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Ten issues to watch in 2025

IN-DEPTH ANALYSIS

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Author: Étienne Bassot
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This EPRS publication seeks to put into context and offer insights on 10 key issues and policy areas that have the potential to feature prominently in public debate and on the political agenda of the European Union in 2025. It has been coordinated and edited by Isabelle Gaudeul-Ehrhart of the Members' Research Service, based on contributions from the following policy analysts: Naja Bentzen (Restoring trust within the public sphere), Sebastian Clapp (Strengthening the European defence industry), Alessandro D'Alfonso (Strengthening capacity to invest in the future), Costica Dumbrava (Speeding up the return of irregular migrants), Mathias Gullentops (Waiting to move up a gear: European electric cars), Martin Höflmayr (Balancing scale with innovation for productivity), Liselotte Jensen (Setting the 2040 climate target), Maria Niestadt (Helping the EU compete on artificial intelligence), Marianna Pari (Shaping the EU's future finances) and Marcin Szczepanski (Taking the next steps towards European economic security). The cover image and other graphics were produced by Samy Chahri.

Further details of progress on on-going EU legislative proposals, including all those mentioned in this paper, are available in the European Parliament's Legislative Train Schedule, at: http://www.europarl.europa.eu/legislative-train/.

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eprs@ep.europa.eu
http://www.eprs.ep.parl.union.eu/ (intranet)
http://www.europarl.europa.eu/thinktank (internet)
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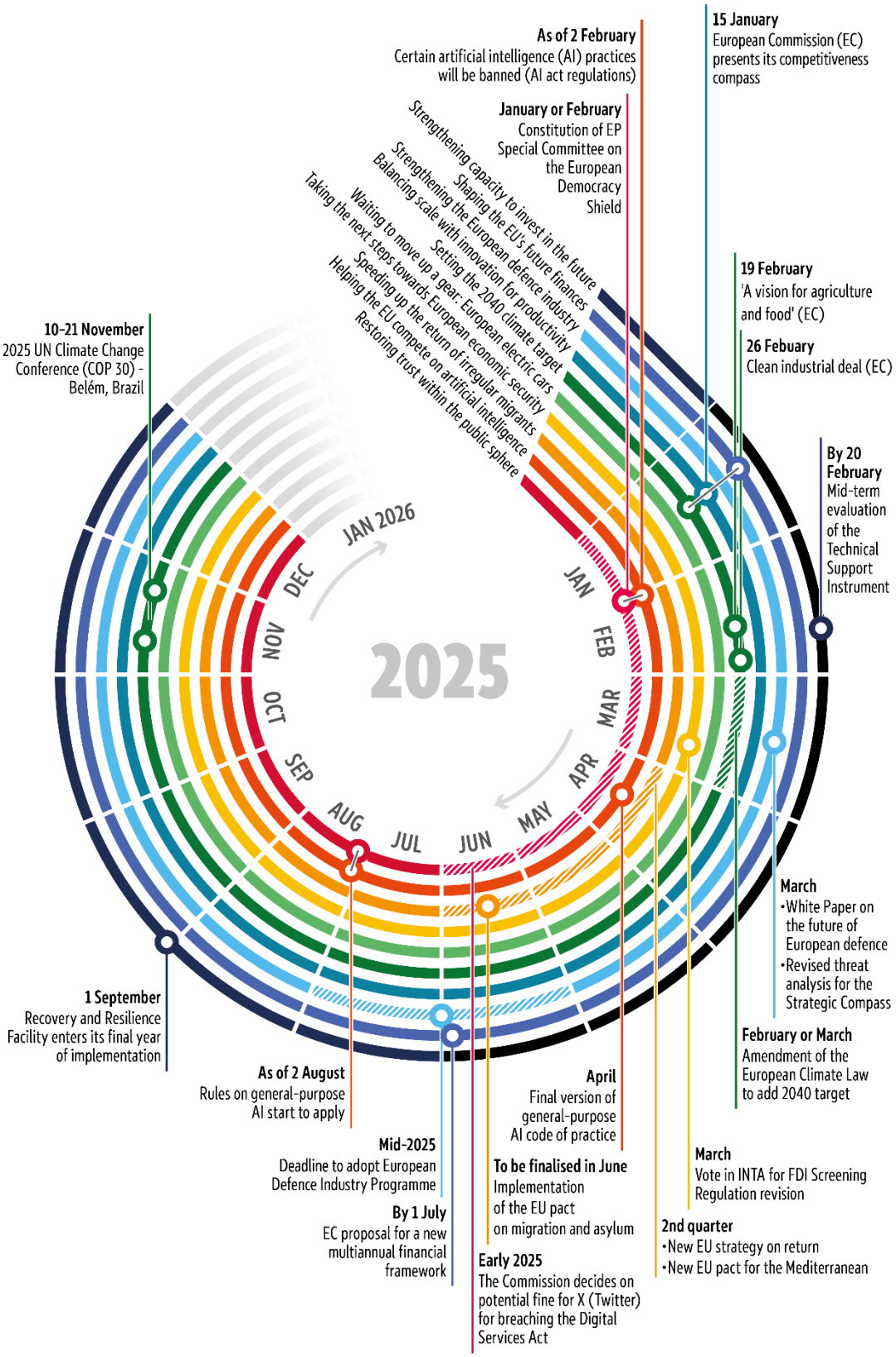


Source: EPRS, 2024.

Introduction

The ninth edition of this annual publication presents 10 issues to watch in 2025, selected by the Members' Research Service of the European Parliament. Some of these issues feature high on the 2025 European political agenda as they reflect the three pillars of the 'competitiveness compass' that the von der Leyen II Commission has identified for its 2024-2029 mandate: balancing scale with innovation for productivity, setting the 2040 climate target, and taking the next steps towards European economic security. Other subjects are more specific, such as waiting to move up a gear: European electric cars, and helping the EU compete on artificial intelligence. For some issues, progress has long been too slow and new impetus is needed: strengthening the European defence industry, and speeding up the return of irregular migrants. All these issues, as well as other issues beyond this list of 10, require financial means and investment, which in turn raises the additional challenge of shaping the EU's future finances and strengthening capacity to invest in the future. The overarching issue of restoring trust in the public sphere – in traditional news media, social media, governments and institutions, and business – meanwhile affects all of the above.

As a new political cycle begins for the European institutions, with the latest mandates having started on 1 December 2024, this list of issues could seem daunting. Alternatively, they can be seen as a list of new opportunities for the European Union to assert itself, bounce back, and move ahead.

History teaches that it has been when under the pressure of events that the European Union (EU) has made most progress. It is already becoming clear how Russia's war on Ukraine and changes in transatlantic relations have made the EU move ahead on security and defence. The challenges that are accumulating are the very same that offer the EU a chance to get stronger and assert itself on the world stage. These issues demand choices; they also offer opportunities. The European Parliament, as the place for debate among directly elected members and as co-legislator, will have an important role to play when it comes to deciding on the EU's future course. The year 2025 will be a year of decisions – a theme that runs through this publication – as illustrated by its cover image.

These choices – these decisions – call for independent, objective and authoritative information: the motto of the European Parliamentary Research Service. EPRS publications rely on research, robust facts and figures, and informed analysis to provide the European Parliament's Members with the elements they need to do their work, and ultimately build the trust that must underpin any democracy.

Readers will find analysis on issues that do not feature on this list of 10 in previous editions of this publication (listed under the 'Further reading section') and in the thousands of publications that EPRS has issued online and in paper over the years, enriching Parliament's knowledge environment.

We hope that you will find this latest edition of 'Ten Issues to watch' informative and useful as you consider the challenges and opportunities of 2025.

Étienne Bassot

Director, Members' Research Service,
European Parliamentary Research Service (EPRS)

1. Balancing scale with innovation for productivity

The debate over Europe's disappointing productivity performance has brought up a major dilemma: should policies focus on scaling up companies so larger companies can compete globally, or should policy-makers foster competition between a greater number of smaller companies in the single market to spur innovation? While prioritising scale may constrain the potential for innovation, fostering innovation-led growth might mean curbing market concentration and, by extension, limiting scale. The need to strike a balance between these two opposing concepts will be at the heart of economic policy-making in 2025.

Two recent reports, respectively under the aegis of the former Italian prime ministers, Enrico Letta and Mario Draghi, have added fuel to the debate. The reports' assessments painted a sombre picture of the Union's economic prospects. Letta points the finger at a still fragmented single market, suggesting a fifth freedom for research, innovation and education. The report makes an economic and political case for a deeper and broader single market, inter alia, to make it easier for European companies to grow and achieve scale. Draghi highlights the urgent need for substantial private and public investment to drive innovation-led growth in the EU. He proposes a nuanced and sector-specific plan for an EU industrial policy, with a delicate policy mix including a competition policy that allows European companies to scale up while fostering an effective innovation policy.

The reports present numerous proposals, many of which will feed into the European Commission's first major initiative, the 'competitiveness compass' focusing on the innovation gap with the US and China, aligning decarbonisation with competitiveness (see Issue 2), and enhancing security by reducing dependencies (see Issue 3). It is essential that those proposals form a coherent and balanced policy mix – something that the European Semester has struggled to coordinate, as noted in Draghi's governance chapter. In particular, the European Parliament should carefully consider that prioritising scale might limit innovation potential, while pushing for innovation-led growth might mean limiting market concentration and thus scale.

