

EUROFI

Macroeconomic Scoreboard

MARCH 2026

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with the support of Elias Krief**

Inside

- Widening economic gap between the Euro area and its main global competitors for more than 20 years
- Increasing economic and fiscal divergences between Member States since the creation of the euro
- Economic and Monetary Union at another critical juncture
- Excessive public debt working against productivity growth and employment
- Is NextGenerationEU a game changer?

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Eurofi
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Executive summary¹

Over the past 25 years, the European Union (EU) has accumulated a significant economic performance gap with the rest of the world, and particularly the United States (US). One of the most striking aspects of this disparity, as this scoreboard shows, is the persistent difference in growth, productivity, and investment levels.

This economic stall is explained by two main factors. Firstly, the policy choices made by many European Member states aimed at increasing demand and encouraged by persistently low or even negative real interest rates have contributed to fostering the financialization of the economy to the detriment of productive investment. Secondly, underlying structural problems, namely demographic slowdown and energy dependence, have only helped exacerbate the negative consequences of poor economic choices.

The Global Financial Crisis of 2008, the subsequent Sovereign Debt Crisis in Europe, the more recent Covid-19 pandemic, and the Russian war in Ukraine have all exposed and amplified these underlying issues.

After periods of turbulence and a return to greater coherence, the Monetary Union is once again at a critical juncture. The euro's successes cannot mask its weaknesses.

In 1999, the euro became the single currency of a vast economic entity whose market of 350 million inhabitants is one of the largest in the world. The monetary union has allowed for an intensification of trade within the zone and has contributed to further trade integration through the elimination of exchange rate risk. The adoption of the euro has also reduced the cost of intrazone transactions. Moreover, the euro has become the second international currency after the dollar.

But the single currency was created without a common economic policy, and the last 25 years have been marked by the failure of many Member States to comply with the rules of the Stability and Growth Pact. Against this backdrop, economic disparities and divergences in living standards between the main Eurozone countries have widened considerably since the creation of the euro.

The Covid-19 crisis and the war in Ukraine hit the Eurozone harder than its main competitors. Since 2020, existing heterogeneities across EU Member States have been intensified. It is an illusion to try to solve the structural problems of our economies by increasing public debt or by creating money. Yet, this false solution has too often been pursued through the repeated implementation of lax fiscal, monetary, and economic policies, the consequence of which inevitably leads to the creation of systemic risks to financial stability and future growth.

This Scoreboard shows that the European countries with the highest levels of public debt have experienced the steepest drops in productivity and are home to the highest unemployment rates in the EU. Furthermore, the least competitive firms are found in the countries with the highest levels of government expenditure as a percentage of GDP.

NGEU is an unprecedented joint response to the Covid-19 crisis. The program aims at making Member States more resilient to future challenges by investing in the green and digital transitions. →

1. Charts and statistics in this report are based on data released as of 4 March 2025. The authors would like to thank Mr. Philippe d'Arvisenet for his insightful comments.

→ Over EUR 800 billion of loans and grants were put at the disposal of Member States. In hindsight, NGEU appeared to have a positive effect on several southern European countries, such as Spain, Italy and Portugal, where investment levels increased compared to the pre-pandemic period. However, these additional capital flows have not yet led to any measurable improvements in labour productivity. In Spain, productivity growth has slowed relative to the pre-Covid-19 phase, and it has even contracted in Italy. These issues call into question the efficacy of NGEU.

As long as it is not sufficiently understood, especially in the highly indebted countries, that excessive debt is a source of under-competitiveness, the economic situation in these countries will continue to deteriorate, thus making the construction of an economic and financial union all the more difficult. In addition, fiscal and economic divergences between EU countries make it more difficult to define what the "common interest" truly is in an EU context. These divergences also encourage an "every man for himself" mentality and sow a climate of mistrust between Member States, thus hampering progress on public and private risk sharing.

If Europe and the Eurozone are to correct their growth disadvantage when compared to the United States and China, major investment efforts are required in research and development, industrial equipment, decarbonisation, digital technology, education and skilled labour. And the sooner the better for the gap continues to widen, requiring ever greater investment and supply-side efforts on behalf of Member States. Immediate action must be taken if Europe wants to escape the fate of eternally remaining a second-rate power.

Consequently, the Euro area needs to get on the right track: strengthen fiscal responsibility, curb persistent inflation, implement more supply-side reforms aimed at raising productivity and promoting equity financing, as well as taking steps to complete the Banking Union and implement the Capital Markets Union. But, before even considering the implementation of these steps, the trend of ever-increasing economic heterogeneity across Member States must be reversed. This can only happen with the return to economic and financial discipline.

1. The economic gap between the Euro area and its global competitors has widened since the Global Financial Crisis

Over the past 25 years, the Eurozone has fallen behind the rest of the world in terms of economic performance, particularly the United States. One of the most striking aspects of this is the persistent difference in productivity, investment levels and growth.

The 2008 global financial crisis, the subsequent European sovereign debt crisis and the more recent impacts of the pandemic and the war in Ukraine have exposed and exacerbated these underlying issues. This succession of crises has highlighted EU vulnerabilities, including its heavy regulatory environment, fragmented markets, and underinvestment in key areas such as information and communication technologies, labour competencies and infrastructure.

After illustrating the performance gap between the Euro area (EA) and the United States (US) since 2000, this chapter identifies its underlying causes. It then demonstrates that the decline in European economic competitiveness was accompanied by a substantial loss of competitiveness among EU financial institutions compared to their US and Asian competitors.

Three reasons explain Europe's economic lag:

First, the economic performance gap is the result of national economic policy choices, such as higher investment in research and development and new technologies, a more business-friendly environment (including the flexibility of the US labour market) and a higher-skilled workforce. In addition, the US has a genuine single market for goods and services, as opposed to the fragmented markets that persist in Europe.

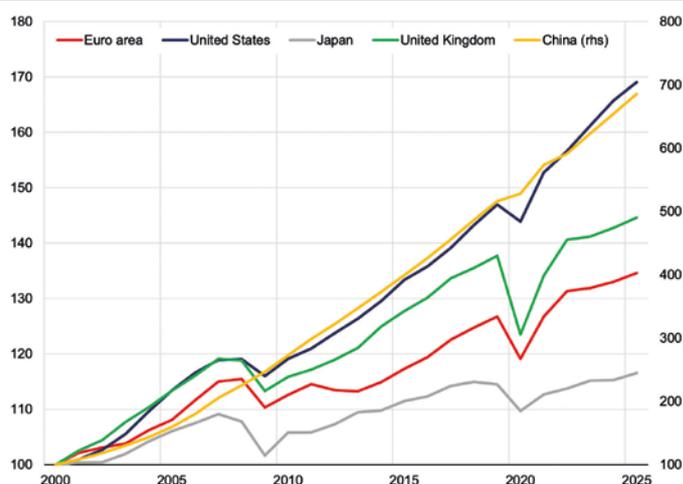
Second, other exogenous and cultural factors have also contributed to the Euro area's economic underperformance, including the United States' energy independence versus Europe's vulnerability to energy shocks (especially after the Russian invasion of Ukraine), the lower risk aversion of American consumers, the high geographical mobility of American workers and the demographic slowdown in Europe as opposed to the expanding working-age population in the United States.

The economic gap between the EU and the US is also explained by the shortcomings of EU policies: insufficient cooperation and coordination of Member States' economic policies; competition policy that has prevented the emergence of 'European champions'; and available EU resources (*e.g.* NGEU and the European Chips Act) that face spending challenges and are slow to produce the expected increased productivity and investment in the countries that benefit most from them (*e.g.* Italy).

1.1 Since the 2000s, the European economy has consistently lagged behind the US in terms of productivity, investment and growth

The difference in economic performance between the EU and the US has been undeniable since 2008. It became even more pronounced after 2020. This is mainly due to underinvestment by the European business sector, resulting in diverging labour productivity growth. Fewer investments in key areas such as technology, research and development, improvement of the competencies of the workforce and infrastructure have resulted in slower productivity growth in the EU compared to the US.

CHART 1.
Real GDP, 2000=100



Source: Ekomics, based on data from the IMF World Economic Outlook (October 2025)

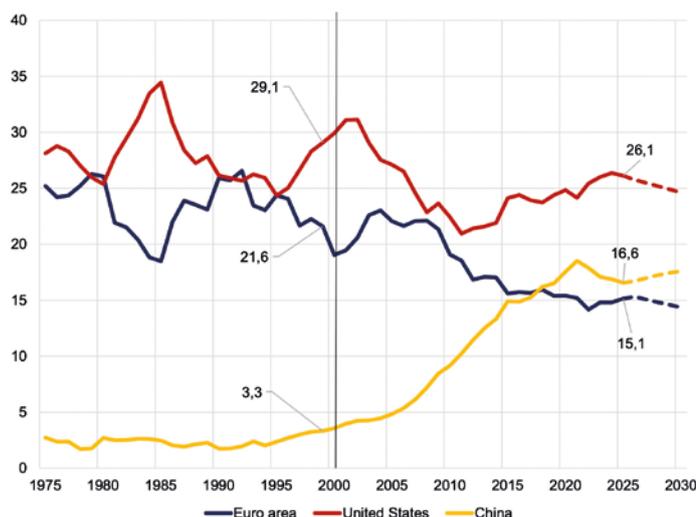
1.1.1 Since 2008, the Euro area has consistently underperformed US growth and that of other advanced economies, leading to a decline in its share in the global economy

Between 2008 and 2025, real GDP in the Eurozone grew at an average annual rate of just 0.9%, resulting in a 16.5% cumulative increase since the start of the global financial crisis. By contrast, the US economy grew by 42% over the same period.

Since the pandemic, the performance gap between the two regions has widened: between the end of 2019 and the second quarter of 2025, US real GDP grew by 13%, which is more than double the growth seen in the Eurozone (+6%).

Relatively weak GDP growth has resulted in a decline in the Euro area's share of the global economy. According to the IMF, the Euro area's share of world GDP was 22.1% in 2007, compared to 24.6% for the US (see Chart 2). By 2025, the Euro area's share had fallen to 15.1%, while the US's had risen to 26%. China's share of the global economy is higher than that of the Euro area since 2018.

CHART 2.
Euro area GDP, worldwide comparison, share of world GDP, %



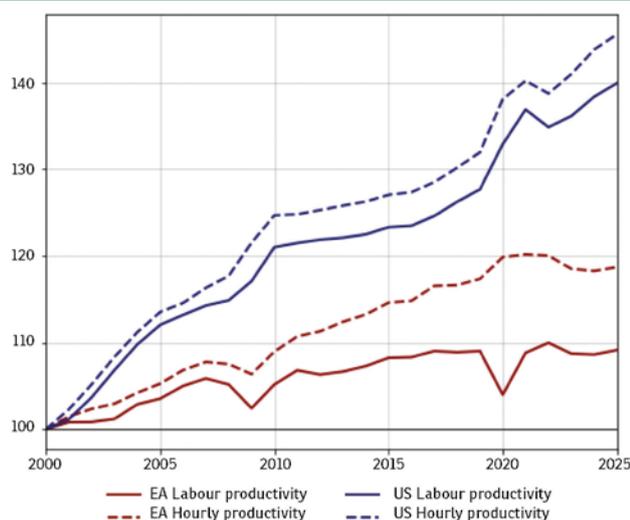
Source: Eikonics, based on data from the World Bank and the IMF. At current price and exchange rate

1.1.2 Labour productivity growth in the US has been more than twice that of the Eurozone over the past two decades

Productivity gains have significantly contributed to the difference in GDP growth between the US and the Euro area over the past two decades. Hourly productivity increased by 45.5% in the US between 2000 and 2025, compared to just 18.7% in the Eurozone (see Chart 3).

Productivity per capita exhibits a gap which is even wider. The latter increased by 39.9% in the US, compared to just 9.1% in the Euro area.

CHART 3.
Real Labour productivity, US versus Euro area, 2000 = 100

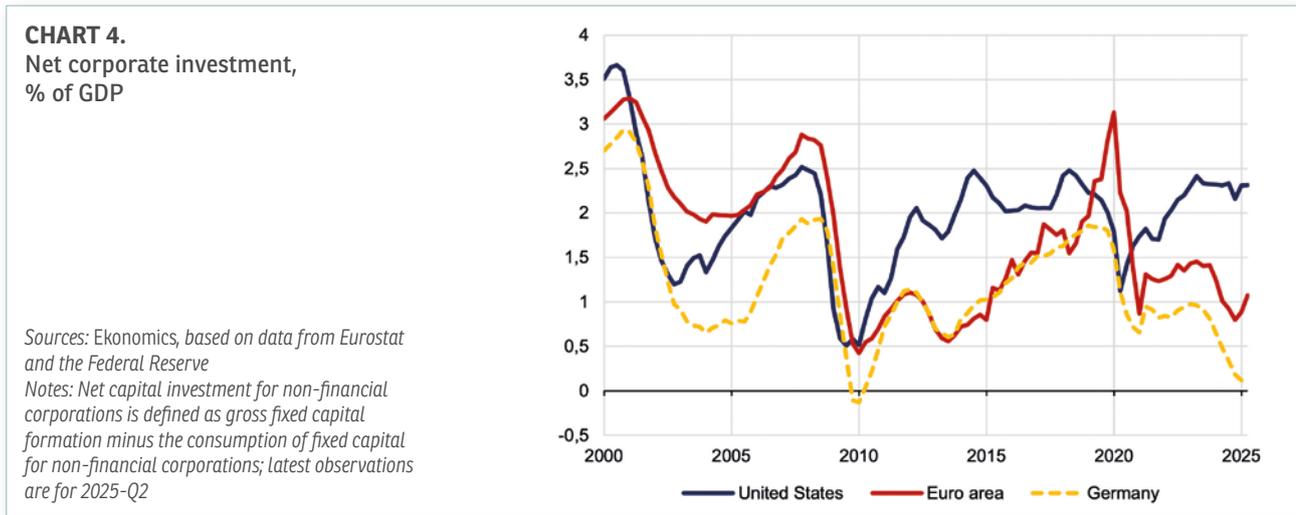


Source: Eikonics, based on data from the European Commission
Notes: Labor productivity is the ratio of real GDP per person employed; hourly productivity is real GDP per hour worked

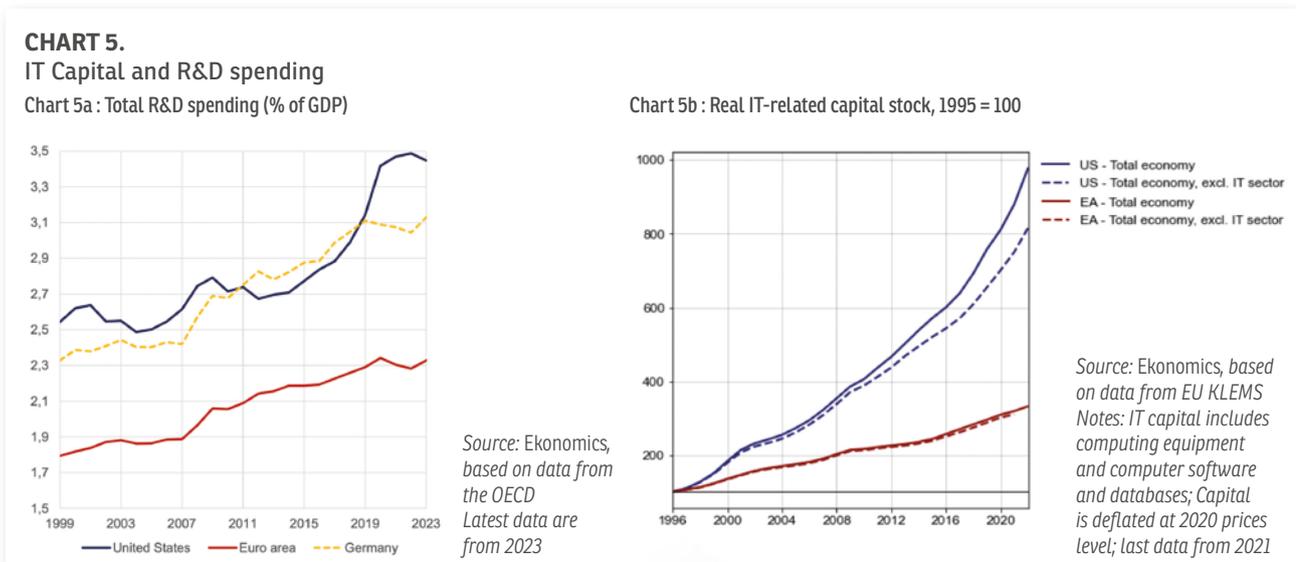
This divergence is evident across all sectors but is most pronounced in the tech sector. Overall, the productivity of US-listed tech firms has increased by around 40% over the past two decades, whereas it stagnated among European tech firms². This divergence is reflected in a widening gap in innovation efforts.

1.1.3 European companies have underinvested in equipment and technologies compared to their US counterparts

Investment is essential for competitiveness and productivity. However, Europe has fallen behind in this area over the past 15 years. While net corporate investment in the Eurozone was slightly higher than in the United States during the 2000s, it fell to almost half a percentage point below US levels in the decade following the financial crisis. Since 2020, both have taken different paths: net investment in the US kept rising steadily, whereas it has halved in the Eurozone, largely due to negative developments in Germany (see Chart 4).



This divergence in corporate investment comes together with a widening gap in innovation efforts. As shown in Chart 5a, the US has consistently outpaced the Euro area in R&D spending, and the gap widened since 2020 when it overtook EU powerhouse Germany for the first time since 2008.



Consequently, US companies have gained a significant advantage by investing in intangible assets and technology. Between 1995 and 2021, IT-related capital stock in the US economy increased tenfold in real terms, compared to a threefold increase in the Eurozone. This trend remains similar even when the information and technology sector, a major contributor to intangible capital, is excluded from the two regions (see Chart 5b).

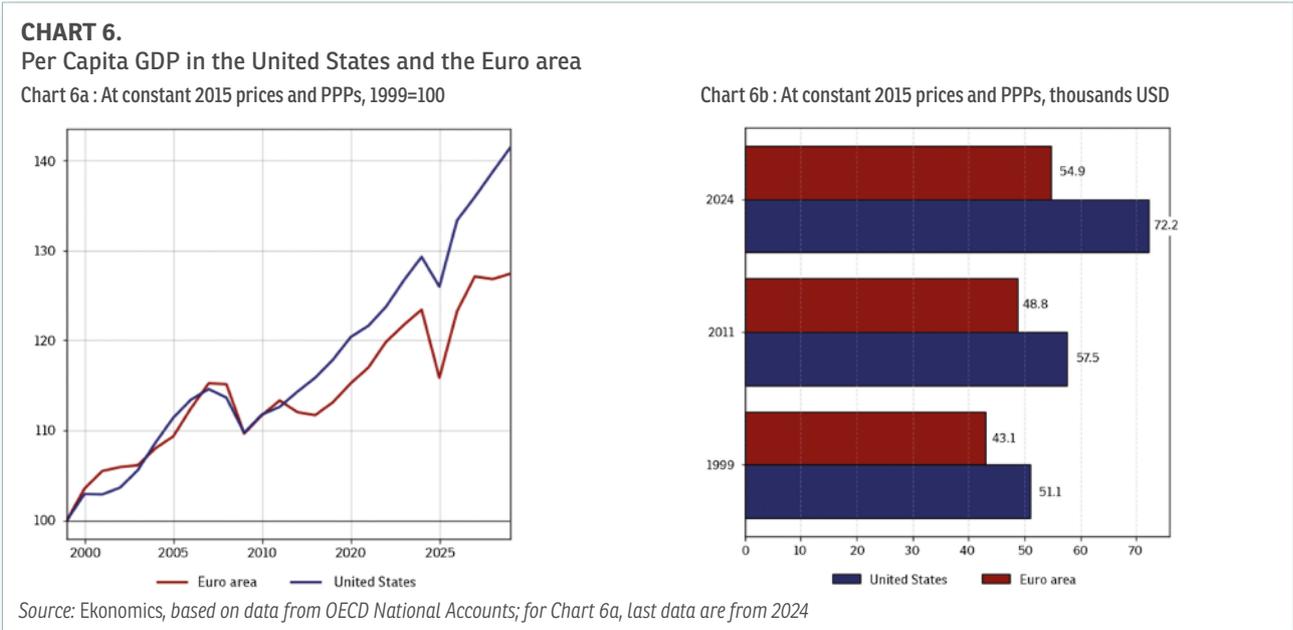
2. Adilbish, O, D Cerdeiro, R Duval, G H Hong, L Mazzone, L Rotunno, H Toprak and M Vaziri (2024), "Europe's Productivity Weakness: Firm-Level Roots and Remedies", IMF Working Paper, 2025/40, Washington DC.

This “striking gap in real IT-related capital stock” between the two regions may illustrate “Europe’s lost IT revolution” in recent years, as I. Schnabel pointed out in a speech in February 2024³. Slow technology diffusion is also a key reason why businesses in Europe have not benefited from the IT revolution.

1.1.4 Sluggish productivity growth in the Euro area has affected households’ living standards, which have fallen behind those of the United States since 2011

The living standards gap between European and American households almost doubled between 2011 and 2024. Prior to 2011, the real GDP per capita was between \$8,000 and \$9,000 lower in Europe than in the US.

The GDP per capita in the Euro area was \$13,000 lower than in the US in 2019. It has continued to widen since the onset of the pandemic, reaching \$17,000 in 2024 (see Chart 6).



1.2 US firms operate in a more business-friendly environment, granting them greater freedom than their European counterparts

US firms, unlike their European peers, benefit from a macroeconomic, financial, and regulatory environment that strongly supports investment and innovation. Most of the reasons for the difference in performance between the US and European corporates can be attributed to the different business environments in which they operate. Compared to their European counterparts, US companies (I) operate in more flexible and less regulated markets; (II) benefit from cheaper and more stable energy prices; (III) face fewer recruitment difficulties thanks to a younger, more dynamic and better-educated workforce; (IV) produce on a large scale, serving a large number of consumers and benefiting from a truly single domestic market; and (V) can more easily finance themselves in larger, more liquid and deeper markets.

1.2.1 US firms operate in a more business-friendly environment, granting them greater freedom than their European counterparts

Product and labour markets in the Eurozone are often highly regulated. Unlike the US, the EU imposes administrative burdens on the creation and expansion of new firms, which leads to higher compliance costs.

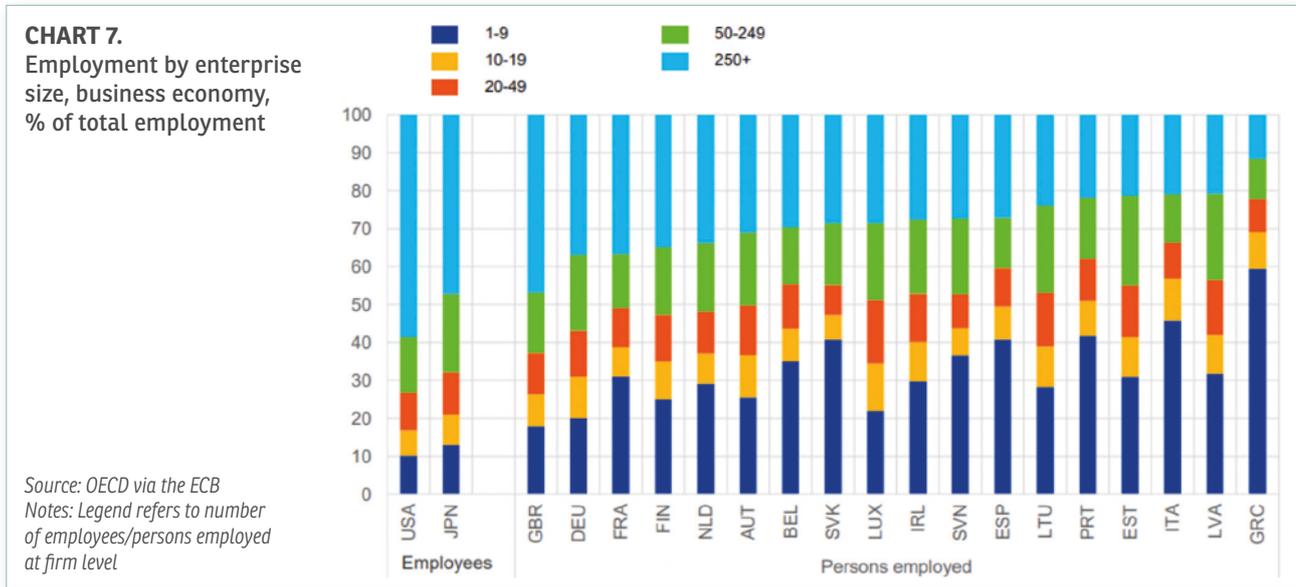
Additionally, taxes and social contributions are higher in Europe due to generous welfare states and high social spending, which undermines the competitiveness of European companies.

