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ASPECTS OF EUROPEAN COMPETITIVENESS – IN THE LIGHT OF THE HUNGARIAN PRESIDENCY

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Aspects of European competitiveness – in the light of the Hungarian Presidency[1]

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Abstract

Competitiveness is a complex concept that can be applied at various levels, such as micro-, meso-, and macro-levels. Comparative analysis of countries can be relevant in certain areas, such as foreign trade and foreign direct investments. These fields primarily reflect the Central and Eastern European region's strong integration into global value chains. Foreign direct investments have also been perceived as an indicator of competitiveness, although in different ways across industries and economies. This study concentrates on the two domains of foreign trade and FDI, often overlooked in the recent extensive reports on the European single market and competitiveness. Trends and data from 2005 to 2023 are analysed, comparing the USA, China and the EU. Our findings prove the loss of position of the EU but also point to the heterogeneity of the European regions and countries. Finally, we analyse the Budapest Declaration on the New European Competitiveness Deal.

JEL: F14, F15, F21

Keywords: FDI, foreign trade, competitiveness, European Union

1. Introduction

The "competitiveness" of a country is in itself a rather vague category. It is applied in many different ways and approached from different angles. Several economists argue that competitiveness cannot be understood at the level of the national economy. Many researchers think that competitiveness should be considered at various levels, i.e. micro-

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, meso-, macro- (Delgado et al., 2012). These levels are linked (Chikán, 2008), interact with each other and enhance the level of productivity of a country (Schwab and Sala-i-Martin, 2013). Porter (1990) lists several conceptions of competitiveness and the factors that have contributed to the success of some countries (macroeconomic phenomena, cheap labour, natural resources, government policies, and corporate governance), but he considers none of them satisfactory. According to Porter, the only meaningful concept at the level of the national economy is productivity, mostly in specific industries and segments. Krugman (1994) also argues that it is meaningless to apply competitiveness at the level of the national economy; international trade is not a 'zero-sum game.' Countries sell competing products, but they are also each other's export markets and sources of imports. The standard of living for any country depends on its own domestic economic performance, not on how it performs relative to other countries.

Nonetheless of these views, various notions and concepts of competitiveness exist at the national level. The focus of the competitiveness concept has also changed, shifting to a more holistic perspective, involving additional concepts of well-being and sustainability. The importance of innovation and human capital is also considered. Recently two closely related concepts, sustainable competitiveness and green competitiveness, have emerged. Sustainable competitiveness is an umbrella concept including economic, social, and environmental aspects; green competitiveness puts more focus on economic and environmental goals, more precisely reducing carbon emissions (Bruneckiené et al. 2023). Aiginger (2018) provides an interesting conceptualization of competitiveness by distinguishing between high-road and low-road strategies for enhancing competitiveness. In a low-road strategy, the comparative advantages are low costs (wages, energy, and taxes) and the growth drivers are subsidies and foreign direct investment. In a high-road strategy, however, the comparative advantages lie in quality, productivity, and sophisticated products, not in low costs. Therefore, the growth drivers became innovation and education. This conceptualisation shows that competitiveness is not a uniform category, but that its content can vary according to the different definitions.

There are also different competitiveness rankings, compiled by international organisations and banks. The World Economic Forum constructed a Global Competitiveness Index, which includes 112 different components grouped into 12 pillars:

(1) institutions, (2) infrastructure, (3) macroeconomic environment, (4) health and primary education, (5) higher education and training, (6) goods market efficiency, (7) labour market efficiency, (8) financial market development, (9) technological readiness, (10) market size, (11) business sophistication, and (12) innovation. Although the index has been criticised from several sides, it was also used for detecting interdependence with growth of countries (Kordalska and Olczyk, 2016). Also for beyond GDP aims competitiveness can be a useful tool (the ability of a country to deliver the beyond GDP goals for its citizens today and tomorrow: Aiginger and Vogel, 2015) if we concentrate on the outcome side instead of the input, cost side. Some relate competitiveness to the increasing economic complexity. China has significantly improved its ranking based on the economic complexity index, while the USA and the main core EU member states stagnated or lost place in the ranking (Arnal and Feás, 2024).

Considering all this, comparative analysis can be relevant in certain areas, one is foreign trade. Several types of specialization or revealed comparative advantage indicators are used to assess the competitiveness of foreign trade and to identify which countries are strong in which areas in international markets. These look at the products in which the country specialises in the world market compared to other countries. However, with the development of the global value chains and fragmented production gross trade figures are not necessarily consistent with comparative advantages in production and largely reflect the activity of foreign multinational companies. European countries – mostly the Central and Eastern European region have been strongly integrated into the global value-chain trade as it is shown by value-added trade databases. Trade and investment integration can improve competitiveness through two channels: first, by increasing the size of the market available to domestic firms and, second, by driving productivity and innovation by exposing firms to international competition, expertise and technology (WEF, 2016).

According to the Commission's paper: "Long-term competitiveness of the EU: looking beyond 2030," trade and open strategic autonomy is one of the nine driving forces of competitiveness (European Commission, 2023). Others drivers include circularity, energy, education, R&D, infrastructure, single market, access to capital.

Another area of comparison can be foreign direct investments (FDI). In the case of former transition economies, now many of the members of the EU, in the nineties, FDI has been perceived as an indicator of competitiveness (Hunya, 2000). This approach can be applied for having a look at the changes in the international positions of EU FDI. However, studies on the causal link between competitiveness and FDI have produced conflicting results. Although some studies show that FDI boosts competitiveness (Bonelli, 1999; Škare and Cvek, 2020), others contend that FDI is drawn by competitiveness (Apostu et al., 2023). Different industries and economies may have different relationships between FDI and competitiveness. However, the impacts may vary depending on financing sources and investment composition as well as by the absorptive capacity of the economy in question or trade liberalization and the local business environment (Bonelli, 1999).

Our study concentrates on the two areas of foreign trade and foreign direct investments, which are rather neglected in the recent large reports on the European single market and competitiveness. We try to approach the EU's performance from different angles, as well as perceiving these two indicators to be able to reinforce, contradict, or supplement the results of the previous analyses. The study is organized as follows: First, we briefly present the main findings of the recent flagship analyses of the competitiveness of the European Union. Then show some supportive or nuanced results of the analysis of foreign trade and FDI developments. Third, the main elements of the Budapest Declaration on the New European Competitiveness Deal are presented, and a link is made between our results and the declaration's main target areas. The final section concludes.

2. Recent developments in the European Union

Recent studies indicate that the EU's competitiveness has faced challenges in the global market. Its main competitor, the US, performed better, and there is a rising competitor, China, which could take over the EU in various areas, including in certain high-technology sectors. While the EU maintained a strong position in high-tech and upmarket products in the early 2000s (Curran and Zignago, 2009), its competitiveness has deteriorated since the global financial crisis even in these segments (Cheptea et al., 2014). However, the 2004

enlargement has helped to maintain competitiveness in certain industries through increased division of labour within the European Union (Curran and Zignago, 2009) with lower-wage Central and Eastern new members taking over labour-intensive activities. Economic shocks, such as those related to the COVID pandemic and to Russia's invasion of Ukraine, deteriorated and magnified the competitiveness problems.

In response to the pandemic effects, state aid regulation was eased in the EU. In July 2021, the European Commission adopted the amendment of the block exemption regulation (GBER, 651/2014/EU) concerning state aid. Companies hit by the pandemic could be supported based on any of the entitlements under GBER, and the regulation further introduced several new entitlements. A further amendment of the GBER in 2023 largely increased the threshold value that states need to report, and the approval process has been simplified and accelerated. The Commission has also extended until 2026 the effect of the general block exemption regulation. In 2023, the European Commission temporarily relaxed state aid rules even further in certain policy areas (accelerated processing and authorisation). In the new Temporary Crisis and Transition Framework, which came to replace the Temporary Crisis Framework created in 2022, governing rules changed in four areas: (1) renewables (open tenders are no longer required in the case of the most recent technologies); (2) industrial decarbonisation projects (flexible aid ceilings and a certain percentage of investment costs could be funded in the case of hydrogen, energy efficiency, and electrification investments); (3) greater support for strategic net-zero technologies; (4) targeted support for strategic net-zero value chains (tax benefits, coordination of member state aid to increase transparency and consistency).

The pandemic and the war showed the vulnerability of transportation routes and global production chains. Resilience has become an important notion. The external shifts in the world economy (e.g., the rise of China and weakening liberal international order) have also induced new processes of selective fortification within Europe, which involve the development of new instruments, institutional capacities, and targeted reforms. Earlier, the Single Market hindered member states from implementing protectionist measures against non-EU imports and European industry integrated into the global production chains. After the Great Financial Crisis, new industrial policy instruments have

been created at the EU level. Non-trade issues and security objectives, are increasingly included into the EU's trade agenda. The FDI screening mechanism became operational in October 2020 and responds to fears regarding hostile acquisitions of European industrial assets by foreign entities. The Foreign Subsidies Regulation, applied from July 2023 intends to limit trade distortions within the Single Market. It attempts to insulate European industry from state-subsidised Chinese firms gaining a foothold in key strategic sectors, including critical raw materials, energy, semiconductors, and infrastructure (Lavery, 2024).

The main concept of European resilience is Strategic Autonomy. Already in 2013, the Council Conclusions of December called for measures to support a European defence to enhance strategic autonomy (European Council, 2013). The concept has been successively used in security and later in other areas like trade, digital technology, health, and energy. In 2021 „open strategic autonomy" (OSA) was presented as the EU's new trade doctrine (European Commission, 2021). Open Strategic Autonomy, means qualified openness: to remain as open as possible but also become as autonomous as necessary, to protect European interests more (Schmitz and Seidl, 2023). Several instruments reducing strategic dependencies have been launched (Freudlsperger and Meunier, 2024). An idea originally born in the area of security and defence has entailed strong internal debates and has become more embedded in trade and external economic relations (Juncos and Vanhoonacker, 2024). Nevertheless, there is a kind of pendulum between "reluctant and deep geopoliticisation" (Herranz-Surrallés et al, 2024), the first being the adoption of geoeconomic instruments with strict definitions but only used as a last resort. For deep geopoliticisation the anti-subsidy investigation into Chinese electric vehicles is an example. With Trump's return as president of the USA, the EU's security debates on strategic autonomy will probably rise again.

Another concept similar to strategic autonomy is de-risking. It was raised in 2022 for strengthening the EU's competitiveness, new defensive measures, and seeking cooperation with other international partners (Jerzyniak, 2024). In the political discourse, it refers to an "ability to make ourselves more resilient and reduce the risks arising from economic linkages that in past decades we viewed as benign," pointing to actions

"diversifying economic ties to reduce harmful dependencies and increasing local production" (European Commission & High Representative, 2023).

