to a 0.7 percent decrease in FDI from foreign investors.<sup>73</sup> What's particularly noteworthy is that FDI in R&D activities exhibits

<sup>69</sup> Thomadakis, A. (2023). EU corporate taxation in the digital era—The road to a new international order (CEPS-ECMI Task Force Report). Centre for European Policy Studies.

<sup>70</sup> For companies with turnover in excess of EUR 750 million. See Council Directive (EU) 2016/881.

<sup>71</sup> Council Directive (EU) 2016/881

<sup>72</sup> Commission, E., Directorate-General for Internal Market, E., Industry, SMEs, Council, E. I., Agency, Sme. E., Di Legge, A., Ceccanti, D., Hortal Foronda, F., Németh, M., & Csonka, M. (2022). Tax compliance costs for SMEs – An update and a complement – Final report. Publications Office of the European Union. <https://doi.org/doi/10.2873/180570>

<sup>73</sup> Overesch, M., & Wamser, G. (2009). Who Cares About Corporate Taxation? Asymmetric Tax Effects on Outbound FDI. *The World Economy*, 32(12), 1657–1684. <https://doi.org/10.1111/j.1467-9701.2009.01174.x>

twice the sensitivity compared to the average sector, underscoring the significant impact of tax levels on investment decisions. The recent proposal for a 15 percent minimum corporate tax rate<sup>74</sup>, affecting only large companies, may mitigate the investment incentives arising from tax differentials across locations, but businesses now face substantial new challenges concerning multiple aspects of the tax system, including complexity and the availability of tax incentives.

The corporate income tax landscape within the EU exhibits considerable diversity, adding layers of complexity for companies navigating business activities across different jurisdictions. While governments maintain the authority to determine tax policies and rates, the multitude of regulations has contributed to a labyrinthine tax environment. Figure 8 illustrates the relative tax complexity index for 2022 across EU countries, where data is available, along with comparisons to Switzerland, Canada, the US, and the UK. This index dissects complexity stemming from both the tax code itself, including specific rules associated with various tax instruments, and the administrative procedures necessary for tax system compliance. Notably, Estonia's index indicates a complexity level half that of Poland's. Interestingly, the EU's average tax complexity is lower (0.37) than that of the UK (0.39) and the US (0.4), yet substantially higher than Switzerland's (0.23).<sup>75</sup>

**FIGURE 8: TAX COMPLEXITY INDEX, 2022**



Source: taxcomplexity.org.

Figure 9 shows how complexity has increased in relation to Controlled-Foreign-Company (CFC) rules since 2016, when the Anti-Tax Avoidance Directive (ATAD) regulation was adopted in the EU. According to the OECD, CFC rules "respond to the risk that taxpayers can strip the tax base of their country of residence and by shifting income into a foreign company that is controlled by the taxpayers. Without such rules, CFCs provide opportunities for profit shifting and long-term deferral of taxation."<sup>76</sup> The figure shows that those countries that already had a stringent

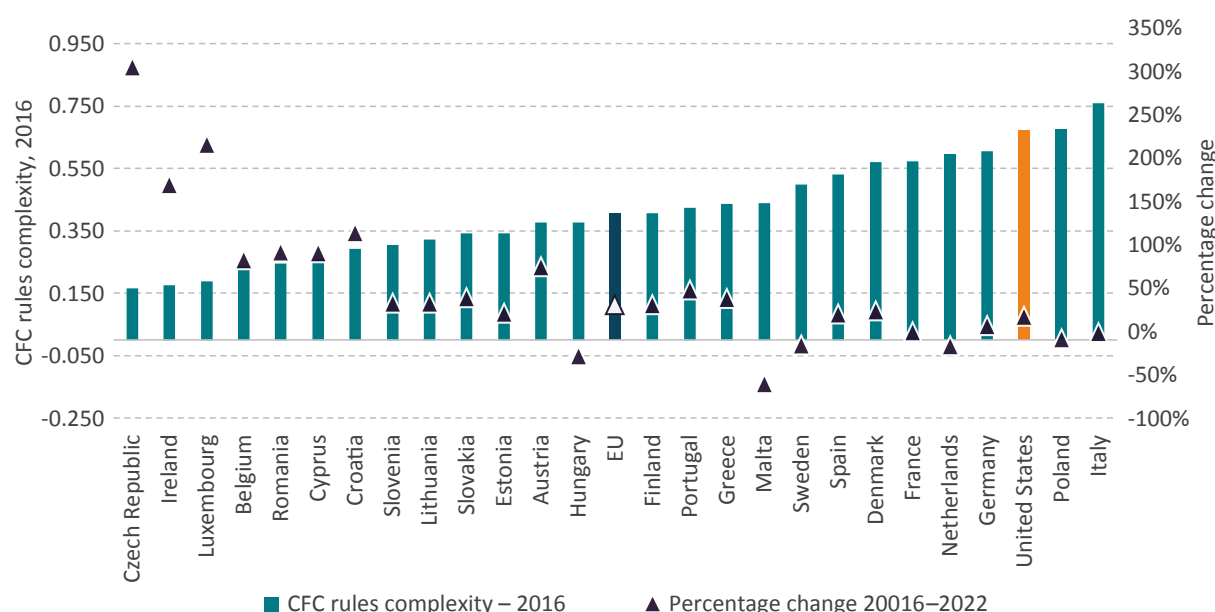
<sup>74</sup> Taxation and Customs Union. (nd) Minimum corporate taxation. Available at: [https://taxation-customs.ec.europa.eu/taxation/corporate-taxation/minimum-corporate-taxation\\_en#:~:text=On%201%20January%202024%2C%20ground,active%20in%20EU%20Member%20States](https://taxation-customs.ec.europa.eu/taxation/corporate-taxation/minimum-corporate-taxation_en#:~:text=On%201%20January%202024%2C%20ground,active%20in%20EU%20Member%20States).