The continued expansion of the public sector in some Eurozone countries, such as France, has resulted in an unwieldy and burdensome system. Maintaining this large public sector requires greater financial resources, resulting in higher tax burdens for companies and individuals alike.

3. I. Schnabel, “From laggard to leader? Closing the euro area’s technology gap” Speech at the European University Institute (February 2024).

Higher administrative burdens may also discourage younger firms from expanding. In France, for instance, certain labour laws only apply once a company exceeds the 50-employee threshold.

While larger firms tend to invest more and be more productive, many European firms are too small and constrained by regulation to take full advantage of new technologies. As I. Schnabel notes, firms with more than 250 employees account for almost 60% of private-sector employment in the US, compared to just 12% in Greece and 37% in Germany (see Chart 7).

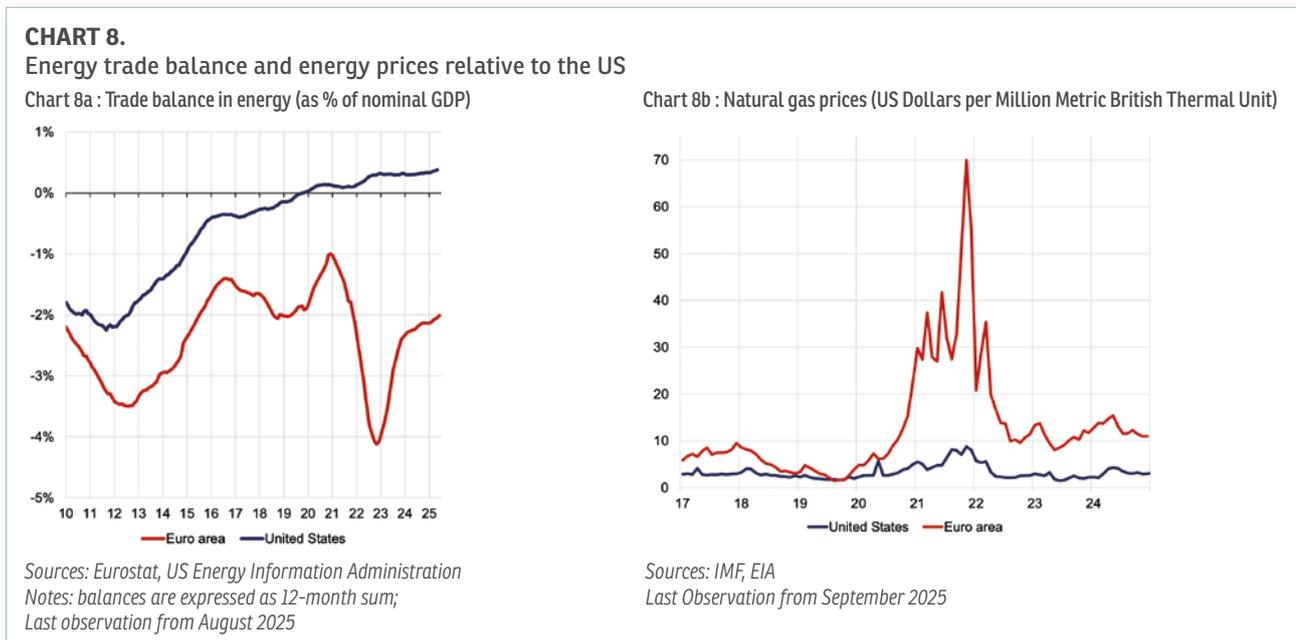


Without domestic structural reforms to reduce these supply-side constraints (labour shortages, administrative and tax burdens, high labour costs...) that weaken the competitiveness of European firms, the performance gap between the EU and the US will keep widening.

1.2.2 US firms benefit from lower and more stable energy prices

Unlike the Euro area, which is almost entirely dependent on energy imports, the US is a net exporter of energy. It became the world's largest producer of oil and natural gas in 2018. According to the EIA, US oil supplies will account for one-fifth of the world's supply in 2022.

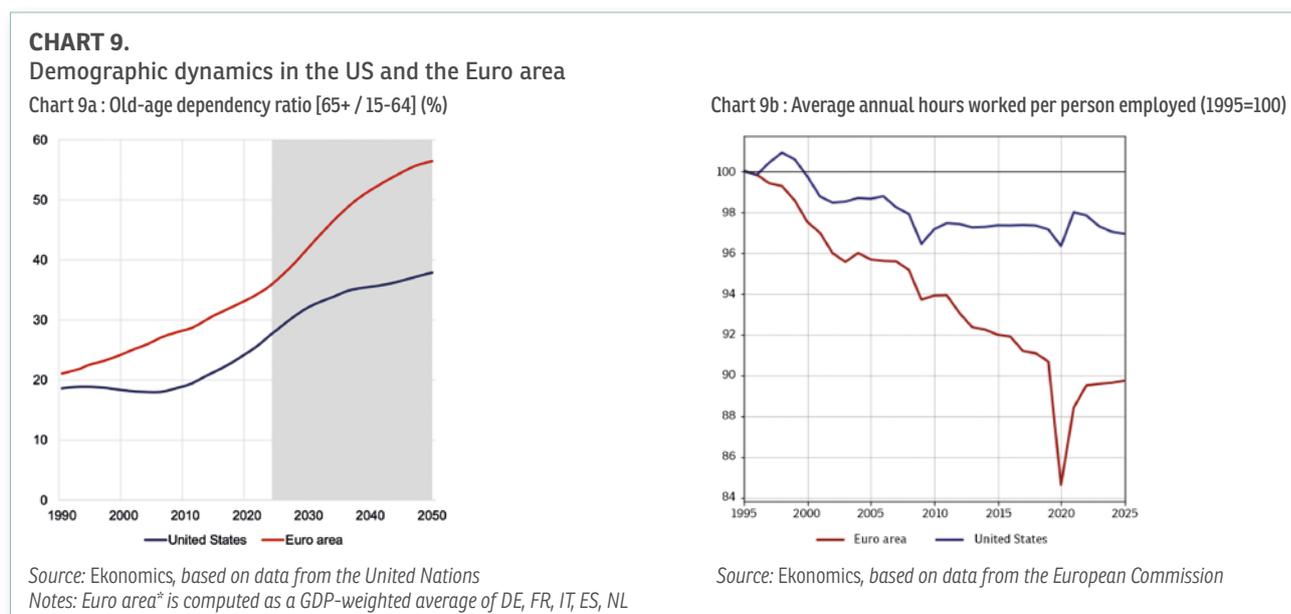
Being energy self-sufficient, the US was not as vulnerable to energy supply disruptions as the EU following the war in Ukraine in 2022. In 2025, industrial electricity prices in the EU were almost three times higher than in the US and more than twice as high as in China (see Part 1.3.4 for further details).



1.2.3 US firms face fewer recruitment difficulties due to more favourable population dynamics

Regarding the size and quality of the labour force, the United States outperforms Europe. The US has a larger and faster-growing working-age population, which rose by 33% between 1990 and 2023. In contrast, the Euro area's working-age population increased by just 6% over the same period, with several major countries experiencing stagnation or decline. Consequently, Europe experiences faster population ageing: the Eurozone's old-age dependency ratio is projected to increase from 35% in 2023 to 56% by mid-century, whereas the US is experiencing a more moderate rise from 27% to 38%.

European workers also supply fewer labour hours. Americans work approximately 1,700 hours per year – around 200 hours more than Europeans – and this difference has increased over time, with total hours worked in the Euro area now around 10% lower than in the US.



Finally, the US labour force is better aligned with the needs of firms. The country hosts many of the world's top universities and effectively leverages its highly skilled workers, whereas European education systems tend to lag behind their peers according to the OECD PISA assessments. Skill shortages remain widespread in Europe, with almost half of EU firms reporting difficulties in recruiting IT specialists in 2023.

1.2.4 Unlike the EU, the US has a genuine single market

The US benefits from a large domestic consumer market and hosts many multinational companies operating worldwide. Consequently, US companies can scale up more quickly, as the large, integrated market fosters innovation, and the common language and regulatory system facilitate cross-border operations.

This contrasts with the EU, where companies operate in smaller, less integrated domestic markets. Linguistic, administrative and cultural differences, heterogeneous bankruptcy laws and contract terms, as well as various regulatory barriers and protectionist policies, prevent banks and firms from operating easily across borders.

Regarding product markets, an IMF study⁴ shows that reduction of existing barriers in the internal market for goods and services by 10% could increase the European output by 7 percentage points in the long term. This highlights the significant fragmentation of European markets.

1.2.5 Despite abundant savings in Europe, financial markets in the US play a role three times more important in financing the economy than the EU

The United States boasts the world's deepest and most liquid financial markets, offering companies ample access to funding. US stock market capitalisation is around 170% of GDP, compared to less than 100% in most other countries. Around half of all global venture capital also flows to American companies.

4. Baba, Chikako, Ting Lan, Aiko Mineshima, Florian Misch, Magali Pinat, Asghar Shahmoradi, Jiaxiong Yao, and others. 2023. "Goeconomic Fragmentation: What's at Stake for the EU." IMF Working Paper 2023/245, International Monetary Fund, Washington, DC.

In contrast, Europe attracts only 8% of US venture capital investment, with EU start-ups receiving less than half the funding of their US counterparts. Venture capital and private equity assets under management are also much smaller in Europe, which limits the ability of European firms to scale up. This contributes to Europe's lag in sectors such as AI, big data and robotics.

Three structural factors explain this gap:

First, EU corporate financing remains heavily bank-based, with around 75% of borrowing coming from banks and 25% from markets – the reverse of the US structure. Bank lending is poorly suited for funding long-term, high-risk, intangible investments, while equity and market-based finance remain underdeveloped in Europe.

Second, weak returns on savings – exacerbated by years of negative real interest rates – have discouraged productive investment and encouraged capital outflows. Europe's current account surplus of nearly €200 billion largely flows to the US, where equity returns have historically been higher. Given the difference in stock market returns between the two regions, it is not surprising that capital has been flowing from Europe to the US. Between 1900 and 2020, the average annual nominal return on US equities was 9.6%, compared with **7.2% in Europe**.

Third, Europe's banking market remains fragmented, with national regulations, tax and insolvency regimes, and supervisory ring-fencing preventing cross-border capital mobility. Furthermore, the link between sovereign debt and the banking sector cannot be broken as long as government deficits remain high.

The absence of a securitisation market and the heterogeneity of the legal and fiscal frameworks of Member States are major obstacles to the creation of a Capital Markets Union, an idea that has made very little progress over the past 25 years. This affects areas such as securities regulation, investor protection, bankruptcy laws, tax procedures, market and corporate supervision, accounting standards for SMEs, trading rules (including those relating to short selling) and investment rules for institutional investors, including pension funds, insurance companies and investment funds. It also affects listing requirements, including the languages used for prospectuses. Consequently, EU capital markets remain segmented, with institutional investors exhibiting a pronounced home bias.

1.2.6 Several major EU policy shortcomings contribute to Europe's lag behind the US

The introduction of the Euro in 1999 aimed at unifying and strengthening the European economy. However, the economic performance of the Eurozone has not lived up to expectations, especially when compared to the US robust growth. As detailed above, several indicators illustrate this growing chasm: real GDP growth rates, labour productivity, and levels of corporate investment. The US has consistently outperformed the EU in these areas, leading to a significant shift in global economic power.

As global competition intensifies, the relative decline in the EU's economic performance has wide implications. It affects not only the prosperity of European nations, but also their influence on global economic policy and their ability to respond to future economic challenges. Understanding the causes of this lag is essential for policymakers aiming at closing the gap and ensuring sustainable economic growth for the EU in the decades to come.

I. The EU Commission faces significant challenges in coordinating economic policies across Member States within the Eurozone.

Despite the introduction of mechanisms such as the Stability and Growth Pact (SGP), the Six Pack and the Two Pack, effective economic governance remains elusive. These frameworks were designed to enforce fiscal discipline and strengthen economic surveillance, but their implementation has often been inconsistent and slow to adapt to crises.

II. The EU's competition policy, focused on preventing market dominance and state aid, has inadvertently stifled the development of European champions capable of competing globally.

The EU's competition policy framework aims at ensuring a level playing field within the internal market, often at the expense of fostering large, competitive firms that can scale up internationally. This approach contrasts sharply with the US, where regulatory frameworks are more supportive of mergers and acquisitions that create globally competitive firms. For example, American tech giants such as Apple, Amazon, Microsoft, and Google benefited from a permissive regulatory environment, allowing them to dominate global markets. In contrast, the EU has blocked several high-profile mergers, such as the proposed merger between Siemens and Alstom, citing competition concerns. This political stance is preventing the consolidation needed to build companies capable of competing with their American and Asian counterparts.

III. The EU's lack of a coherent industrial policy has left it vulnerable to protectionist measures by other major economies, such as the US and China.

While the US and China have aggressively supported their domestic industries through subsidies, tariffs, and strategic investments, the EU has been slow to respond.

The EU needs to adopt a strategic industrial policy that promotes key sectors like technology, renewable energy, and advanced manufacturing. This policy should include targeted investments, research and development funding, and measures aimed at protecting critical industries from foreign competition. The recent introduction of the Digital Strategy is a step in the right direction, but more comprehensive and aggressive policies are needed to ensure that the EU remains competitive.

IV. The EU funds are also difficult to disburse and slow to reach the countries that need them most.

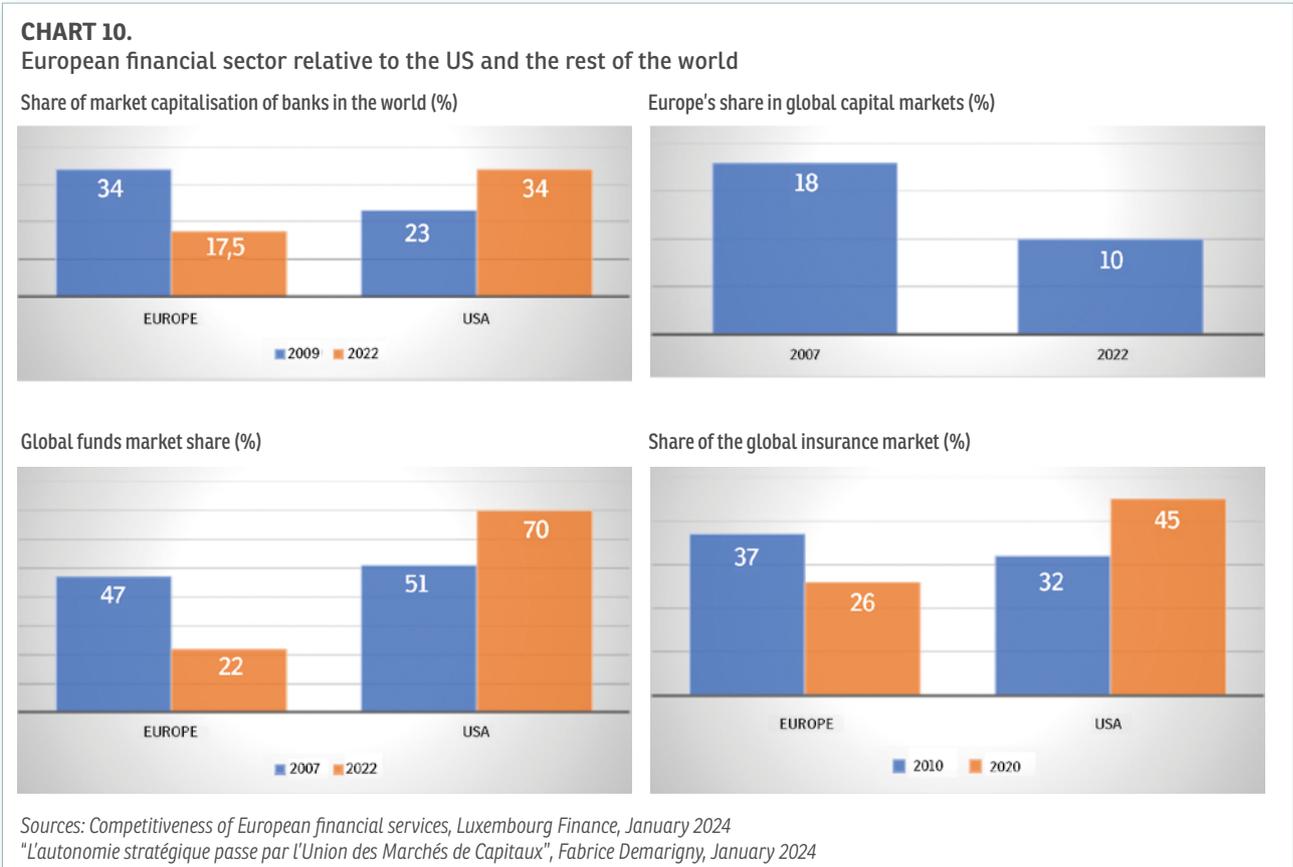
The Next Generation EU (NGEU) fund, designed to support economic recovery after Covid-19, has attracted significant financial resources comparable to those in the US. However, its effectiveness has been hampered by bureaucratic complexity and slow disbursement procedures. Countries such as Italy and Spain, which are among the largest beneficiaries, have struggled to make effective use of these funds due to administrative bottlenecks and strict compliance requirements.

The NGEU aims at promoting digital and green transitions, but its impact on productivity and investment has been limited. Streamlining the application and approval processes, as well as better coordination at national and EU levels, could increase the effectiveness of these funds.

1.2.7 The decline in European economic competitiveness has also affected of the international competitiveness of the EU financial players

The sharp downturn in Europe's banking industry reflects the EU's broader struggle to remain competitive in global financial markets. As the graph below shows:

I. The share of European banks in global market capitalization has fallen significantly. In 2009, European banks accounted for 34% of global market capitalization, but by 2022, this share had plummeted to 17.5%. By contrast, US banks have increased their share from 23% to 34% over the same period⁵. This shift highlights the growing dominance of US financial institutions and the declining global influence of European banks.



5. Europe's leading bank BNP Paribas had a market cap of around \$70 bn in 2022. JP Morgan Chase, the US leader, was worth more than \$400 bn. The market capitalization of the 4 largest European banks was about half that of JP Morgan in 2022. Scale is not everything of course. Profitability and efficiency are also key considerations. But for profit, scale gives the biggest banks a huge competitive advantage. Take the issue of technology arguably the battleground of the future of financial services. Bank of America spends more than \$10 bn a year on maintaining and building its technology. That's almost double the profits made in 2022 Société Générale.

- II. The EU's share of global capital markets has also decreased sharply. In the last 16 years, this share has fallen from 18% to just 10%. This decline is partly due to the more dynamic and better-integrated financial markets in the US and Asia, which offer more attractive conditions for investment and growth.
- III. The European asset management sector has experienced an even steeper decline. In 2007, European asset managers accounted for 47% of global funds, and US managers for 51%. By 2022, the European share had dropped to just 22%, compared to 70% for US funds. Only two European asset managers (Amundi and Natixis) are among the world's top 20.
- IV. The EU's share of the global insurance market has fallen from 37% in 2010 to 26% in 2020. Meanwhile, the US's market share has risen from 32% to 45%. This shift highlights the stronger growth and resilience of the US insurance industry compared to its European counterpart.
- V. In the payments market, American players (Visa, Master Card, Paypal, Apple Pay, Google Pay) dominate in most European countries. This dominance reflects not only the technological superiority of these companies but also highlights the lack of competitive European alternatives. The reliance on American payment systems raises concerns about strategic dependencies and the ability of European firms to innovate and compete in this critical sector.

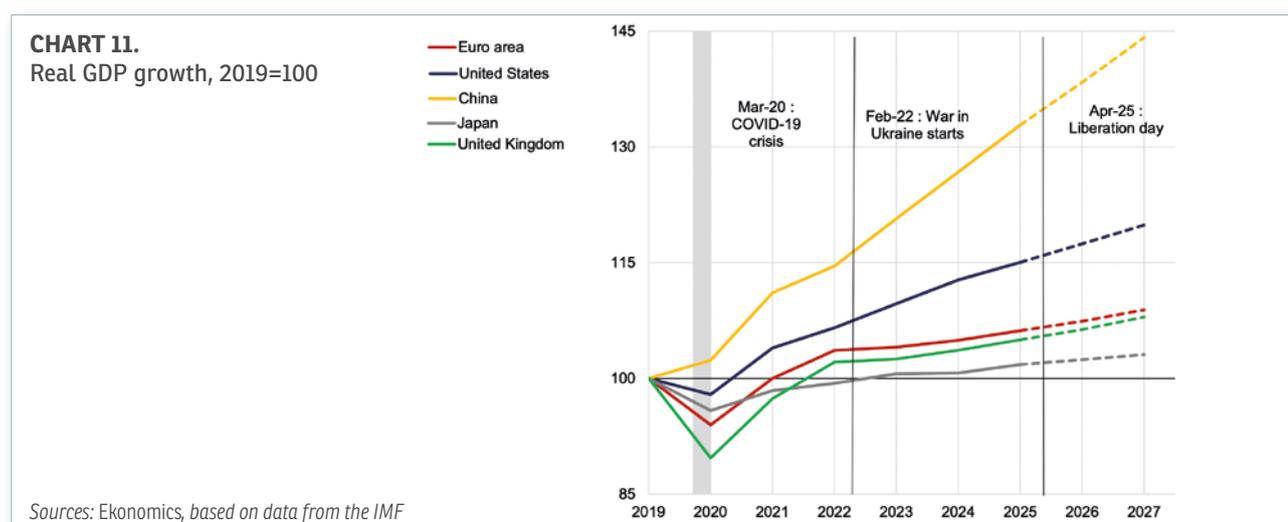
The decline in the competitiveness of the European financial players reflects broader structural and regulatory challenges within the EU. Addressing these issues will require significant policy shifts, greater integration of financial markets, and a more supportive regulatory environment to enable European banks and financial institutions to compete effectively on the global stage. Without these changes, the gap between the EU and its global competitors is likely to widen further, affecting the overall economic performance of the region.

1.3 Since the Covid-19 crisis, Europe's loss of competitiveness has further accelerated

1.3.1 The economic consequences of the Covid-19 crisis were more severe in Europe than in the United States and the recovery has been slower

In 2020, the Eurozone GDP contracted by 6%, nearly three times the decline recorded in the US (-2.1%). Japan also experienced a smaller contraction (-4.2%) and China even recorded a 2.3% rise in GDP.

In 2021, real GDP growth in the Euro area reached 6.4%, slightly exceeding that of the United States (+6.2%). However, this performance was insufficient to bring GDP back to its pre-pandemic level. By the end of 2021, real GDP in the Euro area had just recovered to its 2019 level, while US GDP exceeded its pre-pandemic level by nearly 5%.



1.3.2 Following the war in Ukraine and the spike in energy prices, the Euro area experienced a major terms-of-trade shock that resulted in a permanent loss of wealth relative to the rest of the world

The war in Ukraine has delivered another negative supply shock to the global economy, with a particularly severe impact on Europe.

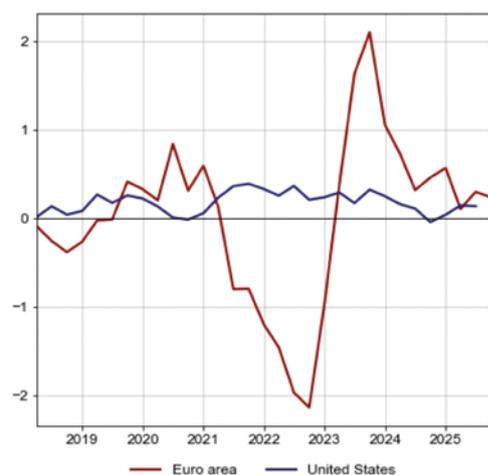
The main difference between the United States and the Euro area is that the former produces its energy while the latter has to import it. As a result, the United States, unlike Europe, benefits from an energy trade surplus.

Dependence on energy imports is very costly for the Euro area in 2022: higher energy prices led to a deterioration in its terms of trade, which amounted to 1.9% of GDP in 2022. As a net exporter of energy since 2019, the United States did not suffer the economic consequences of the energy shock, as shown by the virtually unchanged level of its terms of trade over this period (see Chart 12a).

