Sustainability can drive European competitiveness

European competitiveness is increasingly in the spotlight, but after decades of underperformance is a turning point in sight? Howard Risby examines the argument that Europe's sustainability ambitions have impacted the region's competitiveness and assesses how sustainability may provide an edge in future.

Setting the scene

Economic competitiveness is the ability of a country or region to achieve high productivity, so that it can deliver strong, rising living standards. Sustainable economic competitiveness is being able to deliver this productivity in a way that does not erode the environmental, social, and institutional foundations on which future prosperity depends. This includes elements such as natural capital and social cohesion.

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Theme: Climate Change

Europe has a competitiveness problem. It has experienced weak growth over two decades, lagging the US, and increasingly Asian markets too.[1] Capital, labour and skills are often locked into low-growth industries. Europe also lags in terms of developing new industries, and technological and digital innovation, especially in relation to AI and biotech.

There are many underlying reasons for this. Europe has a partially harmonised political system, but the single capital market remains incomplete in several ways. Companies face different regulations, tax regimes, and standards across member states. Consequently, scaling a business across Europe is more burdensome and costly than scaling it within the US or China.

Historically, there has been under-investment in research and development (R&D), venture capital and emerging technologies, partly caused by a conservative approach to capital at risk. This has made it harder to scale innovation despite Europe having strong research and start-ups. Fast-growing firms often relocate to the US for funding, talent or regulatory clarity.

High energy costs have added to the challenge, especially since the 2022 disruption to the energy markets caused by Russia's invasion of Ukraine. This means that energy-intensive industries such as chemicals, steel and automotives face declining competitiveness. An ageing population increases the welfare burden.

[1] Cumulative GDP growth since the Global Financial Crisis (2008–2023) United States: 87%, European Union: 13-15%, China 280% to 290% An investment strategy to keep the European Green Deal on track (https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=CN).

Europe's sustainability ambitions

Europe has also led the way on sustainability. The European Climate Law, supported by the Green Deal and the Fit for 55 legislative package, targets climate neutrality by 2050. The Corporate Sustainability Reporting Directive and Corporate Sustainability Due Diligence Directive aim to increase transparency on sustainability performance to drive market-wide standards. Similar standards are being developed in the UK.

Europe has positioned renewables and efficiency as a driver of industrial, security and climate policy. Renewables accounted for nearly half the electricity generated in the UK and EU in 2025, driven mainly by wind and solar. Europe is also focused on circularity and reducing resource dependency.

Europe is pursuing an ambitious decarbonisation agenda for transport, with a focus on electric vehicles (EVs), alternative fuels and the inclusion of aviation and shipping under carbon pricing. Rail produces less than 1% of EU transport emissions but carries around 17% of freight and some 6% of passengers.[2]

This policy has been reinforced by comparatively high environmental awareness. Sustainability is a focus for consumers, although cost of living pressures are driving more green fatigue. But European countries also spend a significantly higher share of their GDP on social protection than most of their global peers. Across Europe there are high standards for worker protection, social security, work-life balance, and access to healthcare.

Does sustainability help or hinder competitiveness?

Is there a link between Europe's lack of competitiveness and its ambition on sustainability? Has the sustainability ambition contributed to the lack of competitiveness? Or could leaning further into sustainability become a driver of competitiveness?

Some argue that Europe's sustainability agenda has increased costs, harming competitiveness. Carbon pricing has internalised previously unpriced environmental costs, raising short-term costs for emissions-intensive activities, while

energy prices have remained elevated due to a continued reliance on fossil fuels, grid constraints and system inflexibility. Compliance and permitting costs often apply in Europe before equivalent measures exist elsewhere. Permitting delays – at least partly driven by environmental constraints – can slow development. Grid bottlenecks, not helped by an insufficiently agile regulatory and policy framework, can also deter growth as Europe adapts to the energy transition.

Europe also tends to regulate on sustainability before markets reach scale. For example, rules for emerging areas such as hydrogen, circular materials, and product traceability have been introduced before technologies are commercially mature. This approach can slow innovation and deter risk-taking and investment. There are also some arguments that welfare protections limit the ability of company to adapt quickly and grow.

However, other evidence suggests that Europe has benefited from its sustainability ambition. By setting the rules that companies operating in Europe must follow, European regulators can shape the environment that global firms must operate within. This gives European companies a first-mover advantage.