<sup>75</sup> For the methodology, see: Hoppe, T., Schanz, D., Sturm, S., & Sureth-Sloane, C. (2023). The Tax Complexity Index – A Survey-Based Country Measure of Tax Code and Framework Complexity. *European Accounting Review*, 32(2), 239–273. <https://doi.org/10.1080/09638180.2021.1951316>

<sup>76</sup> OECD. (2024). Action 3—OECD BEPS. OECD. <https://www.oecd.org/tax/beps/beps-actions/action3/>

system in 2016 only experienced a modest increase in complexity until 2022. However, those countries that had to converge their standards to the minimum of the Directive experienced a large increase in complexity.

**FIGURE 9: CHANGE IN CFC-RULES COMPLEXITY, 2016-2022**



Source: taxcomplexity.org

## Systemic Ignorance of the Corporate Tax Incidence

The broader economic impact of corporate taxes often shifts burdens onto workers, consumers, and shareholders, complicating the overall assessment of these taxes' effectiveness. The ways in which the firm passes on the additional cost from taxation matters for the overall tax incidence and effectiveness. On top of reducing firms' investment incentives, corporate income taxes have indirect effects on firms' international profit reporting and on workers' wages. A recent study on German firms finds that a EUR 1 increase in the corporate tax bill is associated with a 56 cent decrease in the wage bill, showing the negative effect of higher corporate taxes on wages.<sup>77</sup> This is problematic as it is a clear indication of a non-neutral tax system: the indirect consequences of the tax extend beyond the firm's economic decisions because workers' wages are further impacted.

Corporate transfer pricing regimes are another case of concern. Transfer pricing allows multinational companies to price operations within the group at different prices from market conditions, allowing to optimise on certain transactions. Firms operating across different jurisdictions can therefore lawfully shift profits across different tax systems. To the extent that such behaviour is sizeable, it stems mainly from a difference in national tax rates, whereby the larger the differences across tax systems lead to larger profit shifting behaviour. Though

<sup>77</sup> Fuest, C., Peichl, A., & Sieglöcher, S. (2018). Do Higher Corporate Taxes Reduce Wages? Micro Evidence from Germany. *American Economic Review*, 108(2), 393–418. <https://doi.org/10.1257/aer.20130570>

difficult to estimate, one study reports that one percentage point increase in the corporate tax rate leads to a tax revenue flight of 17.2 percent of the planned tax collection.<sup>78</sup>

## Less Effective Tax Incentives

The European tax system, characterised by its punitive approach and complexity, has often hindered rather than helped attract investments, particularly in crucial areas like R&D and green technologies. Unlike the US Inflation Reduction Act (IRA) system, which provides substantial tax credits and incentives, the EU has traditionally increased costs and complexity for companies without offering comparable benefits. This approach has made it difficult to encourage much-needed investments, as evidenced by a 2022 business survey where R&D-related tax credits were deemed more influential in investment decisions than corporate tax rates.<sup>79</sup>

Given the significant financial requirements of initiatives like the European Green Deal, which aims for climate neutrality by 2050 and necessitates around EUR 1 trillion in investments, the EU must rethink its fiscal strategies. Current tax reforms have not been sufficient to mobilise the necessary private investments. The Letta report suggests that the EU should draw inspiration from the IRA tax credit scheme to mobilise private investments and strengthen the Capital Markets Union.<sup>80</sup> However, the effectiveness of such measures is compromised by high administrative and compliance costs, which deter potential investors.

## 5.3. The Case for Abandoning Corporate Taxes

Considering these significant drawbacks, there is a strong case for a radical shift, including the abolition of taxes on corporate income within the EU accompanied by changes in capital income, labour income, and sales taxes. A bold political move would eliminate the complex web of compliance issues currently plaguing businesses and would substantially enhance the EU's position as an attractive hub for both domestic and international investments. Although some may consider it unrealistic, abolishing corporate income tax within the EU, as opposed to capital income tax, could be a progressive step towards economic efficiency and economic renewal. This shift would enhance social justice by redistributing the tax burden more equitably, ultimately supporting social welfare and reducing income inequality.