CHART 12.

Energy dependence and terms of trade

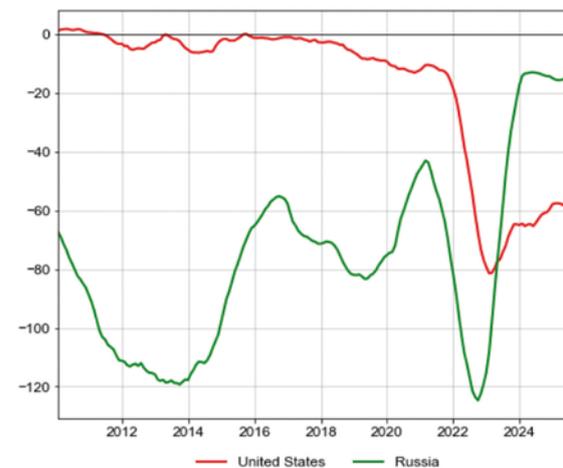
Chart 12a: The income effect of the terms of trade shock (impact on year-on-year GDP growth in percentage points)



Sources: Economics, based on data from Eurostat & US Bureau of Economic Analysis

Notes: The income effect of terms of trade is calculated by weighting export and import price changes by their respective past values (one-year lag) and is expressed as a percentage share of GDP. The latest observations are from Q3-2025 for the Euro area and Q2-2025 for the United States

Chart 12b: Euro area's Trade balance in energy with Russia and the United States, EUR bn (12-month sum)



Sources: Economics, based on data from Eurostat
Last observation from September 2025

The energy crisis has widened the competitiveness gap between Europe and the US for at least two reasons.

- I. **Gas prices have remained high and more volatile in Europe than in the US, where they have rapidly returned to pre-war levels.** While gas prices in the two regions were roughly similar in 2019, they diverged sharply from the beginning of 2021 (see Chart 15). In August 2022, when European gas prices peaked at \$70 per MMBtu, US gas prices were eight times lower at \$8.5 per MMBtu. Despite the decline in energy prices since late 2022, prices remain elevated in Europe, both relative to their historical levels and compared to the US. In the second half of 2023, European gas prices averaged \$11 per MMBtu – more than double the 2019 level (\$5 per MMBtu) and over three times higher than the US average of \$3.5 per MMBtu.
- II. **Europe has replaced its gas and oil imports from Russia with more expensive imports, partly from the US. This transfer of wealth has widened Europe's energy balance deficit with the United States.** While the Euro area imported almost €80 billion worth of energy products from Russia in 2019, the value of these imports has fallen significantly since 2022, reaching just €15 billion in September 2025. The United States has greatly benefited from this reallocation. Before 2019, annual energy imports from the US were worth no more than €10 billion; since 2022, however, they have exceeded €50 billion per year (see Chart 12b).

1.3.3 As a major loser of the US trade policy, the Euro area has been hit by the reallocation of Chinese exports, which now threatens its manufacturing industry

In April 2025, the Trump administration adjusted its trade policy by imposing tariffs on all its trading partners. Although some tariffs were later reduced, they remain at their highest level for decades. The average US statutory tariff has increased by around 14 percentage points since the beginning of 2025, reaching 18%.

Europe is affected by this trade policy both directly and indirectly. Directly, effective tariffs on EU exports to the United States have risen from around 2% to 10%, hurting a significant proportion of European exports to the US market. Indirectly, Europe faces intensified competition from Chinese exports being diverted away from the US

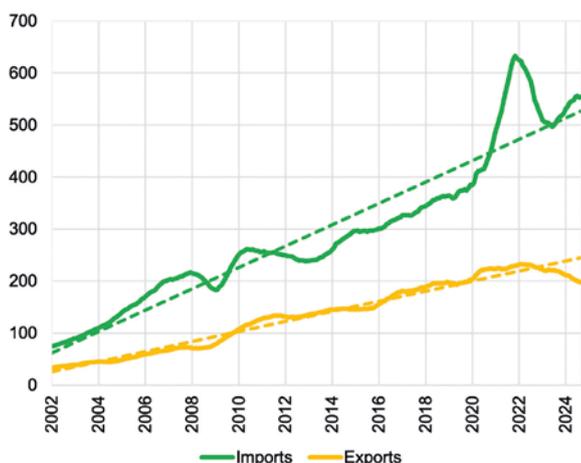
market as access becomes significantly more costly, with effective tariffs reaching 36%. Between May and October 2025, compared with the same period in 2024, Chinese export volumes to the United States fell by more than 25%, while exports to emerging Asian economies increased by 14%, and exports to the European Union by slightly more than 10%. This pressure has been boosted by exchange rate developments: since the beginning of 2025, the euro has appreciated by almost 10% against the yuan. Compared with pre-pandemic levels, European export volumes have fallen by a staggering 30%.

European export-oriented industries, particularly in Germany, are therefore caught between weaker trade with the United States and mounting Chinese competition. Chinese ‘hyper-competitiveness’ is underpinned by much lower production costs and substantial support for production and exports. Since the end of 2019, producer prices in China have increased by only 2%, compared with 26% in the Euro area. Labour costs illustrate this difference: for comparable BYD and Volkswagen models, labour costs in China are estimated to be 77% lower than in Germany. Manufacturing wages in China also remain almost 70% below European levels. Consequently, Chinese cars have rapidly gained market share, with imports from China accounting for 14% of total car imports into the Euro area – up from around 4% in 2019.

For Germany – Europe’s largest economy and a traditional powerhouse in capital goods such as cars and machinery – this poses a risk of further domestic production weakness and increased dependence on China, rendering it more vulnerable than most other European countries to the current trade shock.

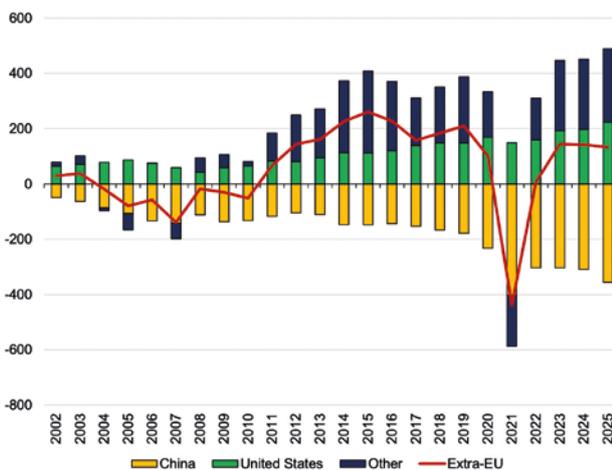
CHART 13.
Extra-EU trade performances

Chart 13a : European Union : Trade imports and exports vis-à-vis China, EUR billions (12-month sum)



Sources: Economics, based on data from Eurostat
Notes: The latest observations are from September 2025

Chart 13b : EU trade balance vis-à-vis the rest of the world, EUR billions (12-month sum)



2. Europe's loss of competitiveness is linked to the increasing economic and fiscal fragmentation among its member states over the past 25 years

In this chapter, we demonstrate that the Euro area's loss of competitiveness since its inception has coincided with growing economic and fiscal fragmentation among its member states.

While European economic developments were relatively synchronised until the late 1990s, significant disparities have since emerged, particularly between southern and northern countries. GDP per capita levels reflect this fragmentation; countries with lower initial income levels have grown more slowly than those with a higher GDP per capita. This has resulted in an increase in the gap between living standards over the past 25 years.

The euro has contributed to these divergences. By eliminating exchange rate risk, the single currency has reinforced sectoral specialisation, thereby widening competitiveness gaps between member states. These differences in competitiveness have fuelled substantial trade imbalances. Although price competitiveness gaps in southern countries narrowed after the sovereign debt crisis, current account imbalances persist, with southern countries approaching balance while northern countries continue to exhibit large excess savings vis-à-vis the rest of the world. However, rather than being invested within Europe, these savings surpluses have largely been invested abroad, particularly in the US, where returns are more attractive. This highlights the lack of investment projects in EU countries and the lack of financial integration within the Euro area.

At the same time, the euro has been accompanied by a relaxation of fiscal discipline in some member states. France, Belgium and several southern countries have maintained budget deficits above 3% of GDP regardless of cyclical conditions, whereas Germany and other northern countries have more regularly returned to surplus following crises. This lack of fiscal consolidation has resulted in divergent public debt trajectories, with nearly seven countries now exhibiting public debt levels above 90% of GDP. In the context of economic slowdown and rising interest rates, highly indebted countries will therefore be increasingly vulnerable to debt sustainability risks in the years ahead.

2.1 Since the 2000s, growth, productivity, and GDP per capita have diverged sharply between Northern and Southern European countries

2.1.1 While productivity and growth dynamics between Southern and Northern European countries were broadly synchronized until the late 1990s, a sharp divergence has emerged since then

Until the end of the 1990s, the countries participating in the European Monetary System achieved a degree of economic convergence in terms of total factor productivity (TFP) growth.

- France and Germany exhibited similar productivity growth rates that were higher than in the United States.
- In Spain, TFP level fluctuated within a range of approximately $\pm 5\%$ relative to Germany.
- In Italy, TFP was consistently around 10% lower than in Germany.

CHART 14.

Total factor productivity across Eurozone Member States since 1980

Chart 14a: Total Factor Productivity, 1980 = 100

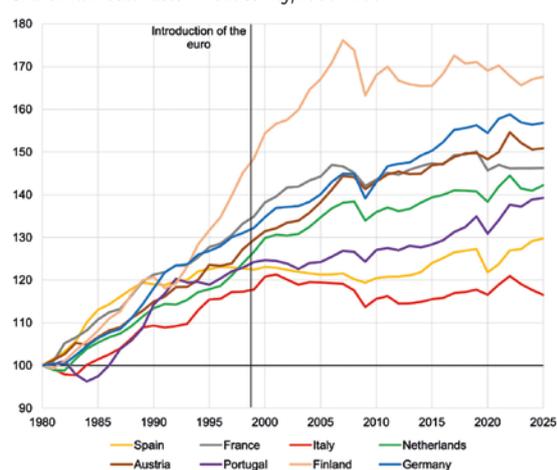
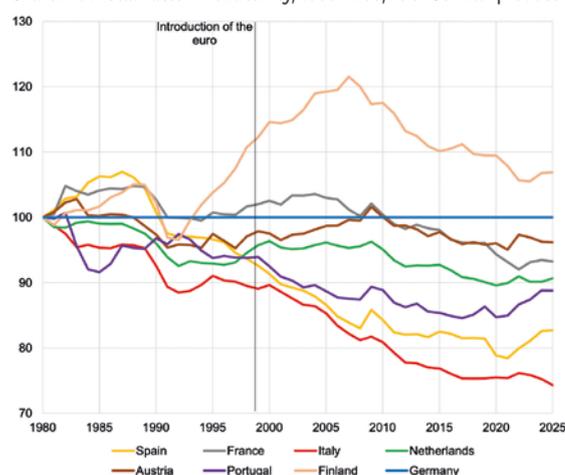


Chart 14b: Total Factor Productivity, 1980 = 100, % of German productivity



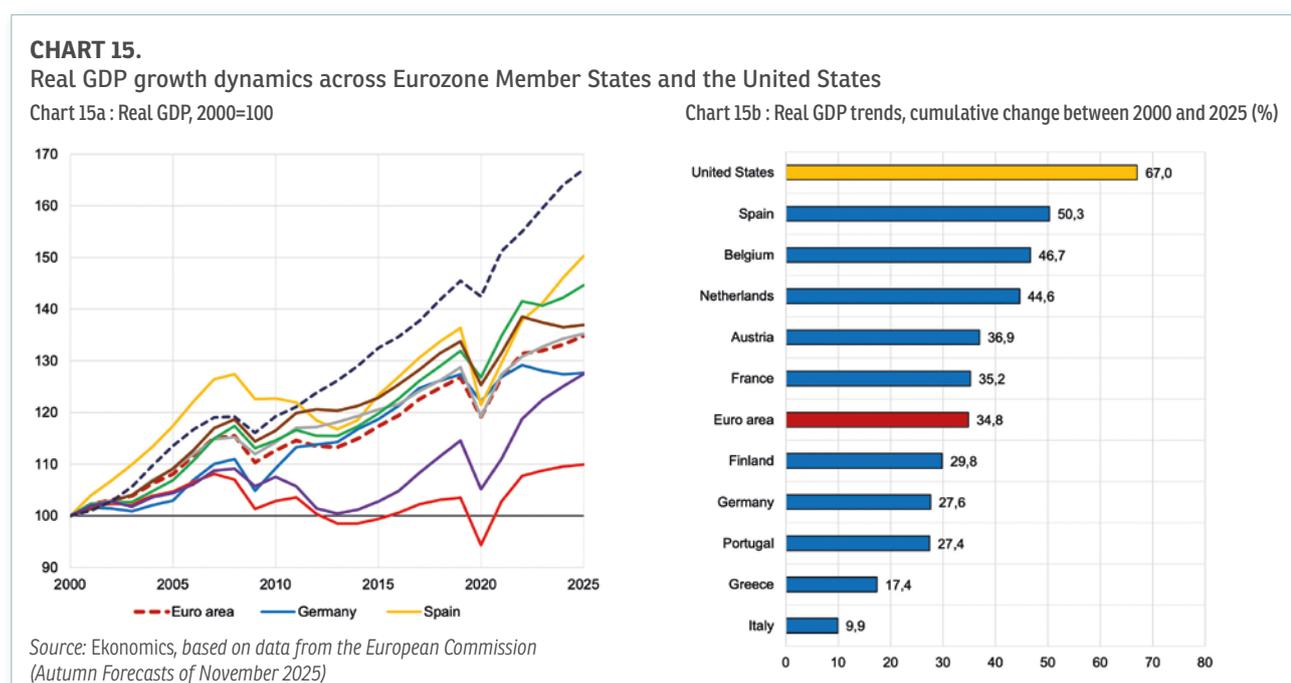
Source: Economics, based on data from the EU Commission (Autumn Forecasts of November 2025)

Since the introduction of the euro, a striking coincidence has emerged: the productivity gap between EU countries has widened considerably. Over the past 25 years, TFP growth in Germany averaged 0.7% per year – three times higher than in Spain (0.2%) – while Italy saw virtually no productivity growth between 2000 and 2024.

As a result, relative productivity levels diverged. Italy's and Spain's productivity levels fell from 89% and 91% of Germany's productivity levels in 2000 to 74% and 82% respectively in 2025 (see Chart 14b). France initially outpaced Germany until 2010 before declining.

The divergence in productivity after 2000 was reflected in growth performance. Real GDP growth over the past 25 years can be divided into three groups.

- “Lagging” countries: Greece and Italy, with cumulative growth of around 10%.
- “Intermediate” countries: Germany, France, Austria, and Finland, with growth of 30-40%.
- “High growth” countries: The Netherlands, Spain and Belgium which exceeded 45%. However, these countries still grew by 10-15 percentage points less than the United States (+67%).



However, the evolution of Spanish growth deserves some comment:

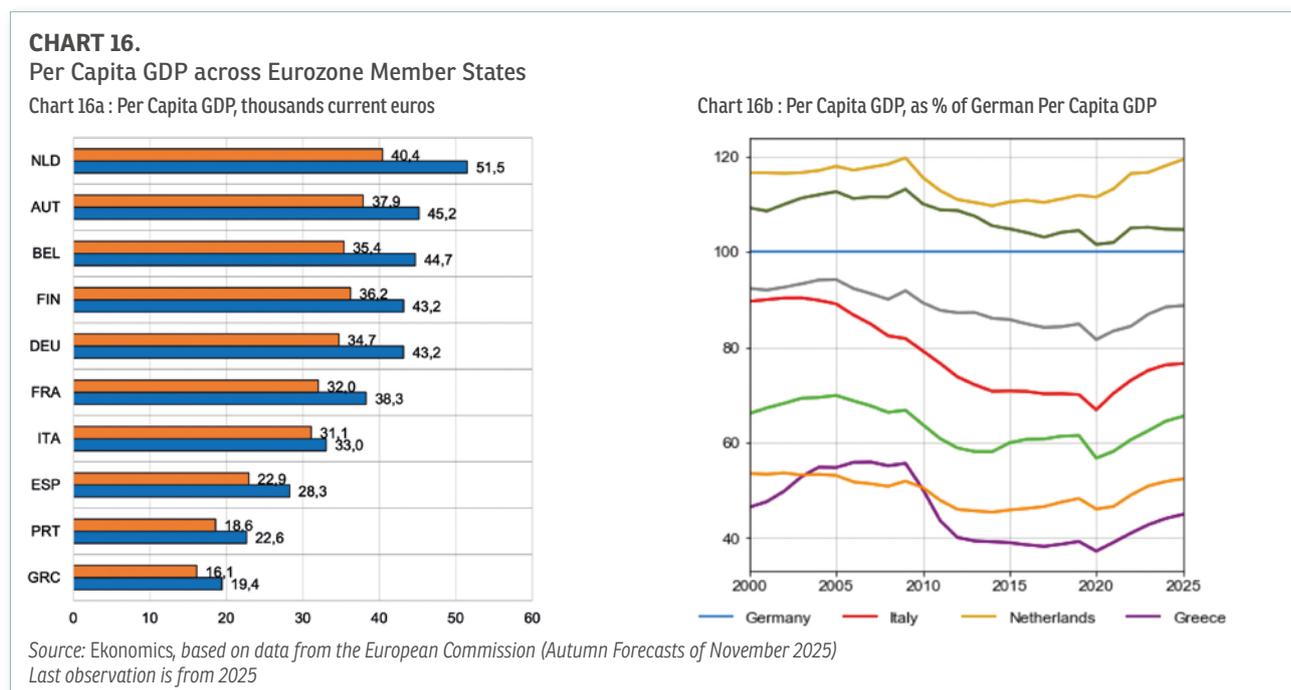
- **2000-2008:** As A.-V. Robert notes, low real interest rates in the southern European countries (Greece, Spain, Portugal, Italy) encouraged borrowing. In Spain in particular, this led to a speculative bubble in real estate and financial assets. This bubble developed at the expense of increased productive investment, reinforcing the slowdown in productivity growth during this period.
- **2012-2023:** Spain's economic performance has been driven by the tertiary sector, especially tourism, which relies on low-skilled and low value-added jobs. Productivity gains have been minimal, with TFP increasing by only 5.2% between 1999 and 2024, one of the lowest in the Euro area.

2.1.2 Heterogeneity in GDP per capita within the Euro area was higher in 2025 than before the euro was introduced

Since the year 2000, real GDP per capita has increased in all Euro area countries, but growth has been much stronger in Northern Europe than in Southern Europe. Between 2000 and 2025, Italy's GDP per capita increased by less than 7%, which is about one third of Germany's 26.3%. This occurred despite Italy starting from a higher initial level of €31,000 per capita compared to Germany's €34,000. Greece, Spain and Portugal, which also had lower initial GDP per capita levels than Germany, experienced similarly slow growth.

Rather than converging, the gap in living standards has instead widened across Member States. While the average gap in GDP per capita amongst Euro area countries was around €8,000 in 2000, it has increased to €10,000 by 2025. In 2004, France's GDP per capita was only 6% below Germany's, but this gap widened to 12% by 2025.

Consequently, the Eurozone is far more diverse than the United States. While the poorest US state has a per capita income close to 80% of the national average, eight European countries have a GDP per capita below 80% of the EU average.



2.2 These disparities in productive performance have been exacerbated by the euro, generating persistent current account imbalances across the region

The euro has strengthened the most industrialised countries at the expense of those experiencing a deeper industrial decline. The completion of the European single market is an essential objective, but the progress made in recent years has not reduced this heterogeneity. Positive results would require all member states to progress with structural reforms at an adequate pace.

2.2.1 Countries with the best-performing economies before the introduction of the euro have benefited even more from the external value of the single currency

The external value of the euro appears undervalued in Northern Countries...

Northern countries (notably Germany and the Netherlands), which are less prone to inflation and are endowed with highly competitive industries, have benefited from a depreciation of the euro in real terms given its role as an average currency, thereby strengthening their export competitiveness. Indeed, the external value of the euro reflects an average across the entire economic area and appears undervalued relative to these countries' economic fundamentals, granting them an additional competitive advantage. Without the euro, their national currencies would have appreciated, thus eroding the price competitiveness of their exports.

For example, CEPII⁶ has estimated that Germany's real effective exchange rate was undervalued by around 20 percentage points relative to the rest of the Euro area. Correcting this misalignment would require an annual inflation rate of 2% in Germany and 0% in other countries for a decade – an unrealistic outcome.

In other words, thanks to the euro, competitive countries have been able to avoid the currency appreciation that would have occurred in its absence and that would have weakened the price competitiveness of their exports.

... and overvalued currency in Southern Countries

Simultaneously, the euro has prevented currency depreciation in southern countries, which were more prone to inflation. Without the euro, their currencies would likely have depreciated, reducing the purchasing power of their populations. Such market-driven devaluations would have promoted competitiveness, provided that domestic

6. E. Faure & al. "Current Account Balances' Divergence in the Euro area: an Appraisal of the Underlying Forces", CEPII Working Paper, 2022.

demand was properly managed to contain inflationary pressures and reduce the propensity to import. However, this stability comes at a price: reduced competitiveness for southern countries and increased competitiveness for northern countries.

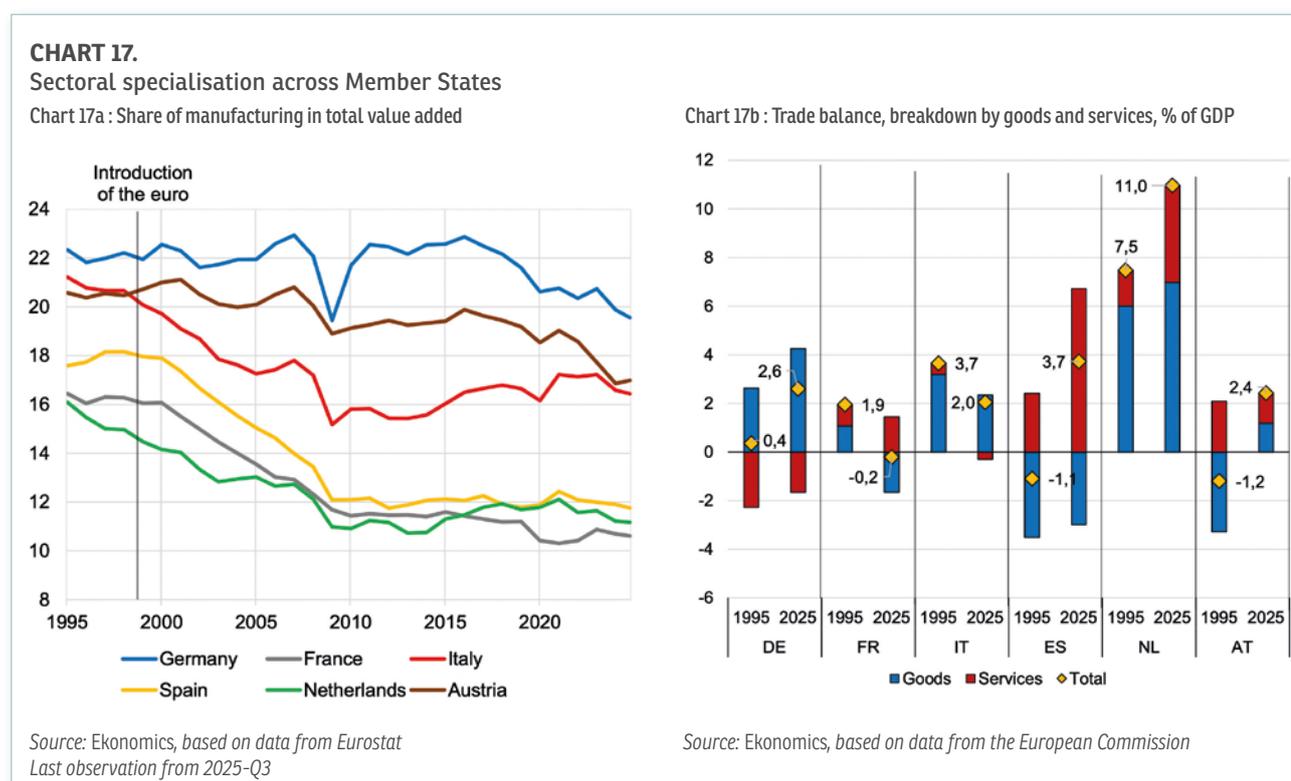
2.2.2 Diverging inflation rates within the Euro area, particularly pronounced in the run up to the European sovereign debt crisis, contributed to growing competitiveness disparities between countries and distorted productive structures in some Member States

As it is obvious in a common currency area, the Eurozone Member States exhibit different sectoral specialisations, with consequences for relative productivity and potential growth rates. The elimination of exchange rate risks tends to encourage specialisation within the monetary union; it mainly benefits net exporters, *i.e.* those that have specialised in tradable products for which they are highly competitive.