Scaling up argument: Both reports argue that the Union needs to enable companies to grow and scale up within the single market to enhance productivity and to compete at global level. One main argument for this is that EU industries are increasingly exposed to competition with China, as China has gained export market shares on the back of investment-centric policies that have built up overcapacity. Another important argument is that firm size is linked to technology adoption. Evidence shows that technological adoption rises with firm size for all advanced technologies. This is particularly striking since EU productivity growth over the past 20 years is broadly on a par with the United States (US) if the tech sector is excluded. Policy proposals centre on two main levers: competition policy and capital markets. However, both reports acknowledge that competition policy should not be reformed in isolation. For instance, merger and acquisition decisions would allow for an 'innovation defence', proving that the effect of a merger would be innovation-enhancing.

Innovation argument: Typically, greater competition and increased innovation go hand in hand, whereas market power often hinders innovation and productivity growth. The two reports concede that the EU is facing considerable structural headwinds, having lost ground to global competitors in particular in digital technologies while lagging behind in technology creation and diffusion. The EU has a strong presence in mid-technology sectors, which are less affected by rapid technological advances. At the same time, EU companies are less active in high-productivity sectors such as information and communication technologies (ICT) and large-scale digital services. With EU companies are stuck in a 'middle technology trap', the EU's productivity growth is lagging behind that of its peers, particularly in industries driven by cutting-edge technology. Despite public research and development (R&D) spending on par with peer countries, there is an investment gap on account of private R&D spending, as European businesses invest significantly less in R&D than their counterparts in the US and China.

The trade-off

Evidence – particularly from the US, often cited as a benchmark in both reports – shows that market concentration can reduce innovation returns, while innovation can enable companies to evade competition. This implies that there is an optimal level of competition that allows for efficacious innovation, with major policy implications. While there are very good reasons to focus on both policy objectives, i.e. both scale and innovation, understanding this complex trade-off is crucial to design an effective policy mix.

Schumpeter–Arrow debate

The Schumpeter–Arrow debate epitomises these conflicting goals. Arrow's theory suggests that competition drives innovation because firms in competitive markets must adopt efficient methods and differentiate to gain an edge ('escape effect'). In contrast, Schumpeter argues that less competition (with a few large firms) promotes long-term innovation, as the resulting high profits incentivise firms to invest in significant, riskier R&D projects. The contradicting theories were summed up by Aghion et al. in 2005, finding an inverted U-shaped relationship between competition and innovation. In other words, when the degree of competition is low, there is a positive impact of increased competition on innovation, while at a certain level of competition, a further increase instead reduces incentives for innovation.

Competition and innovation in the EU single market

Over the past 25 years, the EU business environment has seen a rise in industry concentration and profits, especially among firms at the top of the mark-up and profit distribution, and a widening productivity gap between leading companies and smaller ones. Large firms are increasingly dominant, creating a 'winner-takes-most' environment. This trend has mixed effects: while it has driven efficiency in some sectors, it has also raised barriers for new entrants, limiting innovation diffusion and competition intensity. Illogically, industries where competition is weaker are subject to more frequent competition enforcement interventions in the EU. The result is less business dynamism and slower productivity growth. This is an issue often raised in the context of promoting 'European champions'.

This tendency is problematic, as companies that grow and dominate their markets often shift their focus from innovation to protecting their market position and gaining political power . In such an environment, R&D spending sees diminishing returns in the following two main ways.

Funding: Current EU R&D investments and subsidies are fragmented and tend to favour established sectors such as the automotive industry (see Issue 6) and mechanical engineering, while high-tech sectors (ICT) remain underfunded. US firms specialise in technologies that use ICT more intensively and innovate in new products. At the same time, the EU specialises in technologies that use non-ICT forms of capital more intensively and tend to innovate in the area of perfecting the quality of existing products (the above-mentioned middle technology trap).

Labour: Innovation-stifling hiring is observed when large incumbent companies hire key employees from young competitors. Evidence in the US shows that inventors are increasingly concentrated in large incumbents and, once hired, an inventor's earnings increase while innovative output declines. Similarly, larger Italian enterprises tend to innovate less and instead engage in activities that limit competition by hiring local politicians, thus channelling resources into maintaining dominance rather than fostering innovation.

Competition and innovation are mutually dependent but vary depending on market structure, industry characteristics, and firm strategies. This complex interaction makes designing competition and innovation policies challenging, as policy-makers must carefully balance openness to competition with incentives that ensure firms can benefit from innovation. To build a coherent European industrial strategy, EU institutions must carefully weigh the balance between competition and innovation policy goals. It is time to take decisive action and prioritise a strategy that drives both competitiveness and innovation across Europe.

2. Setting the 2040 climate target

In 2025, the EU Climate Law is expected to be amended to introduce an intermediate 2040 target, as required by the law itself, to ensure a path to 2050 climate neutrality. The objective is to set a net 90 % emissions reduction target by 2040, compared to 1990. Alongside this target, the Commission has prepared a first indicative EU greenhouse gas (GHG) budget for the period 2030 to 2050. This new budget will require new carbon management policies.

The first indicative EU GHG budget, for 2030 to 2050

GHG emissions triggered by human activity are causing global warming, which in turn is destabilising the earth's climate with a rise in extreme weather events and ever more climate damage. The near-linear relationship between cumulative CO_2 emissions and global warming levels this century make it possible to estimate the remaining carbon budget for staying below 1.5°C or 2°C. The Paris Agreement mandates rapid emission reductions to reach net zero in the second half of this century, yet global GHG emissions are still growing. If near-term emissions are not reduced rapidly, the 2024 United Nations emissions gap report estimates a 90 % chance of 3°C peak warming by 2100.

Aiming to stay below a certain warming level requires countries to limit their GHG emissions to the remaining carbon budget. Several principles exist for calculating fair-share distribution – how to divide the remaining budget among nations. For example, historical emissions or ability to pay can be a factor. In its scientific advice on the EU 2040 climate target and GHG budget, the European Scientific Advisory Board on Climate Change (ESABCC) concludes that no matter the principle applied, a gap exists between the EU's fair-share and what is technically feasible in the EU economy. Considering the restraints on what can realistically be achieved, the ESABCC recommends that the EU ensure emissions below 14 gigatonnes of CO_2 equivalent emissions ($GtCO_2e$) over the 2030 to 2050 period and that it set an ambitious 2040 emissions reduction target of at least -90 %.

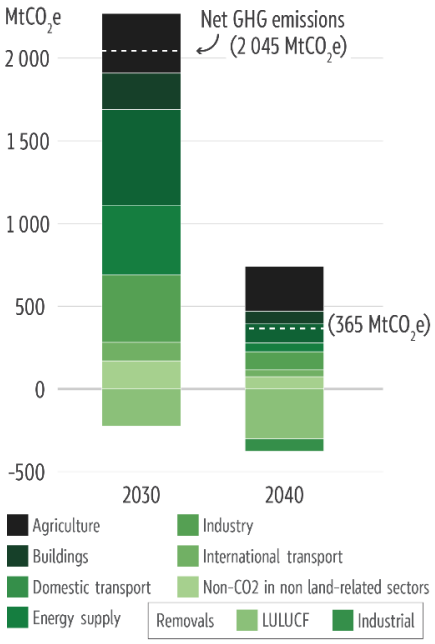
The Commission has announced its intention to amend the EU Climate Law to add an interim 2040 target of net 90 % emissions reduction compared to 1990. It estimates that the EU's net cumulative GHG emissions between 2030 and 2050 should amount to maximum 16 $GtCO_2e$.

From 'fit for 55' to 'fit for 90' by 2040

Figure 2 illustrates the emissions reduction efforts needed across sectors from 2030 to 2040, as per the Commission's impact assessment. Within 15 years from today, the EU-27 would need to reduce its net emissions almost to the level of Italy in 2023 (470 million tonnes of CO_2 equivalent ($MtCO_2e$) compared with 400 $MtCO_2e$ for Italy). As it is a 'net' target, carbon removals will provide the flexibility needed to offset hard-to-abate emissions above the threshold. According to the Commission's 2040 target communication, carbon removals should reach up to 400 $MtCO_2$ by 2040.

The adoption of the higher 2030 target in 2021 triggered a broad revision of climate legislation and saw new policies added, most of which were proposed under the 'fit for 55' package. In 2025 and 2026 it will become clear how the Commission intends to get 'fit for 90' by 2040.

Figure 2 – Projected future emissions shares per sector



Source: SWD(2024) 63 final.

Carbon management and industrial competitiveness

The Commission's 2040 climate target communication assumes a decarbonised power sector by 2040, relying on the expansion of renewable energy, grids, storage, and efficiency gains, with limited carbon capture of remaining emissions by 2040. It is an essential building block that enables the substitution of fossil fuels through increased electrification and production of clean hydrogen. This would in turn increase EU energy independence and reduce the volatility of electricity prices.