Sustainability can also reduce economic and geopolitical risk. By cutting reliance on imported fossil fuels, improving energy efficiency, and promoting the circular use of materials, Europe is insulating its economy from volatile commodity prices and supply-chain shocks, such as the Strait of Hormuz crisis. Early transition lowers the risk of stranded assets and a disorderly transition, providing a more predictable long-term investment horizon. Finally, strong worker protections and social safety nets help maintain public support for structural change, reducing political instability. Over time, this can support innovation and competitiveness.

Is Europe approaching sustainable competitiveness?

There is some evidence that over the long term, Europe's sustainability ambitions will reinforce, rather than hinder, competitiveness. Much of the focus over the last decade has been on driving sustainability standards through regulation. However, Europe's approach is now shifting from green regulation to its green industrial strategy. Initiatives such as the Clean Industrial Deal (2025), the Net-Zero Industry Act (2024) and the Critical Raw Materials Act (2024) seek to align

[2] https://www.mdpi.com/2624-6511/9/4/64

decarbonisation objectives with competitiveness, affordability and scale. Meanwhile, the UK is adding a growth component to its carbon budget delivery plan.

There are also signs that clean tech at scale is becoming economically viable in Europe. Renewables are now cost competitive with fossil fuels and over the long term, renewables offer the prospect of lower cost energy.[3]

Capital constraints may be easing. Large-scale EU green bond issuance under NextGenerationEU, the expansion of the Innovation Fund, stronger involvement by the European Investment Bank, and renewed political momentum behind a Capital Markets Union (CMU) indicate an increased willingness to mobilise finance at scale.

Support for start-ups is also improving. The 2025 EU Startup and Scaleup Strategy and the 2026 European Innovation Act and Scaleup Europe Fund aim to close the investment gap and remove legal barriers. There is also growing evidence that renewables deployment, energy efficiency, and green technologies can support productivity and long-term growth in advanced economies.[4]

The role of investors and EOS's engagement

Over a longer time horizon, Europe's sustainability ambitions have the potential to translate into a competitive advantage. Long-term investors therefore have a vested interest in ensuring that Europe succeeds in delivering the transition needed to fulfil this ambition. Companies in Europe need to adapt to take advantage of the opportunities presented by the transition. But for this to happen, the societal, political and economic systems in which companies operate also need to transition.

Many European companies are already transitioning to more sustainable operating models, presenting opportunities for investors. Companies that are not yet sustainable, but have the potential to become so, also present an opportunity for investors, but only if they succeed in transitioning. However, credible transitions rarely happen smoothly or in isolation – they require structured pressure, guidance and accountability. Investors have a key role to play in this evolution.

Investor stewardship can help to strengthen European companies' transition plans through ongoing oversight,

dialogue and challenge. Stewardship helps companies understand investors' perspectives, reducing the financial and execution risks from transitioning. Strong stewardship can also improve the visibility of the progress being made in the transition by encouraging companies to report on their own activities. Positive outcomes can attract additional capital, reinforcing a cycle of investment, stewardship and improvement – all of which can drive competitiveness at the company level, and across the region.

This philosophy underpins EOS's company engagement model. For example, in engagement with the German auto manufacturers, we asked them to include in their financial statements how they are seizing the opportunities and mitigating the risks associated with the sector-wide transition to electric vehicles. Making this link in the financial statements helps investors assess the investment case at these companies.

In the fossil fuel sector, we have engaged with TotalEnergies on its energy transition strategy, seeking robust governance to ensure capital discipline, strong emissions performance to underpin efficiency and competitiveness measures, and the capturing of transition opportunities through the delivery of a profitable low-carbon energy business. The company has performed strongly, with the highest return on average capital employed of its direct peers over the period 2022-25.[5]

At Engie we have engaged for many years on improving its energy transition strategy. This has been well-received by markets, driving its outperformance over peers with its delivery of an accretive renewables and battery storage pipeline. This is reflected in the over 90% share price growth since 2021, allocating 70% of its capex to renewables and energy solutions in this period.[6]

Company-level stewardship can also increase the transparency of the challenges that companies and investors face in transitioning. Many challenges cannot be addressed by companies alone and require collaboration with policymakers, financial services, research and technology providers, and civil society to overcome these challenges. This creates the need for systemic stewardship by investors.