Moreover, as noted above, countries that were already performing well before the introduction of the single currency were further favoured by the external value of the euro and lower inflation rates.

In this context, the northern countries (in particular Germany and the Netherlands) have been able to maintain a competitive industry, while the southern countries (in particular Greece, France and Spain) have gradually deindustrialised. The northern countries have gained market shares in world trade, while the southern countries experienced the opposite.

Chart 17 shows how industrial specialisation has changed across Member States since the introduction of the single currency. In several southern European countries, as well as France, manufacturing's share of value added has fallen sharply, and the trade balance relies mainly on service exports. However, these countries are struggling to compensate for the import of goods, a situation that is particularly pronounced in France. Conversely, trade surpluses have strengthened in Germany and the Netherlands during this period. Austria's deficit was eliminated.



2.2.3 The current account imbalances resulting from these divergences are significant and have not yet been addressed, as illustrated by the scale of positions within Target 2

Following the introduction of the euro in 1999, there was an increase in the difference in inflation rates between southern countries such as Greece, Italy and Spain, and Germany. By 2008, these divergences had widened the competitiveness gap between member states, leading many (including Spain, Greece, Italy and Portugal) to run significant current account deficits.

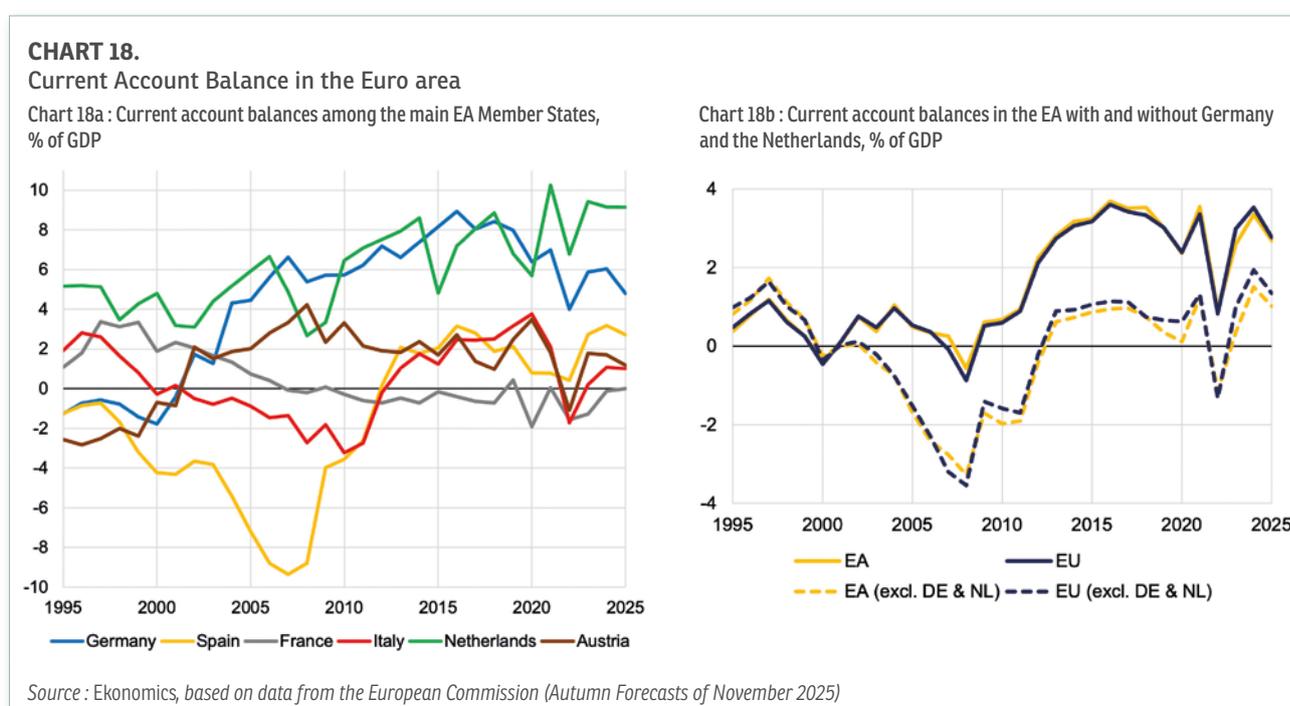
Between 2000 and 2010, Spain's and Portugal's average deficits reached 6.5% and 9.5% of GDP, respectively. Since 2012, the competitiveness gap between these countries has narrowed as a result of the adjustment policies they have had to implement following the sovereign debt crisis.

Although peripheral countries (Italy, Spain and Portugal) have returned to balanced current account positions since 2012, significant divergences remain within the Eurozone.

Since 2012–13, both Spain and Italy have recorded current account surpluses, averaging 1.9% and 1.5% of GDP per year respectively between 2012 and 2024. However, in Germany and the Netherlands, surpluses averaged 7.3% and 8% of GDP per year, respectively (see Chart 18a).

The external performance of these two countries was the main contributor to that of the Eurozone as a whole. Excluding these two countries, the Eurozone's current account would have been around two points lower than it has been since the launch of the euro (see Chart 18b).

In 2025, heterogeneity remained high. According to the European Commission's November forecasts, Germany and the Netherlands are expected to record current account surpluses of 4.8% and 9.1% of GDP, respectively. Meanwhile, France's balance is projected to be close to equilibrium. However, this balance is threatened by the intensity of Chinese import competition (see Section 1), with Germany's current account surplus expected to fall to 3.8% of GDP in 2026 – half its average annual surplus during the pre-Covid-19 period.



Target 2 imbalances in the Eurozone have increased with the ECB's asset purchase programs (2015-2022)

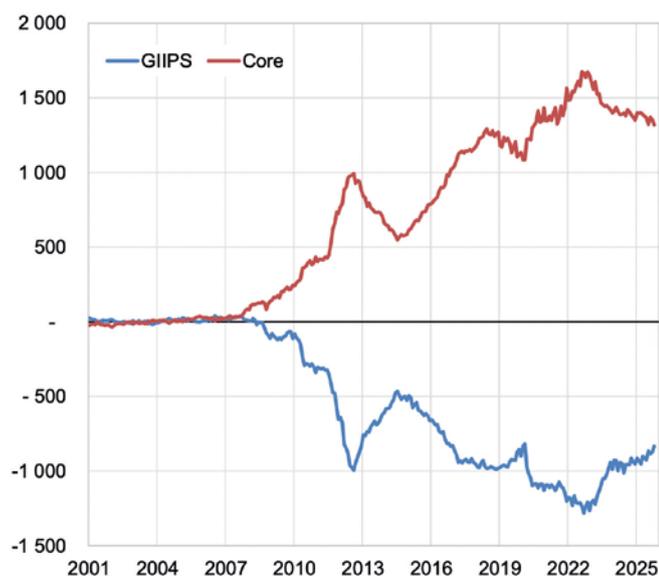
Since the creation of the euro, Target 2 balances have gone through several distinct phases. Before 2008, balances were practically zero: current account imbalances between Euro area countries were settled through interbank liquidity transfers. After the 2008 financial crisis and the 2012 Sovereign Debt Crisis, Target 2 balances rose dramatically due to tensions on the interbank market and a flight of deposits from "peripheral" countries (Italy, Greece, Spain, Portugal, Ireland) toward "core" countries (Germany, Netherlands, Luxembourg), before gradually declining. Total Target 2 national surpluses in these countries amounted to €900 billion in mid-2012, before gradually declining and stabilising at around €600 billion at the end of 2014.

Since 2015, the ECB's asset purchase programs have led to an increase in balances. Since the mid-2010s, the countries with the highest Target 2 liabilities were Greece, Ireland, Portugal, Spain and Italy, and the countries with the largest surpluses were Germany, the Netherlands, Finland and Luxembourg.

The net Target 2 liabilities of the Bank of Italy and the Bank of Spain are quite high, amounting to €348 bn and €392 bn respectively in October 2025 (equivalent to 18.2% of GDP for Italy and 29.5% for Spain). Conversely, the Bundesbank has a net Target 2 credit of €1,047 bn in October 2025 (27.1% of German GDP).

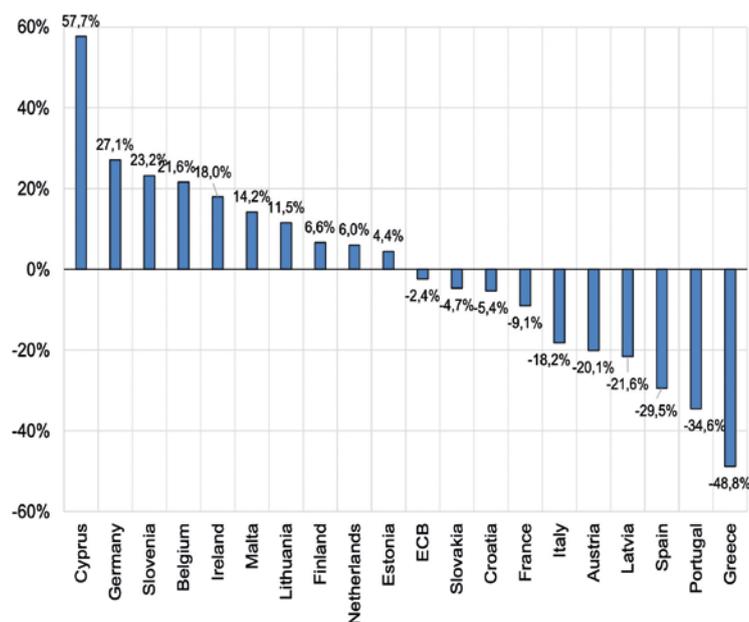
CHART 19
Target 2's imbalances
in the Euro area

Chart 19a : GIIPS Liabilities versus Core's claims, EUR bn



Source: Economics' calculations based on Euro Crisis monitor
For Chart 19a, GIIPS = Greece, Italy, Ireland, Portugal, Spain ; Core = Germany, Netherlands, Luxembourg
Last observation from October 2025

Chart 19b : Target 2 imbalances as of October 2025, % of GDP



Source: Economics' calculations based on Euro Crisis monitor and Eurostat

Today, Target 2 balances reflect the legacy of Quantitative Easing (QE) bond portfolios and will fall steadily as the ECB reduces its balance sheet. In January 2017, in a letter to members of the European Parliament, Mario Draghi wrote⁷ that "if a country were to leave the Eurosystem, its national central bank's claims on or liabilities to the ECB would need to be settled in full."

According to B. Drut⁸, "At least three problems would arise in the event of an exit from the Euro area of countries with significant net Target 2 liabilities:

- I. For several countries (Spain, Italy, Portugal), the Target 2 liabilities are very large when taken as % of GDP, which implies that the amounts needed to settle the commitments would be colossal,
- II. In the event of the exit of the Euro area from a relatively weaker country from an economic point of view, its new currency would probably be weaker, which would further increase the settlement to be made,

7. Letter from Mario Draghi to the members of the European Parliament Marco Valli and Marco Zanni, January 2017.

8. B. Drut, "Target 2 imbalances, again at the center of attention", CPR, 2018.

III. Would a country leaving the Eurozone necessarily want to settle all its commitments? We have seen in the case of Brexit that some British politicians were totally opposed to the divorce bill."

Ultimately, the Target 2 imbalances – and the potential losses in the event of an exit from the Euro area and the non-settlement of Target 2 balances – could strengthen the bargaining power of debtor countries in the event of tough negotiations with core countries.

Target 2 imbalances should decline as the ECB reduces its asset purchase programmes and, more generally, as progress is made on the Banking Union and the Capital Markets Union to the extent that cross-border flows become more north-south than south-north.

2.3 Rather than being invested in Europe, the savings surpluses of certain countries are increasingly flowing outside Europe, which threatens the coherence of the EMU

In a genuine economic union, current account imbalances within the Union would not be problematic as adjustments would occur automatically through capital and labour mobility, as well as fiscal transfers, in the same way that they do in the United States. However, the Eurozone is not such a union. National budgets and balance-of-payments constraints persist, meaning that macroeconomic imbalances are primarily the responsibility of individual countries.

In the absence of exchange rate adjustment, countries address competitiveness imbalances through internal devaluations, which rely on price and wage compression that depresses domestic demand. While some heterogeneity is inevitable, particularly for lower-income countries, the EMU should mitigate rather than amplify these divergences.

Before 2008, cross-border capital flows financed unproductive asset bubbles. Since the sovereign debt crisis, however, surplus countries such as Germany and the Netherlands have largely stopped financing investment in lower-income member states. This reflects higher returns abroad, especially in the United States, as well as persistent financial fragmentation within the Euro area. This has constrained investment and potential growth in peripheral countries, while also reinforcing income disparities across the Euro area.

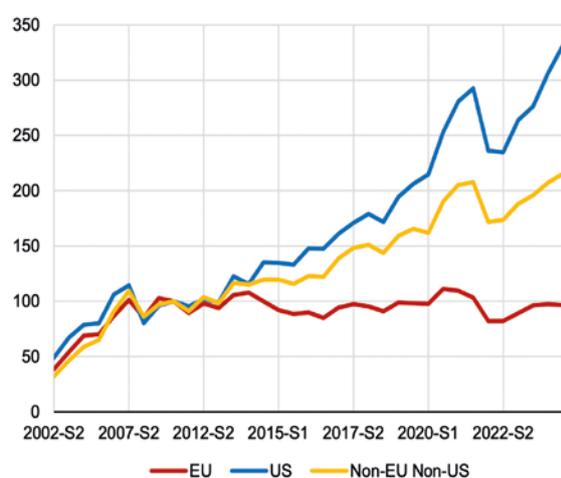
2.3.1 Around EUR 300 billion of savings flow out of the EU in net terms every year, primarily funding investment in the United States

According to the EU Commission, an average net savings of more than EUR 300 billion (approximately 25%) has flowed into foreign assets each year since 2015, reaching EUR 437 billion in 2024. These savings are primarily invested in foreign direct investment, equity and bonds. The US has been the main destination for these funds,

CHART 20.

Capital flows within and outside the Euro area

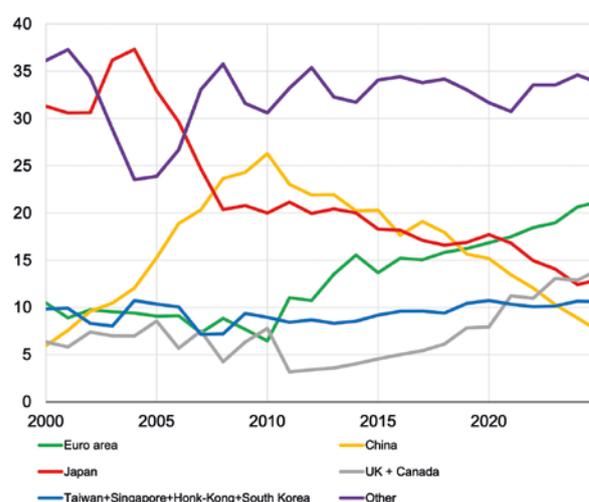
Chart 20a : Outstanding amount of equity and bonds held by EU countries, 2002 = 100



Source: Economics, based on data from the IMF (CPIS dataset)

Notes: the EU includes France, Germany, the Netherlands, Belgium, Ireland, Spain, Italy, Sweden, Denmark, Finland; last observation: December 2024

Chart 20b : Share of US Treasuries held by non-residents, breakdown by holder (%)



Source: Economics, based on data from the US Treasury Department

Notes: the Euro area includes France, Germany, the Netherlands, Belgium, Ireland, Spain, Italy and Luxembourg; last observation: October 2025

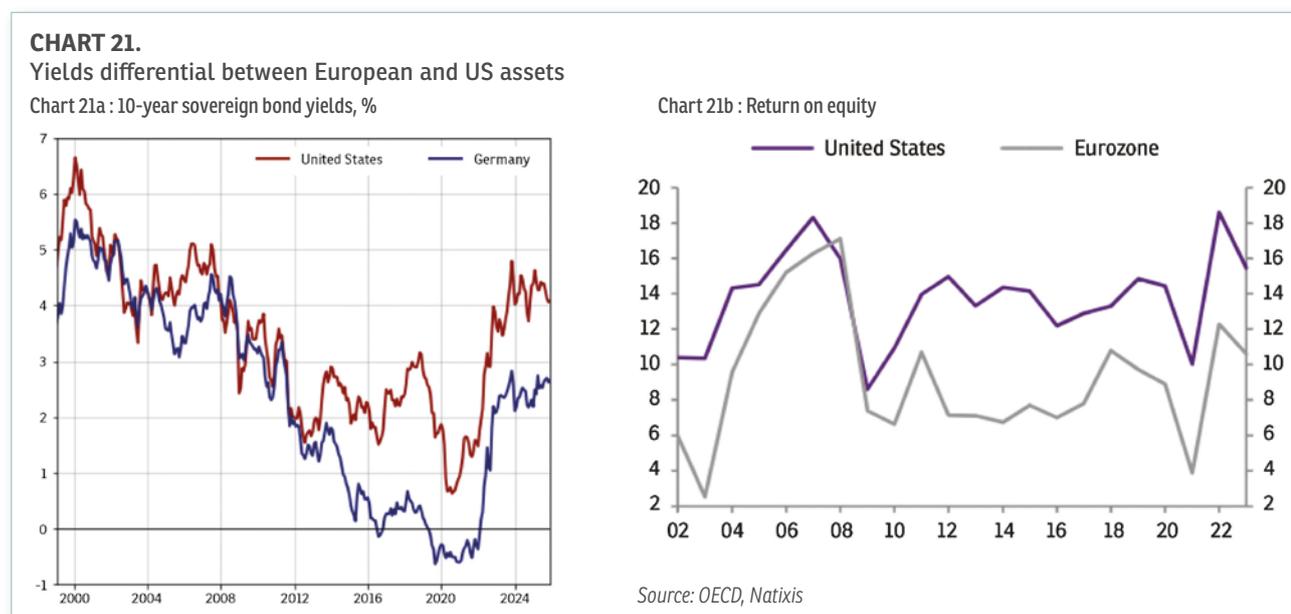
particularly for portfolio investments. Between 2016 and 2024, the EU financed around 40% of the US external deficit. According to IMF data, of the total portfolio assets held by European residents amounting to USD 13 trillion in 2024, USD 3.5 trillion was allocated to US assets and USD 4.3 trillion to European assets. The stock of US assets held by European residents has grown much faster than that of European assets, reflecting substantial capital flows towards the United States and significant valuation gains.

A significant proportion of these investments consists in US Treasury securities. Between 2003 and 2025, the stock of US federal debt held by Euro area residents increased tenfold, rising from USD 145.2 billion to USD 1.95 trillion, while total US public debt increased fivefold over the same period. Consequently, by October 2025, Euro area residents held over 20% of US public debt owned by non-residents, surpassing China (8.7%) and Japan. As of today, European governments and private investors own over USD 3.4 trillion or 11.6% of US government securities⁹.

2.3.2 US financial markets remain particularly appealing to European institutional investors thanks to their liquidity and relatively high returns

H. Tran¹⁰ also highlights that investment flows to the United States are driven by the higher returns offered by US equity markets compared to those in the EU. The average annual nominal return on US equities was 9.6% between 1900 and 2020, compared to 7.2% in Europe. As long as it remains, savings from the EU and the rest of the world will be attracted to the US, where foreign investors currently own 40% of the stock market.

According to McKinsey¹¹, between 2015 and 2022, corporate Europe's return on invested capital was four percentage points lower than in the US. Over this period, large public companies in Europe achieved a return on invested capital of around 14%, compared to approximately 18% in the US. Europe's lower returns undermine investment at a time when capital is becoming scarcer. The widest gap is in technology, hardware, software, services, and pharmaceuticals. In contrast, Europe's more fragmented, bank-based financial system provides fewer opportunities for financial investment.



The development of cross-border financial flows within the Euro area is essential. One of the key objective of a currency area is to allow savings flows to finance the most productive investments within the area. Indeed, in a monetary union, the elimination of currency risk allows savings from countries with a high level of capital per capita (Germany, the Netherlands, France) to finance investment in countries with a lower level of capital per capita and a higher marginal productivity of capital (e.g. Spain, Italy, Portugal). Thus, income convergence usually results from the transfer of savings from the former to the latter. However, as mentioned above, such transfers disappeared after the 2008-2010 period.

9. R. Shapiro, "Follow the Money: Why Trump Pulled Back From Invading Greenland", Washington Monthly, 27 January 2026.

10. H. Tran, "The Enrico Letta Report and the state of the EU's Capital Market Union", Atlantic Council, 7 May 2024.

11. McKinsey Global Institute, "Investment: Taking the pulse of European competitiveness", June 20, 2024.

This phenomenon is here to stay. In fact, the Euro area is not a true monetary union. We have to take into account a structural feature, which is the increasing industrial specialisation of the surplus countries. Success breeds success. Aided by the implicit devaluation resulting from favourable cost developments, the surplus countries' exports are becoming more profitable.

It would be illusory to believe that southern or eastern European countries could copy the structural advantages of German exports, given their different industrial histories. These countries cannot become the next Ruhr, whereas the Ruhr is becoming stronger.

2.4 The Stability Pact rules have too often been ignored in some countries

2.4.1 France, Greece, Portugal and Spain had deficits above 3% of GDP for more than 15 years

Between 2000 and 2025, France recorded a deficit exceeding 3% of GDP for 20 years. This was followed by Greece (18 years), Portugal (17 years), Spain (16 years), Italy (14 years) and Belgium (12 years). By contrast, Germany, Austria, the Netherlands and Finland did not exceed 10 years in which the 3% rule was not respected (9, 8, 6 and 4 years, respectively).

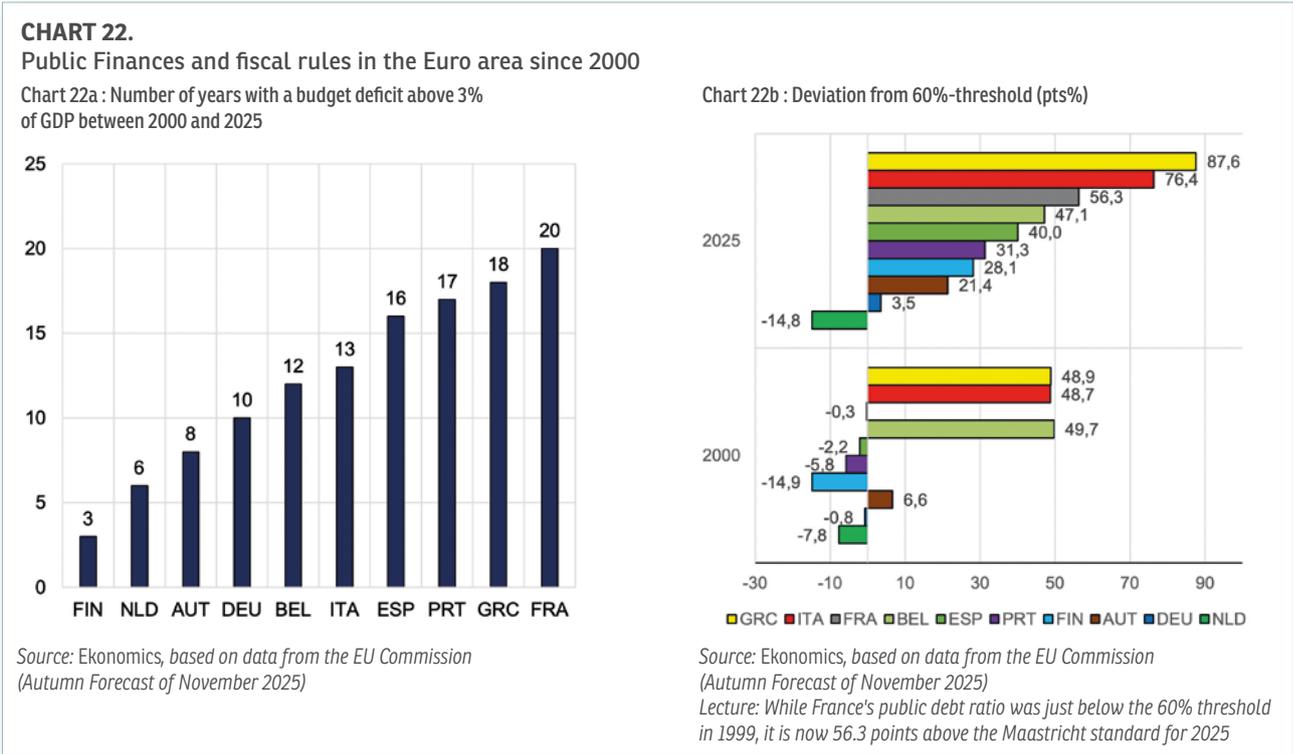
It should be noted that most of these deficits occurred outside of periods of crisis. For example, between 2014 and 2019, a period of relative economic stability, France, Spain, Belgium and Italy recorded average annual deficits of 3.4%, 4%, 2% and 2.3% of GDP respectively, while Germany and the Netherlands posted surpluses ranging from 0.2% to 1.2% of GDP. France and Spain in particular stand out for maintaining high primary deficits exceeding 1% of GDP, whereas the others recorded primary surpluses (fiscal balances excluding interest payments).