Four areas have been at the centre of the OSA debate: the defence sector; the energy transition; microchips manufacture; and critical raw materials. In all these areas critical materials play a role, which are complicated to define (examples are batteries and their components, hydrogen technologies, rare earth metals, solar panels, pharmaceuticals, computer chips). There is no systematic way so far of telling which imports are genuinely critical (Mejean and Rousseaux 2024, Pisani-Ferry et al., 2024) and reexport within the global value chains modify the picture drawn based on gross trade data. Concering microchips, the European Chips Act with EUR 43 billion investment aims to increase the EU's global market share in semiconductors from the current 10 percent to 20 percent by 2030. Russia's invasion of Ukraine and China's weaponisation of critical raw materials (CRMs) have exposed vulnerabilities and economic dependency on these minerals. The EU is highly dependent on China for gallium, cobalt, magnesium, and manganese, CRMs are essential inputs for green technologies, defence and robotics. The EU has established several trade and digital barriers (the Carbon Border Adjustment Mechanism and the Artificial Intelligence Act) that are likely to raise import costs and pose significant challenges to EU's competitiveness (Erixon et al, 2024). The Critical Raw Materials Act (CRMA, adopted in 2023) establishes domestic capacity targets for 2030 (at least 10% of the EU's annual consumption for extraction and 40% of the EU's annual consumption for processing). Adopted in 2023, the Net-Zero Industry Act identified eight strategically important clean energy industry technologies, including solar energy, wind energy, battery production, geothermal energy, biogas, carbon dioxide capture and storage, fuel cells, and network technologies. By 2030, at least 40% of the needs of these industries need to be covered within the EU. The control, monitoring, and accelerated administration will be mostly up to the member states.

There seems to be a delicate balance between OSA and a liberal single market. Despite the EU's historical commitment to harmonization and liberalization, services, have witnessed the imposition of new laws and rules that hinder trade. Increased regulatory burdens (a regulatory spiral) result from a lack of harmonisation and divergent industry regulations across Member States. This fragmentation hinders the seamless movement of

goods and services. All this may discourage European or foreign investors from entering the EU market as it involves additional costs. Based on OECD data on the restrictiveness of services trade, Bauer and Pandya (2024) calculated that there is an increase in services trade restrictiveness from 31% in the total number of country- and sector-specific observations in the period 2014-2018 to 80% in the period 2018-2022. This substantial surge in the "more restrictive" category signals a significant tightening of regulations affecting services trade among EU Member States. Apart from these, there has been a noticeable increase in both anti-dumping and countervailing duty investigations over the past decade.

One recent important study, the European Council commissioned Letta Report (2024) also states that many obstacles caused by borders, national regulation and fragmentation of EU rules still exist and consists of a detailed list of policy proposals to strengthen the Single Market that needs speed, scale and sufficient financial resources. These proposals are: the completion of the Capital Markets Union, consolidation in the areas of finance, telecoms and energy, increased defence integration and spending, deepening coordination in the energy, transport, and infrastructure sectors, a „fifth freedom" to enhance research, innovation and education, protecting and expanding cohesion policy, creating a Savings and Investment Union, protecting a level playing field by strict State Aid rules combined with EU fund for industrial policy.

Another complex work from 2024 is the Draghi Report, that deals with the EU's competitiveness. It shows the deficiencies of the single market and investment and lists the challenges for the EU. The *first* is innovation that is slowed by regulatory, financial, and training barriers. The report proposes creating a European agency, incentivizing business angels and seed capital, reforming pension plan regulations to channel European savings toward investment, and simplifying the research and development framework program. It also suggests increasing R&D spending, and fostering a more innovation-friendly regulatory ecosystem. The *second* is aligning decarbonization with competitiveness. The report calls for a reform of the European electricity market and details sector-specific competitiveness measures for energy, clean technologies, key raw materials, automotive, pharmaceuticals, transport, aerospace, and high-tech sectors. The *third* challenge involves the integration of Europe's fragmented defence industry. The

report calls for more EU funding and an EU authority to procure on behalf of EU countries. The *fourth* issue is strategic autonomy and economic security.

According to the report the additional annual investment need is about 5 percent of the EU GDP, and this is the most problematic part of the implementation. On the one hand it is not sure that there will be enough viable investment projects. On the other hand, the willingness for deeper integration probably decreases with the strengthening of the right-wing parties in the Member States.

Both the Letta and Draghi report conclude that the present EU competition policy is a barrier to innovation and growth and firms should be allowed to merge in order to be able to compete in foreign markets. Yet, there are two much bigger hurdles to EU innovation. The first is that EU firms rely largely on bank lending, which requires short-term return on investment; thus European firms invest much less in adopting technology than similar American firms. The second is that the single market could function better to allow European firms rapidly expand across the entire EU (Meyers, 2024).

Nevertheless, the Draghi and Letta reports gave relatively little attention to the issues of foreign direct investment (FDI) and trade patterns. These are of pivotal importance for a comprehensive analysis of the EU's competitiveness. In our research, we have identified the challenges and opportunities that the EU is facing in these areas, which must be taken into account in the development of a competitiveness strategy.

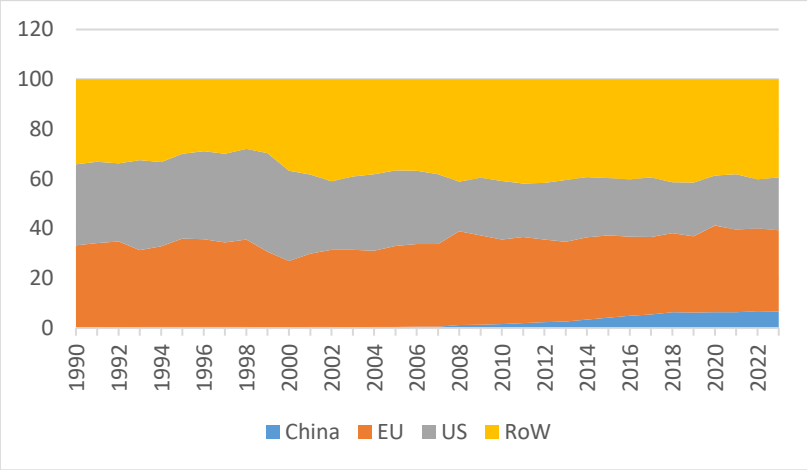
3. EU in the global FDI flows

Evolution and stock of outward foreign direct investments (FDI) can be a good indicator of international competitiveness of firms of the respective country or entity. Integration affects FDI: according to Bruno et al. (2021) inward FDI increased by about 60% from non-EU sources and 50% from within the EU and the effects of EU membership on FDI surpass those of other regional agreements. However, the impact varies between EU15 and Central and Eastern European member countries, with EU15 experiencing increased inward FDI and CEE countries seeing rather a surge in outward FDI (Meinhart, 2023), which research result underlines important country differences. However, lack of data on the ultimate owners' nationality and other problems with FDI data (see e.g. among others

O'Mahoney and Barry, 2019 or Fertő and Sass, 2020) significantly hinder the use of gravity and other econometric models relying on country level data.

The European Union plays a significant role in global FDI flows and stock, accounting for approximately 30% of outbound FDI stock in the period between 1990 and 2023 (Figure 1). However, the EU's position has been challenged by recent global economic shifts and a slowdown in FDI flows (Witkowska, 2021). Especially China and the emergence of other emerging outward foreign investor economies led to some shrinking of the EU's share and a more considerable decrease in that of the US. Furthermore, economic and non-economic shocks led to a considerable slowdown in global FDI flows, especially after the 2008-9 financial crisis as well as later on due to the Eurozone crisis and the COVID-pandemic related problems. Thus available FDI is smaller and thus policies that mobilise capital for investment have become increasingly important.

Figure 1. Shares of the EU, US, China and the rest of the world in the world stock of FDI, 1990-2023, %

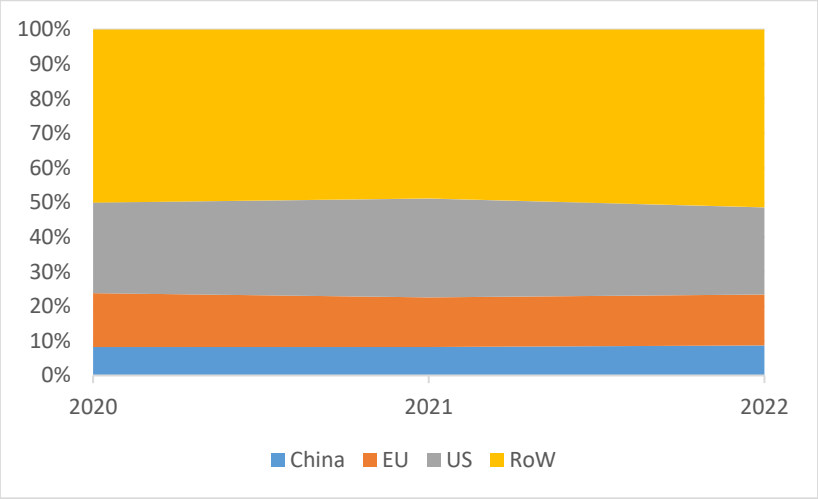


Source: own compilation based on UNCTADstat data

Around one third of the European Union FDI is represented by intra-EU investments according to the data published by Eurostat. Deducting the intra-EU FDI stock, the recalculation of the breakdown of the world FDI stock for the period between 2020 and 2022 (due to the availability of data) gives a similar picture, with the rest of the world

being responsible for an ever larger share of FDI. (Figure 2) The share of the EU is around 15%, that of the United States is above one-quarter and that of China is now above 8%.

Figure 2. Shares of the EU, US, China and the rest of the world in the world stock of FDI, 2020-2022, %



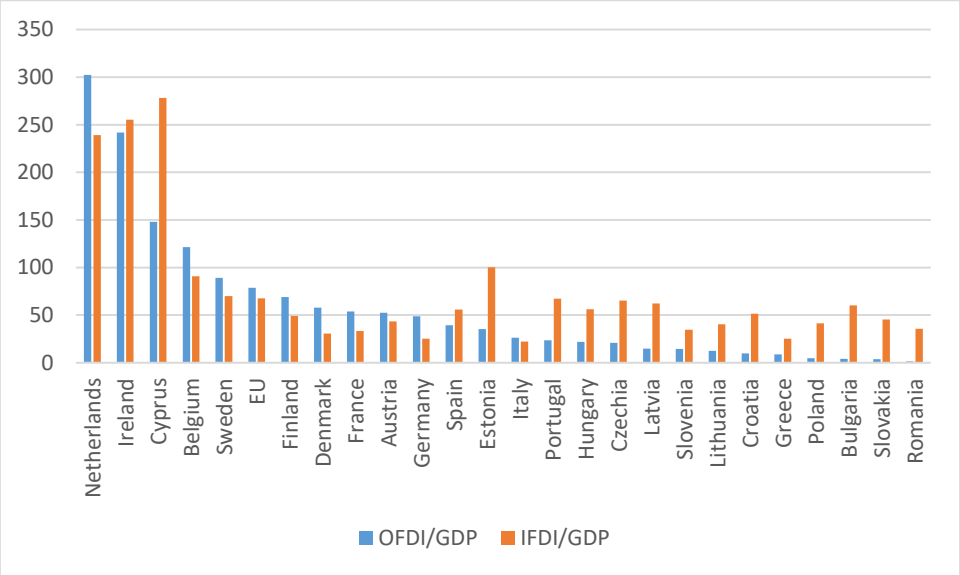
Source: own compilation based on UNCTADstat and Eurostat data

Intra-EU FDI can be in reality somehow smaller, as the available FDI statistics are based on the immediate as opposed to the ultimate owner's nationality. Based on the data where both immediate and ultimate breakdowns are available, as a simple average, around four-fifth of this FDI is indeed intra-EU, while one-fifth of FDI is realised by outside EU investors through a European intermediary country, within Europe. This is usually common practice among outside EU investors, for various reasons: besides tax optimisation, organisational, management reasons, or even to conceal the real origin of FDI can play a role (Gubik et al., 2020).