The corporate income tax, coupled with substantial legal differences in tax systems across member states, has led to several failures, yet few debates have questioned its actual necessity. Comparing compliance costs against tax revenues from CIT in the EU offers interesting insights. On one hand, taxes on corporate income across the EU amounted to 3 percent of GDP, or EUR 518 billion in 2022, representing 9.2 percent of total tax revenues.<sup>81</sup> On the other hand, the

<sup>78</sup> Huizinga, H., Laeven, L., & Nicodeme, G. (2008). Capital structure and international debt shifting. *Journal of Financial Economics*, 88(1), 80–118. <https://doi.org/10.1016/j.jfineco.2007.05.006>

<sup>79</sup> Teigland, J. L., Bax, H. J., & Lhermitte, M. (2023). How can Europe attract next-generation inward investment? EY. [https://www.ey.com/en\\_be/attractiveness/ey-europe-attractiveness-survey](https://www.ey.com/en_be/attractiveness/ey-europe-attractiveness-survey)

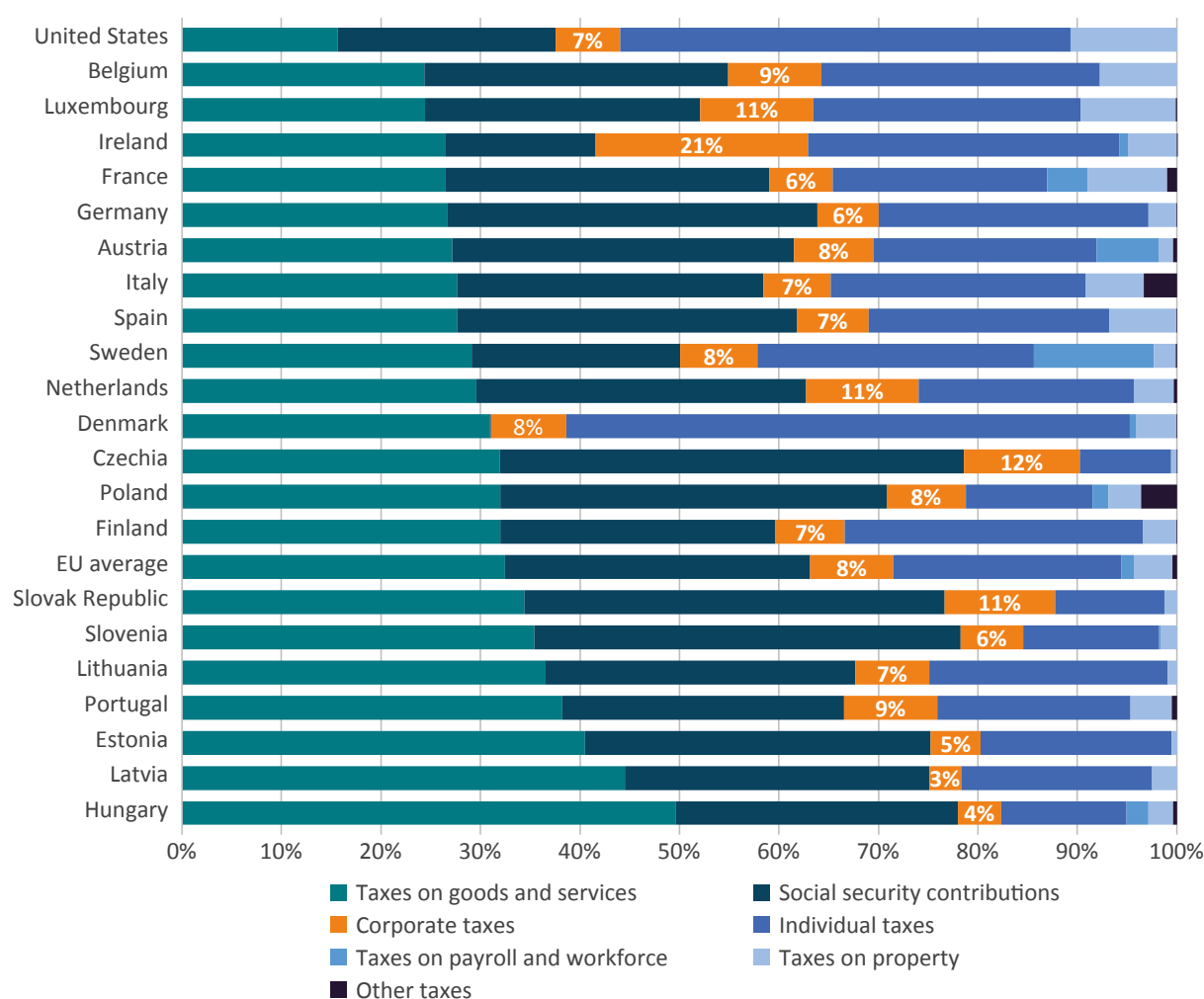
<sup>80</sup> Letta, E. (2024). Much more than a market—Speed, security, solidarity: Empowering the Single Market to deliver a sustainable future and prosperity for all EU Citizens.