2.4.2 The accumulation of deficits has resulted in diverging public debt ratios among Member States

Despite the various reforms adopted after the sovereign debt crisis to improve economic governance in the Eurozone, public debt-to-GDP ratios have continued to rise in major countries such as France, Italy, Belgium and Spain. These ratios are approaching – and in some cases exceeding – 110% of GDP.

In contrast, countries such as the Netherlands and Germany have maintained a public debt-to-GDP ratio of around 60% or less.

Consequently, fiscal fragmentation has increased over the past 25 years. According to European Commission forecasts, French public debt could reach 56.3 percentage points above the 60% Maastricht threshold in 2025, compared with 0.3 percentage points below it in 2000; in Spain, the gap would widen from -2.2 points to 40 points; and in Italy, it would increase from 48.7 to 76.4.



2.4.3 Against a backdrop of slowing growth and rising interest rates, highly indebted countries will increasingly be at risk of debt sustainability issues in the years ahead. There will also be growing fiscal divergence among member states

Since 2022, the gap between slowing growth and rising interest rates has worsened, accelerating the public debt trajectory in highly indebted countries. While some countries, such as those in southern Europe, have offset this through fiscal adjustments that prevent an increase in public debt, others, including France and Belgium, continue to run primary budget deficits that are incompatible with stabilising their public debt. This increases their vulnerability, exacerbates divergence, and ultimately poses a risk to the euro.

TABLE 1.

Fiscal and economic aggregates for the main EU Member States

	Gross public debt (% of GDP)				Interest payment (% of GDP)				Real GDP growth (year-on-year, %)				Primary budget balance (% of GDP)			
	2024	2025	2026	2027	2024	2025	2026	2027	2024	2025	2026	2027	2024	2025	2026	2027
France	113,2	116,3	118,1	120,0	2,1	2,3	2,5	2,8	1,2	0,7	0,9	1,1	-3,7	-3,2	-2,3	-2,5
Belgium	103,9	107,1	109,9	112,2	2,2	2,4	2,6	2,8	1,1	1,0	1,1	1,3	-2,1	-2,9	-2,9	-3,1
Italy	134,9	136,4	137,9	137,2	3,9	3,9	4,0	4,1	0,7	0,4	0,8	0,8	0,5	0,9	1,2	1,5
Spain	101,6	100,0	98,2	97,1	2,4	2,5	2,6	2,6	3,5	2,9	2,3	2,0	-0,8	0,0	0,5	0,6
Portugal	93,6	91,3	89,2	88,2	2,1	2,1	2,2	2,2	2,1	1,9	2,2	2,1	2,6	2,2	2,0	1,8
Greece	154,2	147,6	142,1	138,0	3,5	3,3	3,1	3,2	2,1	2,1	2,2	1,7	4,7	4,3	3,4	3,2
Austria	79,9	81,4	82,8	83,9	1,5	1,7	1,8	1,9	-0,7	0,3	0,9	1,2	-3,2	-2,7	-2,3	-2,4
Finland	82,5	88,1	90,9	92,3	1,6	1,6	1,8	2,0	0,4	0,1	0,9	1,2	-2,8	-2,8	-2,2	-2,0
Germany	62,2	63,5	65,2	67,0	1,1	1,2	1,2	1,2	-0,5	0,2	1,2	1,2	-1,6	-1,9	-2,8	-2,6

Source: Economics, based on data from the EU Commission (Autumn Forecast of November 2025)

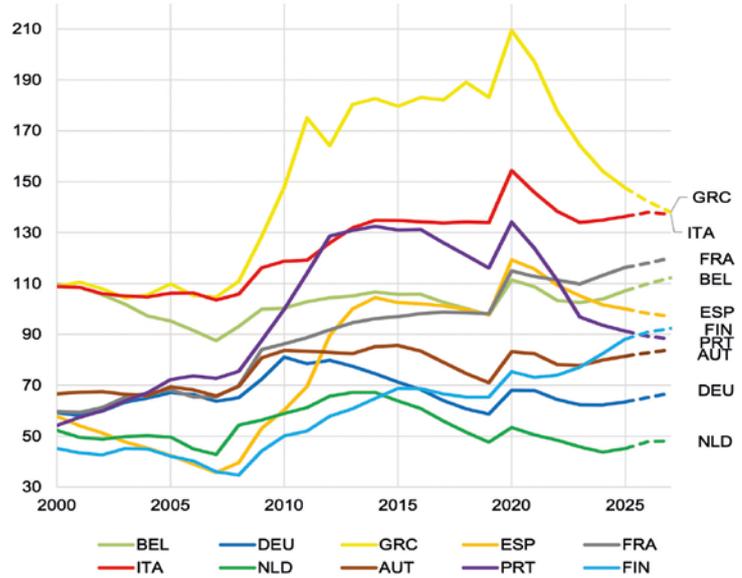
By 2026, it is expected that five Euro area countries will have a public debt ratio above 90% of GDP. Greece (142.1%), Italy (137.9%), France (118.1%) and Belgium (109.9%) are expected to exceed this threshold, while Portugal (89.2%) is expected to fall just below it. Spain (98.2%) and Finland (90.9%) will be close to the 90% threshold, while Portuguese debt (89.2%) will fall below it from 2026 onwards.

While all highly indebted countries face a sustained increase in their interest burden, their fiscal trajectories diverge sharply in terms of deficits. Three groups can be identified among highly indebted countries:

1. **Current budget deficits are incompatible with debt stabilisation in France and Belgium.** In 2026, the primary deficit in France is expected to exceed 2% of GDP for many years, reaching 2.3%. Meanwhile, the primary deficit in Belgium is expected to reach 2.9%, also exceeding the 2% threshold. These figures are well above the levels required to stabilise public debt (0.6% and 0.7%, respectively). The rising interest burden, expected to reach 3% of GDP in both countries by 2027, together with a pronounced slowdown in economic growth, has a significant impact on public debt dynamics in both countries. According to the European Commission's November 2025 forecasts, debt would reach 120% of GDP in France by 2027 (6 percentage points higher than in the Covid-19 year) and 109% in Belgium.
2. **Fiscal surpluses will initiate the stabilisation, or even a decline, in public debt in Italy, Spain, Portugal and Greece.** All of these countries are expected to achieve primary surpluses: 2% of GDP in Portugal, 3.4% in Greece, 1.2% in Italy and 0.5% in Spain. These surpluses would enable their public debt to stabilise or even decrease over the next two years. The public debt ratios of Portugal and Greece are expected to continue falling, with the latter projected to reach Italy's level for the first time since 2007.
3. **By maintaining primary deficits above 2% since 2020, Finland and Austria are moving away from their tradition of fiscal discipline and gradually joining the group of the most indebted countries.** Austria has consistently recorded primary deficits above 2% of GDP since 2024, whereas it posted average surpluses of 1.3% before the pandemic. Consequently, its debt is expected to reach 82.8% of GDP, compared with 70% prior to the Covid-19 crisis. Finland's debt was still at 63% of GDP in 2019, but it is expected to cross the 90% threshold in 2026 due to a series of deficits above 2% since 2020.

Although German public debt is expected to remain well below the 65.2% of GDP threshold in 2026, a weakening of fiscal discipline is becoming apparent. Germany is expected to have one of the highest primary deficits in Europe in 2026, at 2.8% of GDP – higher than France's, which is expected to be 2.3%. Only Poland and Romania are expected to have higher levels that year.

CHART 23.
Gross Public Debt, as % of GDP



Source: Ekonomics, based on data from the EU Commission (Autumn Forecast of November 2025). Dashed lines represent projections through 2027

All of the above shows that the Member States have not taken control of their own destiny by ensuring the minimum level of coordination necessary to make the system work better.

The current intensity of fiscal and economic divergence between EU countries makes it harder to establish a shared interest within the European context. It encourages the current “every man for himself” policy and fosters a climate of mistrust between Member States, which ultimately hinders progress in terms of public and private risk sharing and weakens the Eurozone. Consequently, it is notably harder to achieve global objectives (e.g. the green transition, digitalisation, defence, social redistribution and migration) while maintaining such divergent fiscal policies.

As long as Member States – especially the largest ones – do not properly understand that excessive debt makes them uncompetitive, their economic situation will continue to deteriorate, thus making the move towards shared public and private risk-taking all the more difficult.

3. The EU countries with the highest levels of government expenditure as a percentage of GDP also have the least competitive companies

3.1 At 57.8% of GDP in 2025, France has one of the highest level of public spending in the EU

Between 2000 and 2025, public spending in the European Union increased generally, rising from 47.4% to 49.6% of GDP. This is approximately 10 percentage points higher than in the United States, where it stood at 39.6% of GDP, as shown in Chart 24a. However, this overall trend masks significant disparities among member states.

In 2025, four countries recorded public expenditure exceeding 55% of GDP (see Chart 24b): France, which recorded public spending of 57.8% of GDP in 2025, had one of the highest levels of public expenditure in Europe, alongside Finland (58.9%), Austria (55.2%), and Belgium (54.6%). These countries share a common feature: since 2000, their spending has grown at twice the EU average.

This is in stark contrast to the 17 countries whose public spending was below 50% of GDP in 2025. Notable examples in this group include Denmark (49.4% of GDP), Greece (48.4%), Spain (45.5%), Portugal (44.1%) and the Netherlands (45%), all of which have experienced significant reductions in public spending over the past decade. Among the countries most affected by the sovereign debt crisis, Greece and Portugal cut their public expenditure by more than three percentage points between 2014 and 2025.

A third group of countries occupies a middle ground, with public spending hovering between 50% and 51% of GDP in 2025. Germany (50.6% of GDP) and Italy (50.7%) are in this category, though their fiscal trajectories have diverged over the past five years. Traditionally below the European average, Germany's public spending has risen since 2024 and is expected to continue rising due to new military and infrastructure investment programmes announced in 2025. In contrast, Italy's public spending, which remained above 52% until 2023 due to the 'Superbonus' scheme, is now converging back towards 50% of GDP.

CHART 24.
Public expenditures in the European Union, % of GDP

Chart 24a: Public expenditures across the main Member States since 1995, % of GDP

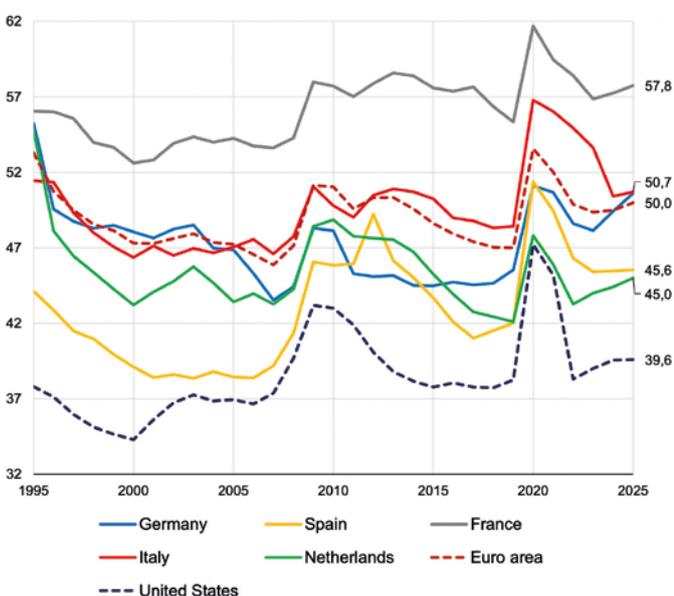
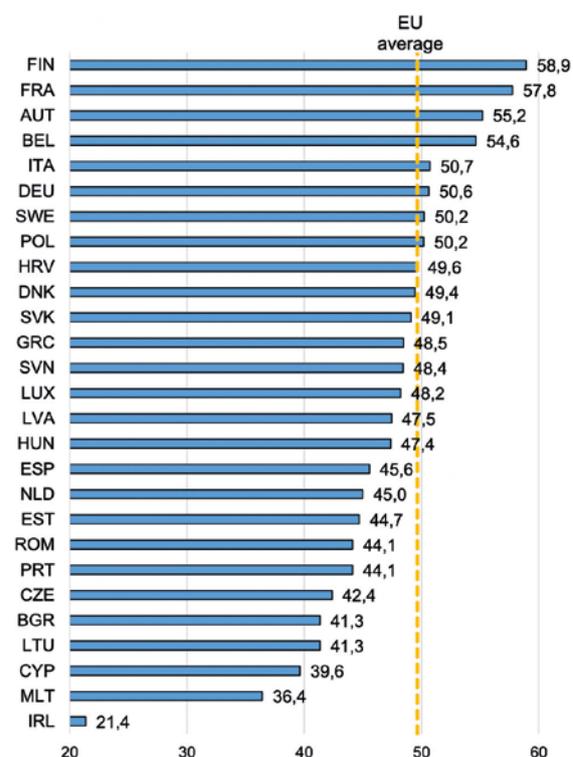
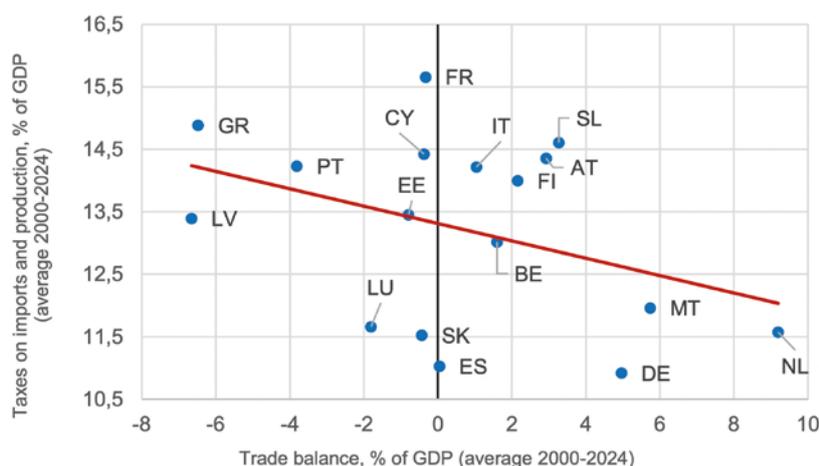


Chart 24b: Public expenditures in 2025, % of GDP



Source: Economics, based on data from the EU Commission (Autumn Forecast of November 2025)

CHART 26.
Corporate taxation and competitiveness across Euro area Member States



Source: Economics, based on data from the European Commission

CHART 27.
Trade Balance in France and Germany, EUR bn

Chart 27a : France

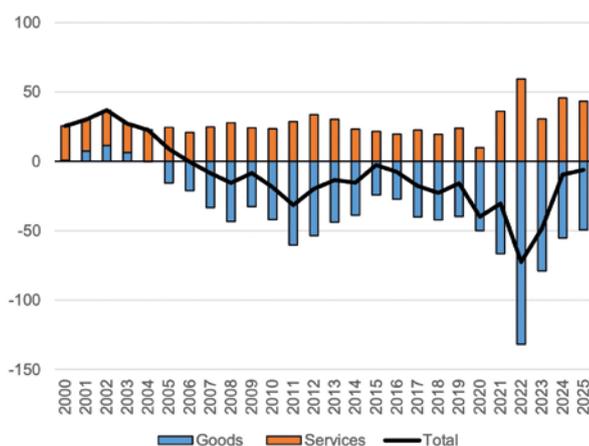
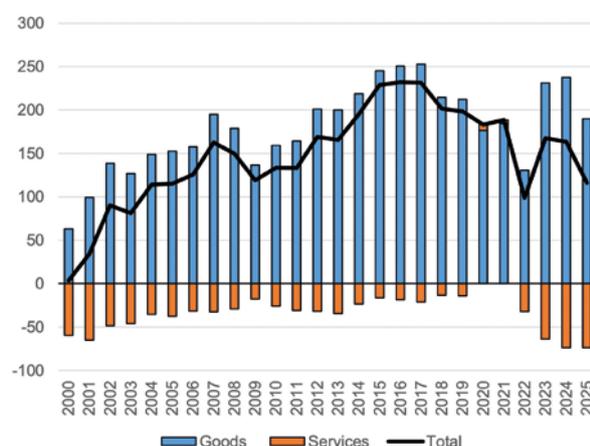


Chart 27b : Germany



Source: Economics, based on data from the EU Commission (Autumn Forecast of November 2025)

3.3 Most government expenditures are allocated to social protection, health and public services

On average, Euro area countries allocated 40% of their public expenditure to social spending in 2023, *i.e.* 20.1% of GDP (see Chart 28). France and Finland had the highest shares as a percentage of GDP at 23.3% and 25.7%, respectively. Healthcare is another significant area of public spending in the Eurozone, accounting for 15% of total expenditure in 2023, followed by general public services (12%). **Public pensions account for the largest proportion of social expenditure, which has increased significantly since 2000 (see Chart 29a).** In 2023, they accounted for 11.9% of the Eurozone's GDP. This figure is closely linked to the average age at which people leave the labour market (see Chart 29b). In most EU countries, the earlier people retire, the higher the total cost of pensions. France, which has one of the lowest average retirement ages in the EU (62.6 years), has one of the most expensive pension schemes, accounting for 14.1% of its GDP in 2019 compared to the Eurozone average of 11.9%.

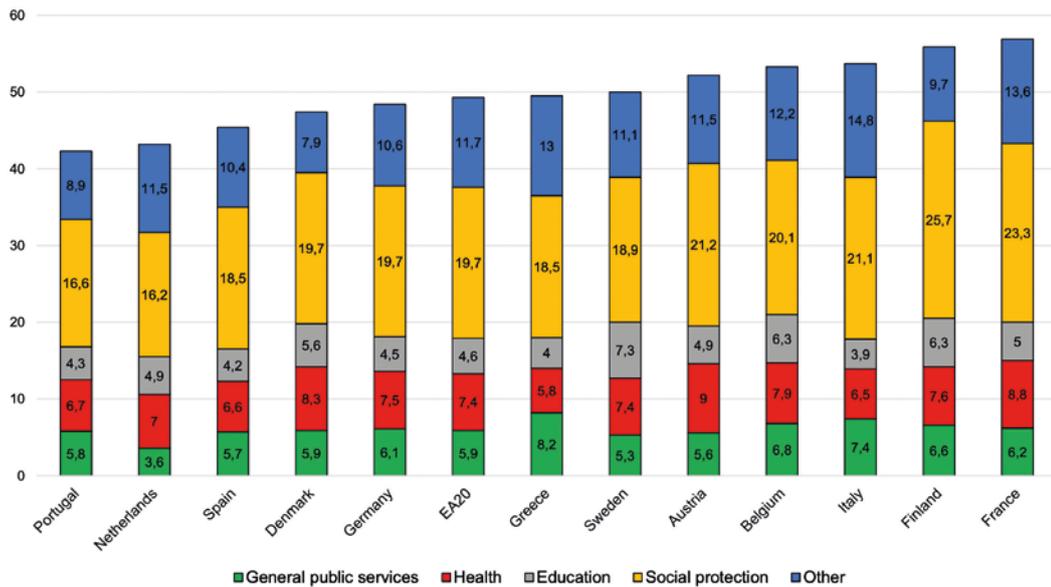
This issue is exacerbated by demographic ageing, with the proportion of elderly individuals growing while the working-age population shrinks. By 2030, the proportion of people aged 65 and over is expected to rise to 23.7% (up from 21.4% in 2023), while the proportion of the working-age population (25–64) is expected to decrease to 35.6% (down from 36.5% in 2023).

In Italy, despite having one of the highest average effective retirement ages in the EU, the pension system remains one of the most expensive for the government in terms of GDP. There are three main reasons for this:

- **The generosity of the system.** In 2022, the replacement rate – *i.e.* the percentage of an individual's annual earned income replaced by pension income – was 15 percentage points higher than the EU average (59.3% in Italy compared to 44.2% in the EU).

CHART 28.

Major Functions of Public Expenditures of Selected EU Member States, % of GDP (2023)



Source: Economics, based on data from Eurostat

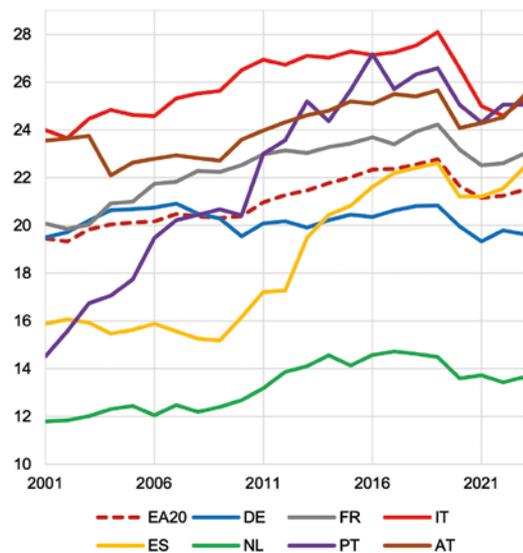
Notes: 'Other' includes Defence, Public Order and Safety, Economic Affairs, Environmental protection, Housing and community amenities; Recreation, culture and religion

- **The persistently low employment rate.** In 2019, 64.8% of people aged 20–64 were employed. This was the second lowest employment rate in the EU, just above Greece (66.3%), and almost 10 percentage points below the EU average (74.1%).
- **The ageing population.** Italy's demographic decline is one of the most pronounced in the EU. By 2023, 24.2% of the Italian population will be aged 65 or over. This is the highest proportion in the EU, which averages 21.8%. This contributes to a further deterioration in the old-age dependency ratio (population aged 65 and over relative to the working population (20–64)). This ratio is expected to reach 48% in 2030 (compared with 43.3% in the EU), up from 37.3% in 2023.

CHART 29.

