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Europe's Quest for Global Economic Relevance: On the Productivity Paradox and the Draghi Report

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Abstract: Europe's existential economic challenge has been laid bare in Mario Draghi's September 2024 competitiveness report. The continent faces a profound productivity crisis, one that threatens to relegate Europe to the margins of global economic influence. Yet, while the report offers a comprehensive diagnosis and prescribes remedies for Europe's anaemic productivity growth, it overlooks a crucial dimension: the power of place. This paper examines how this territorial oversight undermines the report's effectiveness. We argue that Europe's path to renewed economic vigour lies not in homogeneous continental strategies, but in harnessing its potential and diverse regional capabilities. The continent's economic renaissance depends on recognising that its apparent weakness – its territorial diversity – may indeed be a great strength. From our perspective, unlocking Europe's latent potential requires policies tailored to regional specificities. Only by embracing rather than suppressing its endogenous potential, wherever it can be found, can Europe hope to reverse its productivity decline. The challenge ahead is not merely technical but fundamentally territorial: Europe must craft a future where productivity growth emerges from its territorial distinctiveness, not in spite of it.

Keywords: Draghi report, European competitiveness, regional dimension.
JEL classification: R10, R58.

1. Introduction: the European challenge

There is something both revealing and unsettling about Europe's latest bout of economic soul-searching. The European Union's September 2024 report on competitiveness – the «Draghi report» (Draghi, 2024), named after its coordinator Mario Draghi – reads less like a bureaucratic or scientific document and more like a confession. In its mission is to bring to the fore the critical challenges the European economy is confronted with, it unveils uncomfortable truths about the continent's economic recent trajectory.

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The numbers tell a brutal story. Over two decades, Americans have seen their disposable income grow at twice the European rate. The culprit is not hard to identify: a grinding slowdown in productivity growth that has haunted Europe since well before the dawn of this millennium. The continent finds itself not merely trailing the United States but also watching how China and other formerly emerging economies, such as Singapore, South Korea, or Taiwan, disappear over the innovation and productivity horizon. Draghi does not mince his words. Should Europe maintain its anaemic productivity growth rate, it would barely keep GDP constant until 2050. Europe's position in the world will sink into almost irrelevance, becoming a marginal player in a thoroughly redefined world stage. This at a moment when the continent faces an existential challenge that demands investments of historic proportions (Draghi, 2024, p. 1).

The technological revolution has largely passed Europe by. That only four of the world's top fifty tech companies are European is not merely a statistic; it is an indictment of the state of Europe's economy. Having missed the first wave of digital innovation, Europe cannot afford to be late to the next. Meanwhile, its firms labour under energy costs that would make an American industrialist blanch: electricity prices two to three times higher than across the Atlantic, gas prices four to five times dearer.

For Draghi (2024), what was once a concerning trend has metastasised into something far more ominous. The old economic order, where European prosperity could piggyback on expanding global trade, has expired. The continent finds itself caught in the crossfire of American-Chinese decoupling, buffeted by Washington's muscular industrial policies, and wrong-footed by geopolitical upheavals from Ukraine to the Middle East. «The days of unchecked offshoring and blind resilience on imports are over», declared the Spanish 2023 Presidency of the EU (Spanish Presidency, 2023, p. 26). Europe must now walk a frail tightrope: protecting its trade interests while reducing external dependencies. This is a feat easier proclaimed than achieved.

The scale of investment required is breathtaking. To digitalise and decarbonise while bolstering defence capabilities, Europe must increase investment by roughly 5 percentage points of GDP, a level not seen since the economic golden age of the 1960s and 1970s. For perspective, this dwarfs the Marshall Plan's contribution of 1-2% of GDP annually between 1948 and 1951 (Draghi, 2024, p. 1). The continent stands at the foot of a monetary and investment mountain.

2. The path to productivity relaunch: a European dilemma

The Draghi report prescribes three remedies to the slowdown in productivity: *a*) closing the innovation gap; *b*) advancing decarbonisation; and *c*) reducing dependencies. Its recommendations within each domain are precise, technocratic, and entirely sensible. They are also, in their current form, partial.

In the realm of innovation, Draghi advocates strengthening Research and Innovation (R&I) programmes, promoting coordination across member states, raising the standard of European academic institutions to global prominence, and nurturing an environment where disruptive innovation can flourish.

For energy policy, it champions a technology-neutral approach to accelerating decarbonisation, supporting clean-tech manufacturing while remaining pragmatic about available solutions to speed up the green transition.

The recommendations for reducing dependence align with *Open Strategic Autonomy* (European Commission, 2022) principles, though the report maintains a diplomatic silence on this connection. The *Open Strategic Autonomy* strategy emphasises the importance of the EU's ability to act independently on the global stage and to shape international relations proactively. At the same time, it calls for the EU to secure the capacity to uphold its external policy goals without over-reliance on international partnerships, ensuring its autonomy as a global actor. In line with this, the report proposes strengthening internal industrial capacity to produce critical raw materials, harnessing domestic resources through mining, recycling, and innovation in alternative materials, and pursuing a coordinated EU strategy to expand domestic production capacity.