<sup>81</sup> European Commission. (2024). Data on Taxation Trends. European Commission. [https://taxation-customs.ec.europa.eu/taxation/economic-analysis-taxation/data-taxation-trends\\_en](https://taxation-customs.ec.europa.eu/taxation/economic-analysis-taxation/data-taxation-trends_en)

compliance costs alone are significant: in 2018, total CIT compliance costs in the EU<sup>82</sup> reached EUR 43 billion, equating to 8 percent of CIT revenue if costs remain unchanged over time.<sup>83</sup>

Data highlights that tax revenues from corporate income tax are surprisingly low across the EU27, typically accounting for less than 10 percent of total tax revenues (Table 10). For instance, France and Germany both report corporate tax revenues at just 6 percent, while Estonia's corporate tax revenue stands at 5 percent. Hungary reports an even lower figure at 4 percent. Despite the significant political debates often centred around corporate taxes, these figures suggest that corporate tax contributions are relatively minor compared to other sources of revenue like individual taxes, social security contributions, and taxes on goods and services. This discrepancy raises questions about the intensity and focus of the political discourse on corporate taxation, given its comparatively small share of overall tax revenue.

**FIGURE 10: TAX REVENUES BY TYPE OF TAX IN 2022, IN PERCENT**



Source: OECD tax revenue statistics 2022.

<sup>82</sup> The EU pertains to the EU-28 countries. Although the UK is included in the sample, this should nonetheless serve as a useful benchmark in the absence of EU-27 CIT compliance cost data.

<sup>83</sup> D'Andria, D., & Heinemann, M. (2023). (see note: 65)

Tax competition is another point of discussion. Firms' investment decisions are sensitive to tax rates, prompting countries to use CIT to attract businesses. This has led to a gradual decline in statutory and effective tax rates (tax competition) and a subsequent decrease in the tax base and relative revenues. The average CIT fell from around 35 percent in 2000 to less than 22 percent in 2021.<sup>84</sup> For example, Bulgaria had a statutory corporate tax rate as low as 10 percent in 2022. In a context requiring significant capital investment, tax competition raises the question of whether CIT is self-defeating.

Additionally, there are several political economy aspects to consider. The CIT rules and rates are subject to influence by various interest groups, such as political entities, industry associations, and tax advisory specialists. Political capture occurs because different governments have varying preferences regarding corporate profits. They could use CIT to advance political goals, particularly targeting sectors and economic activities subject to lobbying, increasing tax code complexity.

Simultaneously, international differences in CIT rules and rates create a substantial market for tax intermediaries, such as law and accountancy firms. Their role is to optimise tax planning for companies operating in multiple jurisdictions, making them valuable service providers. However, the more complex the tax system, the higher the compliance costs, leading firms to increasingly rely on tax intermediaries. These advisory firms might also lobby government authorities to maintain the status quo or at least not reduce tax system complexity. With their expertise, tax intermediaries are often consulted on tax system reforms, especially those related to corporate taxes. Additionally, the largest tax advisory firms typically advise finance ministries and the European Commission, conducting studies and impact assessments. They leverage their rich pool of data and legal expertise to provide valuable insights and recommendations.

## Alternative Revenue Sources

Reducing or eliminating corporate taxes would dramatically simplify the tax code, reducing administrative burdens and compliance costs, and making the EU more attractive for business operations. This approach would also create a more predictable legal environment, conducive to economic planning and long-term investments.

To compensate for the potential revenue loss from abolishing corporate taxes, the EU could consider enhancing other forms of taxation, such as taxes on capital income and labour income, and sales taxes. These tax streams can be more straightforward to administer and might prove less distortive to economic incentives:

- **Labour Income Taxes:** Adjusting labour income taxes could balance the fiscal shift, potentially with progressive structures that protect lower-income workers while ensuring sufficient revenue generation.

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<sup>84</sup> Thomadakis, A. (2023). EU corporate taxation in the digital era—The road to a new international order (CEPS-ECMI Task Force Report). Centre for European Policy Studies.



- **Sales Taxes:** Modifying sales taxes, possibly with variances based on the essential nature or luxury status of goods and services, could help offset the revenue shortfall from eliminating corporate taxes.
- **Capital Income Taxes:** Increasing capital income taxes could target investment earnings more effectively, aligning tax obligations with the ability to pay.

## Alternatives to Tax Incentives

Abolishing corporate income tax in the EU could address these challenges by reducing administrative and compliance costs, making the fiscal landscape more attractive for businesses. Instead of a punitive tax system, governments could implement direct subsidies targeted at critical sectors such as green technologies and R&D. These direct subsidies can be more accountable and transparent, ensuring that funds are used effectively and reach the intended sectors. This approach could simplify the fiscal environment, allowing businesses to allocate more resources towards innovation and growth.