Member countries have different exposure to both inward and outward FDI (Figure 3). Certain countries play an important role as intermediaries due to their beneficial regulations and tax environment offered to foreign investors. That is the reason why Malta and Luxembourg are not represented on Figure 3, as in their cases both the IFDI/GDP and the OFDI/ GDP ratios are well above 1000 %. However, the top three-four countries (the Netherlands, Ireland, Cyprus and Belgium) are also important

intermediaries, as well as for example Austria towards CEE or Estonia towards other Baltic countries.

Figure 3. Inward FDI stock/GDP and outward FDI stock/ GDP ratios for the EU member countries (%, 2023)

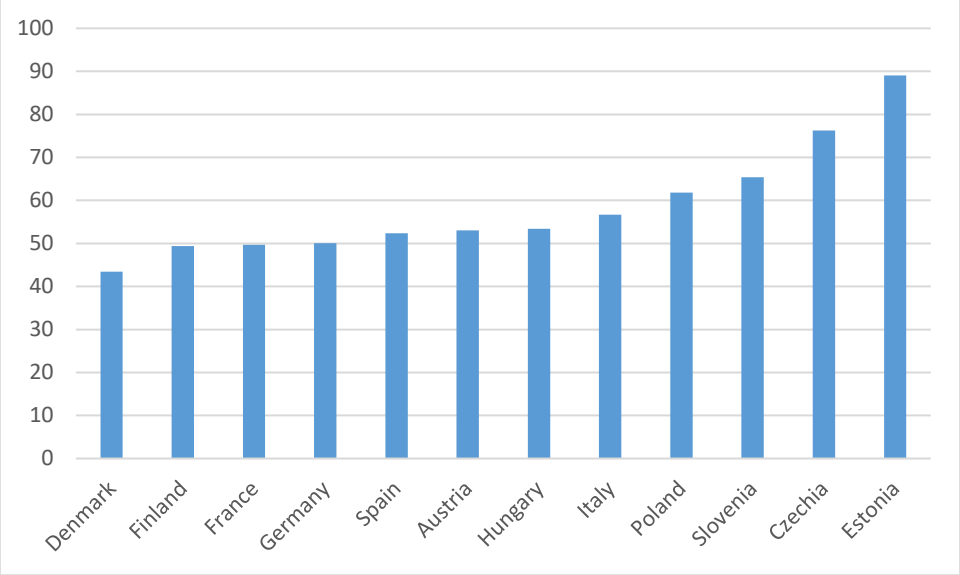


Source: based on UNCTADstat data

There are also differences in terms of the share of intra- and extra-EU inward and outward FDI among the member countries. (Figure 4 and 5) For inward FDI, data for only those countries are presented, which publish datasets according to the nationality of the ultimate owner. While differences are obvious, it is also apparent, that intra-EU capital inflows usually dominate in the member countries.

For outward FDI (Figure 5), there are no data available about the final destination country. Country differences are large in terms of the share of EU countries in outward FDI stock, but for the majority of member states, other EU countries are dominant as destinations of outward FDI. Exceptions are Spain (major FDI in the Americas), the Netherlands (large FDI "in transit"), Denmark (the US and UK are important destinations), Slovenia (OFDI to former Yugoslav countries) and Sweden (United States, Norway and UK are important directions).

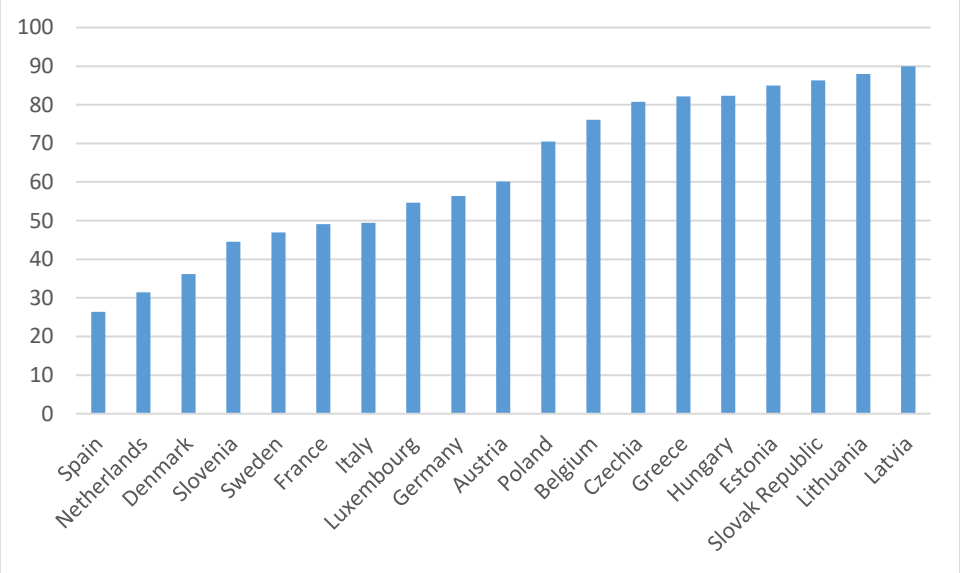
Figure 4 Share of ultimately EU-owned FDI in total inward FDI (%), 2022



Source: OECD Data Explorer

Note: data for Germany and Hungary refer to 2021

Figure 5 Share of intra-EU OFDI in total OFDI of the member states (%), 2022

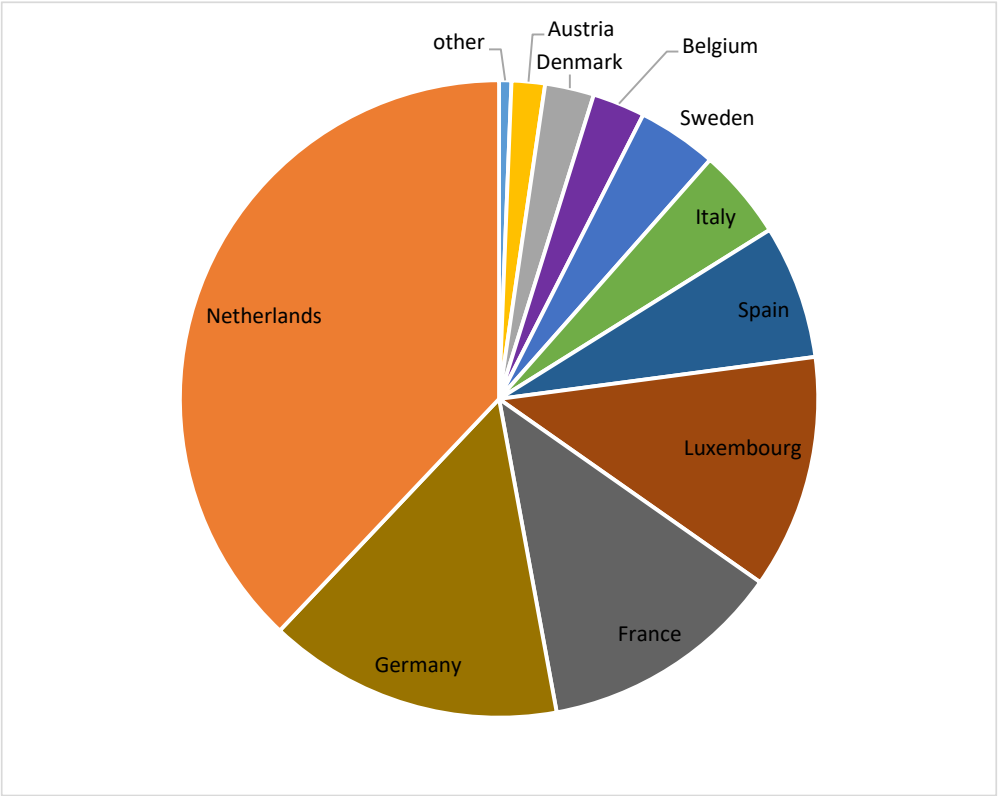


Source: OECD Data Explorer

Note: confidential data for Finland, Ireland and Portugal; Data for 2020 for Lithuania, data for 2021 for Sweden

Overall, the European Union is a large outward investor, however, the share of the individual member countries differs in the outward FDI stock. Netherlands and Luxemburg can owe their high shares mainly to being an intermediary country for FDI, thus in reality the leading EU foreign investors are Germany, France, Spain, Italy and Sweden. (Figure 6)

Figure 6 The share of the individual EU member states in the extra-EU OFDI stock, 2022 (%)



Source: OECD Data Explorer

Note: no data for Finland, Ireland, Lithuania and Portugal; Sweden: 2021

Data on sector composition of extra-EU IFDI and OFDI are available only sporadically, but they also point to large country differences.

Overall, FDI data, which have many shortcomings, show that differences between the member states on their relative reliance on and openness to IFDI and OFDI are large. They also differ in terms of their shares of extra-EU IFDI and OFDI in total. A few member states

represent the majority of extra-EU OFDI of the European Union. Countries also differ in terms of the extent to which they act as intermediary countries for both IFDI and OFDI to and from other EU member countries, leading to tax and allocation problems. Sectoral patterns of FDI also differ between the member states.