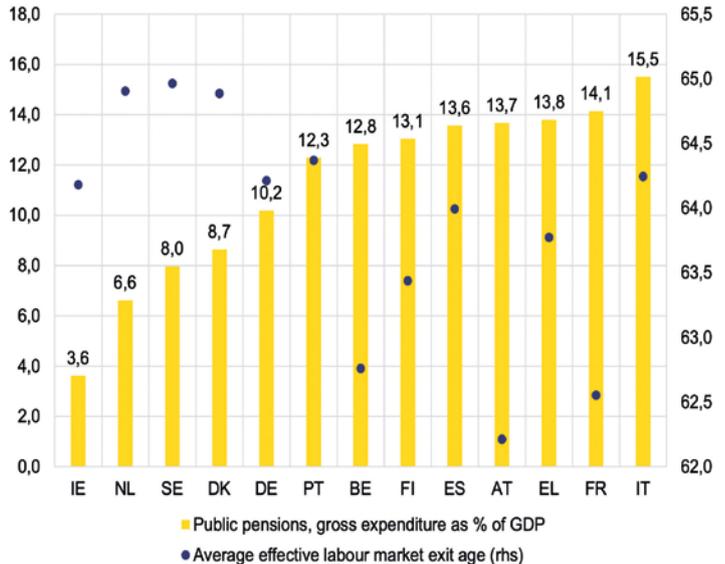
Public pensions and labour market exit age

Chart 29a : Gross public pensions expenditures, as % of total public expenditures



Source: Economics, based on data from Eurostat

Chart 29b : Public Pensions Spending and Labour Market exit age in selected EU Member States in 2023



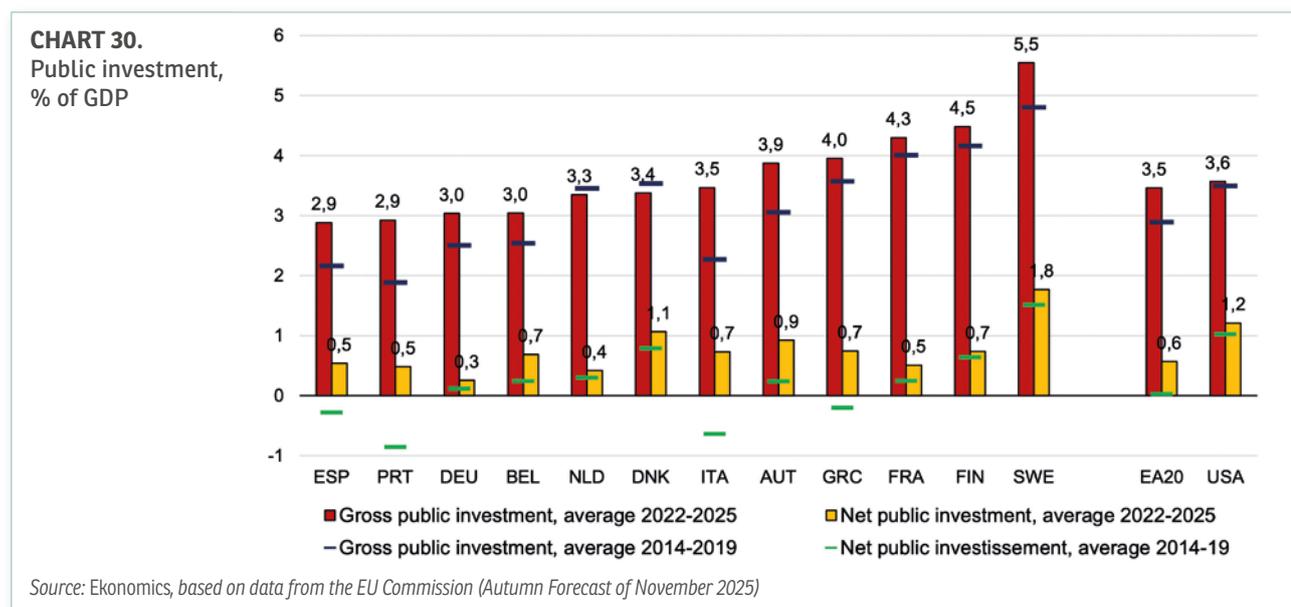
Source: Economics, based on data from the Ageing Report, EU Commission (May 2024)

3.4 This level of public spending has been achieved at the expense of productive investment

Apart from during periods of crisis, the proportion of public investment has never exceeded 3.5% of GDP in the Eurozone since 1996. Moreover, amid rising public expenditure, the proportion of public investment in total public spending decreased in several member states between 2007 and 2024.

Following a peak of 3.4% of GDP in 2007 – the highest level outside the crisis period – the ratio of public investment to GDP in the Eurozone declined gradually to 2.8% in 2017 (see Chart 52), before rising slightly to 3% in 2019. With an average of 2.8% of GDP between 2014 and 2019, public investment in the Eurozone remained below that of the United States (3.5%).

This underinvestment at the EU level was largely due to Germany, where public investment never exceeded 2.7% of GDP between 1995 and 2019. Spain and Italy also contributed to this decline by investing less than 2.5% of GDP between 2012 and 2018.



While France has a relatively high level of gross investment compared to its neighbours, this is not reflected in net investment. When adjusted for capital depreciation, the flow of new investment aimed at increasing the capital stock is similar in both countries, averaging 0.2% of GDP per year between 2014 and 2019 (see Chart 30).

In the Euro area, net public investment remained close to 0% of GDP during this period. Although this figure has recovered to around 0.6% of GDP in the post-Covid-19 period, it remains almost half that of the United States.

The situation is even worse for some southern European countries, where net investment was negative in the years following the sovereign debt crisis. This means that investment levels were so low that they did not even compensate for the depreciation of the public capital stock.

Although current expenditure has increased in some key EU member states, the share of public investment in total public expenditure has declined by around 0.5 percentage points overall at the EA level between 2007 and 2025, from 7.6% to 7.1%. At an average of 6.1% between 2014 and 2019, the Euro area's share of public investment is one of the lowest among other advanced economies, such as the United States (9.3%) and Switzerland (9.5%).

Although public investment has rebounded in some highly indebted countries and reached historically high levels since 2022, this must be considered alongside the increase in interest expenditure.

Among the largest EU member states, Germany and Belgium have increased the proportion of public investment in total government expenditure over the past 25 years, although their level of gross fixed capital formation remains among the lowest in Europe.

The most indebted Member States have experienced the sharpest decline in the proportion of expenditure allocated to public investment over the past two decades. While France allocated an average of 8% of its total expenditure to investment in 2000, it dropped to 7.4%. There was also a marked fall in southern countries such as Italy, Spain, Portugal and Greece.

As the EU Commission states, such a decline in highly indebted countries suggests that 'the accumulation of public debt has not resulted in a higher capital stock, indicating that deficit spending has not been channelled into investment, but rather into financing consumption'. In other words, these data show that countries with the highest public debt invest less to increase their growth potential and prepare for the future.

Public investment now exceeds 2% of GDP in the Southern countries such as Spain, Portugal, Greece and Italy, driven notably by the NGEU. However, these recoveries must be weighed against the rise in interest rates, with interest expenditure exceeding or approaching 3% of GDP as a result of high public debt. It is important to note that rising interest burdens typically force cuts to future-oriented spending in order to be financed, which can weigh on future growth.

CHART 31.
Public investment and interest payment across the most indebted EU Member States, % of GDP

Chart 31a : Gross fixed capital formation, public sector, % of GDP

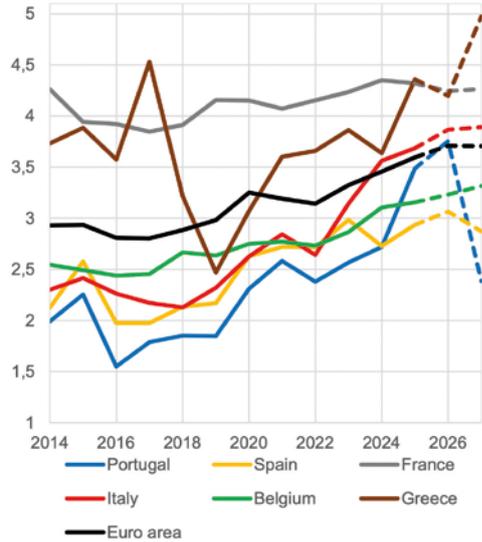
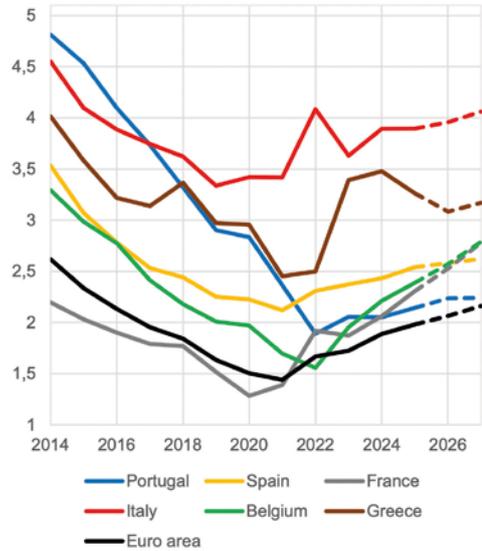


Chart 31b : Interest payment, public sector, % of GDP



Source: Ekomics, based on data from the EU Commission (Autumn Forecast of November 2025)

4. An excessive level of government debt does not boost productivity or employment

4.1 Over the last two decades, the countries in the Eurozone with the highest levels of debt have achieved the lowest productivity growth

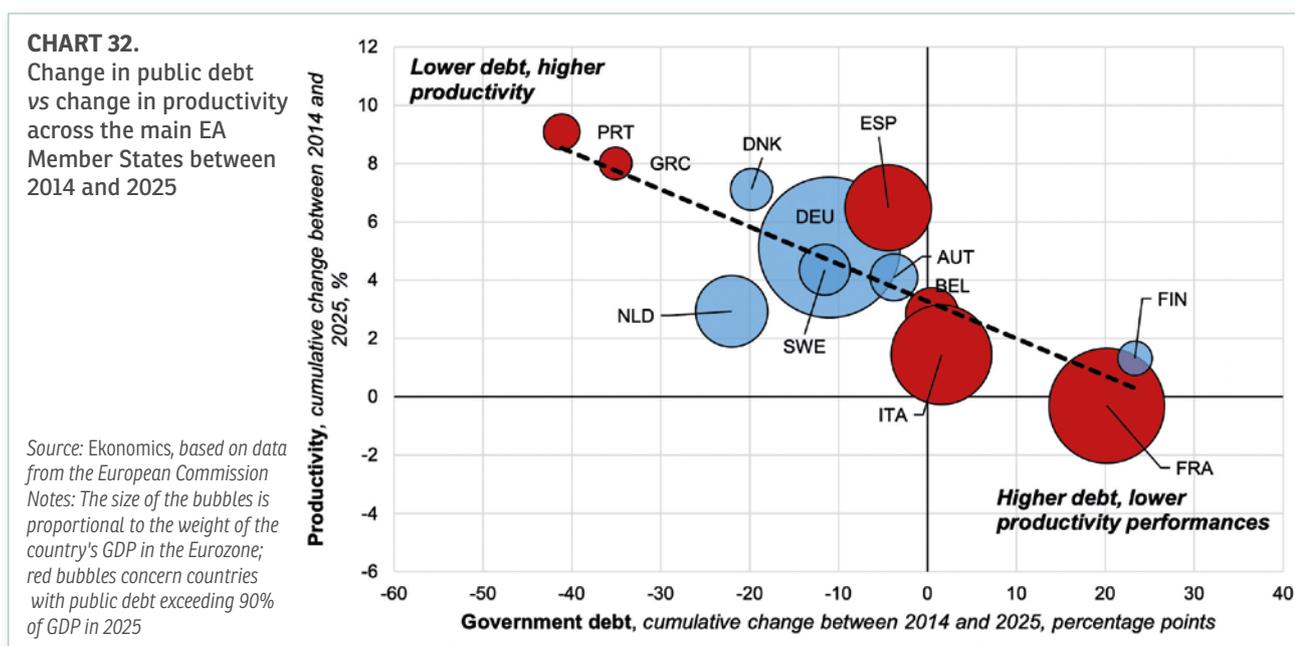
Those that have experienced the greatest increase in public debt since 1999 and have recorded the weakest performance in terms of total factor productivity growth and recorded the weakest total factor productivity growth are the member states that have performed the worst¹². While public debt increased by 30 and 60 percentage points respectively in Italy and Spain between 1999 and 2025, productivity growth remained below 10% in both countries and even declined by 1% in Italy – performances well below the European average of +13%.

In contrast, productivity gains were almost twice as high in countries where public debt rose moderately or fell over the same period. These are essentially member states whose public debt did not exceed 80% of GDP in 2024, such as Austria, the Netherlands and Germany.

This negative correlation between public debt and productivity gains highlights the detrimental effect that excessive reliance on public debt can have on the supply side of the economy by undermining incentives for long-term investment and innovation. This is detrimental to productivity.

These differences in productivity result in variations in living standards across the Euro area. K. Knot, former Governor of De Nederlandsche Bank, stated that this issue is worrying¹³, "because it threatens the coherence of the Economic and Monetary Union [...]. Resilience is about balance [...]. If you put more pressure on one leg than the other, you are bound to get some serious health problems at some point. That is not what the patient needs [...]. What the patient needs is some care to wean it from its dependence on debt and to bring back balance in economic growth."

The inverse relationship between changes in productivity and public debt became even more pronounced between 2014 and 2025, as economic and fiscal divergences widened. In particular, France, Italy and Spain experienced an increase in public debt accompanied by a decline in productivity. However, this relationship cannot be generalised to all highly indebted economies. Despite their public debt still exceeding 90% of GDP, Greece and Portugal achieved cumulative productivity gains of over 5% between 2014 and 2025.



12. To quote the OECD: The indicator reflects the "overall efficiency with which labour and capital inputs are used together in the production process. Changes in Multifactor Productivity Growth reflect the effects of changes in management practices, brand names, organisational change, general knowledge, network effects, spillovers from production factors, adjustment costs, economies of scale, the effects of imperfect competition and measurement errors."

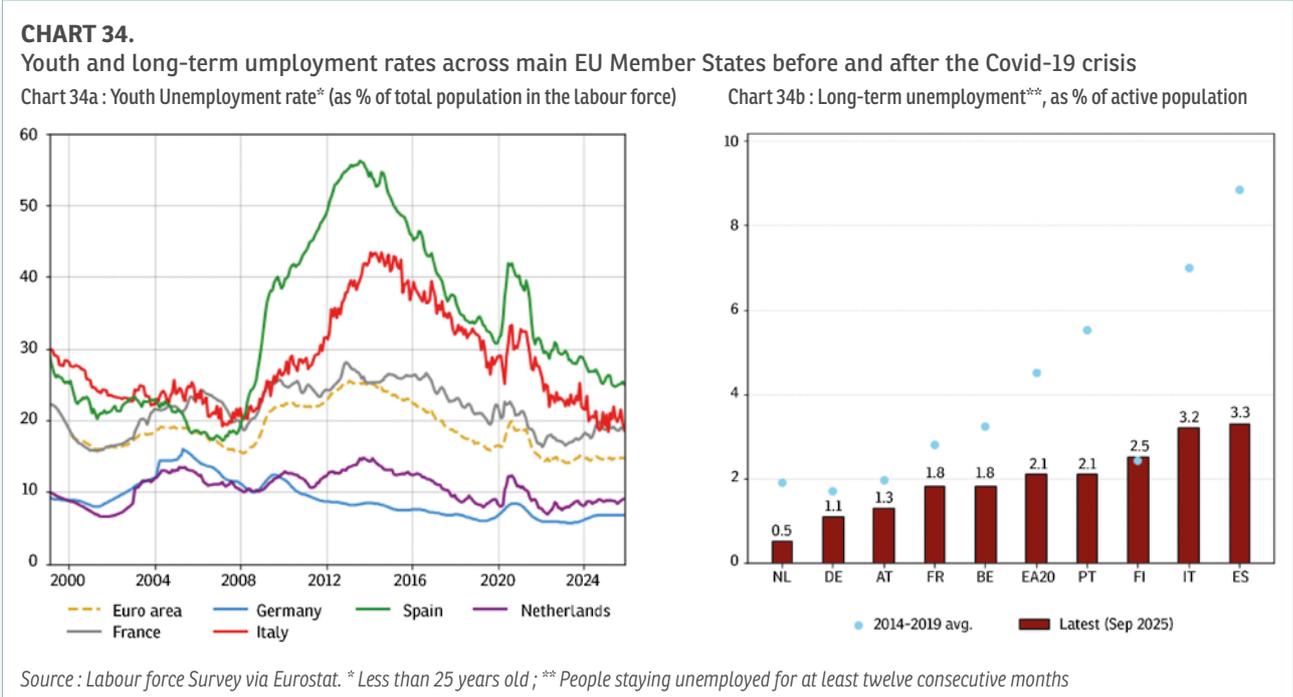
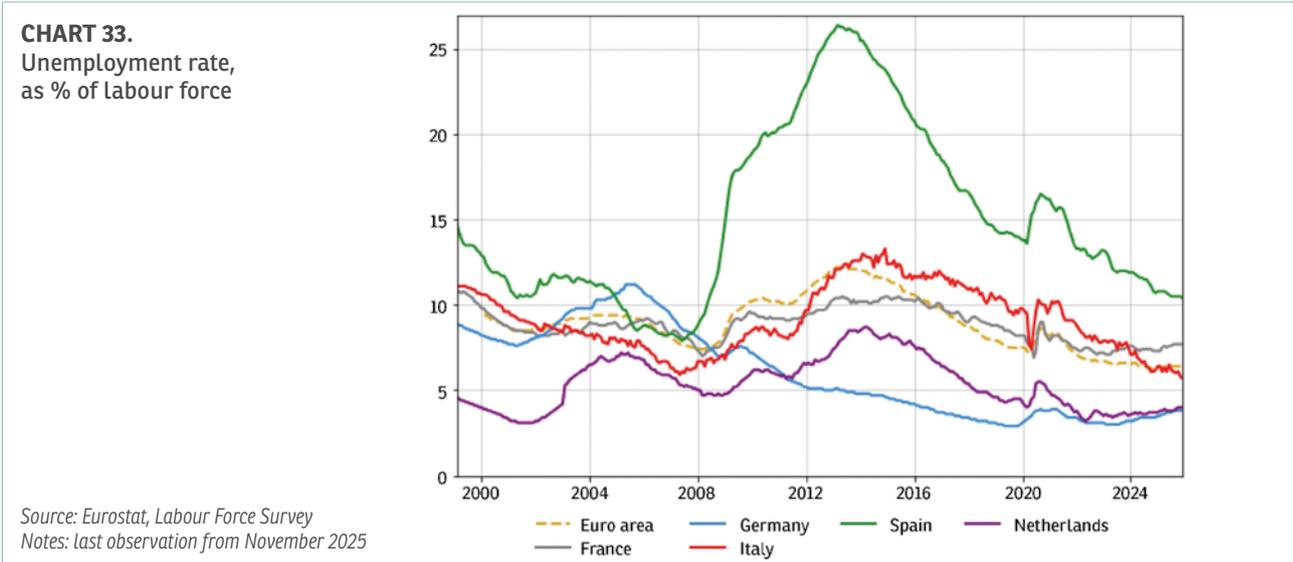
13. K. Knot, "Rebuilding resilience: meeting the challenges beyond Covid-19", Eurofi Forum, 11 September 2021.

These gains coincided with a significant reduction in public debt of over 25 percentage points. Thus, the Greek and Portuguese cases over the past decade demonstrate that reducing public debt can go hand in hand with improving economic fundamentals and can serve as a model for other indebted economies rather than causing a recession.

The outlook for Euro area public debt issuance in 2026 does not appear to deviate from current trends. Against the backdrop of persistent fiscal deficits and stagnant productivity, Eurozone governments are expected to issue a record amount of debt. The gross debt issued by the eleven largest Eurozone economies is set to increase by €100 billion, reaching €1.45–1.48 trillion in 2026 – a record level. Net issuance, defined as borrowing not used to refinance maturing debt, is expected to rise by around EUR 50 billion to reach approximately EUR 550 billion.

4.2 The most indebted EU countries have experienced the highest unemployment rates in the EU since 2007

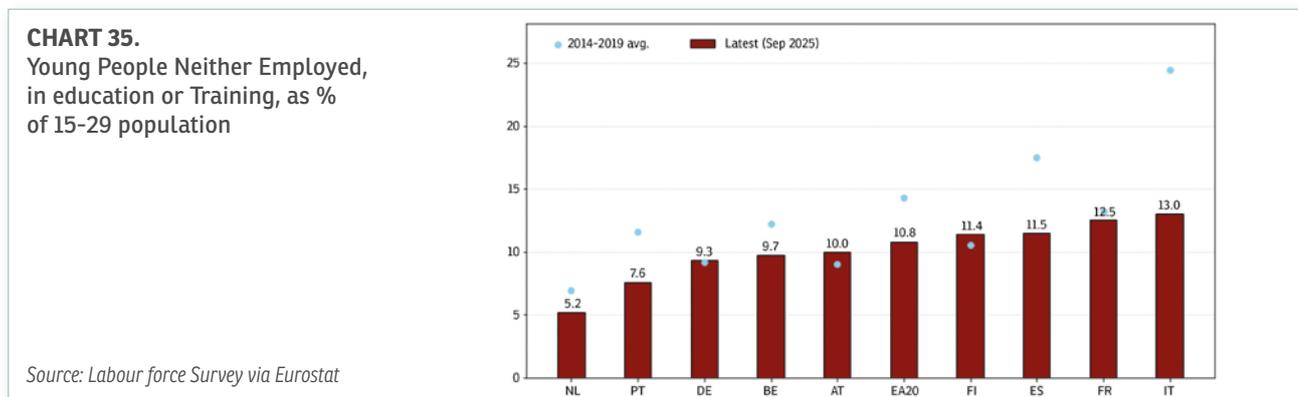
Since the sovereign debt crisis, the Eurozone has become divided into two distinct groups of countries regarding their unemployment rates. The first group comprises countries such as Germany and the Netherlands, where unemployment remains below 4% of the working population. The second group comprises countries such as France and Italy, where unemployment consistently exceeds 6%, as well as Spain, where it exceeds 10%.



Although there has been a positive trend since the end of the pandemic, unemployment in these countries appears to be structural, as reflected in persistently high levels of youth and long-term unemployment.

As of November 2025, Spain and Greece had the highest unemployment rates for 15–29-year-olds in Europe (25% and 16.6%, respectively). Despite record spending on education and job training (5% of GDP in 2023 compared to 4.6% in the Eurozone), France also had the highest youth unemployment rate (18.5%, compared to 14.6% in the Eurozone). In contrast, less than 10% of young people were unemployed in Germany (6.8%) and the Netherlands (9.1%).

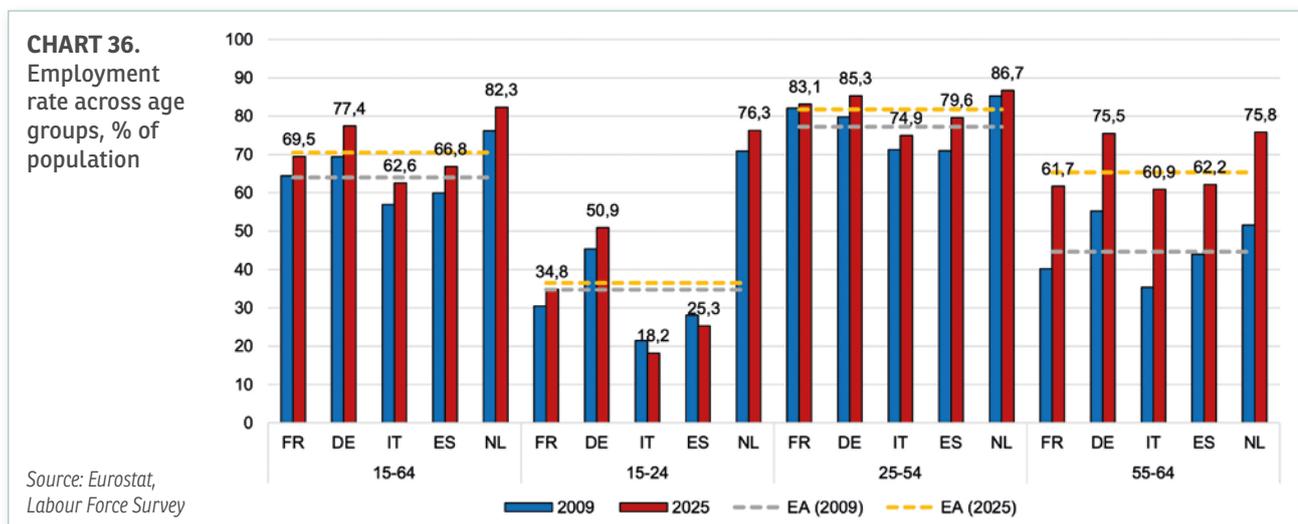
In most southern EU Member States, a higher proportion of the unemployed struggle to find a job. In the first quarter of 2025, more than 3% of the labour force in Spain and Italy had been unemployed for over 12 months (see Chart 34b). **The high youth unemployment rate in some EU countries highlights the difficulties young people face when trying to enter the labour market.** This has led to an increase in the number of ‘NEET’ youth (young people who are not in education, employment or training). In Italy, for instance, 14.8% of individuals aged 15–29 were in this situation in 2025, representing the highest proportion in the EU (see Chart 35). However, compared with the previous decade, progress has been made, with the proportion of NEETs in Italy falling by almost 10 percentage points. This brings Italy closer to France, where the proportion has remained almost unchanged.



4.3 The employment rate in France, Spain and Italy is almost 10 percentage points lower than in Germany and the Netherlands

Two distinct groups emerge within the Eurozone:

- The ‘economically virtuous’ nations, where the employment rate (employment/working age population) exceeds 70%. These include the Netherlands, Germany and Austria, and Portugal since 2021.
- In several countries as Italy and Spain, the employment rate remains below 65%. As illustrated in Chart 36, the gap between northern and southern Euro area nations is largely due to weak labour market integration among young people (aged 15–24) and older workers (aged 55–64).