Furthermore, direct subsidisation allows for greater flexibility in fiscal policy, enabling governments to respond swiftly to emerging economic needs and priorities. By providing tailored support to sectors facing specific challenges, resources can be allocated more efficiently. This strategy could enhance the overall investment environment, potentially increasing FDI and positioning the EU as a more competitive and attractive destination for global investors. In essence, abolishing corporate income tax and adopting direct subsidies could help the EU achieve its ambitious economic and environmental goals, such as those outlined in the European Green Deal, by fostering a more supportive and dynamic investment climate.

## 6. TECHNOLOGY POLICY AND DIGITAL TRADE

As the EU strives to maintain and enhance its position in the global economic landscape, the role of technology diffusion and technological openness becomes increasingly critical. Technology diffusion is essential for the economic vitality of the EU, enhancing productivity, fostering innovation, and enabling European companies to compete effectively on a global scale. The free flow of data, fundamental to investment decisions today, significantly impacts the EU's appeal as a hub for data-driven industries. By promoting policies that ensure data accessibility and robust data protection, the EU can advance its leadership in the digital economy. Initiatives that facilitate cross-border data flows and foster a unified digital market are vital for the growth of tech companies and the attraction of international investments.

## Addressing Regulatory Barriers in Non-Digital Sectors

The digitisation of non-digital sectors in the EU also faces significant regulatory barriers, which hinder the broader adoption of digital technologies across the EU. For instance, taxi services<sup>85</sup> and healthcare services<sup>86</sup> are often regulated at the national level, creating fragmented markets that are resistant to digital transformation. These regulatory frameworks can limit the entry and operation of innovative digital services such as ride-sharing platforms and telemedicine.

One significant obstacle to the digitalisation of non-digital sectors in the EU is the lack of clarity and consistency in the application of national export controls on digitally enabled exports. For instance, it is often unclear whether an export license is required for storing dual-use software or technology in the cloud. This uncertainty hinders businesses from fully embracing digital solutions, as they may inadvertently violate export control regulations (for example, is an export license required when storing dual-use software or technology in the cloud). The inconsistency in regulatory interpretation across different Member States further complicates compliance efforts for companies operating in multiple countries within the EU. Consequently, this regulatory ambiguity stifles innovation and slows the pace of digital transformation in various industries. The European Commission's recent initiative to compile national export control lists is thus crucial for enhancing coordinated export controls across the EU.<sup>87</sup>

Furthermore, the adoption of cloud services by government agencies remains low across most Member States, restricting the potential benefits of digital transformation in the public sector. This low adoption rate is often due to stringent national regulations, security concerns, and a lack of non-discriminatory standards for cloud services in the public sector.<sup>88</sup> Encouraging government agencies to adopt cloud solutions can lead to increased efficiency, cost savings, and improved public services.

Addressing these systemic challenges requires a coordinated effort between the EU and Member States to harmonise regulations and promote the integration of digital technologies. By revising regulatory frameworks and encouraging the use of digital solutions in traditional sectors, the EU can foster a more conducive environment for technological innovation and diffusion.

## Addressing the Complex Nature of Digital Ecosystems

The current regulatory framework, primarily influenced by the DMA, views large digital platforms predominantly as infrastructure providers rather than as complex "digital ecosystems."<sup>89</sup> This

<sup>85</sup> See, e.g., European Commission (2022). Commission Notice on well-functioning and sustainable local passenger transport-on-demand (taxis and PHV). Available at [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52022XC0204\(03\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52022XC0204(03)&from=EN).

<sup>86</sup> See, e.g., European Commission (2024). Healthcare Policy in the EU. Available at [https://health.ec.europa.eu/eu-health-policy/overview\\_en](https://health.ec.europa.eu/eu-health-policy/overview_en).

<sup>87</sup> European Commission (2023). EU enables coordinated export controls by compiling national lists. Available at [https://policy.trade.ec.europa.eu/news/eu-enables-coordinated-export-controls-compiling-national-lists-2023-10-26\\_en](https://policy.trade.ec.europa.eu/news/eu-enables-coordinated-export-controls-compiling-national-lists-2023-10-26_en).

<sup>88</sup> See, e.g., Politico (2023). European public sector seeks multi-cloud approach to services. Available at <https://www.politico.eu/sponsored-content/european-public-sector-seeks-multi-cloud-approach-to-services/>.

<sup>89</sup> Network Law Review (2023). Eliana Garces: Regulation and Competition in Digital Ecosystems: Some Missing Pieces. Available at <https://www.networklawreview.org/digital-ecosystems-missing-pieces/>.

perspective potentially overlooks the dynamic and value-generating aspects of these platforms. Large digital platforms function as ecosystems, facilitating joint production and innovation through complex interactions among various stakeholders. Effective regulation should recognise these ecosystems' value generation mechanisms, ensuring that policies do not inadvertently stifle innovation by imposing overly rigid structures.