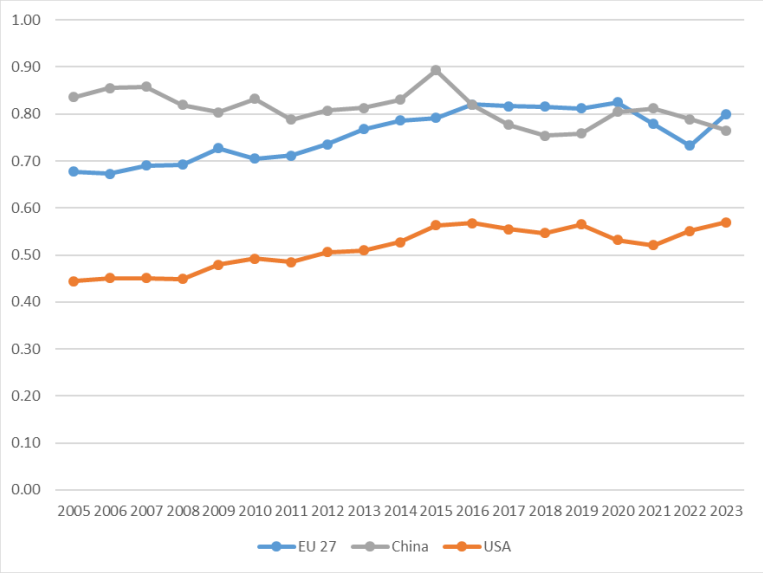
4. Foreign trade

The second area that received relatively little attention in the Draghi and Letta reports is trade patterns. However, trade is important for the micro-level of competitiveness, as exporting companies are usually more productive and innovative. Trade is also crucial for acquiring the technological inputs necessary for the countries. It is therefore necessary to analyse trade patterns and potential challenges in this key area from the perspective of EU competitiveness.

Although the EU's merchandise export share and its GDP's share in the world have decreased in the past 20 years and those of China have increased, in relative terms there is a stagnation (see Figure 4). If both shares were the same, their ratio would be 1. The export of the USA constantly "underperforms" compared to its share in the world's GDP, although with a recent improvement, while in the case of China we see a recent small decline.

However, in addition to looking at total EU trade, it is important to analyse which countries account for the largest share of EU exports and imports, as there are significant differences in the contribution of Member States to external and internal trade. These differences may reflect internal economic disparities and different roles in the EU's internal division of labour. It is crucial to address these factors in a competitiveness analysis, as they may undermine efforts to improve competitiveness. In order to increase competitiveness in an inclusive way, it is necessary to offer a development perspective to each of the EU Member States, which means that a common strategy should also address the challenges faced by countries with different structural positions.

Figure 4. Share in world merchandise exports relative to share in GDP



Source: own calculations based on UNCTADstat and IMF data

In the distribution of EU countries' external exports, the prominence of Germany is clear. In 2023, it accounted for more than 27% of the EU's external exports, more than double the share of Italy, which was the second largest external exporter (Table 1). The EU's external exports are highly concentrated, with four countries accounting for more than 60% of external exports: Germany, Italy, France and the Netherlands. (In the case of the Netherlands the large international port of Rotterdam secures an outstanding role of the country in international trade). Another sign of this centralisation is that the top 10 exporters are mostly the core countries, such as Austria, Sweden, Belgium and Ireland. From the EU's Eastern periphery, only Poland has made it into the top 10.

Table 1. Top 10 exporters share of external EU export in 2023, percent

1	Germany	27.2
2	Italy	12.3
3	France	11.0
4	Netherlands	10.3
5	Belgium	6.5
6	Spain	5.7
7	Ireland	4.8
8	Poland	3.6
9	Sweden	3.1
10	Austria	2.4
	Every other countries	13.1

Source: own calculations based on Eurostat Comext database

Because of this high concentration, the four largest external exporters (Germany, Italy, France, the Netherlands) are analysed separately in the following graphs. For the analysis of the other countries, country groups have been created to facilitate the visualisation of the results. It is worth analysing the other core countries within the EU (Belgium, Luxembourg, Austria, Ireland, Sweden, Denmark, Finland) in one group. It is also worth looking at the two peripheral regions separately. The Southern periphery comprises Spain, Portugal, Malta, Greece and Cyprus. The Eastern periphery includes the post-socialist area, i.e. Estonia, Latvia, Lithuania, Poland, Czechia, Slovakia, Slovenia, Hungary, Romania, Croatia and Bulgaria.

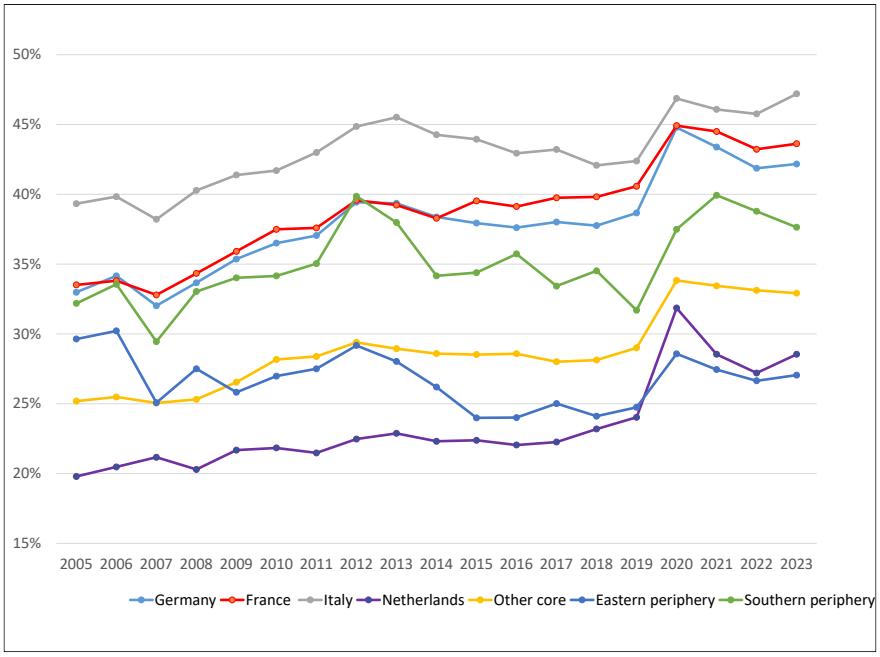
The examination of the share of extra-EU exports over time reveals that Germany has been the dominant external exporter since 2005 (see: Annex, Figure A1). For example, in the mid-2010s, German exports constituted over 30% of total extra-EU exports. This high share appears to decline in the wake of the global COVID pandemic. In the recent years, there has also been a slight reorganisation in the distribution of external exports. The shares of France and Italy have exhibited a gradual decline, primarily due to the increased contribution of the Netherlands and the Eastern periphery to external exports. In

contrast, the Southern periphery's share has remained relatively stable over the period of 2005-2023.

The trends observed in the share of exports outside the EU diverge significantly from those in intra-EU ratios. (see: Annex, Figure A2). While Germany is also the dominant player in intra-EU exports, its share is considerably less pronounced. In 2023, Germany accounted for 21% of intra-EU exports. Germany's share is closely followed by that of the group of core countries. The Netherlands plays a more prominent role in intra-EU exports than France and Italy. Furthermore, a notable realignment is discernible within intra-EU exports. The internal export shares of the core countries (comprising Germany, Italy, France, and the other core country group) have exhibited a gradual decline between 2005-2023, while the Eastern periphery has achieved a notable degree of convergence. By 2023, the Eastern periphery's share had reached 20.8%, a figure that closely matched that of Germany. The exceptions to this were the Netherlands, where the share remained stagnant, and the Southern periphery, where a similar stagnation was observed, just in a lower level.

It is also interesting to investigate which countries and regions exhibit the greatest propensity for external exports (Figure 5). To calculate this, the value of external exports was divided by the total value of exports. The results demonstrate that, among the four main exporting member states of the EU, it is Italy, rather than Germany, that relies more on external exports. Nevertheless, the proportion of exports destined for markets outside the EU does not exceed 50% of total exports in Italy. This is followed by France and then Germany, where we can see similar proportions. It is noteworthy that the Southern periphery exhibits a relatively high external export ratio, averaging above 30%, mainly because of the high levels in Cyprus and Greece. Subsequently, the remaining core countries exhibit a lower average ratio of external exports, with the Nordic countries and Ireland displaying higher figures. However, the Benelux states and Austria appear to prioritise internal exports. The proportion of external exports in total exports is the lowest in the Netherlands among the four main external exporting states. Similarly, the Eastern periphery also evidently prioritises internal exports, which may be attributed to their role as suppliers and manufacturers within European value chains (Kordalska and Olczyk, 2023).

Figure 5. Extra EU export share in total export (averages of the country groups)



Source: own calculations based on Eurostat Comext database

A comparison of the proportion of extra EU imports in total imports (see: Annex, Figure A3) with the previously presented external export proportions reveals interesting conclusions. These ratios indicate the roles in the European division of labour. Of the four main external exporter countries, the Netherlands has the highest proportion of external imports, with over 50% of its imports originating from outside the EU. Furthermore, the Netherlands exhibited one of the lowest rates of external exports, which suggests that it serves as a gateway to the EU (the Rotterdam effect). Italy is the second largest external importer, yet this is combined with a significant external export ratio, indicating that the Italian economy is less dependent on EU trade. The Eastern periphery represents the opposite extreme, with the proportion of extra-EU imports in total imports remaining below 30% for the majority of the period. Moreover, the rate of external exports is also relatively low. This indicates that the Eastern periphery is deeply integrated into the EU trade, and it may be attributed to its role in the assembly and manufacturing positions of the European value chains as well as extra-EU value chains aimed at producing for the EU market.

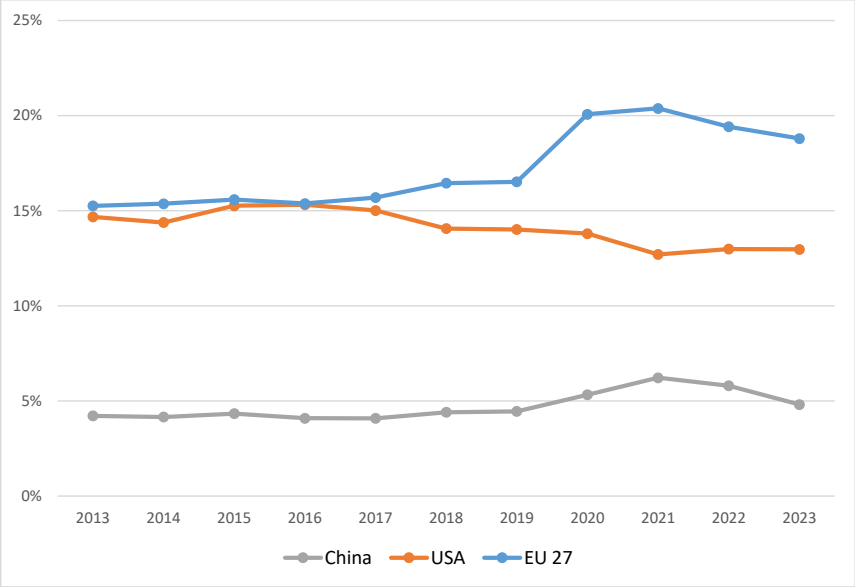
From the perspective of the EU as a whole, regions and countries where external exports exceed external imports could be regarded as export-oriented. Conversely, regions where external imports exceed external exports are characterised by trade deficits from the EU's perspective. Germany is the unquestionable leader within the EU in terms of external export orientation, exhibiting a noteworthy surplus in external exports. Similarly, France and the other core country group also exhibit positive external trade balances. In the wake of the global economic crisis of 2008, Italy was able to transform its previous deficit into an export surplus. Among the four major external exporters, the Netherlands is the only country that has consistently experienced a trade deficit with non-EU partners since 2005. Moreover, the two peripheral regions also demonstrate a negative trade balance.