Achieving the 2040 climate target and staying within the indicative EU GHG budget will however mean broadening climate policy towards an all-economy carbon management approach. This would go beyond the CO_2 or methane emissions linked to energy production and fuels use and tackle the emissions stemming from industrial processes and product manufacturing. Removals through the absorption of CO_2 by soils and trees or via technological means such as direct air capture (DAC) or bioenergy with carbon capture and storage (BECCS) will need to increase. As noted by Climate Action Commissioner Wopke Hoekstra, post-2030 climate policy frameworks will therefore have to be closely aligned with industrial policy initiatives such as the forthcoming clean industrial deal.

Decarbonising the industrial sector will involve measures such as making industry more circular, promoting efficiency gains in energy use but also in raw material demand, through reduce, reuse and recycle methods. This journey has already begun: the 2023 Green Deal industrial plan included the Net-zero Industry Act, the Critical Raw Materials Act and the electricity market reform, which are already in force. These instruments are all essential to the decarbonisation of European industry and to establishing Europe as a hub for clean tech and industrial innovation on the path to net zero.

Where electrification of industrial processes is not feasible and low carbon solutions, such as bio or e-fuels, have only low potential, carbon capture will play an important role in reducing the release of CO_2 into the atmosphere. For some processes, such as cement production, it is currently the only solution. The 2024 industrial carbon management communication presents the concept as an essential complement to mitigation actions and as an area of business opportunity for Europe as a global frontrunner. The EU has adopted a 2030 target for CO_2 storage capacity of 50 Mt per year. The 2040 carbon capture and storage (CCS) need is estimated at five times this level.

The right incentives to accelerate uptake of carbon capture utilisation and storage (CCUS) technologies include strong carbon pricing mechanisms and market demand for captured CO_2 and carbon credits. The EU emissions trading system already allows for an exemption to surrender emission allowances in cases of properly applied CCS. CCS technologies are also included among the net-zero technologies that fall within the scope of the Net-zero Industry Act. The Commission expects circularity of and demand for CO_2 as a feedstock to rise during the 2030s for e-fuels and in the period from 2040 to replace virgin fossil carbon across more products and materials.

2025: A year of critical policy choices

The von der Leyen I Commission referred to the European Green Deal as Europe's growth strategy, and its 2021 sustainable carbon cycles communication began a broader economy narrative for carbon management. Under von der Leyen II, competitiveness and decarbonisation are intricately interwoven, as described in the mission letter to Teresa Ribera Rodríguez – Executive Vice-President (EVP) for a Clean, Just and Competitive Transition. Stéphane Séjourné, EVP for Prosperity and Industrial Strategy has echoed the interdependence of industrial policy and decarbonisation.

Technological solutions already exist to bring the EU quite a long way on its transition journey, though some may not yet be mature enough. In the end, what matters in 2025 is ensuring that the pieces of the puzzle give a framework to boost reindustrialisation towards a net-zero economy. This requires economic security initiatives (see Issue 3) to build resilient supply chains, with synergies in global partnerships and trade. It will also mean boosting investment through new instruments to build scale and offer targeted innovation support (see Issue 1).

3. Taking the next steps towards European economic security

Support for open, rules-based trade governed by a multilateral framework and based on global stability is in the EU's DNA. Recent challenges, such as the COVID-19 pandemic, Russia's war of aggression on Ukraine and intensifying geopolitical rivalries, have exposed vulnerabilities in the Union's economic structure, warranting a strategic response. Consequently, the EU is moving towards strengthening its economic security, a shift that is becoming increasingly visible in its legislative proposals and policies.

A long-held premise that economic interdependence automatically leads to peace and cooperation is in doubt. It now seems that those very economic links on which EU's economic model is built may also be used for harmful purposes. The pressures on the EU have intensified: strategic dependencies on countries with divergent values, profound technological change, cyber and infrastructure attacks, economic coercion by authoritarian countries, foreign interference and misinformation, and weaponisation of trade links have created new category of economic security risks.

The 'geopolitical Commission' established in 2019 recognised this, prioritising concepts such as strategic autonomy and digital sovereignty. Since then, the EU has been expanding its toolbox to be able to identify economic flows and activities that pose a risk to European security and to address them. Laws passed to protect EU's interests from foreign threats include the Foreign Direct Investment Screening Mechanism, the International Procurement Instrument, the Foreign Subsidies Regulation, and the Anti-Coercion Instrument. Coupled with the use of trade defence instruments, sanctions and export controls, this is increasing Europe's assertiveness and means to adapt to an ever-changing nexus of geopolitics and economics. Similarly, initiatives focusing on critical aaw materials, semiconductors, strategic technologies and batteries target sectors crucial to EU competitiveness, where dependency on foreign suppliers is known to be high and where supply chain resilience needs to grow.

Adding new pieces to the economic security puzzle

Economic security is an emerging concept, with no agreed EU definition or precise scope as yet. Some experts also consider the competences division in this policy area to be blurred, as national security is a prerogative of the Member States. The Commission issued its first-ever economic security strategy in 2023. It underlined the need to develop a more cohesive and impactful common EU approach. The strategy identified four top priority categories of risk: (i) to supply chain resilience; (ii) to the physical and cyber security of critical infrastructure; (iii) to technology security and technology leakage; and (iv) of weaponisation of economic dependencies and economic coercion. To address these, the strategy proposes to: (i) promote EU competitiveness and its scientific, technological and industrial bases; (ii) protect the EU from economic security risks including through new instruments; and (iii) partner with like-minded countries who share the same concerns and interests. While only one of these mentions 'protecting', some voices argue that the strategy indicates that the EU is taking a more defensive position.

As a follow-up, in October 2023 the Commission recommended that the Member States conduct joint risk assessments in areas critical to economic security: advanced semiconductors; artificial intelligence (AI); and quantum and biotechnologies. Further areas requiring risk assessments in the near future are: connectivity; navigation and digital technologies; sensing technologies; space and propulsion; energy; robotics; advanced materials; and manufacturing and recycling technologies. This was followed in January 2024 by the first economic security package, containing five initiatives: improving foreign direct investment screening; launching discussions on stronger EU coordination of export controls; identifying potential risks stemming from outbound investments in selected technologies; improving support for dual-use technology research and development and enhancing research security.

What other democracies are doing

Experts consider economic security to be one of the most dynamic policy areas at present; the G7 and its members, as well as like-minded countries such as Australia and South Korea, continue to deepen and adapt their policies. While many authorities are still at the stage of mapping the risks and devising mitigating measures, researchers draw attention to: (i) investment screening policies (inbound and outbound); (ii) export controls and sanctions; (iii) access to critical raw materials; (iv) resilience of supply chains; (v) cybersecurity and protection of critical infrastructure; (vi) procurement restrictions; and (vii) anti-coercion policy.

Despite some alignment of policies in advanced economies, their unique concerns, interests and priorities mean they each adopt slightly different policy approaches. The degree of economic integration with China also plays a role: while there is an appetite to counter its industrial overcapacity, building resilience in economies by turning away from Beijing is costly, and may reduce efficiency and increase domestic prices. Although the EU is following a policy of de-risking from China, the firmer approach of the last few years does not mean that it has adopted broad-based protectionism that would result in significant welfare losses. Instead, it is focusing on addressing the main risks stemming from strategic dependencies.

What experts are saying

A 2024 study for Members of the European Parliament argued that a comprehensive strategy should be built around: (i) advancing a common understanding of economic security risks; (ii) diversifying imports and exports to avoid over-reliance on major economic partners; (iii) intervening in critical sectors by funding industrial policies, increasing technological security, stockpiling and arranging joint procurement of critical products; and (iv) acting to deter economic coercion and mitigate harm.

A 2024 Centre for Economic Policy Research study explains that while the global geoeconomic map requires an EU shift towards economic security, it should not become a political excuse for protectionism, which is contrary to EU's economic model based on free trade. Instead it should reinforce novel international cooperation, based on innovative policy instruments, contingency planning, and stronger governance mechanisms at both EU and international levels. The Merics think tank stresses that building a solid analytical and intelligence base for economic security policy is a prerequisite for actively shaping the future technological landscape. The European Policy Centre calls for implementation of economic security across all policies, coupled with robust interinstitutional governance, reinvented partnerships and mechanisms to manage inevitable costs. Finally, it is becoming increasingly clear that economic security cannot be achieved without deepening the single market and capital markets necessary to finance innovation and boost competitiveness – as argued by the Letta and Draghi Reports (see Issue 1). This will require a joint rethinking of trade, industrial and economic policies.

What will happen next

The 2024-2029 Commission has put this issue high on its priority list, as evidenced by the creation of a Commissioner portfolio for Trade and Economic Security. The mission letter to Maroš Šefčovič signals work on a new economic security doctrine, including economic security standards for key supply chains with G7 partners, mitigation measures to address risks identified to critical technologies, and new economic security instruments. Further initiatives will follow. In the context of his confirmation hearing, Šefčovič heralded a new foreign economic policy that will bring together economic security, trade and new partnerships. He also pointed to a re-examination of the EU toolbox, looking at whether the existing instruments are being used well and if there is a need for new ones. The first flagship initiative will be the 'competitiveness compass', seeking to boost the EU's productivity and increase its security by reducing dependencies. The 2025 Polish Presidency of the Council of the EU, focused on *Security, Europe!*, will seek to build sovereignty and resilience.