A digital ecosystem is a complex network of interconnected digital platforms, services, and participants that collectively generate value through their interactions. Unlike traditional businesses, digital ecosystems encompass a variety of stakeholders, including individual users, businesses, developers, and service providers, all of whom contribute to and benefit from the ecosystem's overall value. These ecosystems facilitate joint production of value, often through shared technology infrastructure and collaborative innovation. They are characterised by dynamic interactions, continuous evolution, and the ability to adapt and expand by integrating new capabilities and services. This interconnected and collaborative nature makes digital ecosystems particularly effective at fostering innovation, reducing transaction costs, and creating efficiencies that drive competitive advantage and growth in the digital economy.

Accordingly, large technology companies and digital platforms are more than mere intermediaries; they are complex, multi-stakeholder ecosystems that generate significant value through the integration and coordination of various participants, including users, businesses, and third-party developers.<sup>90</sup> Incorporating insights from ecosystem theory can enhance regulatory approaches by acknowledging the generative and evolutionary nature of digital platforms. This involves understanding that platforms are not static entities but continuously evolve, integrating new technologies and expanding into new markets.<sup>91</sup> Recognising this dynamism can lead to more nuanced and effective regulatory interventions. For example, platform participants, including individual users, typically create and contribute to the platform's value, enhancing the overall ecosystem. This joint production of value takes the form of contributing, sharing, or integrating resources, such as user-generated content or third-party applications.

Furthermore, platform owners actively contribute to and build for the development and success of the complementary services they support. This includes developing core platform technologies, offering tools and resources for developers, and establishing governance mechanisms to align participants' interests. Effective regulation should therefore aim to preserve these value-generating capabilities while ensuring fair competition and consumer protection.

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<sup>90</sup> See, e.g., Akman (2022). Regulating Competition in Digital Platform Markets: A Critical Assessment of the Framework and Approach of the EU Digital Markets Act. Available at <https://eprints.whiterose.ac.uk/181328/7/Akman%2C%20DMA%2C%20ELR%201-12-21%2C%20SSRN.pdf>.

<sup>91</sup> See, e.g., ITIF (2021). The Digital Markets Act: European Precautionary Antitrust. Available at <https://www2.itif.org/2021-digital-markets-a4.pdf>.

## 6.1. Need to Draft Innovation-Friendly Digital Policies

The investment gap between the EU and the US in ICT and cloud-related sectors, totalling some USD 1.36 trillion, presents a significant challenge for native European companies.<sup>92</sup> To maintain competitiveness and foster a vibrant digital economy, the EU must draft innovation-friendly digital policies that do not discriminate against non-EU operators. An inward-looking approach to cloud computing and data policies – as envisaged by supporters of a European Cloud Cybersecurity Regime (EUCS) – risks stifling innovation and competitiveness by promoting domestic champions at the expense of accessing global cloud capabilities.<sup>93</sup> Limiting market diversity and access to best-in-breed solutions could hinder digital transformation across sectors, raising costs and constraining growth opportunities. By contrast, a free trade approach to cloud computing can offer guardrails and security while championing non-discriminatory cross-border and regulatory policies, yielding economic advantages by stimulating investments, fostering innovation, and enhancing competition.

A non-discriminatory, technical requirement-based approach (as originally intended by the European Commission) would ensure competition, innovation, and ensures access to the best cloud solutions. This approach also aligns with international agreements, supports economic growth, and aids the EU's digital transformation goals without imposing harmful restrictions. Importantly, globally leading cloud service providers offer industry-leading cybersecurity capabilities, which is particularly important during a period of heightened malicious cyber activities. They also provide technical tools to ensure their EU users have full control over their data, such as encryption, data localisation options, and Sovereign Cloud solutions with physically and logically discrete architectures. Sovereignty measures create operational inefficiencies and hinder seamless cybersecurity management, stifling innovation and economic growth. Abandoning restrictive sovereignty requirements would foster a more open and secure digital ecosystem, crucial for maintaining the EU's competitive edge in the global market. Failure to do so risks not only technological stagnation but also economic divergence within the EU, disproportionately affecting smaller Member States.<sup>94</sup>

Unfortunately, some EU policymakers still envision Europe building an independent ICT infrastructure, exemplified by initiatives like the European Alliance on Industrial Data, Edge and Cloud.<sup>95</sup> This approach prioritises arbitrary and discriminatory criteria, e.g., favouring data localisation and country-of-headquarter policies, while ignoring the technical solutions offered by some global CSPs that allow European users to remain in full control of their data. However, the resources required for "pure-EU firms" to rise as significant competitors

<sup>92</sup> To catch up by 2030, 2040, and 2050, European technology companies would need to substantially increase annual investments, ranging from approximately USD 157 billion to USD 1.2 trillion annually, representing 0.8 percent to 6.4 percent of the EU's GDP. This underscores the urgency for an open and non-discriminatory EU policy approach to bolster Europe's position in the rapidly growing and technologically changing digital landscape. See ECIPE (2024). The EU's Trillion Dollar Gap in ICT and Cloud Computing Capacities: The Case for a New Approach to Cloud Policy. Available at <https://ecipe.org/publications/eu-gap-ict-and-cloud-computing/>.