This diversity highlights the internal imbalances that exist within the EU, which must be taken into account in the formulation of a competitiveness strategy. In order to enhance the EU's external export performance, it is imperative to address the distinctive circumstances of the peripheral regions and the Netherlands, where external import surpluses currently prevail.

Services and technology level

Although it was presented that the European Union is experiencing a decline in terms of both GDP and merchandise exports on the global stage, this trend is not discernible when examining service exports. In this context, the EU27 maintains a dominant position in comparison to China and the USA, with China exhibiting a notable degree of disadvantage (Figure 6). In the competitiveness strategy of the EU, it is therefore important to build on the role played by services in exports, as this is the EU's significant strength. Since 2019 the EU share in this regard has even increased. During the period of the pandemic, more than 20% of the world's total service exports came from the EU. In this regard, the gradual decline of the USA’s share can be observed.

Figure 6. World share in service exports, percent



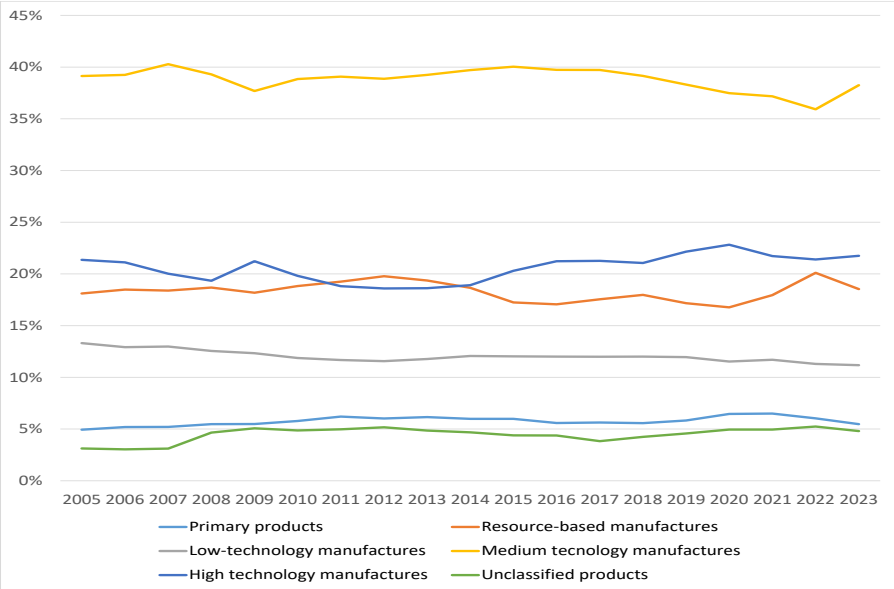
Source: own calculations based on UNCTADstat data

In the context of the EU's external services exports, Ireland plays a prominent role, accounting for 17.8% of the external EU service exports in 2023. This can be attributed to Ireland's distinctive position in the digital services sector, which is likely influenced by the presence of US companies. Furthermore, the Nordic countries and the Benelux states also hold considerable shares. Germany accounts for approximately 20% of external services exports, although this figure has declined in recent years (see: Annex, Figure A4). France follows Germany in terms of service export shares, exceeding the shares of the Southern periphery and the Netherlands. Italy lags behind in services exports, with its share falling below 5% in the 2020s. The Eastern periphery also demonstrates lower shares in terms of external services exports.

The EU's external exports by product category is dominated by machinery and transport equipment (see: Annex, Figure A5). Since 2005, external exports within this product group have constituted over 40% of the total; however, there has been a decline in this proportion in recent years. In contrast, the export of chemicals and related products, which represents the second largest external export category, has demonstrated minimal growth. Additionally, manufactured goods and other manufactured articles play a notable role in the external export structure. The machinery and transport equipment are also significant in imports from outside the EU (see Annex,

Figure A6). In 2023, this category accounted for more than 30% of external imports. Similarly, the group of mineral fuels, lubricants, and related materials represents a substantial proportion of external import, which serves to illustrate the EU's scarcity of natural resources. External import is also considerable in the categories of manufactured goods, other manufactured articles, and chemicals and related products.

Figure 7. Extra-EU exports by product groups based on technological levels, percent



Source: own calculations based on UNCTADstat data

An examination of the EU's external exports by product categories based on technological levels reveals that medium-technology manufactures constitute the largest share (Figure 7). From 2005, this category accounted for approximately 40% of total extra-EU exports, with a decline observed in recent years. Additionally, high-technology and resource-based manufactures constituted notable proportions, whereas primary products exhibited a minimal presence.

The EU has an export surplus in medium-technology and resource-based manufactures, but low-technology manufactures show a growing trade deficit. Nevertheless, the largest trade deficit is observed in the primary products category, which encompasses raw materials as well. Another problematic aspect is the consistently negative trade balance in the high-technology manufactures. Such imbalances carry

inherent risks that could potentially erode the EU's strategic autonomy, and therefore the EU should take this factor into consideration in a competitiveness strategy.

Trade in value added

In the past decades, the fragmentation of the production and the globalisation reached the highest possible level. The earlier general way of industrialisation, in which one nation had to develop the entire set of components that made up a final product, has changed with the rise of the global value chain (GVC) manufacturing model. The GVC production allows countries to specialise in one or more phases of manufacturing and create only specific components for the final product or products of a GVC, rather than having to develop a whole local sector in order to export. Thus, the need of distinguishing between intermediate and final goods commerce has increased due to the growth of GVCs. Indicators, databases of trade in value added (TiVA, WIOD, Eora) and global input-output tables have enabled a more recent extension of the study of economic interconnection.

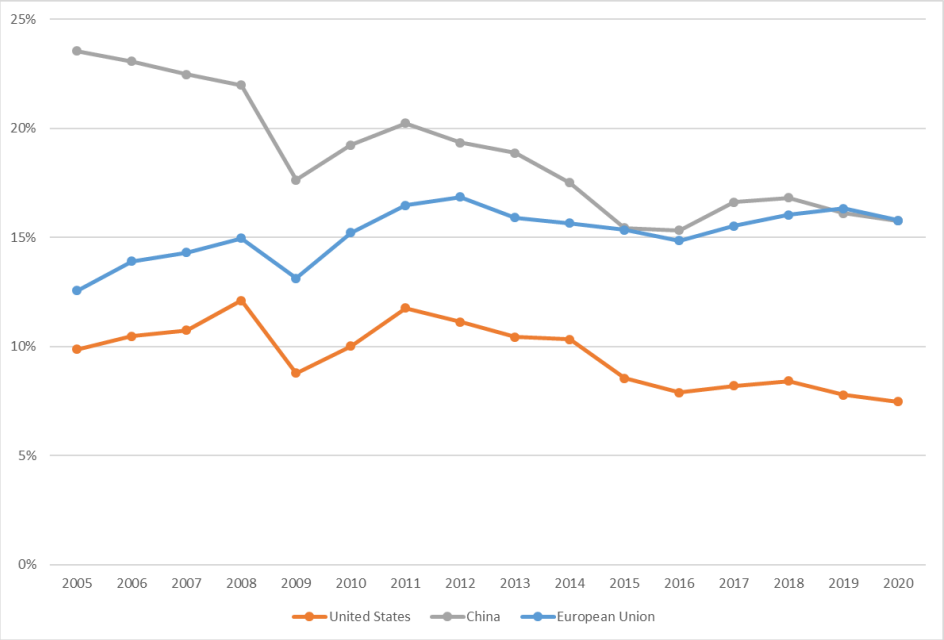
In the EU, especially the Central and Eastern European (CEE) region has become strongly integrated into the GVCs (Cerná et al., 2022) and scholars analysed upgrading and specialization within these chains (Kordalska and Olczyk, 2023). Germany emerged as the primary trading hub, creating a manufacturing core for Central Europe (Stehrer and Stöllinger, 2015). Similarly, while discussing the core-periphery paradigm in Europe, Grodzicki and Geodecki (2016) and Kersan-Skabic (2017) discovered that Central European countries are in a stronger position than Southern European ones in terms of GVC involvement. German exports to third countries include many components made in other (Eastern or Southern) member states but also in third countries. The export of a given country therefore contains “foreign value added” (imported inputs). The CEE countries are called “factory economies” (Baldwin and Lopez-González, 2015), because of their high foreign value-added share in exports (called as “backward GVC participation” otherwise).

The data indicate that the EU exhibits a greater share of foreign value-added in gross exports than the USA (Figure 8). In the USA, the share of foreign value-added in gross

exports was 7.5%, whereas in the European Union this figure was more than double in 2020 (15,8%). Between 2005 and 2020, the proportion of foreign value-added in the USA exhibited a gradual decline, whereas in the EU, it remained above 15%. In China's exports, the share of foreign value-added was notably high in the late 2000s, reaching almost 25%. However, over the course of the previous decade, this proportion has declined gradually, reaching the level of the EU by 2015. This illustrates the strengthening of the domestic Chinese economy and its gradual independence from foreign companies. This shows a potential challenge for the EU, given that both the USA and China are demonstrating a declining trend in foreign value-added of gross exports, while the EU remains relatively stable.

Nevertheless, there is a considerable variation in the role of foreign value-added in gross exports across EU countries. An examination of the share of foreign value-added in total gross exports in 2020 (which includes both intra-EU and extra-EU exports, see Annex, Figure A7) reveals that particular countries exhibit notably high shares. This is the case for smaller states such as Luxembourg, Malta and Cyprus, where offshore activities are significant. It is noteworthy that several Central and Eastern European countries, including Slovakia, Hungary, Czechia, and Estonia, also exhibit high shares of foreign value-added. This illustrates their integration into global value chains and their status as "factory economies" within the European division of labour. Moreover, Ireland exhibits highs shares, which may be attributed to the presence of American technological companies. In contrast, the share of foreign value-added is lower in larger economies such as Germany, Italy, France, and Spain. It is also important to note that the Eastern periphery is not uniform; there are countries with lower levels of foreign value-added, such as Romania, Croatia, and Poland. These differences should be considered when designing a competitiveness strategy, as the concept of strategic autonomy is interpreted differently in countries where foreign exposure plays a significant role in gross exports.