4. Shaping the EU's future finances

In just a few months, long and heated discussions will start on what should be the direction for the EU's next long-term budget. The European Commission has to present a first draft proposal before 1 July 2025. Questions abound. Which priorities should the EU finance? How large should the EU budget be? How should it be financed? How will it be structured? Opinions and ideas on how the post-2027 EU budget should be shaped are already emerging. Some are daring, and already provoking mixed reactions.

Funds for the challenges ahead

The continuously tense geopolitical situation has underscored new areas that require financing support at EU level. Russia's war against Ukraine has triggered the need to support Ukraine (the EU budget has already provided €45.6 billion), make the Union more self-sufficient and enhance its defence and security preparedness. In the Safer together report, Sauli Niinistö, former President of Finland and special adviser to the President of the European Commission, urges the EU to reinforce its defence preparedness. He recommends an increase in joint defence spending, with 20 % of the EU's budget allocated to security and climate disasters, more flexibility and quicker response instruments. Commission President Ursula von der Leyen has estimated the EU's additional defence investment needs at €500 billion for the coming decade. This, she said, could be financed from additional national contributions, or additional EU own resources, either calling on them immediately or through EU borrowing.

Why EU level spending?

The notion of **European added value** (EAV) has been defined as 'the value resulting from an EU intervention which is additional to the value that would have been otherwise created by Member State action alone'. It has been inherent to the EU's integration and has long guided budgetary decisions.

A related notion is that of **European public goods**: 'policies and initiatives whose value to the citizens are higher when conducted at EU rather than at national level'.

A recent EPRS study estimated the **cost of non-action at EU level** in 10 policy areas at up to €3 trillion each year, or €6 700 of potential benefits of greater EU action per citizen per year.

According to the Draghi Report, the EU must invest in innovation, decarbonisation, security and dependency reduction, and human skills in order to increase its competitiveness. The report calls for an additional €750 to €800 billion in investment per year from 2025 to 2030. It also recommends reforming the EU budget to make it more focused on projects with the highest EU added value and more supportive to private investment.

Currently, the EU's contribution to climate financing is €658 billion (including Next Generation EU). To achieve climate neutrality by 2050, the Commission assesses that an additional investment of 1.5 % of GDP per year is needed compared with the decade 2011 to 2020.

Next, repayment of the capital relating to NGEU is due to start in 2028 and will last for 30 years. As a result of higher than estimated interest rates, the cost has increased abruptly in the current financial period. The total cost for the period 2028 to 2034, covering both the capital and the interest rates, is now estimated at between €140 billion and €168 billion (current prices) depending on whether repayment is spread with an equal yearly amount or with an equal share of gross national income (GNI).

The financing cost of another major challenge – potential EU enlargement to 10 new member states – must also be factored in. The accession cost of the current candidate countries, excluding Türkiye, is estimated – under multiple caveats and under current law – at between €15.7 billion and €26 billion per year. However, it is likely that most accessions will occur only after 2034.

The EU budget may see a change in its structure. The Commission President referred to moving from a programme-based to a policy-based budget. There may be a plan for each Member State, linking key reforms and investments. As to the volume of the future EU budget (the current budget is roughly 1 % of EU GNI – 1.7 % together with NGEU), some experts suggest 2 % of EU GNI, one study went as far as 4 % of GNI, providing goods with EU value added and enhancing the EU economy's stability and resilience. With these challenges on the financial agenda, the next MFF will have to be sufficiently robust to back up the EU's political orientations.

Ensuring the necessary financing

To rise to these challenges, the EU will need additional sustainable sources for the EU budget. There are three possibilities: new EU own resources; additional GNI contributions; and joint borrowing on the capital markets. On the first, Parliament's long-standing position has been to introduce genuine new own resources and move away from the *juste retour* logic. Despite Parliament's repeated requests for progress, Commission proposals for new own resources have so far stalled within the Council. If no new own resources are established, then the second possibility, a GNI-based top-up will be needed to balance an increase in expenditure. A third possibility could be to issue additional EU debt, which would require financial guarantees by the Member States and would thus also require additional permanent own resources. A new NGEU-type instrument, if not financed from own resources, would have to meet the following conditions: be exceptional, serve a specific purpose for a specified amount and be backed up by EU own resources. Some analysts support the idea of increasing the EU's common debt, within the legal limits, for emergency cases or for joint investment projects, while some Member States have expressed reluctance regarding joint EU borrowing.

Another requirement is to have a sufficiently flexible budget to adjust to new priorities and cope with unforeseen budgetary needs. The current MFF was initially adopted with 2.4 % flexibility but that proved insufficient. The Parliament has made repeated requests for the EU budget to be endowed with appropriate flexibility.

Principles, values and conditions of EU financing

Parliament's involvement from an early stage in the procedure is a condition for reaching a common vision for the EU's financing priorities. This is even more relevant since the issues at stake could well make the MFF negotiations more complex – and they require unanimity in the Council. Early cooperation and exchange, as described in Article 312 of the Treaty on the Functioning of the EU and the Interinstitutional agreement on budgetary discipline, cooperation, sound financial management and own resources will help the parties agree in time and ensure a smooth transition to the next MFF.

When it comes to implementation of the EU budget, effective European parliamentary control is required to ensure its democratic legitimacy. Budgetary scrutiny by the European Parliament should cover all EU expenditure, including any off-budget instruments. The Court of Auditors notes that there is room to improve accountability.

The rule of law conditionality regulation is a powerful tool to protect the EU budget and ensure that it is implemented in line with the principles of sound financial management. For the European Parliament, this regulation lays down essential conditions for Member States to obtain EU funds.

Will the new EU budget be a game changer for the EU's finances?

In her political guidelines for the 2024-2029 Commission, Ursula von der Leyen pleaded for a more focused, simpler and more impactful budget, one that is 'fit for our ambitions'. The Commission proposal is eagerly awaited. It then remains to be seen whether the EU will choose to step up with a stronger budget that can support the Union in meeting its challenging and ambitious objectives. The debate begins in 2025.

5. Strengthening capacity to invest in the future

Investment is under the spotlight in 2025, not only as a growing need for the EU and its Member States to ensure that their economies and societies can thrive in today's complex geopolitical ecosystem but also as a challenge when it comes to complementary reforms and capacity-building to increase impact.

The investment challenge

According to the Draghi Report on European competitiveness, the EU is facing an existential challenge: to become more productive and avoid economic decline, it will require reforms and massive amounts of investment. Needs in strategic areas such as the green and digital transitions, research and innovation, and defence are estimated at some €800 billion in additional investment from private and public sources per year, i.e. more than the entire Next Generation EU (NGEU) recovery instrument for 2021 to 2026 or around 5 % of the EU's gross domestic product (GDP). However, implementation of ambitious strategies requires strengthened administrative capacities on top of new financial resources, as also highlighted by the Letta Report on the single market. In the field of the green transition, for example, the roll-out of investment in renewables and energy grids warrants an effective permitting process. Limited administrative capacity and digitalisation often remain major obstacles to effective implementation, however, with 69 % of municipalities reporting a shortage of skills relating to environmental and climate assessments.

The EU budget is an obvious candidate for financing jointly agreed priorities (see Issue 4). Despite its limited size (around 1 % of EU GDP), a number of features make it a significant source of public investment, in some Member States in particular. However, the deployment of EU resources has traditionally faced a number of hurdles, as suggested for example by the experience with cohesion, a major EU investment policy endowed with €392 billion for the 2021-2027 period. In 2020, an OECD study recommended reinforcing cohesion funding governance, and identified room for improvement in three broad areas: (i) being more strategic and innovative in how staff, processes and programmes are managed; (ii) managing the impact of framework conditions on stability and certainty in administrative and investment processes; and (iii) ensuring that capacity building among managing authorities and/or beneficiaries is undertaken at the appropriate level.

Launched as a response to the socio-economic crisis triggered by the COVID-19 pandemic, NGEU almost doubles the firepower of EU resources in the years up to 2026, providing an extra €712 billion for investment and reform across the Union. Its centrepiece, the Recovery and Resilience Facility (RRF), represents a noteworthy experiment in stepping up efforts to strengthen the administrative capacities needed to manage much needed investment at different levels. At the same time, the coexistence of two major EU investment tools applying different rules – the RRF and the cohesion funds – has added a new layer of complexity for implementing authorities.

Next Generation EU and the Technical Support Instrument

Member States implement the bulk of NGEU through national recovery and resilience plans (NRRPs) and are expected to receive around €650 billion in EU resources from the RRF. The RRF stands out for its innovative approach, supporting both investment in strategic areas – such as the green and digital transitions – and complementary reform measures to reinforce the impact of investment.

Across the plans, at least 30 reform measures are aimed directly at strengthening the RRF's management and, in some cases, that of other EU funding, including through various milestones and targets relating to setting up appropriate implementation, monitoring and control systems. Such qualitative and quantitative objectives are usually frontloaded in the timeline of the plans. In specific cases, Member States cannot receive any RRF payments before meeting some of these objectives, which provides an incentive for action.