[3] The cost gap between European and global production from solar, batteries and heat pumps is narrowing, and any cost premium is offset by increased stability and resilience. Reshoring Solar Manufacturing to Europe - SolarPower Europe. The falling cost gap between EU and Chinese batteries | T&E.
[4] https://www.sustainabilityperformances.eu/wp-content/uploads/2025/05/D5.2-SPES-Working-Paper-on-Green-technology-and-productivity_def.pdf; https://wiiw.ac.at/the-impact-of-green-technologies-on-gdp-and-employment-in-the-eu-dlp-6918.pdf
[5] TotalEnergies - 2025 Results & 2026 Objectives presentation - Transcript.
[6] Bloomberg (March 2026); Vision stratégique | Groupe | ENGIE; past performance is not a reliable indicator of future performance.

Solving the policy puzzle

Systemic stewardship aims to address system-wide issues that affect the long-term performance of the whole economy, not just individual companies. This is especially relevant for Europe given its ambition to drive sustainability and competitiveness across the region. Europe is particularly well suited to systemic stewardship. It has a large base of investors that are broadly diversified across the economy and aligned with long-term economic performance rather than short-term company outperformance. European policymakers regularly consult investors on regulation design and request feedback on its market impact.

EOS has a long track record of systemic engagement with a focus on addressing sustainability issues and supporting competitiveness across Europe. In 2025, the EOS team undertook over 160 public policy and market best practice actions with European-based organisations, across a range of issues, always anchored within the context of Europe's sustainable competitiveness ambitions.

We have engaged on Europe's sustainable finance architecture – the framework intended to support investment in funds and companies to aid the transition. This includes engaging at EuroFi on sustainable competitiveness and the revised Sustainable Finance Disclosure Regulations (SFDR) (see box) and through Eumedion, to advocate for enhanced support for start-up and scale-up finance for European companies.

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We have also focused on sectoral transition plans. Building on our work with the UK Transition Finance Council on a finance playbook for sectoral transition plans, which seeks to mobilise transition finance to boost the UK's competitiveness, we engaged MEPs on how this approach could be rolled out across Europe.

Other activities include advocating for the EU sustainability reporting and due diligence regimes (CSRD and CSDDD) to have a clearer focus on value creation and information that is useful for investors. We have also engaged extensively with European policymakers and standard setters on how climate is incorporated into company accounts and audit reports, aiming to provide investors with the necessary information to understand companies' exposure to climate risk.

Our engagement on governance standards in the region also supports sustainable competitiveness. Maintaining shareholder rights and access helps to provide a strong governance foundation, which supports the investor stewardship that is critical for navigating a credible transition. To this end, we are participating in consultations on the revised Shareholder Rights Directive. We are also engaging with the German Investment Funds Association (BVI) on improving board independence and remuneration practices in German companies.

EOS at EuroFi

EOS attended the 2025 Eurofi meeting in Copenhagen and the online 2026 Eurofi event hosted by Cyprus. This was held online due to unrest across the Middle East.

Eurofi is a Paris-based European think tank and trade association for financial services, which offers a platform for dialogue between EU economic and financial policymakers and senior financial sector leaders. It focuses on EU and international financial regulation, macro-financial policy, capital markets, banking, insurance, digital finance, and sustainable finance.

The Eurofi events provide the opportunity for face-to-face meetings with policymakers across the region. In Copenhagen we held 22 separate meetings with MEPs, European Commission representatives, financial regulators and other organisations including the Bank of England and the Network for Greening the Financial System.

Our engagements and panel discussions focused on topics relevant for driving sustainable competitiveness across the region, including the development of sectoral transition roadmaps, nature-related risk frameworks, sustainability disclosure requirements, stewardship codes and climate stress testing.

At the Cyprus event we participated in a panel, saying that the revised Sustainable Finance Disclosure Regulations should focus on recognising investor stewardship as a key component supporting Europe's transition to a more sustainable, competitive economy.

Outlook

It is too early to say whether Europe will succeed in achieving its ambitions to transition the region to deliver competitiveness and sustainability. This will depend on the ability of politicians to create the necessary policy, social, and financial incentives to transition against an uncertain geopolitical backdrop. But the role of investors is clear, and the benefits to be accrued from transitioning are extensive. EOS will continue to advocate on behalf of our clients – at both the company and systemic levels – for this transition.

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EOS

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Federated Hermes is a leader in active, responsible investing.

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Why EOS?

EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of public companies. EOS is based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

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