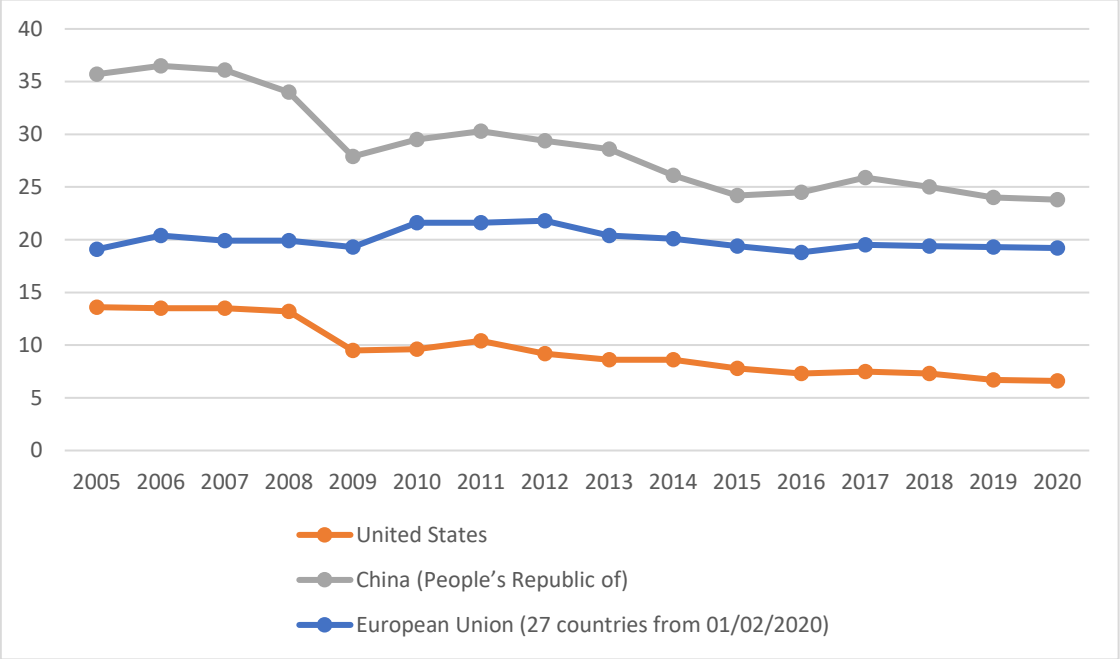
Figure 8. Foreign value-added share in gross exports, percent



Source: own calculations based on OECD TiVA database

It is also worthwhile to analyse certain industries, as this can demonstrate the industrial variation of foreign value added in gross exports. Figure 9 illustrates the percentage of foreign value added in gross exports for the industry covering the manufacture of computer, electronic, and optical products, as well as electrical equipment, from 2005 to 2020. It is of considerable importance to analyse the electronics sector, given that, according to the results of Turégano and Marschinski (2020), this sector was one of the contributors to the EU's loss of competitiveness. Its global share declined to a greater extent than that of the manufacturing industry. In this pivotal sector, it is evident that China has successfully reduced its foreign dependency, whereas the EU demonstrates a relatively stable position in this regard (around 20%). The United States also demonstrates a declining trend, consistently remaining below the European Union's figures. This shows a key challenge for the EU. Conversely, in the industry of manufacture of motor vehicles, trailers, semi-trailers, and other transport equipment, the situation is more balanced, with all three major powers having a similar share of foreign value-added in gross exports (see Annex, Figure A8). However, China commenced from a higher level in this sector as well, which has since decreased.

Figure 9. Foreign value-added share in gross exports for the electronics industry (manufacture of computer, electronic and optical products; manufacture of electrical equipment), percent



Source: own calculations based on OECD TiVA database

Data on value-added trade show that the role of foreign value added (foreign contribution to the exports) has not decreased in the EU, while in the USA and China there is a decreasing trend. This means a better or more intensive use of domestic resources, intermediate goods in the latter two countries. However, the heterogeneity of the EU shall be mentioned also here, the foreign value added being the highest in the CEE factory economies. The Hungarian presidency of the EU Council aimed to strengthen competitiveness within this "factory" framework.

5. Competitiveness and the Hungarian Presidency

Two additional areas of competitiveness analysed in our working paper indeed reveal that the European Union has been losing ground compared to its main competitors. Furthermore, relatively large country differences and positions are also shown and thus the differing competency of the member countries in strengthening the growth and competitiveness "momentum" in the EU. Structural weaknesses of especially the larger-

sized countries, temporarily eased by relying on within-EU "factory economies" and by fiscal expansion, have important consequences for the competitiveness of the whole European integration. Handling these problems should take into account the above facts as well. However, existing schemes do not really do that.

One of the declared priorities of the Hungarian EU Council presidency was European competitiveness. At the beginning of the presidency, a background paper was prepared by the Hungarian government for the COMPET informal meeting on the support of the electric vehicle market in Europe. It contained proposals like establishing an EU subsidy program up to 2035 for public charging for all vehicle segments, easing of state aid rules for R&D and their industrial implementation and production of carbon-neutral vehicles and their supply chain. The proposal suggested a EUR 4500 incentive for all citizens to purchase EVs. Recycling and the circular economy should be promoted. For the Hungarian economy, the automotive sector is highly important; after other OEMs recently BMW and BYD are building factories. The Orbán government has especially put the EV and EV battery sector in focus of the Hungarian economy, adopting a National Battery Industry Strategy in 2021 and attracting several Asian (South-Korean and Chinese) plants in the country. Regarding the fact that the forced overdevelopment of this sector (aiming for 300 GWh battery capacity for 2030) has huge costs (direct state aid, infrastructure building, energy source creation), high risks (Éltető, 2024a) and serious environmental consequences (Éltető, 2024b), it is crucial for Orbán to boost demand for EVs in Europe.

On 8 November at the informal European Council meeting in Budapest, leaders adopted the Budapest Declaration on the New European Competitiveness Deal. This declaration does not contain the suggestions of the Hungarian background paper but sums up in 12 general points the aims of the EU:

1. Providing full potential to the Single Market, issuing by June 2025, a new strategy including a roadmap.

2. Taking decisive steps towards a Savings and Investments Union by 2026, and making progress on the Capital Markets Union and on the Banking Union.

3. Ensuring industrial renewal and decarbonisation, develop a European industrial policy.

4. Launching a simplification revolution of the regulatory framework for businesses, reducing reporting requirements by at least 25% in the first half of 2025.

5. Strengthening the defence technological and industrial base of the EU.

6. Objective of meeting the 3% GDP expenditure target on R&D by 2030. (Work on Letta Report's proposal of a 'fifth freedom.')

7. Build a genuine Energy Union characterised by a fully integrated and interconnected energy market.

8. Developing an integrated market for secondary materials, especially for critical raw materials, creation of a Circular Economy Act.

9. Strengthening the EU's technological capabilities, accelerating the digital transformation. 10. Harnessing Europe's talent and investing in skills to foster high-quality jobs, strengthen social dialogue, reduce inequalities.

11. Pursuing an open and sustainable trade policy of economic diversification and resilience. 12. Delivering a competitive, sustainable, and resilient agricultural sector, providing a stable and predictable framework for farmers.

The first two points mean the reinforcement of European Institutions and address the shortcomings of the single market. The third point is a very general one as such, without specifying the meaning of the "European industrial policy." Recently the Important Projects of Common European Interest (IPCEI) are tools for that, but the easing of state-aid rules should be reconsidered. Also, the connected externalities should be assessed, because without this it is simple to spend money on poorly planned industrial policies. Negative climate impacts, lack of key infrastructure, and scale in the internal market, as well as differences in the depth of the pockets of the member states can hinder the efficiency of industrial policy and state aid. Moreover, a successful European industrial policy should take into account the different structural positions of the countries and regions within the EU. A common industrial policy is only viable if it goes beyond relying on the relative backwardness of some regions, but it ensures a convergence trajectory for all countries below the developmental level of the EU's core. The presented FDI and trade data illustrate the complex internal division of labour within the European Union, which

must be taken into account when formulating such an industrial policy. While the aim to establish a common European industrial policy is undoubtedly an important one, the absence of concrete details at this stage renders it somewhat superficial. It does not clarify the manner in which it will align with sustainability and social objectives. Industrial policy is not neutral with respect to its impact on the environment or societal well-being (Chang and Andreoni, 2020), therefore, incorporating sustainability and social considerations into a common industrial policy will be essential. The mention of decarbonisation points in the right direction, but it does not, of itself, exclude other forms of environmental harm. Furthermore, it does not yet address structural differences between the member countries and their regions.

Regulatory easing (4. point) should be implemented in a targeted manner. Due to the scale of its internal market and the development of a strong institutional framework, the EU has emerged as a major global regulator. The EU is able to regulate not only the single market but the global market too. This is the "Brussels Effect" that affects the food people eat, the air they breathe, and the products they produce and consume. Corporations have the business incentive to extend the EU regulation to govern their worldwide production or operations (Bradford, 2020). Therefore, when aiming to simplify regulations and deregulate, this effect must be taken into account. In order to enhance the EU's competitiveness, it is essential to build on the EU's strengths. Regulatory power is one of the strength, offering numerous untapped opportunities. A competitiveness strategy should employ selective deregulation, reducing regulation only in areas that enhance the EU's innovation capacity, without jeopardizing its regulatory power. On the contrary, the aim should be to leverage this power more effectively.

Strengthening defence, R&D and technological capabilities, harnessing talent and skills are certainly good-sounding aims but execution is not defined and largely varies among member states due to their structural differences. The Hungarian new industrial policy anyway has a controversial relationship to EU's Strategic Autonomy. The significant Chinese investments into the EV battery sector and massive battery production in Hungary will shorten the value chain, European (German) car producers will have good quality batteries nearby. Thus, they will be shielded from long transport risks. On the

other hand, however, security risks will increase and dependence on China remains even if they produce within the EU. The BYD plant built in Hungary will be a direct competitor for German automotive firms. Hungary has become China's European bridgehead (Éltető et al, 2024). For the Hungarian government, China is an attractive development model, with the state playing a strong role in managing economic relations and industries of strategic importance. The Orbán government is against any Western policies of de-risking and protectionism against China.

The sixth point is particularly significant as it goes beyond general statements and sets a specific goal: an increase in research and development spending to 3% of GDP. However, it is crucial to ensure that this goal is achieved in a territorially balanced manner, as unequal progress would only exacerbate economic disparities. It is therefore essential to place greater emphasis on the promotion of R&D in peripheral countries and regions. The principle of the 'fifth freedom,' as articulated in the Letta report, can be rephrased as the necessity to incorporate the free flow of knowledge into the core European values. Nevertheless, achieving this objective requires more than just financial investment. It is essential to implement initiatives and collaborations that facilitate the exchange and transfer of knowledge between member states. These aspects are not currently addressed in the declaration, but they should be incorporated into future plans.