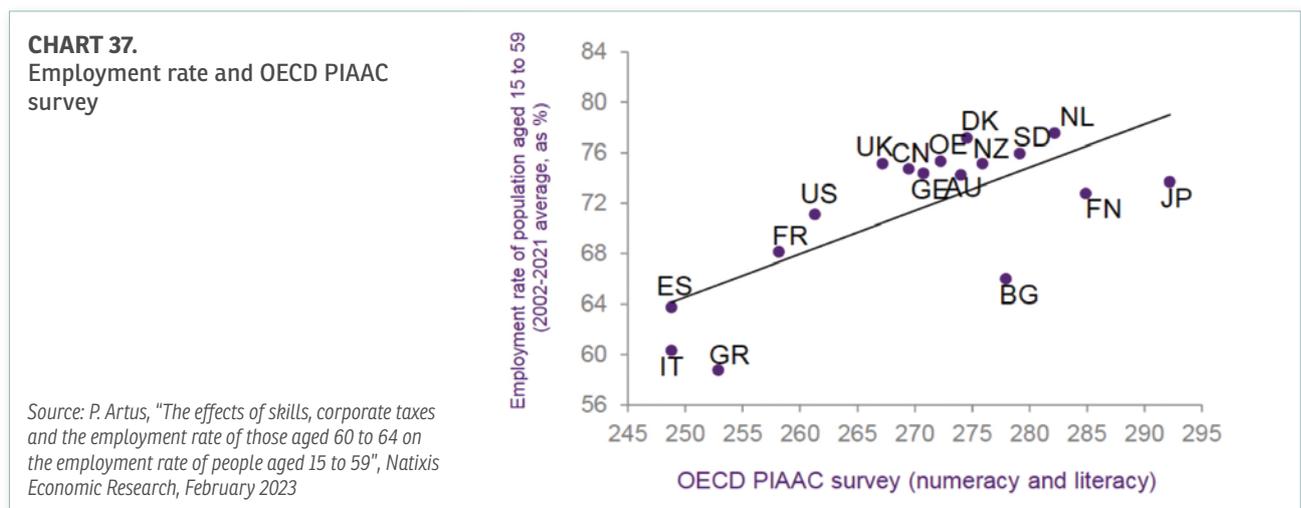


In mid-2025, 69.5% of people aged 15 to 64 were employed in France, compared to 77.4% in Germany.

This difference is primarily due to the employment rate of 35% for 60–64-year-olds in France in 2021, compared to 62% in Germany. As the effective retirement age is lower in France, workers leave the labour market earlier than in Germany.

In addition, the persistent employment gap between the two countries results from other factors: (I) a lack of appropriate skills; and (II) a tax burden that forces businesses to make trade-offs, such as relocating activities and reducing domestic employment and investment.

Workforce skills account for 53% of the employment rate gap between OECD countries, while corporate contribution and tax burdens on production explain 35%. As P. Artus highlights¹⁴, countries with a low-skilled labour force have the lowest employment rate (see Chart 37). France is close to the bottom quarter of OECD countries in terms of adult skills and the scientific abilities of young people. It also has the second highest tax burden on production in Europe after Sweden (17% of GDP compared to 13.2% in the Euro area in 2022 (see Part 4).



The persistently low employment rate is closely linked to public finances and inequality. With fewer people employed and fewer firms producing domestically, government revenue is reduced. Increasing the employment rate would increase tax revenue and thus create fiscal space.

There is a negative correlation between income inequality (before redistribution) and the employment rate. This relationship is strongest in countries undergoing deindustrialisation, where job quality and incomes have deteriorated. This is because workers' living standards have fallen in line with per capita productivity; wages in manufacturing are relatively higher than in the rest of the economy.

4.4 In economies where deindustrialisation is occurring, 'bad jobs' are more common. These jobs tend to be low-skilled and insecure

Although employment rates have increased over the past decade, the quality of jobs has deteriorated in some EU Member States. This is primarily the result of an increase of the services sector.

In France, for example, manufacturing employment has plummeted by over 35% since the 1980s, while employment in the services sector has increased by over 60%. Consequently, the services sector accounted for 81% of total employment in France in 2022, which is well above the Euro area average of 76.7% (see Chart 38). Manufacturing employment in France has fallen from 18.5% in 1985 to 9% in 2022 – well below the Euro area average of 12.9%.

Compared to other large EU member states, Spain and the Netherlands have experienced a particularly significant shift towards a service-oriented economy. In 2023, 79% and 83.5% of their workforces were employed in services, respectively, compared to 65.3% and 76.4% in 1995. The majority of job creation in the service sector is concentrated at the extremes of the skill spectrum: high-skilled jobs in finance, information technology, and complex business services, as well as low-skilled or unskilled positions in hotels, restaurants, distribution, transport, leisure, and

14. P. Artus, "France: is public spending the answer?", Flash Economics, Natixis (09 May 2022).

personal services. The polarisation of the labour market has led to a decline in the proportion of medium-skilled workers, who previously dominated the manufacturing sector. There has also been an increase in low-skilled or 'bad jobs', which characterised by precariousness and hardship, and are poorly paid.

CHART 38.

Employment in manufacturing and services activities, as % of total employment

Chart 38a : Share of employment in manufacturing activities

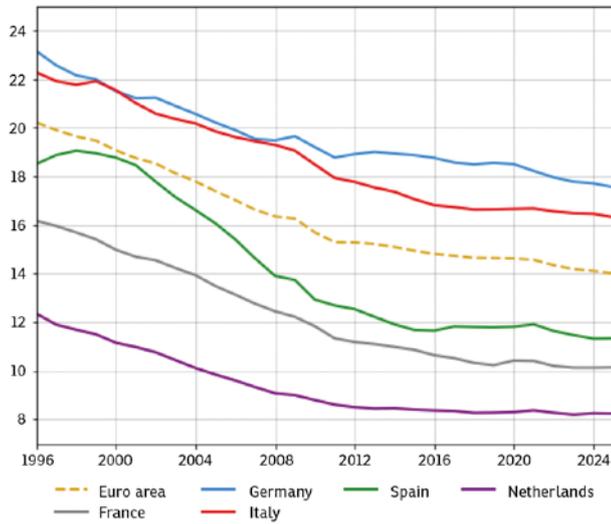
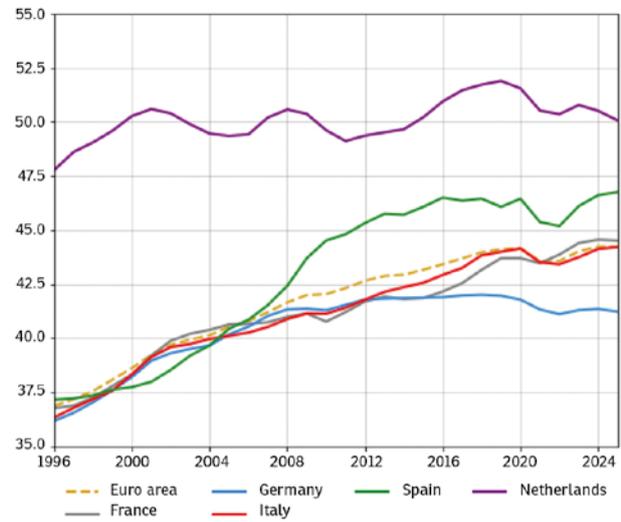


Chart 38b : Share of employment in private services activities



Source: Eurostat

5. NGEU: a game changer for the European Union?¹⁵

Executive summary

On the 21st of July 2020, in response to the unprecedented Covid-19 crisis that took the world by surprise, the Council of the EU agreed upon a massive and unprecedented recovery plan: Next Generation EU. The plan aimed at kick-starting the European economy and supporting the energy and digital transitions in order to make the EU more resilient to future crises. The announcement of this program also aimed at reassuring markets about the EU's stability and strength, through a show of solidarity among Member States¹⁶.

NGEU comprises a combination of loans (**€385 bn**) and grants (**€217 bn**) which Member States can call upon to finance national projects. The fund came into effect in February 2021 and is set to end in August 2026¹⁷. It cannot be understated how revolutionary NGEU was for its time due to being the first EU program financed by common debt issuance. Many political commentators have called it the EU's Hamiltonian moment.

Currently, despite being an initiative grounded in a qualitative and performance-based approach, NGEU remains significantly underutilized compared to its ambition. Its implementation has proven slower and more complex than expected, reflecting heavy administrative procedures and absorption constraints in several Member States.

At first glance, NGEU appeared to have a positive effect on several Southern European countries such as Spain, Italy and Portugal where investment levels increased compared to the pre-pandemic period. However, these additional capital flows have not yet generated measurable improvements in labour productivity. Productivity growth has slowed in Spain relative to the pre-Covid-19 phase and has even contracted in Italy as of the end of 2025. These issues raise the question of NGEU's efficacy. So far, NGEU has been slow to generate the productivity gains that were hoped for at its inception. This both suggests critically inefficient resource allocation and a structurally slow disbursement issue.

Although NGEU has successfully secured market access for its financing, the sharp rise in interest rates since 2022 has fundamentally altered its long-term budgetary implications. **Annual interest and principal repayments are projected at around €24 billion from 2028**, or approximately **15% of the EU budget**, thereby transforming a temporary recovery tool into a **permanent** and politically salient expenditure item for the EU's next Multiannual Financial Framework (2027 onwards). This shift redirects the debate from **borrowing capacity to growth effectiveness** and fiscal sustainability: while investment has increased in several Member States, productivity gains remain **uneven**, raising uncertainty about whether NGEU will generate sufficient long-term growth dividends to ensure its repayment.

The grant component of NGEU also entails a specific repayment mechanism with important distributive implications. Unlike loans, which are repaid by beneficiary Member States, grants are financed through common EU borrowing and repaid collectively via the EU budget. Repayments are therefore allocated according to each Member State's contribution to the EU budget which is largely based on Gross National Income (GNI), rather than according to the amounts received. This implies that some countries will ultimately be net contributors to the repayment of NGEU grants, while others will remain net beneficiaries, reinforcing the redistributive dimension of the programme and potentially intensifying political sensitivities during the repayment phase. As of 2025, Portugal, Italy, Greece and Spain were the recipients of 78% of available funds whilst contributing to only 28% of GDP¹⁸.

The collective repayment of the programs' grant component will only further intensify distributive tensions, particularly in the absence of robust new own resources. Essentially, NGEU exposes the **limits of debt mutualisation without deeper fiscal federalisation**. Designed as an exceptional crisis response rather than a permanent fiscal instrument, NGEU now faces a decisive post-2028 stress test in which its sustainability will depend less on continued market confidence than on Member States' willingness to sustain durable fiscal commitments and on the Union's capacity to deliver visible economic convergence that can anchor the political economy of common debt over time.

15. The author would like to thank Azra Ersevik (Master's student, Sciences Po Paris and Université Paris Nanterre) and Kiann Conlon (Master's student, HEC & Sciences Po) for their valuable contribution to this chapter.

16. European Commission, Europe's moment: Repair and Prepare for the Next Generation, Press Release IP/20/940, 27 May 2020, available at: https://ec.europa.eu/commission/presscorner/api/files/document/print/en/ip_20_940/IP_20_940_EN.pdf?utm_source=chatgpt.com

17. European Commission, "the EU as an issuer – the NextGenerationEU transformation", EU budget policy brief, July 2022.

18. Storbeck et al., Financial Times, Reversal of fortunes: Europe's thriving south and stagnant north, 14/01/2025.

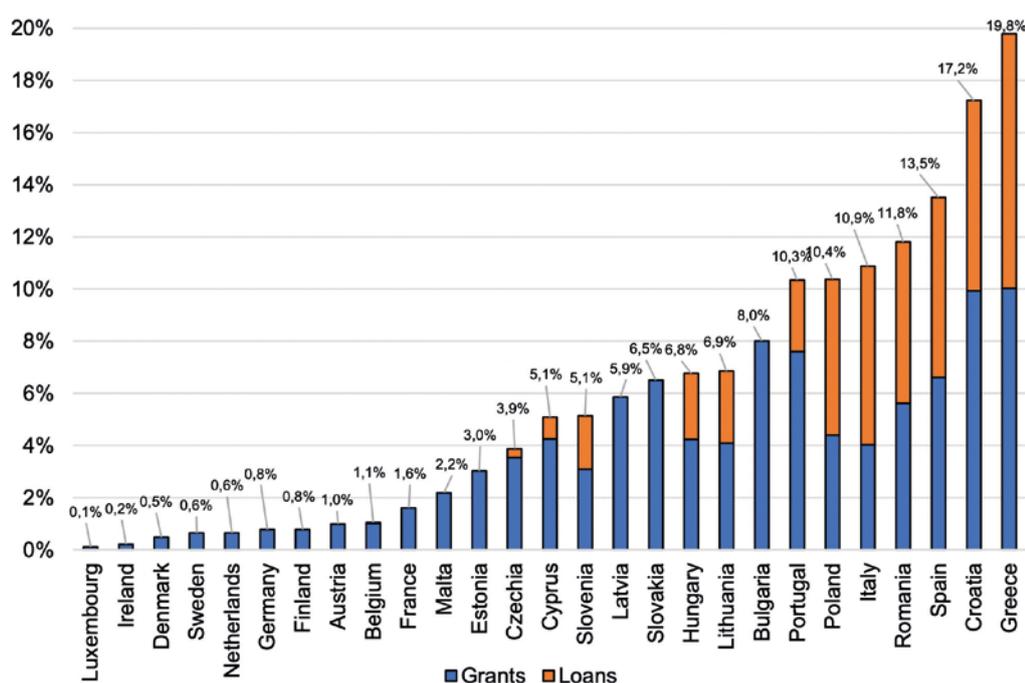
5.1 NGEU: An Unprecedented €800 bn joint EU Response to Covid-19 supporting Green and Digital transitions

NGEU builds on earlier EU crisis-response instruments and embeds the post-pandemic recovery within the Union's longer-term objectives of climate neutrality and strategic autonomy, notably through its alignment with the European Green Deal and the Fit for 55 package.

Whilst NGEU is comprised of multiple investment vehicles totalling over €800bn, **the centrepiece of NGEU is the Recovery and Resilience Facility (RRF)**. The RRF represents €577 bn (5.2% of EU-27 GDP) (2019) and aims to finance the green and digital transitions: at least 37% of the RRF is dedicated to climate-related expenditure, with another 20% to support digitalisation.

CHART 39.

RRF funding (loans and grants) to be received by EU Member States, % of GDP



Source: EU Commission, NGEU tracker

Beyond the RRF, NGEU also includes REPowerEU. This fund was introduced in October 2022 in response to the energy shock induced by Russia's invasion of Ukraine. REPowerEU focuses on energy savings, renewable deployment and supply diversification.

Considering the extraordinary nature of NGEU and the politically sensitive ramifications of common debt issuance, a strong emphasis was placed on transparency and efficacy of funds. That is why NGEU funds such as the RRF operate as performance-based instruments: disbursements were conditional on the satisfactory fulfilment of predefined milestones and targets embedded in national recovery and resilience plans rather than on individual projects' eligibility. Grant allocations also reflect factors such as population size, GDP per capita and average unemployment rates. To safeguard the integrity of the framework, the Commission had the power to suspend or interrupt payments in case of deficiencies and apply ex post financial corrections when failures are identified.

5.2 NGEU financed by common debt: the largest EU bond-funded programme to date

NGEU is financed primarily through common debt, marking an unprecedented step in EU budgetary history. For the first time, large-scale common borrowing and a degree of risk-sharing have become central features of an EU spending programme. To fund NGEU, the European Commission issued debt through a diversified strategy combining short and long-term instruments. These include EU-Bills and EU-Bonds across a wide range of maturities, as well as a significant share of green bonds.

Since the launch of SURE and NGEU, EU bond issuance has expanded rapidly. Outstanding EU debt rose from less than €50 billion before the pandemic to around €580 billion by the end of 2024 and approximately €695 billion by

mid-2025¹⁹. By the end of NGEU, total issuance is expected to reach between €800 billion and €950 billion, placing the EU among the largest issuers in euro-denominated bond markets²⁰. Despite the sharp rise in interest rates since 2022, EU bond issuance has proceeded smoothly, with continued strong investor demand across maturities. Green bonds play a central role in the NGEU funding strategy.

The EU plans to finance up to 30% of NGEU, around €240 billion, through green bonds dedicated to eligible climate-related expenditure, including clean energy, energy efficiency and sustainable transport. By early 2025, around €70 billion of NGEU green bonds had been issued. This strategy has positioned the EU as the world's largest green bond issuer and a major player in the euro-denominated debt market.

The debt raised by the EU Commission to fund NGEU is backed by the European Union's general budget²¹. This means that the European Commission is responsible for repaying the bonds using EU budget resources. In practice, if the Commission were unable to repay its debts from its usual budget revenue, it could request that Member States cover the shortfall up to the budget ceiling.

To reinforce this guarantee provided by the EU budget, the ceiling on the EU's own resources (the maximum amount that the Commission can request from Member States) has been temporarily increased by 0.6% of the EU's GNI, in addition to the permanent ceiling of 1.4%. This additional margin ensures that the EU can always meet its repayment obligations, whatever the circumstances.

Therefore, the Member States indirectly guarantee the debt through their commitment to contributing to the EU budget within the framework of the own resources ceiling.

In other words, net contributors to the EU budget are surreptitiously financing structurally weak countries most affected by the Covid-19 crisis (Italy, Spain) *i.e.* in a manner hidden from public scrutiny.

5.3 NGEU Current disbursement and key data of NGEU: an overview in numbers

By the end of January 2026, all 27 National Recovery and Resilience Plans (NRRPs) had been approved by the European Commission and formally adopted by the EU Council. All Member States also submitted amendments to their plans, primarily to integrate REPowerEU chapters aimed at strengthening energy security and addressing implementation bottlenecks in the final phase of the programme.

The total envelope of the Recovery and Resilience Facility (RRF) currently stands at €577 billion, reflecting both initial allocations and subsequent revisions. The envelope comprises €360 billion in grants and €217 billion in loans. The grant is funded by €338 billion coming from the original RRF allocation, complemented by €20 billion stemming from the auctioning of allowances under the Emissions Trading System (ETS) and €2 billion from the Brexit Adjustment Reserve (BAR)²².

As of today, cumulative disbursements amount to approximately €394 billion, including €238 billion in grants and €156 billion in loans. This amounts to around two-thirds of the overall RRF envelope.

	Total RRF	RRF Grants	RRF Loans
Available (EUR bn)	577	360	217
Disbursed (EUR bn)	394	237.53	155.88
Percentage disbursed	68%	66%	54%

Source: EU Commission
Notes: amounts are expressed in 2026 prices. The €360 billion in ent Reserve) grants is split in €338 billion of original RRF grants, €20 billion in ETS grants and €2 billion in BAR (Brexit Adjustmts). The loan envelope reflects revisions recorded by end-January 2026, following the decommitment of approximately €74 billion in loans by several Member States

These data describe the situation as of January 2026, while the legal deadline for the completion of RRF-funded reforms and investments is set for August 2026. The programme is therefore in its final implementation phase,

19. S&P Global Ratings. RatingsDirect: European Union and European Atomic Energy Community. Rapport, 30 juin 2025. PDF. Commission européenne (Luxembourg/Strasbourg). https://commission.europa.eu/system/files/2025-07/RatingsDirect_EuropeanUnionandEuropeanAtomicEnergyCommunity_3398360_Jun-30-2025.pdf

20. European American Chamber of Commerce (EACC), "European Commission to issue €90 billion in long-term EU-Bonds in the first half of 2025", 11 décembre 2024, communiqué, <https://eaccn1.eu/european-commission-to-issue-e90-billion-in-long-term-eu-bonds-in-the-first-half-of-2025/>

21. Germany is the largest contributor to the EU budget (~22.5%), followed by France (~18.3%) and Italy (~12.9%).

22. European Commission, The Recovery and Resilience Facility : https://commission.europa.eu/business-economy-euro/economic-recovery/recovery-and-resilience-facility_en

with a significant share of approved investments still to be executed over a compressed timeframe. This points to substantial progress in the mobilisation of NGEU resources, but they provide only a partial picture of the programme's effective economic transmission. Disbursement ratios reflect the formal fulfilment of milestones and targets, but do not necessarily capture the pace, balance or quality of on-the-ground execution. In several Member States, payments have advanced faster than project implementation, with effective expenditure remaining backloaded as the deadline approaches.

Execution and absorption constraints: the binding limitation of NGEU.

Despite its innovative, performance-based design, the implementation of NextGenerationEU has proven slower and more complex than initially anticipated. Administrative bottlenecks, heavy documentation requirements and delays in the assessment of payment requests have constrained execution across Member States. The coexistence of the RRF with other EU instruments, notably REPowerEU and traditional cohesion funds, has further increased the procedural complexity and strained administrative capacities, particularly at regional and municipal level. In other terms, the fragmentation of NGEU into different funds appears to seriously inhibit its efficacy and flexibility due to the additional administrative burdens.

As the August 2026 deadline approaches, implementation risks have intensified. Inflationary pressures and changing economic conditions have forced some projects to be rescaled or revised, while political transitions have led to renegotiations of national plans. Unlike previous EU programmes, NGEU requires near-complete absorption within a compressed timeframe of five and a half years, amplifying long-standing weaknesses in project preparation, coordination and administrative execution.

In practice, disbursements primarily reflect formal progress against milestones and targets, rather than effective expenditure or economic impact. Information on actual costs, implementation speed and efficiency remains limited, making it difficult to assess the real macroeconomic transmission of NGEU-funded investment. This gap between financial flows and on-the-ground execution indicates that the binding constraint of NGEU has shifted from financing capacity to execution capacity.

Beyond execution constraints, recent developments also highlight limits to EU common borrowing on the demand side. As EU borrowing conditions degraded over 2023–2025, several Member States chose not to draw on the loan component of NGEU. By early 2026, around €74 billion in recovery loans had been forgone²³. As sovereign spreads narrowed relative to the Commission's funding costs, the marginal financial advantage of EU loans diminished, while administrative complexity and tight spending deadlines remained unchanged.

Taken together, these elements confirm that NGEU's effectiveness now hinges less on the availability of resources than on Member States' ability to convert approved allocations into timely, high-quality investment and reforms. They also contribute to increasingly differentiated implementation trajectories and macroeconomic outcomes across countries.

5.4 Italy and Spain are the main recipients of the RRF

Italy and Spain together account for the largest share of RRF resources and therefore provide a relevant benchmark for assessing how differences in national execution conditions shape the macroeconomic transmission of NGEU.

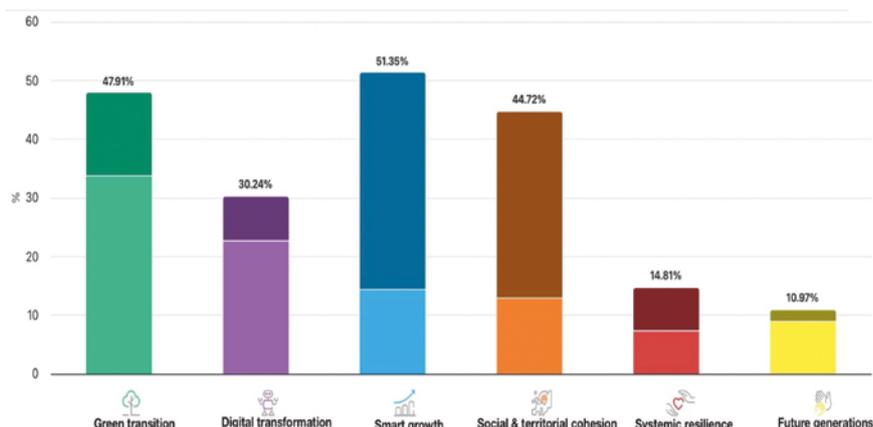
By the end of NGEU's lifecycle, Spain is set to receive €163 billion (€79.8 billion in grants and €83.2 billion in loans) : 13.5% of its GDP and 28.9% of RRF. As of January 2026, Spain had already received €55.1 billion in RRF grants, representing approximately 69 % of its total grant allocation (€79.8 billion). These numbers highlight the sheer scale of RRF support to the Spanish economy.

In terms of planned expenditure, Spain's RRP remains strongly aligned with the RRF's strategic priorities. Measures tagged under "smart, sustainable and inclusive growth" account for the largest share (74,48%), alongside substantial allocations to the green transition (48,25%) and digital transformation (22%). As reforms and investments are systematically tagged under both primary and secondary policy objectives, cumulative shares exceed 200%, reflecting the cross-cutting nature of the plan. Actual disbursements display a different timing. By the beginning of 2026, payments remained concentrated in growth and cohesion related pillars (€20.19 billion and €12.8 billion respectively), while green (€13.10 billion) and digital (€7.52 billion) disbursements lagged behind their programmed shares. This pattern reflects a sequencing effect rather than a misalignment with RRF objectives, as climate and digital intensive investments typically involve longer planning and implementation cycles.