The Italian plan includes the recruitment of 1 000 experts for its implementation, as well as upskilling and reskilling initiatives for more than half a million employees in central and local administrations. The Czech plan supports the creation of a coordination and competence centre tasked with capacity building and offering methodological and information support to public investors. Other RRF measures contribute to improving investment conditions indirectly, including with the significant resources (€53 billion) earmarked for the digitalisation of the public sector in the Member States.

In the various policy areas supported, the NRRPs often combine mutually reinforcing investment and reform measures. For example, in the field of sustainable water management, a reform to improve the efficiency and governance of public water providers in Croatia includes the development of a multiannual infrastructure investment programme, to streamline investment in water supply and sewage. A reform under the green transition dimension of the Polish plan seeks to streamline the permitting for renewable energy sources; this is expected to facilitate their deployment.

In addition, to prepare, amend and implement their NRRPs, all the Member States are making use of the Technical Support Instrument (TSI). Through this EU programme, the Commission, upon request, provides tailored technical expertise to help Member States design and implement reforms. Over 500 reforms supported by the TSI since 2021 relate directly or indirectly to the RRF, suggesting a close interlinkage between the two instruments. More specifically, 23 countries have benefited from general support aimed at enhancing their overall capacity to implement the NRRPs in different areas ranging from project management methods and audit frameworks to the application of the do-no-significant-harm to the environment principle. All Member States have used thematic support for the implementation of specific reform and investment measures under their plans across various policy areas. For example, the Commission has been helping Portugal to improve the efficiency and transparency of its public procurement, Italy to reorganise national governance of health technologies, and the Netherlands to increase the energy efficiency of its public buildings.

The year to learn lessons for the future

The Commission's mid-term evaluation of the RRF highlights its support for reform and capacity building and the links with investment as one of its key positive features. In addition, the Commission acknowledges the crucial role of the TSI. RRF disbursements are progressing at a faster pace than traditional EU budgetary tools, but risks and challenges to their absorption remain. At the same time, the focus on the time-limited RRF is thought to have slowed down the parallel implementation of cohesion policy. The 2024 European Semester identified administrative capacity issues in various Member States. Along similar lines, the RRF annual report of October 2024 pointed out that many Member States had not reinforced administrative capacity sufficiently, including at local and regional levels, with the main delays in the plans' implementation often associated with this issue. Examples of efforts to address gaps and shortcomings include the July 2024 update of the Commission guidance on NRRPs and the regular meetings of the informal expert group on RRF implementation. The latter is a forum where Member States' experts and the Commission can discuss cross-cutting aspects of the RRF, including in a dedicated workshop on governance and administrative capacity.

In 2025, further implementation efforts are needed: the RRF is entering its final phase and Member States have less than 2 years to finalise their NRRPs. Under the EU's new fiscal rules, avoiding delays in the effective use of resources is crucial since the RRF and the other EU funds are expected to mitigate the adverse effects of fiscal consolidation and make the composition of public expenditure more growth-friendly. At the same time, the idea of integrating reform support in all new initiatives and for all levels of governance will be a key part of the debate on the future of EU finances, with the proposals for the EU's post-2027 multiannual financial framework (MFF) expected in mid-2025 (see Issue 4). Similarly, the Letta Report praises the TSI and recommends complementing it with a new pact to enhance European administrations' cooperation and expertise. The objective is to invest in training and establish forums for sharing best practices and identifying promising projects across the EU. RRF and TSI implementation insights will continue to contribute to the debate.

6. Waiting to move up a gear: European electric cars

The green transition and global competition have shaken up the automotive industry. Will 2025 remain a bumpy ride or will electric vehicles pull ahead? The EU has taken measures to curb vehicle emissions drastically. Its 2023 Regulation on revised CO_2 emissions reduction targets for new passenger cars and light commercial vehicles sets in motion a ban on new cars powered by petrol or diesel from 2035. In addition, national and local authorities have established vehicle emissions limits for urban access. Take-up of electric cars depends, not least, on affordability and improvements in battery performance and charging infrastructure capacity, casting doubt on the chances of achieving the overarching objective.

Affordability, a severe speed bump

The year 2025 begins with rising average retail price and a drop in sales of battery electric vehicles (BEVs). The European Commission's Alternative Fuels Observatory notes that the average retail price of BEVs has risen in the last 3 years. BEV sales are struggling, with European carmakers underperforming. The global leaders on BEVs are American Tesla and Chinese BYD, with the European VW Group far behind in third place. In March 2024, the EU witnessed a 5.2 % drop in sales of electric cars compared with March 2023. In August 2024, the number of newly registered BEVs in the EU fell steeply, by 43.9 % compared with the same month the previous year, owing largely to the expiry of subsidies in Germany. High purchase prices, limited new models and limited charging capacity are hindering growth and consumer trust.

Prior to the EU raising vehicles' CO_2 emissions standards, citizens expressed mixed views during the impact assessment phase, while the industry and public authorities responded positively. As 2025 begins, even the industry is bracing itself for a longer downturn. As a consequence of slow sales of electric vehicles, Swedish company Northvolt, a major battery manufacturer supplying European automakers, announced in September 2024 that it was letting 25 % of its workforce in Sweden go and in November 2024 it was on the brink of bankruptcy. On the eve of 2025, Northvolt was still looking for new investment. In October 2024, VW, the EU's largest carmaker, announced plans to close at least three German plants and cut tens of thousands of jobs.

The green transition and intense competition from China have led the European automotive industry into crisis, as Commissioner Valdis Dombrovskis acknowledged during Parliament's October I 2024 plenary session. The EU automotive market saw a decline of 18.3 % in new car registrations across all propulsion systems, making it even harder for BEVs to break through. The von der Leyen I Commission intended to address the crisis with the clean industrial deal, a quality jobs roadmap, and an industrial action plan for the automotive sector. The question is how the von der Leyen II Commission will deal with this in 2025. During her speech before the European Parliament on the new College of Commissioners and its programme, the Commission President committed to convening a strategic dialogue on the future of the car industry in Europe.

There are also significant regional differences in the take-up of electric vehicles between southern and eastern Europe on the one hand, and northern and western Europe on the other hand. Electric vehicle market uptake is linked to annual net income. Parliament highlighted this disparity in a December 2023 resolution. In 2018, long before the current CO_2 emission reduction targets were set, a study by the European Automobile Manufacturers' Association had warned about the affordability of electric vehicles, especially in lower income Member States, and had concluded that a natural shift to electric vehicles would not happen without addressing consumer affordability. To this day, this statement holds true, with people in the 12 countries surveyed by the European Alternative Fuels Observatory stating that price is by far the main disadvantage of driving BEVs.

The race to build charging points and develop battery technology

In the Green Deal, the Commission noted that one million public recharging and refuelling stations in the EU would be needed by 2025. At the start of 2025, there are 800 000 recharging points. With an average growth rate of over 10%, the one million threshold will be passed shortly after 2025. However, the distribution of charging points is very uneven. Almost half of the EU's BEV charging points are concentrated in only two EU countries – the Netherlands and Germany. The Connecting Europe Facility for Transport has already supported more than 42 000 recharging points across Europe. More projects will be financed through the Alternative Fuels Infrastructure Facility, which makes over €1 billion in EU grants available for alternative fuels infrastructure for the period 2024 to 2025. On top of that, the Innovation Fund, funded with revenues from the emissions trading system (ETS), has dedicated €3 billion from 2024 to 2027 to strengthen EU sovereignty in the battery value chain.

Despite the slowdown in car sales, battery technology is starting to see more innovation. Alternatives to lithium-ion batteries are being developed, with cheaper batteries being made at the expense of lower energy density (lithium-iron phosphate) or heavier weight (sodium), translating into shorter travel distance and more likely application in city cars. There are also more powerful and more expensive batteries that will at first appear in luxury or sports models, such as solid-state batteries that promise to revolutionise electric vehicle performance. Continuous improvements are increasing energy density, reducing weight and lowering reliance on critical raw materials. Such advances, though significant, have yet to be produced at scale. In 2025, the effects will start to show of the recently amended EU regulatory framework for batteries, deemed crucial to securing value chains for battery production, reuse and recycling in the EU.

What to watch in 2025

The year 2025 is the deadline for several measures. EU legislation tasks the Commission with monitoring the transition of mobility, keeping track for instance of the deployment of zero-emission vehicles and their price developments, alternative fuels development, infrastructure roll-out, and the potential of innovative technologies.

From 1 January 2025, EU law requires that annual average CO_2 emissions of all new passenger cars or all new light commercial vehicles be reduced by 15 % compared to 2021. Carmakers failing to meet this target could face millions of euros in fines. Road transport is meanwhile being integrated into the ETS, with monitoring and reporting of emissions starting in 2025.