3. What about territory?

Yet for all its analytical rigour, the report harbours a curious blind spot: territory. While masterful in comparing Europe to its global competitors, it appears strangely myopic about Europe's own endogenous economic potential and pronounced geographical diversity. The productivity slowdown malaise affects different regions with varying degrees of intensity, creating what might be called a patchwork of stagnation. As the High Level *Forging a Sustainable Future* report on the Future of Cohesion Policy (European Commission, 2024) underlines, development traps compound this uneven distribution, creating cycles of low growth and limited opportunity in vulnerable regions – including, paradoxically, wealthy and middle-income areas grappling with profound structural challenges.

This oversight matters greatly. The development traps (Diemer *et al.*, 2022) that ensnare not just lagging-behind regions, but also prosperous and formerly prosperous ones represent more than a threat to social equality. They are a drag on aggregate European economic performance. The continent's potential for innovation and growth lies scattered across its territory like uncut diamonds, waiting to be discovered and polished. Regions caught in these traps – those «unable to retain economic dynamism in terms of income, productivity, and employment, while also underperforming national and European peers on these same dimensions» (*ibidem*, p. 489) – are not economic deserts but gardens gone fallow that require urgent attention.

Consider four unlikely success stories: BioNTech's COVID-19 vaccine emerging from Mainz (Germany), Novo Nordisk's diabetes and obesity breakthroughs in Copenhagen (Denmark), or the retail empires of IKEA and Inditex sprouting from such improbable places as Älmhult (Sweden) and Arteixo (Spain), respectively. These examples suggest that European excellence need not – indeed, should not – be confined to the usual suspects among its main innovative cities and regions.

4. The regional imperative

Innovation, like wine, takes on the character of its terroir. Each European region has developed its own distinctive «mode of innovation» – some excel at generating new knowledge through R&D laboratories and universities, others at commercialising breakthroughs through entrepreneurship and creativity, whilst many demonstrate remarkable aptitude for creative imitation (Capello, Lenzi, 2013). To ignore these differences in the name of continental strategy would be akin to forcing Bordeaux to produce Riesling, or Chianti to imitate Rioja.

The implications of ignoring this regional diversity in research, innovation, and production are profound. The territorial dimension of innovation may be conducive to a stronger competitiveness through cost reduction, and/or increased productivity gains. On the one hand, excessively concentrating investment in R&D in a few innovation hubs within the European Research Area (ERA) may lead to decreasing returns. For more investment in R&D to become more efficient and productive, the «R» component funding should target regions with robust knowledge-creation capabilities. Success stories located in other advanced economies exist that provide excellent examples, such as the celebrated Silicon Valley, which boasts some of the highest levels of land rent worldwide. The «D» component – improving the environment for adopting disruptive innovation – demands investment in areas where local entrepreneurs can effectively leverage creativity. Meanwhile, efforts to close skill gaps should focus on regions where adaptive imitation prevails, helping them integrate established innovations.

On the other hand, scientific studies show that allocating R&D funding to regions better suited to adaptive imitation than disruptive innovation can be counterproductive, potentially reducing GDP growth compromising these regions' innate capacity to absorb and adapt innovations (*ibidem*). This challenge becomes particularly acute in territories with embryonic research capabilities, where R&D investment yields meaningful returns only after reaching a critical mass (*ibidem*).

The question of trade policy and economic security presents similar complexities. The laudable aim of reducing external dependencies through domestic mining of critical raw materials and the promotion of «strategic» industries carries hidden geographical consequences. Without careful design, such policies risk becoming a form of economic favouritism, channelling opportunities toward regions already blessed with resources and better endowments from infrastructure to human capital and technology.

The spectre of reindustrialisation raises particularly thorny questions. The romance of bringing manufacturing «home» – whether through backshoring, near-shoring, or friend-shoring – obscures an uncomfortable truth: these processes, if realised, will not spread their bounty evenly across Europe's regions. The factories of tomorrow, humming with robots and digital systems, will naturally gravitate toward existing centres of excellence. This «double dark side» of reshoring and reindustrialisation (Capello *et al.*, 2025) threatens to deepen inequalities both between and within regions, as technological progress concentrates the highest value industries in a handful of European innovation hubs (Capello, Cerisola, 2024).

However, the report's silence on regional productivity strategies risks much more than economic inefficiency. It courts social and political danger. Rising discontent and Euroscepticism feeds on precisely the sort of territorial inequalities that an overly centralised approach to innovation and industrialisation might exacerbate (Rodríguez-Pose *et al.*, 2024). The path to higher productivity cannot bypass the fact that unchecked economic concentration is a fundamental source of public discontent. That such a concentration of advanced industrial production in already dynamic cores will not only undermine cohesion, but also strike at the very glue that binds all Europeans together around a common objective (European Commission, 2024). This is particularly risky in a polity that is becoming increasingly fragile and fragmented and where economic and political nationalism is resurfacing.