The eleventh point addresses trade policy, structured around four core concepts: openness, sustainability, diversification, and resilience. Our analysis of trade data clearly shows that there is a need to prioritise trade policy, which justifies its inclusion in the declaration. However, we also highlighted the need to consider the specific challenges and structural positions faced by different regions within the EU. Furthermore, our analysis indicates that the EU's trade policy can capitalise on the strength of service exports, which represent a competitive advantage. Moreover, our findings highlight the importance of integrating the concept of strategic autonomy into the framework of trade policy. The challenges are particularly evident in the primary products and high-tech manufacturing sectors, where there is a persistent deficit in external trade. In addition, a new trade policy provides an opportunity for the EU to leverage its core strength, namely its regulatory power, to promote sustainable and inclusive convergence pathways for its trade partners.

6. Conclusion

The concept of competitiveness has emerged as a pivotal theme in recent years within the context of the European Union. A multitude of proposals and analyses have been developed in the field of Europe's competitiveness and of the Single Market. However, in this renaissance, it is crucial to emphasise that the meaning of competitiveness is contingent upon the specific definition under examination. The objective of remaining competitive can be achieved either on a purely quantitative basis – by maintaining low costs – or on a qualitative basis, which necessitates the stimulation of innovation and the development of a knowledge-based economy. Therefore, the layered nature of the concept of competitiveness must be taken into account when reflecting upon it.

Our study focused on two areas mostly omitted from the reports analysing European competitiveness: FDI and foreign trade. In terms of FDI, we showed the importance of intra-EU FDI, especially for the less developed members of the EU and large country differences in FDI intensities and in extra-EU FDI as well as distortions due to the fact that certain countries act as intermediaries in FDI flows, leading to fiscal and allocation problems. EU competitiveness strategies should take into account these member country differences.

With regard to trade, our principal assertion is that the EU faces a dual set of challenges and opportunities. To achieve success, a European competitiveness strategy should consider the different challenges faced by member states with varying structural positions. It is therefore evident that – also here - a tailored competitiveness strategy is required, that considers the heterogeneity of the EU. It was demonstrated that while the EU's share of global GDP and merchandise exports has declined over the last two decades, its service exports remain a key strength, with a higher share than that of China and the United States. The heavy concentration of EU trade is evident, with Germany, Italy, France, and the Netherlands accounting for over 60% of external exports. This concentration is reflective of internal disparities within the EU, particularly between core and peripheral regions. The Eastern periphery, functioning as "factory economies" with high foreign value-added shares in exports, has increasingly integrated into EU value chains. Moreover, the Southern periphery is experiencing a decline in a number of areas.

In designing a competitiveness strategy, it is essential to consider the patterns of the European division of labour and modify them in order to provide a clear developmental perspective for all member states. Addressing these imbalances and leveraging strengths such as service exports and medium-technology manufacturing will be vital for a more inclusive and strategically autonomous EU trade policy.

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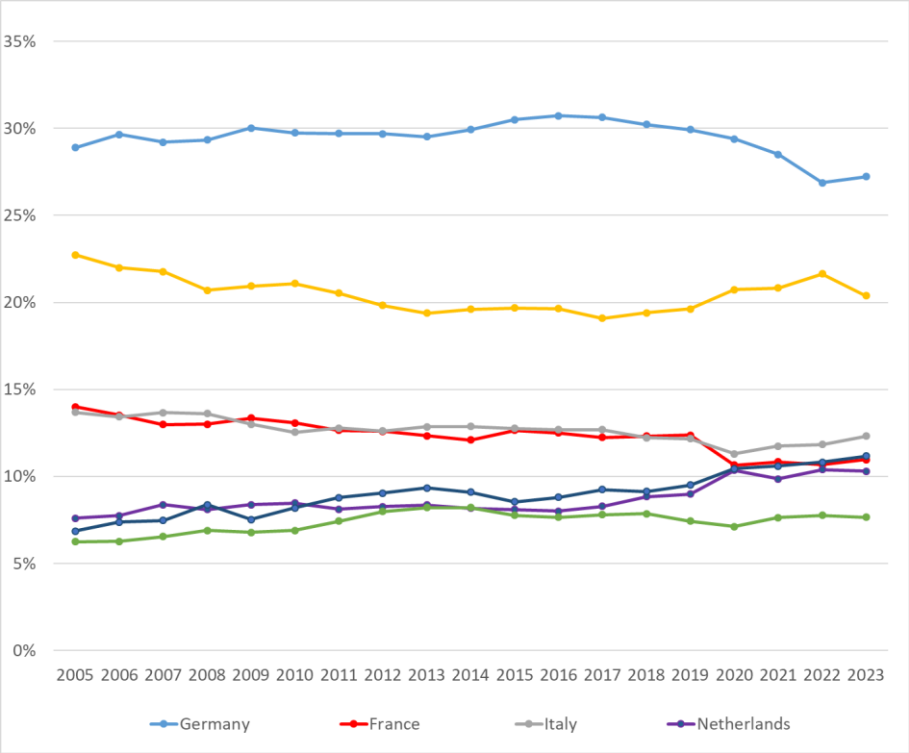
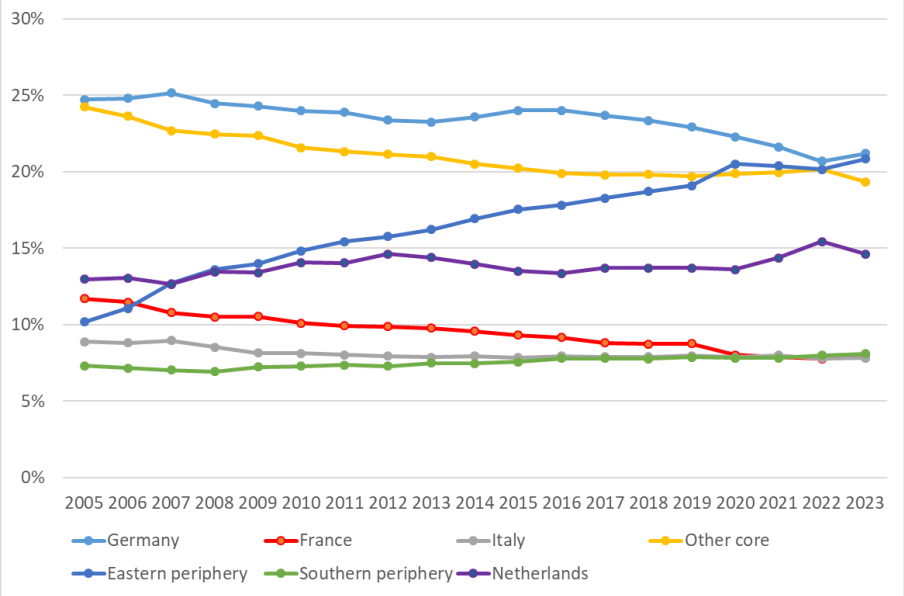
Annex

Figure A1. Share in extra-EU export, percent



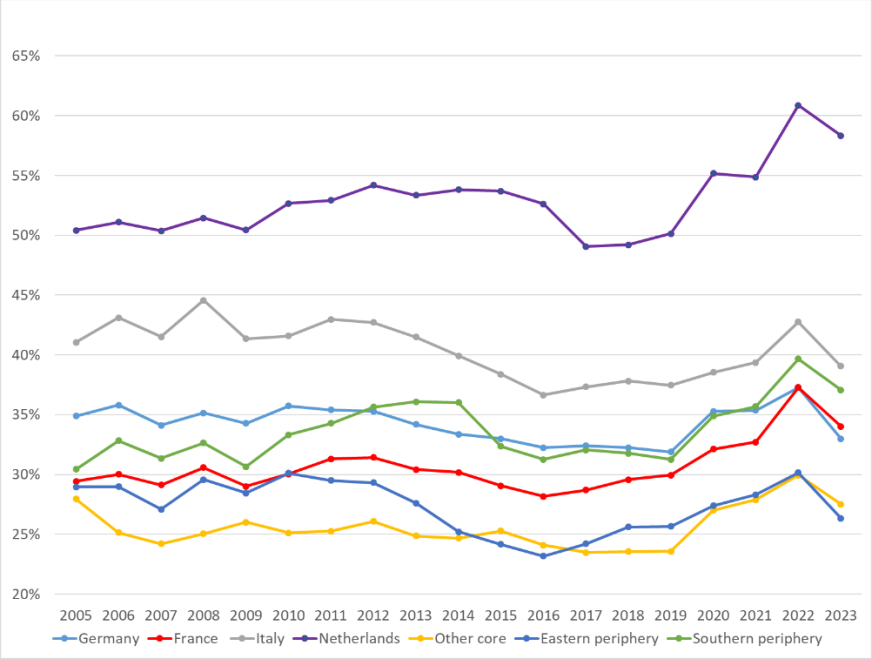
Source: own calculations based on Eurostat Comext database

Figure A2. Share in intra-EU export, percent



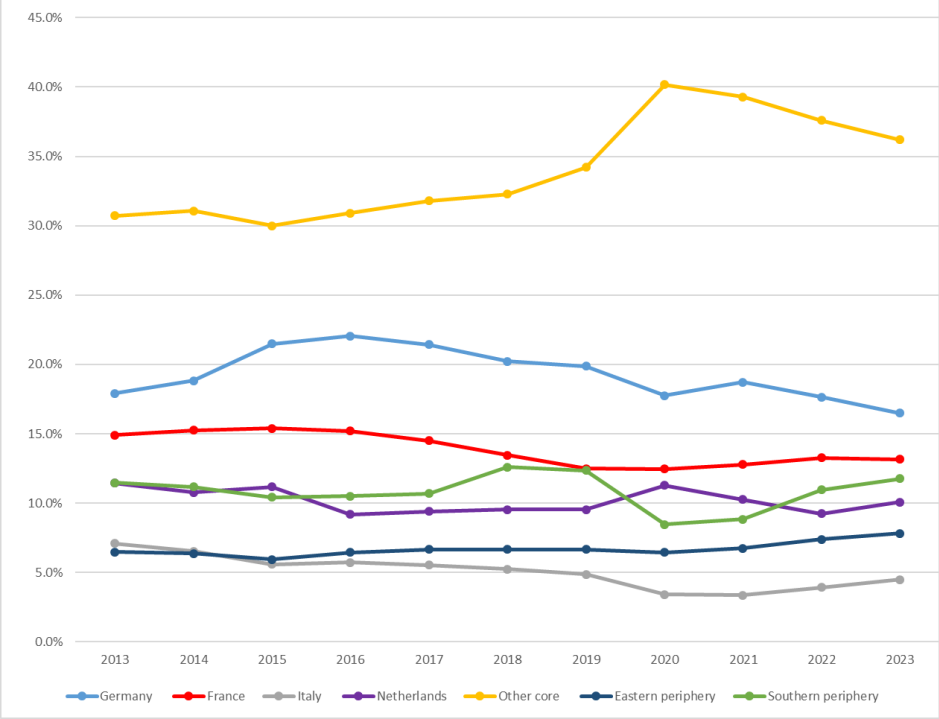
Source: own calculations based on Eurostat ComExt database