<sup>93</sup> ECIPE (2023). Building Resilience? The Cybersecurity, Economic & Trade Impacts of Cloud Immunity Requirements. Available at <https://ecipe.org/publications/resilience-cybersecurity-economic-trade-impacts-cloud-immunity/>. Also see, ECIPE (2023). The Economic Impacts of the Proposed EUCS Exclusionary Requirements: Estimates for EU Member States. Available at <https://ecipe.org/publications/eucs-immunity-requirements-economic-impacts/>.

<sup>94</sup> Ibid

<sup>95</sup> European Commission (2024). European Alliance for Industrial Data, Edge and Cloud. Available at <https://digital-strategy.ec.europa.eu/en/policies/cloud-alliance>.

to global leaders are so large that it would drain other sectors of investments and human capital.<sup>96</sup>

## **6.2. Key Changes to Consider in EU Digital and Technology Policy**

As the EU navigates the digital economy, it must balance regulation and openness to foster innovation and growth. Refining data protection standards, promoting a unified digital market, and engaging in global digital integration will enhance its global competitiveness.

### **Promoting a Unified Digital Market**

Achieving a comprehensive Digital Single Market remains a goal rather than a reality. The EU and its Member States need to enact broad single-market policies that reduce cross-border business barriers and regulatory costs. This includes revising data regulations to provide clarity and foster opportunities for innovation and experimentation. Countries within the Dg+ group, recognised for their digitally-oriented and open economies, should lead in developing these digital regulations and advocating for an open digital economy across Europe. At the same time, it is crucial to prevent national "gold-plating" of EU legislation, such as the AI Act, NIS2 Directive, and Data Act, to ensure uniformity and avoid unnecessary regulatory burdens.<sup>97</sup> Also, the development of cybersecurity certification schemes should strictly adhere to technical criteria, avoiding non-technical factors that could complicate compliance. Lastly, preserving and enhancing "One-Stop-Shop" mechanisms for regulatory compliance and reporting, particularly for data protection and cybersecurity, could significantly streamline processes, improve regulatory efficiency, and reduce administrative costs for businesses.

### **Global Digital Integration and Free Flow of Data**

Active engagement in global digital integration is crucial. This involves not just enhancing internal policies but also fostering international collaborations, particularly with leading technological nations like the US. The substantial investments made by US tech companies in Europe demonstrate a significant mutual dependency, which can be leveraged to fortify both the digital and non-digital sectors of European economies. Additionally, maintaining the free flow of data globally is essential for supporting innovation and economic growth. The EU's position in the World Trade Organisation should reflect this commitment to ensuring data flows freely across borders, facilitating global trade and cooperation.

While the General Data Protection Regulation (GDPR) sets high data privacy standards, its stringent demands can inadvertently erect barriers to innovation. Member States can

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<sup>96</sup> See ECIPE (2024). (see note: 92)

<sup>97</sup> Gold plating refers to the practice of a member state adding additional regulatory requirements or standards to EU legislation during its transposition into national law. These additional measures exceed the minimum requirements set by the EU directive, leading to more stringent regulations that can increase the complexity and compliance burden for businesses.

still regulate data protection at the national level in specific areas, such as public interest exceptions, employment data, and health data, allowing for tailored approaches that address local needs while maintaining overall EU-wide standards. The EU must consider policy adjustments that lessen these regulatory burdens. Harmonising data policies and eliminating obstacles to data flows can improve the EU's global digital economic competitiveness and attract further data-centric investments.

To further these goals, the EU should be encouraged to ensure that the WTO Joint Statement Initiative on E-commerce is commercially meaningful and swiftly ratified; continue working with G7 partners to develop the "Data Free Flow with Trust" initiative into a robust operational framework with concrete trustworthiness criteria and clear governance systems; continue engaging constructively within international standardisation bodies and avoid diverging from internationally agreed technical standards in EU legislation, such as in the implementation of the AI Act; and explore modernising or supplementing existing FTAs with provisions to facilitate the free flow of data, building, for example, on the EU-Japan agreement on cross-border data flows. These actions will support a cohesive approach to digital regulation, enhance global cooperation, and ensure that Europe remains at the forefront of the digital economy.<sup>98</sup>

## Reconsidering Artificial Intelligence Policies

As artificial intelligence (AI) becomes increasingly integral to economic and societal functions, the EU must approach its regulation thoughtfully. Digital policy concerning AI should be enacted primarily when it is urgent to protect consumer rights or fundamental human rights. This necessitates a balanced approach to AI development and adoption, ensuring that innovations in AI are neither unduly hampered by restrictive laws nor left unchecked to the detriment of societal norms.

Given how rapidly AI is developing, EU lawmakers should pause any legislation until they better understand what exactly it is they are regulating. There is likely an equal, if not greater, risk of unintended consequences from poorly conceived legislation than from poorly conceived technology. Unfortunately, fixing technology is usually much easier than fixing bad laws. Therefore, policymakers should very, very carefully monitor EU-based AI developments to ensure they strike the right balance between fostering innovation and protecting societal interests.