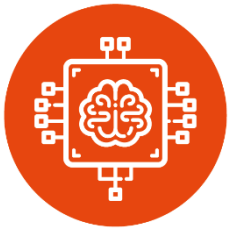
By the end of 2025, the Commission must review the CO_2 emissions targets for cars and vans, including an analysis on funding gaps. It must also report on full life-cycle CO_2 emissions, and progress made towards zero-emission road mobility. Some Member States and political groups, joined by the car industry's lobby ACEA, are open to an earlier review, calling the 2035 ban a self-destructive policy and disagreeing with EU fines for carmakers.

Also by the end of 2025, the Alternative Fuels Infrastructure Regulation (AFIR) and the revised TEN-T Regulation require Member States to install recharging pools for light-duty electric vehicles every 60 km on the core network. In addition, legislation requires the submission of a national policy framework to be made publicly available, and a progress report on AFIR implementation.

These upcoming reports will assess the state of development and confirm whether the downward trend in sales of BEVs continues or if there will be a breakthrough. The reviews will be accompanied by legislative proposals, additional funding and other measures to facilitate the transition. They will also disclose policy measures taken by Member States to facilitate the shift to green mobility.

The combustion engine ban is expected to remain a contentious topic during the year ahead.

7. Helping the EU compete on artificial intelligence



As 2025 begins, the EU finds itself in a challenging situation with regard to artificial intelligence (AI). Although the EU is a frontrunner in regulating AI and ensuring that its citizens can trust it, it has remained behind its global competitors in AI development, uptake and investment. To address this situation, the EU is expected to take several measures in the coming months.

Developing an AI ecosystem of excellence and trust

The EU's approach to AI is to develop an AI ecosystem of excellence and trust, by boosting research and industrial capacity while ensuring safety and respect for fundamental rights. In June 2024, the EU passed its **Artificial Intelligence Act** (AI Act). The AI Act sets a global precedent for a legal framework for AI, with a focus on ensuring that AI systems uphold fundamental rights, and are safe, transparent and accountable. By setting common rules across the EU, the EU aims to make it easier for companies to scale up and offer their services across the EU. The AI Act seeks to increase consumer trust in AI, by addressing various risks posed by AI.

In 2025, the AI Act is entering in the crucial period of implementation. As of February 2025, certain AI practices (such as those using manipulating and deceptive techniques or exploiting vulnerabilities such as age) will be banned in the EU. As of August 2025, rules on general-purpose AI systems will start applying. The final version of the general-purpose AI code of practice is expected to be published in 2025 (a first draft was published in November 2024). A decision of the coordinators of Parliament's Committees on Internal Market and Consumer Protection (IMCO) and on Liberties, Justice and Home Affairs (LIBE) has set up a cross-committee working group to monitor the implementation and enforcement of the AI Act. Its first meeting was held on 24 October 2024.

The EU has also given **financial support** to AI research and innovation through programmes such as Horizon Europe and Digital Europe. Each year these programmes invest at least €1 billion in AI. Together with investment from the private sector and the Member States, the aim is to reach an annual investment volume of €20 billion.

The Commission has set up a variety of **infrastructure for AI innovation**. For example, European digital innovation hubs help businesses and public sector organisations in their digital transformation, AI testing and experimentation facilities enable them to test AI technologies and an AI-on-demand platform provides information on various AI resources, assets, projects and events.

In January 2024, the European Commission also proposed **measures to support AI start-ups and SMEs**, such as giving them access to Europe's supercomputers to train their AI models and adopting a decision setting up a European AI Office.

EU still lagging behind other global leaders

The **EU is home to only 13.3 % of the globe's AI players** (firms, research institutes and governmental institutions involved in AI), coming third after the United States and China (see Figure 3). Only two EU countries (Germany and France) are among the top countries globally in terms of numbers of AI players.

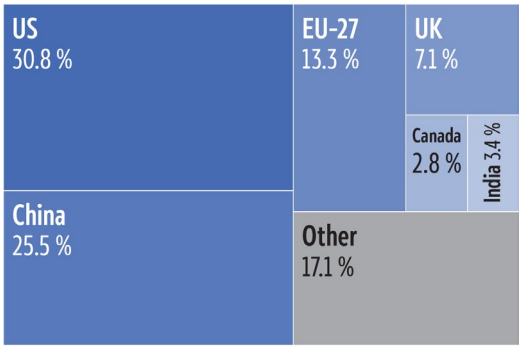
Few EU entreprises use AI technologies. In 2023, only 8 % of enterprises in the EU used AI technologies to conduct their business. This is far from the EU's target of 75 % of enterprises using the cloud, AI or big data by 2030. However, there are country differences, with Denmark (15.2 %),

Finland (15.1 %) and Luxembourg (14.4 %) having the highest shares of enterprises using AI and Romania (1.5 %), Bulgaria (3.6 %), Poland (3.7 %) and Hungary (3.7 %) recording the lowest shares.

Europe is **behind other regions in terms of AI patents** too. In 2021, Europe and Central Asia taken together were responsible for only 4 % of AI patents filed worldwide.

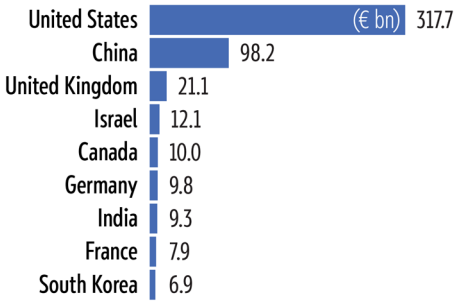
There is a certain **public scepticism** towards AI in the EU. The 2024 AI Index Report shows that respondents from several European countries (such as France and Belgium) are much less positive about AI products and services than people from Indonesia and Thailand. Another survey (2024) concluded that 40 % of Europeans are concerned about potential misuse of AI during elections.

Figure 3 – Main AI players worldwide



Source: AI Watch landscape.

Figure 4 – Private investment in AI by country, 2013-2023, in billion euros



Source: 2024 AI Index Report.

The **EU is behind its global counterparts in terms of investment in AI**, in particular in the private sector. Between 2013 and 2023, the private sector in the US invested €317.7 billion in AI, while in EU countries like Germany the private sector invested only €9.8 billion and in France, only €7.9 billion (see Figure 4). The disparity becomes particularly apparent when looking at private investment in generative AI. Between 2019 and 2023, the private sector in the US invested €20.7 billion, while in the EU together with the United Kingdom the private sector invested only €0.6 billion in generative AI.

According to the European Court of Auditors, the **EU has not coordinated its measures sufficiently** with those of its Member States, and monitoring of investment has not been systematic. It calls on the Commission to do more to ensure that EU-funded research projects are fully commercialised and exploited.

Although the EU has diverse AI talents with various geographical and educational backgrounds, it is facing a challenge of retaining that talent in the EU. Several **EU countries are losing domestic AI talent** to the US and are having **trouble attracting international talent**.

Can the EU reverse the trend and start to catch up in 2025?

If the EU wants to reverse this trend and start catching up with the US and China in 2025, it needs to address all of these challenges. The Council agrees that the EU should scale up investment in AI and facilitate access to digital infrastructure. The EU should cooperate closely with Member States and international organisations to maximise the impact of investment. The Commission President has announced various actions in support of AI: giving start-ups access to supercomputing capacity through the 'AI factories' initiative, developing an 'apply AI' strategy and setting up a European AI Research Council. The Commission Vice-President for Tech sovereignty, security and democracy, Henna Virkkunen, has also committed to prepare a cloud and AI development act. Lastly, the Commission is setting up a 'competitiveness compass' to boost investment, simplification and skills. The road to becoming 'an AI continent' – an objective set by the new Commission – is still long.

8. Strengthening the European defence industry

The war in Ukraine has changed Europe's security landscape dramatically, revealing the limitations of the European defence technological and industrial base (EDTIB) when it comes to meeting heightened demand for military equipment. This wake-up call for the EU has highlighted the urgent need to strengthen its defence capabilities, reduce dependencies on external suppliers, and build a more resilient and responsive EDTIB to supply European armies.

Limitations and weaknesses

The EDTIB comprises prime contractors, mid-caps, and a large number of small and medium-sized enterprises (SMEs). The large prime contractors are centred mainly in Germany, Spain, France, Italy and Sweden, however an equally important part is played by smaller defence companies based all over the EU. EU defence companies – though overall globally competitive – are significantly outmatched in terms of revenue by their counterparts in the United States (US), with the US-based Lockheed Martin, the world's largest defence contractor generating almost as much revenue (around €60 billion) as the entire EU defence industry sector (estimated at around €70 billion).

Although NATO's 2 % gross domestic product (GDP) annual spending target for defence has been in place for years, few Member States have met this benchmark. Had they done so consistently between 2006 and 2020, an additional €1.1 trillion would have been spent on defence, with significant sums dedicated to defence investment. Compounding the problem is the fact that much of the funding that was spent did not benefit the EDTIB, with Member States often opting for military imports from outside the EU, thus creating third-country dependencies. According to French think-tank IRIS, following the full-scale Russian invasion of Ukraine, between February 2022 and June 2023, 78 % of acquisitions of defence equipment by EU Member States came from outside the EU, with the US accounting for 63 % of this total.