Moreover, the fixation on «European champions» in sectors where our competitors are already looking at Europe through the rearview mirror seems particularly misguided. It will put the emphasis on areas in which Europe is bound to struggle enormously to catch up and condemn Europe to be a follower rather than a leader for decades to come, effectively banishing the continent to a minor role in the world stage. As the Forum Disuguaglianze Diversità (2024) warns, this approach could also result in monopolistic practices that stifle regional innovation and consumer choice, weakening the very market competition the EU seeks to promote.

The notion of repatriating manufacturing jobs to Europe also presents significant practical challenges. In a period marked by demographic shifts and persistent labour shortages, a meaningful industrial revival requires three interconnected developments: adjustments to immigration policy, selective reinvigoration of industrial capabilities in specific territories, and enhanced access to critical raw materials. Yet, such aspirations, although legitimate, may encounter considerable political obstacles.

Immigration policy remains a delicate and highly controversial matter across member states, while the emphasis on raw material extraction introduces certain tensions with the EU's environmental objectives and green transition targets. The geographical concentration of both industrial heritage and raw material deposits suggests that economic benefits might flow unevenly across regions, potentially affecting territorial balance.

The reindustrialisation and re-shoring proposals raise interesting questions about their alignment with established European priorities. The emphasis on resource extraction introduces nuanced policy challenges when considered alongside the European Green Deal's environmental protection framework (Rodríguez-Pose, Bartalucci, 2024). Similarly, the revival of traditional industrial practices in specific regions presents an intricate balance with the EU's aspirations for sustainable economic transformation. These considerations highlight the subtle complexities inherent in reconciling various policy objectives.

Overall, there is something almost perverse about the potential outcome: a strategy designed to strengthen Europe could end up weakening its social fabric. Prioritising economies of scale in sectors where the EU is already well behind, while simultaneously overlooking the latent economic potential of many areas of the continent, risks creating what one might call a tale of two Europes: one trying to catch the last train to a digital future, the other neglected, watching from the sidelines, and, ultimately, dragging the rest of Europe further down.

5. Conclusions: a more nuanced path forward

The solution does not lie in abandoning the pursuit of competitiveness. Indeed, competitiveness should be at the heart of every development strategy and every Euro invested. But for these strategies and investment to yield results, there must be a recognition that Europe's strength flows from its endogenous potential and diversity. This calls for a serious effort to identify Europe's potential, wherever it can be found, rather than trying to mirror strategies done elsewhere but where we are arriving late. Europe needs a more sophisticated approach that sees regional variation not as an obstacle to be overcome, but as an asset to be leveraged and utilised.

Hence, Europe has to bet on place-based or place sensitive policies (Iammarino *et al.*, 2019). That is development strategies tailored to the specific potential and needs of each European region, as a one-size-fits-all approach risks inefficient resource allocation and more polarisation. Adjusting investment to each region's innovation mode – whether knowledge creation, commercialisation, or adaptive imitation – would contribute to greatly enhance the productivity returns of the competitiveness investment proposed by Draghi. A European competitiveness policy that takes the economic potential of each territory into account, based on a serious analysis of the endogenous conditions of every region in Europe – as already suggested by the Barca report in 2009 (Barca, 2009) – can have a significant impact on aggregate European productivity.

Such a policy also requires measures to addressing the innovation gap, a key factor for revitalising European competitiveness. The manner in Europe bets on innovation will determine its future. Innovation tends to concentrate geographically, but too much concentration leads to economic inefficiencies and sparks social and political risks. Europe thus needs innovation and development that spread across many parts of the continent. Actions which go beyond the usual innovation hubs can unlock Europe's full competitive potential and economic efficiency. They are also fundamental to ensure that any innovation becomes more inclusive (Lee, 2024). This may also mean developing technology transfer mechanisms that help spread innovation from centres to peripheries or creating incentives for high-value industry to set down roots in unexpected places.

Aligning these efforts with a performance-based cohesion approach, as advocated in the *Forging a Sustainable Future* report (European Commission, 2024), will enable targeted and measurable results that directly benefit regions not firing on all cylinders, as well as Europe as a whole. Identifying endogenous potential and targeting investment to that potential, wherever it can be found, will, on the one hand, ensure social and political stability and, on the other, mean that the no latent potential across the EU goes untapped (*ibidem*). Benefits in terms of innovation and productivity growth will ensue and will be stronger than betting on industries and sectors where, as important as they are, Europe is likely to remain a bit player for the foreseeable future.

The question of which regions will successfully balance economic growth and social equity under changing international trade policies remains open. Further research must illuminate the differentiated regional impacts and guide the design of policies that can mitigate growing inequalities.

The Draghi report has performed an invaluable service in diagnosing Europe's productivity crisis. Yet its prescription requires refinement. Europe's path to renewed competitiveness must wind through its regions, not bypass them. Only by mobilising the latent potential of its entire territory can the continent hope to close its productivity gap with global rivals while maintaining the social cohesion that gives the European project its meaning and distinct character (*ibidem*).

The challenge ahead is formidable. It demands not just investment at unprecedented scale, but also the wisdom to direct that investment with geographical sensitivity. Europe must become more productive not despite its territorial diversity, but through it. In this respect, as the report rightly suggests, there is still much to be done.

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