Furthermore, many AI providers within the EU have expressed concerns about the potential introduction of stringent regulations. These providers fear that such regulations could inadvertently strengthen the market position of the largest global AI companies, primarily based in the US and China. These technologically advanced players already have vast resources and can more easily absorb the costs and complexities of compliance with new regulations. In contrast, smaller EU-based companies might struggle with these burdens, stifling their growth and innovation potential. The risk is that heavy-handed regulations could

<sup>98</sup> See: WTO, Joint initiative on e-commerce. Available at: [https://www.wto.org/english/tratop\\_e/ecom\\_e/joint\\_statement\\_e.htm](https://www.wto.org/english/tratop_e/ecom_e/joint_statement_e.htm); G7, (2023). Ministerial Declaration - The G7 Digital and Tech Ministers' Meeting. Available at: <https://g7g20-documents.org/database/document/2023-g7-japan-ministerial-meetings-ict-ministers-ministers-language-ministerial-declaration-the-g7-digital-and-tech-ministers-meeting>; EU and Japan conclude landmark deal on cross-border data flows at High-Level Economic Dialogue (signed October 28, 2023)

create a competitive imbalance, making it increasingly difficult for EU firms – small and large – to compete on a global scale.

The EU should focus on winning the innovation race, not the regulation race. AI promises to open a new wave of digital progress in all sectors of the economy, but it is not operating without constraints. Existing laws and regulations apply, and it is still too soon to know exactly what new rules may be necessary. Policymakers should ensure that any regulatory framework developed does not disproportionately impact smaller and emerging companies. By maintaining a vigilant yet cautious approach, they can avoid creating a market environment where only the largest providers thrive.

## **Encouraging Advanced Cloud Computing Integration**

There are different components to a successful cloud policy, including policies to spur adoption and cross-border cloud integration in the EU, and more investment in R&D. EU policymakers should adopt a dynamic perspective rather than fixating on static market shares, and pursue policies that prioritise innovation and technological advancement over merely seeking to catch up on current technologies. The cloud market and the broader Internet market are going through rapid changes, leading to new services and new competition. A future-oriented approach to cloud policy advocates for policies that foster competition, drive technological progress, and enable interoperability, all of which align with the dynamic nature of cloud services and global markets.

## **7. CONCLUSIONS AND POLICY RECOMMENDATIONS**

The EU faces significant challenges in maintaining its competitiveness and attractiveness for investment due to complex and fragmented regulations that hinder innovation and economic growth. To address these issues, bold reforms are essential.

This paper proposes major horizontal reforms, discussion three pivotal horizontal policies that urgently require reform: EU competition policy, tax policies, and digital policies. We caution against political complacency, emphasising the necessity to make Europe significantly more attractive for private-sector investments, which heavily rely on accommodating economic, trade, and technology policies, with benefits extending to large as well as smaller and growing enterprises.

To enhance EU competition policy and productivity, the European Commission and national governments must distinguish between innovative firms and those engaging in anti-competitive practices. Harmonising regulations will reduce compliance costs and eliminate legal uncertainties, crucial for digital economy growth. A risk-based approach should focus on high-impact cases like cartels for effective enforcement. Strengthening the European Commission and courts is essential to maintain market fairness without stifling large enterprises. An evidence-based approach to mergers and competition enforcement in markets for digital services will improve consumer welfare and market efficiency.

Harmonising tax and social security frameworks is crucial to reduce legal uncertainties and compliance costs. Simplifying VAT systems, aligning social security laws, and ensuring a uniform approach to competition policy across Member States would foster a more conducive environment for business operations. By prioritising efficiency and reducing excessive regulation, the EU can enhance its attractiveness to both domestic and foreign investors, promoting long-term economic growth and innovation. Abolishing corporate income taxes in the EU would simplify compliance, reduce administrative burdens, and enhance attractiveness for investment. To offset revenue loss, the EU could enhance other forms of taxation, such as taxes on capital income, labour income, and sales taxes. Direct support targeted at critical sectors like green technologies and R&D could replace opaque corporate tax incentives, ensuring funds reach intended sectors and promoting innovation and growth. This approach would support the EU's economic and environmental goals while fostering a dynamic investment climate.

The EU should adopt a forward-looking perspective on digital and technology policies. Emphasising data accessibility, promoting a unified digital market, and engaging in global digital integration will enhance the EU's global competitiveness. Balancing regulation with openness and fostering innovation-friendly policies will ensure the EU remains at the forefront of the digital economy. Streamlined regulatory frameworks and targeted subsidies will enable the EU to achieve its economic and environmental goals, positioning it as a leader in the global market.

Implementing these reforms will require substantial political will, which may vary across the EU27. Coalitions of willing governments could take initial steps, demonstrating the benefits and paving the way for other Member States to follow. This phased approach would allow pioneering countries to lead by example, fostering broader acceptance and eventual adoption of the necessary reforms across the EU.