Fragmentation also hampers the EDTIB's ability to reach its full potential. European defence companies are primarily structured along national lines, with demand mostly driven by national governments that favour their own industries which benefit from close relationships with these governments. This structure has led to a high number of national defence firms operating in smaller markets, resulting in production levels that are insufficient for current high demand. Defence planning is still managed at a national rather than a European or transatlantic level, worsening the issue. A 2024 EPRS study estimated that greater cooperation could yield annual savings of between €18 billion and €57 billion, avoiding costly duplication and improving the interoperability of European armed forces. On the supply side, the industry remains nationally organised, with persistent fragmentation in the EDTIB, particularly outside the aeronautics and missile sectors. Reliance on third countries for important supplies such as critical raw materials and semiconductors meanwhile leaves the industry vulnerable to supply chain disruptions.

The lack of sufficient manufacturing capacity is an additional hurdle, particularly in the production of basic equipment like ammunition. European defence manufacturers have traditionally operated on a 'built-to-order' model, meaning they produce equipment only when they receive confirmed orders, which has led to long production timelines and an inability to ramp up production rapidly in response to sudden spikes in demand. All of these weaknesses have hampered the EU's ability to respond swiftly and effectively to the changing geopolitical climate.

A more robust European defence industry

In the Strategic Compass and the Versailles Declaration, Member States committed to spend 'more and better on defence', reinforce the European defence industry and fill critical capability gaps. For many Member States, Russia's full-scale invasion of Ukraine has been a wake-up call when it comes

to their defence budgets. EU countries are expected to reach a combined defence budget of €326 billion in 2024 (an increase of around €108 billion or 50 % since 2021) thus enabling significantly more defence investment than in previous decades.

The EU has sought to increase defence industry cooperation and investment through initiatives like the European Defence Fund (EDF) – aimed at incentivising joint defence research and capability development – and permanent structured cooperation (PESCO) – a legal framework for defence cooperation including binding commitments on defence for its 26 participating Member States.

The European Peace Facility (EPF) – financed directly by the Member States outside the EU budget – is now worth €17 billion. The EU mobilised €6.1 billion under the EPF to support the Ukrainian armed forces. Overall EU military support for Ukraine, including bilateral Member State commitments, is estimated at €45.5 billion at the time of writing. The EPF has also been leveraged to procure defence products from the EDTIB.

In 2023, the EU adopted the European Defence Industry Reinforcement through Common Procurement Act (EDIRPA) to promote joint defence procurement and strengthen the EDTIB's competitiveness. It also passed the Act in Support of Ammunition Production (ASAP) to boost Europe's ammunition production capacity for a timely supply of missiles and ammunition. Also passed in 2023, the EU Chips Act and Critical Raw Materials Act are aimed at securing a sustainable supply of essential components, thus strengthening the EDTIB's ability to meet increased demand. EU-NATO cooperation has meanwhile been reinforced, with the two organisations working together on defence industry issues.

In March 2024, the Commission launched the first-ever European defence industrial strategy (EDIS) to optimise the EDTIB's potential and tackle future challenges. The EDIS encourages Member States to 'invest more, better, together, and European' to boost European defence readiness. Key actions include enhancing the EU's defence industrial readiness via the proposed European defence industry programme (EDIP), designed to bridge the gap between short-term emergency measures such as EDIRPA and a longer-term strategy to boost the EU's defence readiness. The draft regulation would provide €1.5 billion from 2025 to 2027 as an interim measure to strengthen EDTIB competitiveness, combining financial and regulatory measures. The EDIS also outlines non-binding goals for defence readiness by 2030, for instance procuring at least 40 % of defence equipment collaboratively by 2030. Lastly, it proposes new defence industry financing approaches, such as substantially increasing the defence funds available in the next MFF.

Financial and political challenges

Analysts note that the main challenges for the EDIS relate to Member States' political commitment and to finance (Ursula von der Leyen estimates that an additional €500 billion in defence investment will be needed over the next decade). Experts point out that the 'EU has been promising "substance" in defence capabilities since the St Malo Declaration in 1998, yet a quarter of a century has passed and the EU continues to be hampered by its "capabilities-expectation gap" – a gap between the goals it sets and what the EU is actually able to deliver – when it comes to defence'. The Commission expects pushback from the Member States on some recent proposals, with some observers noting that Member States will not accept their competences being impinged upon. However, external events – such as Trump's second term or a United States withdrawal from NATO – could drive European capitals to move towards further defence integration.

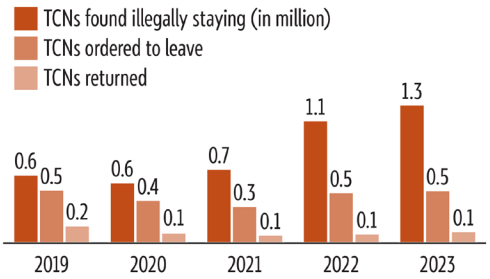
'A new era for European defence and security' is one of the Commission's priorities for 2024 to 2029. The new Commissioner for Defence and Space, Andrius Kubilius, will play an instrumental role in reinforcing the European defence industry, in close cooperation with the High Representative/Vice-President of the Commission Kaja Kallas. Kubilius is also tasked with presenting, within his first 100 days of taking office, a white paper on the future of European defence, which is expected to discuss ways to strengthen EU defence, the defence industry and EU-NATO cooperation.

9. Speeding up the return of irregular migrants

The effective return of third-country nationals (TCNs) without the right to stay has long been a priority of EU migration policy. Despite this, the number of returns has remained low. In the context of an overhaul of the EU's migration and asylum system, there is new focus on fixing return policy. In October 2024, the European Council urged the Commission to submit a new proposal to revise the EU's return rules as a matter of urgency. The Commission is expected to put forward new measures on boosting returns in early 2025.

Limited number of returns

Figure 5 – Return statistics for EU-27 (in millions)



Data source: Eurostat (migr_eipre, migr_eiord, migr_eirtn), November 2024.

Although the vast majority of TCNs arrive and stay in the EU lawfully, some TCNs try to enter the EU irregularly or become irregular by remaining in the EU after their authorisation to stay expires. According to EU rules, TCNs found illegally in the EU should either be ordered to leave or granted authorisation to stay. However, the data available indicate that not all persons found to be staying illegally in the EU are ordered to leave. Moreover, less than a quarter of TCNs who receive a return order actually leave the EU (see Figure 5). This low return rate is seen as a symptom of a long-standing EU migration 'crisis'. However, as acknowledged by the Commission, the Council, and the Parliament, the return rate is not the best indicator for assessing the effectiveness of returns. To better understand return issues, more reliable and systematic data is needed, as well as additional qualitative indicators.

Efforts to improve EU return procedures and operations

The EU Return Directive sets out common rules for the return of TCNs who do not have the right to stay on the territory of EU Member States. Adopted in 2008, the directive leaves many issues open to interpretation. This creates implementation challenges for Member States and contributes to fragmented and diverse return policies across the EU. For example, the directive allows Member States to grant illegally staying TCNs authorisation to stay without further specifications. In practice, Member States use different mechanisms to regularise the stay of certain categories of irregular migrants. The situation on non-removable returnees (whose return is postponed or not enforceable) is particularly acute, as their status may vary widely across the EU. In 2018, the Commission proposed a targeted revision of the Return Directive introducing a new mandatory return border procedure and the obligation to issue negative asylum decisions together with return decisions. However, the EPRS substitute impact assessment on the proposal concluded that there was no clear evidence that the proposal would lead to more effective returns. Whereas the Council adopted a partial general approach on the proposal in 2019, the Parliament could not reach a position.

As progress on the recast of the Return Directive stalled, the pact on migration and asylum introduced several changes that further link border, return and asylum procedures. The new Screening Regulation is aimed at identifying irregular migrants swiftly and channelling them towards return or asylum procedures. When an asylum application is rejected in the border procedure, the TCNs are directed toward a new return border procedure. Return decisions will immediately be issued to applicants whose applications are rejected. The revised Eurodac will facilitate the registration and tracking of asylum applicants and irregular migrants. The risk is that linking asylum and return procedures could lead to more non-enforceable return decisions, greater use of

detention and less use of voluntary returns despite evidence that these returns are more feasible and cost-effective.

To improve return operations, the Commission put forward a series of soft instruments, including a strategy on voluntary return and reintegration, an operational strategy for more effective returns, and a recommendation on mutual recognition of return decisions. A new EU Return Coordinator was tasked with bringing together different strands of EU return policy. A new mechanism for the operational coordination of the external dimension of migration (MOCADEM) was also established in the Council. In line with its expanded mandate, Frontex stepped up its operational, technical and practical support to Member States, including the organisation of return flights.

Working on the external dimension of EU return policy

The migration pact formalises the external dimension of migration, obliging the EU and its Member States to 'promote and build tailor-made and mutually beneficial partnerships' with third countries. However, difficulties in concluding formal readmission agreements with third countries have pushed the EU to conclude non-binding readmission arrangements. In 2021, Parliament deplored such arrangements for failing to include adequate fundamental rights safeguards. The EU has recently signed informal cooperation agreements with Tunisia and Egypt and a migration partnership with Mauritania. The search for more pragmatic and flexible solutions to deal with third countries raises concerns about the respect for fundamental rights, EU policy coherence and institutional balance.