Figure A3. Extra-EU import share in total import (shows the averages of the country groups)



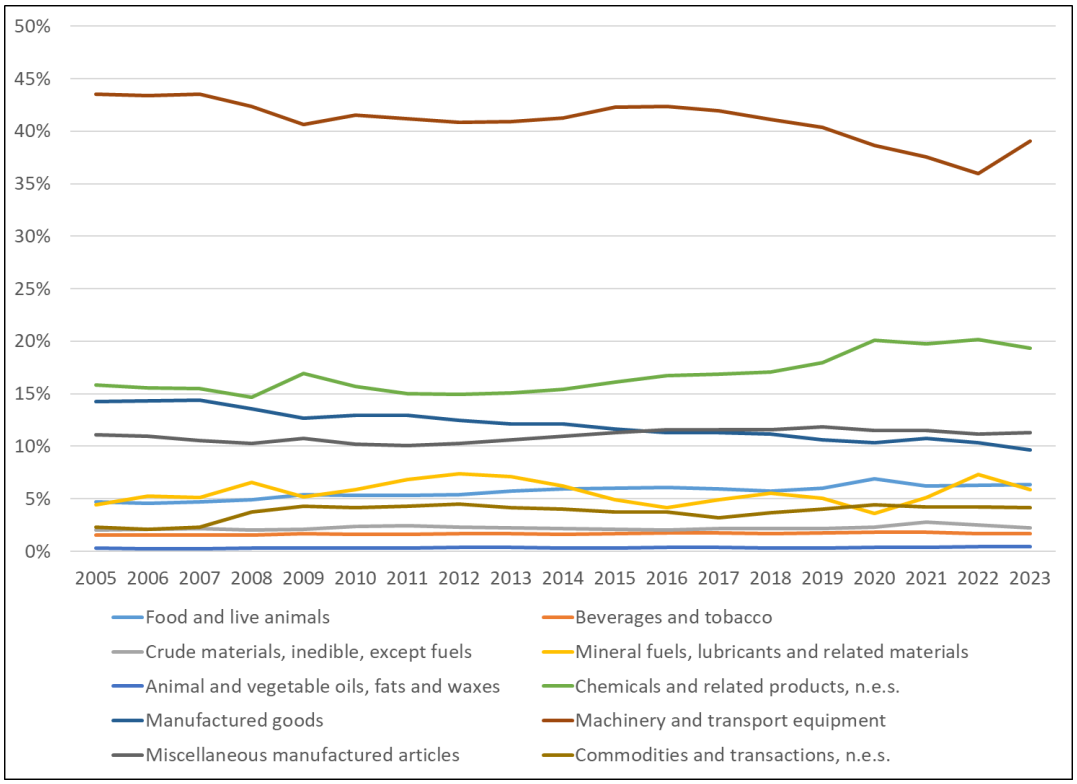
Source: own calculations based on Eurostat ComExt database

Figure A4. Share of extra-EU service exports, percent



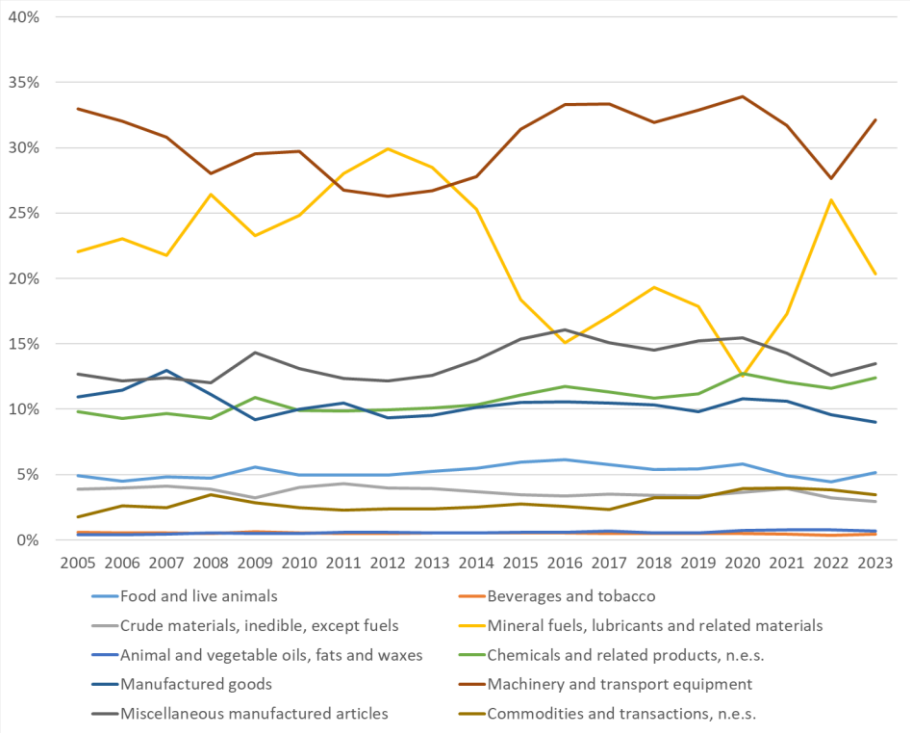
Source: own calculations based on UNCTADstat data

Figure A5. Extra-EU export share by products, percent



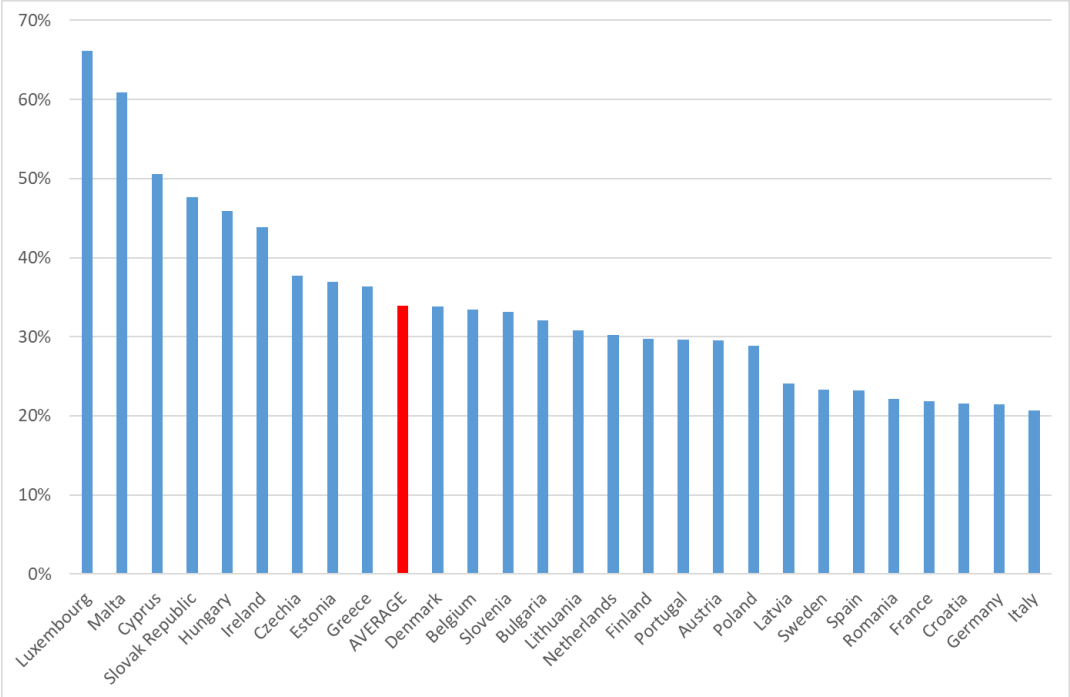
Source: own calculations based on UNCTADstat data

Figure A6. Extra EU import share by products, percent



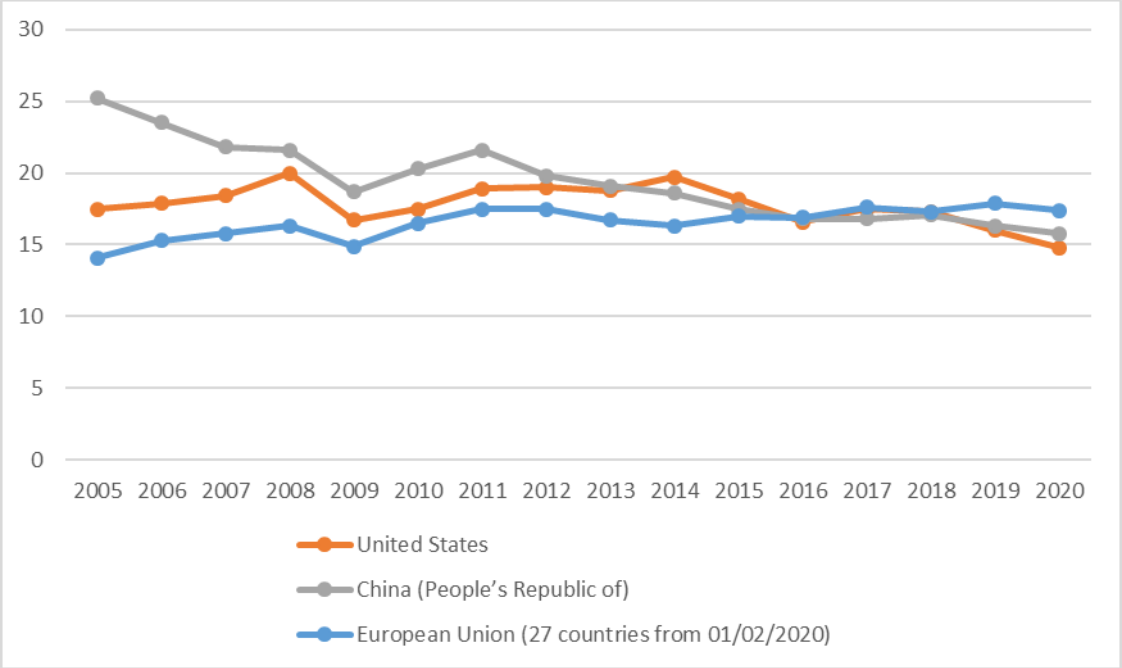
Source: own calculations based on UNCTADstat data

Figure A7. Share of foreign value-added in gross exports in 2020, percent



Source: own calculations based on TiVA database

Figure A8. Share of foreign value-added in gross exports for automotive industry (manufacture of motor vehicles, trailers, semi-trailers and of other transport equipment), percent



Source: own calculations based on OECD TiVA database