To speed up returns, the European Council recently called for all relevant EU policies, instruments and tools to be used, including diplomacy, development, trade and visas. The Commission has already applied Article 25a of the Visa Code to impose visa restrictions on several third countries for inadequate cooperation on readmission. Article 8 of the Visa Regulation also provides for a mechanism to allow temporary suspension of the visa exemption for non-cooperating visa-exempt countries. A revised suspension mechanism was proposed in 2023. In 2021, the Commission proposed the possibility to withdraw trade preferences in cases of serious shortcomings relating to readmission, but the Parliament opposed it. The Neighbourhood, Development and International Cooperation Instrument (NDICI), the EU's main development instrument, includes an indicative 10 % spending target on migration and forced displacement. The risk is that funding earmarked for development is redirected away from development and poverty eradication goals.

What to expect in 2025

As announced in her political guidelines for 2024 to 2029, the Commission President plans to put forward a new EU strategy on returns. This will include a new legislative proposal seeking to clarify the rules and further harmonise Member States' policies on return. The Commission has committed to explore 'innovative ways' to address irregular migration, and has been under pressure from the Member States to develop 'out-of-the-box' ideas to ensure effective returns. One controversial suggestion is to establish extraterritorial centres ('return hubs') to hold TCNs who are waiting to be returned. However, as other extraterritorial experiments on asylum show (for instance the Italy-Albania Protocol), such solutions are riddled with fundamental legal and practical challenges. Return is a key building block in the ongoing implementation of the pact on migration and asylum, which needs to be operational by June 2026. On the external dimension, the Commission will pursue sustained engagement with key partners such as Egypt, Morocco and Algeria. The envisaged pact for the Mediterranean will also serve to operationalise the external aspects of EU migration policy.

10. Restoring trust within the public sphere

Trust has become a scarce resource worldwide. Amid increasing geopolitical uncertainty and anxiety, public trust in traditional news media and social media platforms, in governments and democratic institutions and processes, in big corporations in general and in AI companies in particular, is plummeting. At the core of the trust polycrisis – the interplay between multiple ongoing trust crises – is the digital information infrastructure that underpins the public space for debate, where people form and express opinions, and discuss solutions to shared challenges. Public concern over the proliferation of information manipulation is high, with 45 % of Europeans listing disinformation as one of the issues with the biggest personal impact on them. As trust in the digital infrastructure is decreasing, public pressure on governments across the world to regulate it increases. At the same time, the economic stakes in the global tech competition are skyrocketing. In 2025, this underlying tension will come to the fore.

A trustworthy information environment: A key pillar in democracy

As the Freedom of the net 2024 report points out, a 'healthy 21st-century democracy cannot function without a trustworthy online environment, in which free expression and access to diverse information prevail'. However, not only journalists are facing increasing (political) pressure across the world. Civil society groups, fact-checkers and researchers who work to document and analyse information manipulation and boost trustworthy information are facing a backlash, including in democratic countries such as the United States and some EU Member States. At the same time, media organisations that produce high-quality, trustworthy news that adheres to journalistic standards are facing severe economic strains: global ad revenue has halved in 6 years for print media as traffic to news websites moves to social media. Generative AI is likely to further accelerate that trend. Meanwhile, trust in traditional news media continues to plummet. Young people are particularly suspicious and distrustful not only of news, but of all information. Their scepticism towards news organisations' agendas makes them avoid news and look for alternative voices and perspectives, selecting stories that are less upsetting than (some) news.

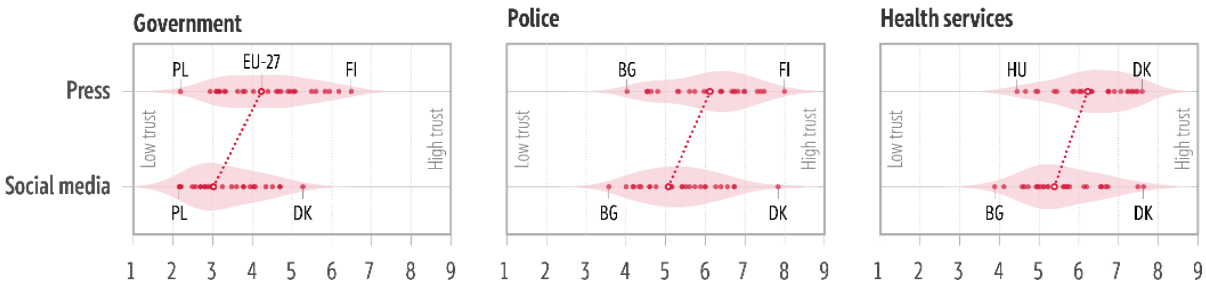
Impact of online platforms and new technologies on democracy

Twenty years after the advent of some of the world's most popular social media platforms – Facebook was created in 2004, YouTube in 2005, Twitter in 2006 – promising to connect people and facilitate the democratic debate, trust in the online platforms that underpin our public debate is decreasing. The 2024 Edelman Trust Barometer identified social media as the least trusted industry, amid growing concern over the impact of social media on young people's mental health. Despite growing concern, some major online platforms have cut back on teams focused on content, integrity and trust and safety, with an impact on transparency mechanisms and policies to counter mis- and disinformation. This contrasts with the EU's digital services act (DSA). The least trusted social media platform is X: marketers' trust in the platform has dropped since Elon Musk bought Twitter in 2022. Only 4 % of respondents to a September 2024 survey believed X provided brand safety. Social media are not only facing distrust, they are driving it. In 2023, Eurofound pointed to social media 'as a key driver of declining trust': respondents who use social media as their preferred news source had a trust score in governments of 3 out of 10; compared to 4.2 for consumers of traditional media (see Figure 6).

Although AI can create new pathways for democratic engagement, the perception of AI as a disruptive force that can alter what people see and hear already appears to be eroding trust in the digital sphere. Although there is no decisive evidence that AI has altered the outcome of democratic elections so far, IE University's European Tech Insights (October 2024) showed growing public concern about the potential impact of AI on democratic elections. Some 67 % of Europeans think

election results could be hacked. 40 % are concerned about potential misuse of AI during elections, such as disinformation and voter manipulation. Some 31 % of Europeans believe AI has influenced their voting. This can benefit the 'liar's dividend', where those who lie to avoid accountability become more believable, precisely owing to growing awareness of threats, for example from deepfakes.

Figure 6 – When social media is the preferred news source, trust drops.



Source: Eurofound 2024.

Digital trust (defined by the World Economic Forum as 'individuals' expectation that digital technologies and services – and the organizations providing them – will protect all stakeholders' interests and uphold societal expectations and values') links trust in governments with trust in the tech industry. As the OECD points out, declining trust in public institutions erodes governments' ability to address urgent challenges. Low trust in government accelerates political disengagement and polarisation. The problem is further exacerbated by misleading information and echo chambers.

Balancing values and interests in an era of multidimensional distrust

The new European democracy shield, proposed by Ursula von der Leyen to counter information manipulation and strengthen enforcement of related EU legislation, including the DSA and the AI Act, will be tested in the digital realm in 2025 when the Commission is expected to finalise its investigations into Elon Musk's X. Launched in December 2023 to determine whether X is in line with the Digital Services Act (DSA), the investigations are among the first legal proceedings under the DSA and concern risk management, content moderation, dark patterns, advertising transparency and data access for researchers. This puts the EU on a collision course not only with Musk but potentially also with Donald Trump's White House and a more tech/AI-industry-friendly Congress. A growing gulf between what Anu Bradford describes as the American market-driven regulatory model and the European rights-driven regulatory model would affect historically fluctuating mutual transatlantic trust. Stalling cooperation at this crucial time could, however, provide a window of opportunity for competing models, providing tailwind for state-driven digital authoritarianism.

The question of competitiveness of technology – notably the opportunities of AI as a consequential technological revolution – is often framed as a dichotomy, with 'utopian visions of economic growth' clashing with 'dystopian fears of existential risks with catastrophic effects'. In the upcoming readjustment of diplomatic priorities in transatlantic relations, EU-US cooperation has to bridge this gulf. Corporate diplomacy or even brinkmanship – embodied by corporate leaders like Elon Musk – are likely to temporarily overshadow US executive diplomacy, including efforts in multilateral contexts to boost information integrity, with potential far-reaching repercussions for public trust in the information ecosystem and infrastructure. This unprecedented challenge for the EU's rights-driven regulation model will put the bloc's digital diplomacy to the test. The 'Brussels effect' may not trump the 'billionaire's effect' in the short term, but the values-based, human-centric EU approach – that aims to put safeguards in place to protect citizens in the digital realm – may garner more public and diplomatic trust in the long run than superimposing business interests on geopolitics.

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This is the ninth edition of an annual EPRS publication aimed at identifying and framing some of the key issues and policy areas that have the potential to feature prominently in public debate and on the political agenda of the European Union over the coming year.

The topics analysed encompass economic productivity, the 2040 climate target, economic security, investment capacity, the EU's future finances, electric vehicles, competitiveness in artificial intelligence, European defence, migrant return policy, and trust within the public sphere.

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