23. Paola Tamma and Barney Jopson, "EU states spurn €74bn in unused Covid recovery loans", Financial Times, <https://www.ft.com/content/92168da8-f822-4b3b-adc5-3f0f6b45987a>

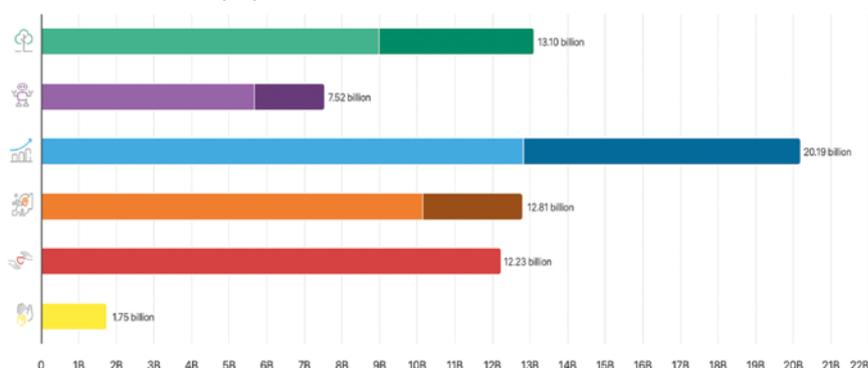
CHART 40.
Spain's RRP expenditures

Chart 40a : Share of the plan's estimated expenditure contributing to each policy pillar



This graph displays the share of the recovery and resilience plan's estimated contribution to each policy pillar. As each measure contributes towards two policy areas of the six pillars (primary and secondary assignments), the total contribution to all pillars displayed in the graph amounts to 200% of the RRF funds to the Member State.

Chart 40b : Disbursements per pillar



08 May 2024: The data in the 'Disbursements per pillar' graph was revised due to a technical issue. Each disbursement reflects progress in the implementation of the RRF, across the six policy pillars. This graph displays how disbursements under the RRF relate to the pillars. The amounts were calculated by linking the milestones and targets covered by a given disbursement to the pillar tagging (primary and secondary) of their respective measures. Over time, the pre-financing that Member States have received is offset with each payment that is disbursed. Therefore, the amounts per pillar in the above graph reflect the gross payments, i.e., the actual disbursements under each instalment together with the corresponding shares of pre-financing that has been cleared, i.e., set off with each paid amount. The amounts are updated after each payment.

Source: European Commission

Overall, Spain combines a strong formal compliance with RRF priorities and a relatively high absorption with a more gradual rollout of green and digital spending. While this has had limited the immediate macroeconomic impact, available evidence suggests a credible and progressive transmission of NGEU-financed investment, conditional on timely completion of remaining projects ahead of the 2026 deadline.

Italy is the largest beneficiary of the RRF, with a total allocation of €194.4 billion, or 10.9% of its GDP and 26.1% of RRF. By the beginning of 2026, Italy had received €54.1 billion in grants and €99.1 billion in loans, bringing total disbursements to around €153 billion. This represents around 79% of its total allocation and roughly 7% of Italy's nominal GDP in 2025 (based on IMF estimates of \$2.39 trillion)²⁴.

However, effective spending remained significantly lower, at around €86 billion. This amounts to approximately 44% of Italy's total RRF allocation (€86 bn / €194.4 bn ≈ 44.2%), or roughly 56% of the funds already disbursed (€86 bn / €153 bn ≈ 56%), highlighting a **persistent gap between formal disbursements and effective on-the-ground execution**²⁵.

24. IMF, World Economic Outlook Database, April 2024 edition, variable NGDPD (Nominal GDP, current prices), Italy, 2025 projection.[urlr.me/gMQZ3V](https://www.imf.org/external/tables.aspx?view=table&table=NGDPD)

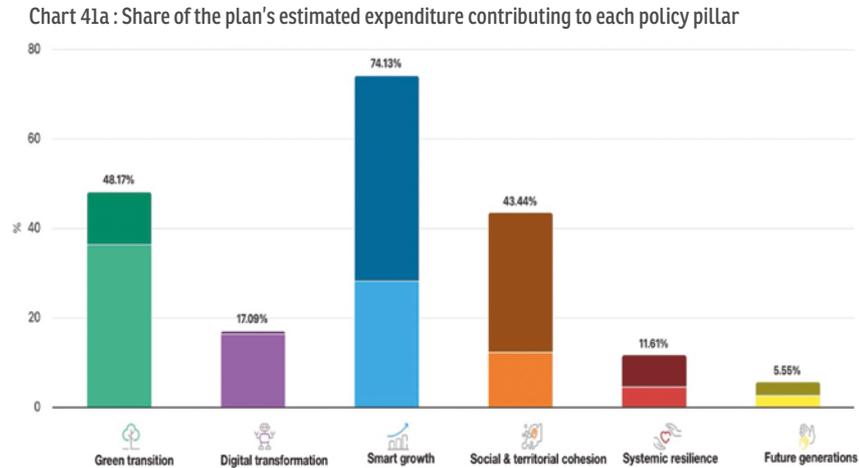
25. European Parliamentary Research Service. China's Belt and Road Initiative – A Human Rights Assessment. EPRS Briefing 2021/698847, European Parliamentary Research Service, European Parliament, July 2025. [https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/698847/EPRS_BRI\(2021\)698847_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/698847/EPRS_BRI(2021)698847_EN.pdf). https://ec.europa.eu/economy_finance/recovery-and-resilience-scoreboard/country_overview.html?country=Italy

While Italy's NRRP is formally aligned with RRF climate and digital objectives, 47.9% of planned expenditure tagged to climate objectives and 30.2% to digital transformation when accounting for primary and secondary policy tagging, actual disbursements remain skewed toward other pillars. As of early 2026, payments were concentrated in "smart, sustainable and inclusive growth" (€39.2 billion), health and resilience (€29.7 billion) and social and territorial cohesion (€27.5 billion), while the green transition (€27.8 billion) and digital transformation (€18.5 billion) lagged behind their programmed weight.

Although disbursements accelerated in 2025 and further progress is expected ahead of the August 2026 deadline, Italy's NGEU-related growth effects are therefore likely to remain backloaded and contingent on sustained improvements in administrative capacity and project execution.

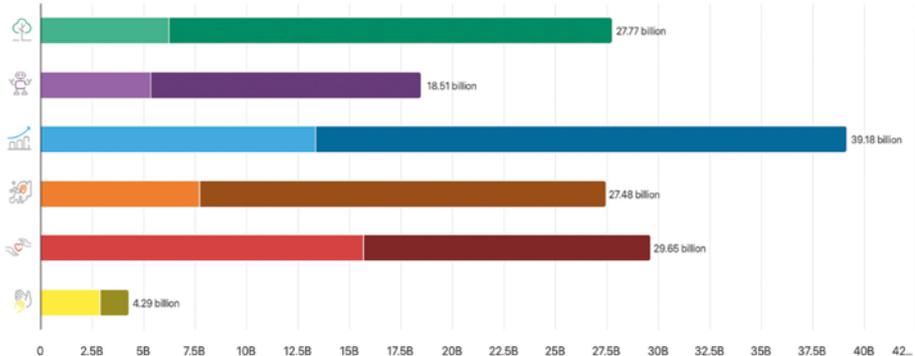
There are numerous factors that have contributed to these delays. First and foremost, Italy suffers from structural administrative weaknesses. There is a significant lack of public engineering capacity. Moreover, the public procurement procedure has historically been cumbersome. Project monitoring and oversight is lacking. Many investments such as schools, hospitals and local infrastructure rely on a multitude of administrative strata (municipalities, provinces, regions and local public operators).

CHART 41.
Italy's RRP expenditures



This graph displays the share of the recovery and resilience plan's estimated contribution to each policy pillar. As each measure contributes towards two policy areas of the six pillars (primary and secondary assignments), the total contribution to all pillars displayed in the graph amounts to 200% of the RRF funds to the Member State.

Chart 41b : Disbursements per pillar



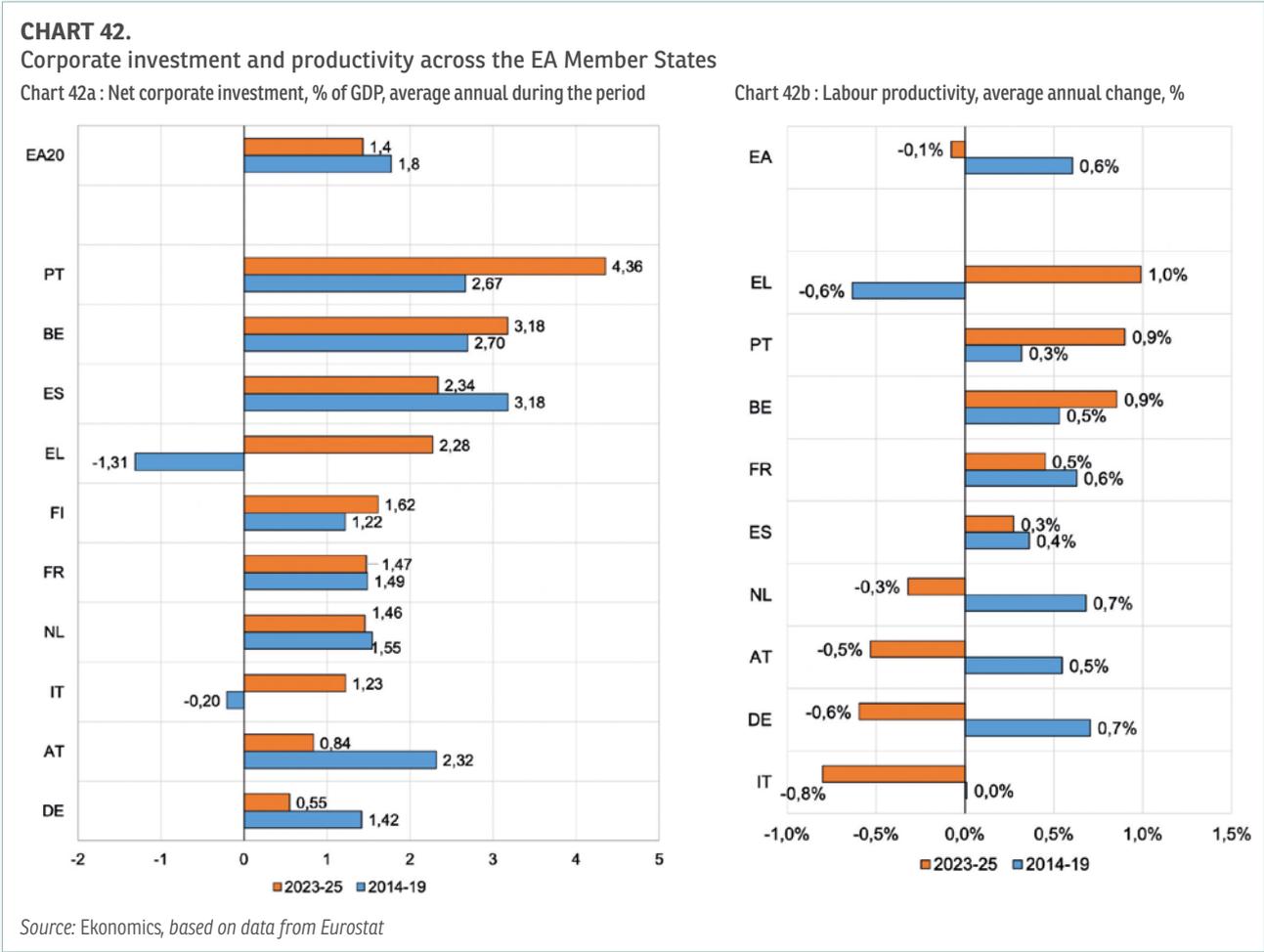
08 May 2024: The data in the 'Disbursements per pillar' graph was revised due to a technical issue. Each disbursement reflects progress in the implementation of the RRF, across the six policy pillars. This graph displays how disbursements under the RRF relate to the pillars. The amounts were calculated by linking the milestones and targets covered by a given disbursement to the pillar tagging (primary and secondary) of their respective measures. Over time, the pre-financing that Member States have received is offset with each payment that is disbursed. Therefore, the amounts per pillar in the above graph reflect the gross payments, i.e., the actual disbursements under each instalment together with the corresponding shares of pre-financing that has been cleared, i.e., set off with each paid amount. The amounts are updated after each payment.

Source: European Commission

These issues have led the Italian Court of Auditors and the Bank of Italy to call for stronger administrative capacity and better financial planning. Centro Studi Confindustria has also expressed concern over the effectiveness of the Transition 5.0 measure and the risk of underspending by the deadline²⁶. There is a silver lining however. The implementation of NGEU had lead Italy to undertake numerous reforms, especially in the speed and efficiency of the judicial branch.

5.5 Has NGEU succeeded in accomplishing its objectives?

Before examining country-specific implementation patterns, it is necessary to assess whether the increase in productive investment following the launch of NGEU has led to measurable productivity gains in the Euro area countries that benefited most from it.



The charts above highlight a central paradox in the post-pandemic Euro area recovery. While NGEU has mechanically supported investment in several Southern European economies, notably Spain, Italy and Portugal, this investment surge has not resulted into measurable gains in labour productivity.

As shown in Chart 42a, annual net corporate investment (excluding the consumption of fixed capital, thus reflecting the flow of new investment) increased markedly in Southern European countries between the pre- and post-Covid-19 periods. In Italy, it turned positive (from -0.2% to 1.2%); in Portugal, it almost doubled (from 2.67% to 4.36% of GDP); and in Spain, it remained high but did not increase further.

However, this increase in investment does not appear to have been accompanied by commensurate productivity gains (see Chart 42b). In Italy, for example, average annual labour productivity growth, which had been flat before the pandemic, turned negative between 2023 and 2025. In Spain, productivity growth slowed from 0.4% between 2014 and 2019 to 0.3% between 2023 and 2025. At the aggregate level of the Euro area, productivity growth weakened from 0.6% to -0.1%.

26. Banca d'Italia. 2025. Economic Bulletin No. 2/2025. Rome: Banca d'Italia. https://www.bancaditalia.it/media/notizia/economic-bulletin-no-2-2025/?com.dotmarketing.htmlpage.language=1&utm_source=c

However, this increase in investment does not appear to have been accompanied by commensurate productivity gains. In Italy, average annual labour productivity growth, which had been flat before Covid-19, turned negative between 2023 and 2025. In Spain, productivity growth slowed, from 0.4% between 2014-19 to 0.3% between 2023-25. At the Euro area aggregate level, productivity growth weakened from 0.6% to -0.1%.

This divergence between capital formation and productivity performance raises questions regarding the composition and efficiency of post-pandemic investment. According to the European Commission's assessment of the RRF, the growth impact of recovery funds depends critically on project selection, administrative capacity and the timely implementation of complementary reforms conditions that influence whether higher investment translates into durable productivity gains²⁷.

5.6 Italy has faced implementation constraints with NGEU funds, whilst Spain has used them more efficiently

Spain: a gradual but observable macroeconomic transmission supported by investment additionality.

As stated previously, Spain's Recovery and Resilience Plan is one of the largest under the RRF, reflecting both the severity of the pandemic shock and the allocation criteria applied at EU level. By 2026, Spain had absorbed a substantial share of its grant envelope following the fulfilment of milestones and targets, while loan take-up remained more limited and backloaded. Available macroeconomic estimates suggest that the programme is already having measurable effects: simulations by the Observatoire français des conjonctures économiques (OFCE)²⁸ point to a GDP increase of around 1.2 percentage points over 2021–2031, with peak effects in the mid-2020s, while CaixaBank Research²⁹ estimates a cumulative impact of 2–3% of GDP by 2026. Firm-level survey evidence analysed by the Banco de España and the Real Instituto Elcano indicates a high degree of additionality, with a large share of supported firms reporting that investments would have either not have occurred or been scaled down without RRF funding.

Spain relied on a relatively centralised governance structure and sequenced reforms and investments aimed at reducing early administrative bottlenecks, prioritising structural reforms before scaling up major investment projects. The European Commission has highlighted the strong climate and digital orientation of the plan, particularly in sustainable transport, renewables and digital public services. Implementation has nevertheless been uneven, with delays in capital-intensive projects and rising absorption risks as the August 2026 deadline approaches. Moreover, Spain's solid post-pandemic growth cannot be attributed to NGEU alone: cyclical factors such as tourism, immigration and favourable energy prices have also played an important role, while longstanding productivity weaknesses and investment gaps may limit the programme's long-term structural impact.

Italy: high nominal disbursements and weak macroeconomic transmission.

Italy, in contrast to Spain, illustrates the limits of large scale financing in the absence of adequate execution capacity. Although it is the largest beneficiary of the Recovery and Resilience Facility, the translation of disbursements into effective expenditure has been uneven: by early 2026, roughly €153 billion had been received³⁰, but only about €86 billion had been spent, leaving a persistent absorption gap. This timing mismatch has also produced temporary macro-fiscal effects, including a return to a small primary surplus in 2024–2025, partly because transfers preceded actual investment outlays.

Macroeconomic projections confirm the limited short-term growth impulse. The European Commission expects GDP growth to remain modest at below 1% in 2025–2026, while public debt is projected to edge up towards 137–138% of GDP³¹. Private forecasts by Prometeia³² similarly suggest that NRRP-related investment will peak only in 2026, implying backloaded macroeconomic effects. Structural bottlenecks such as administrative fragmentation, complex procurement rules and the heavy reliance on tax incentives have limited these productivity spillovers. Although implementation accelerated in 2025, the concentration of spending in the programme's final phase raises risks for both absorption capacity and expenditure quality ahead of the August 2026 deadline.

27. European Commission, Recovery and Resilience Facility Annual Report 2024, Brussels, 10 October 2024, https://reforms-investments.ec.europa.eu/technical-support-instrument-0/publications-0/recovery-and-resilience-facility-annual-report-2024_en

28. OFCE, Quel impact du plan de relance européen NGEU sur la croissance ?, Blog OFCE, 6 January 2025. https://www.ofce.sciences-po.fr/blog2024/fr/2025/20250106_CR/?

29. CaixaBank Research, How the NGEU funds are going in Spain: bread for today and hope for tomorrow, March 2025.

30. European Parliament Research Service, National Recovery and Resilience Plans: Latest State of Play, February 2025, <https://epthinktank.eu/2022/02/03/national-recovery-and-resilience-plans-latest-state-of-play/>

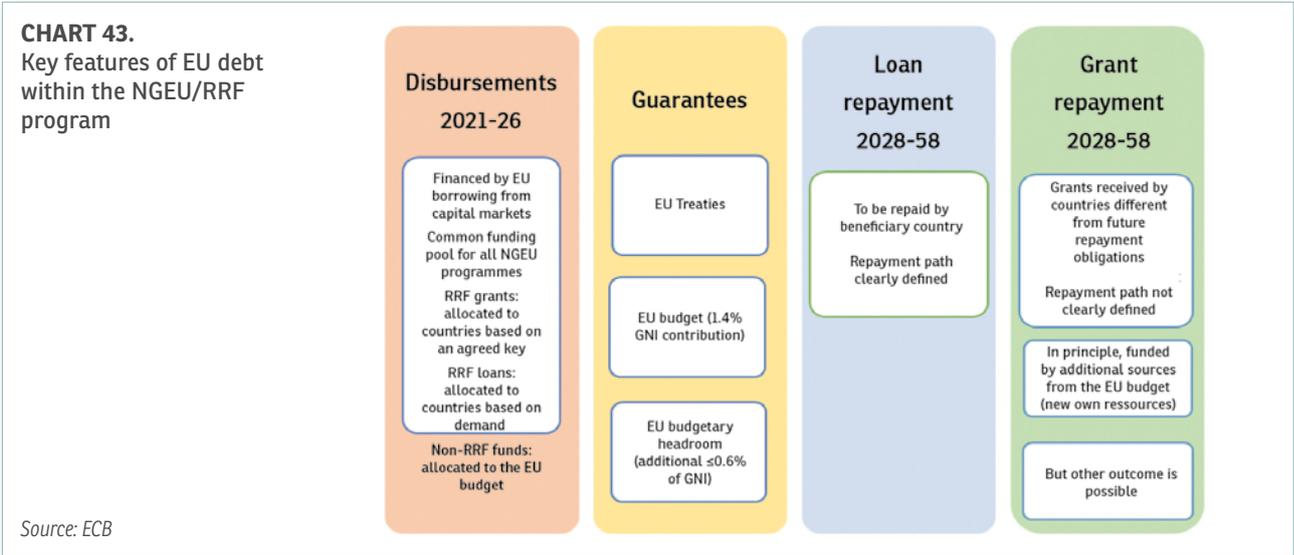
31. European Commission, Spring 2025 Economic Forecast, country chapter Italy, p.111. https://economy-finance.ec.europa.eu/publications/european-economic-forecast-autumn-2025_en

32. Prometeia, Italy in the Global Economy, February 2026. <https://prometeia.img.musc3.net/static/7372/documenti/ConsoleDocuments/Prometeia-Brief-2026-2.pdf>

5.7 The transition of NGEU into its repayment phase

Before examining the implications of the repayment phase, it is important to distinguish between the two components of NGEU financing. Loans granted to Member States are to be repaid directly by the beneficiary countries themselves, in accordance with the terms set by the EU.

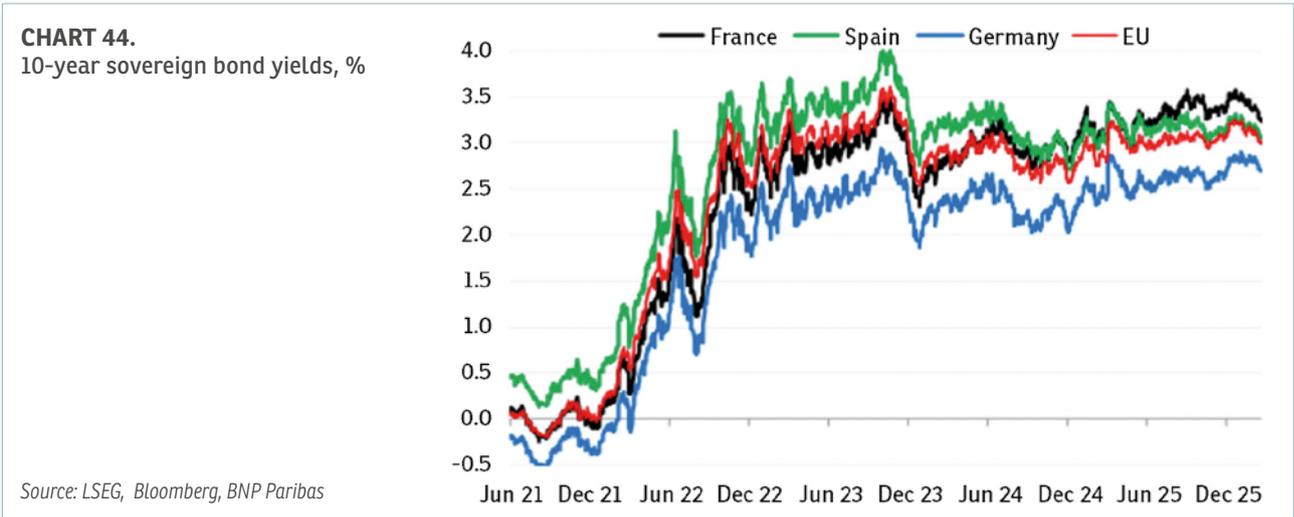
By contrast, the grant component is financed through common EU borrowing and will be repaid collectively via the EU budget, implying a mutualisation of repayment through EU budget revenues (see Section 6.2). All borrowing operations to finance NGEU must be completed by the end of 2026, while repayments of the associated debt are scheduled to extend over several decades, with final maturity no later than 2058.



Rising interest rates and the structural fragility of NGEU's repayment architecture.

While market access has not constituted a binding constraint for NextGenerationEU, the financial environment in which EU common debt is being serviced has shifted markedly compared with the assumptions prevailing at the programme's launch in 2020. At that time, borrowing costs were expected to remain close to zero for a prolonged period, allowing the servicing of large-scale common debt to be absorbed gradually within the EU budget. This assumption has proven overly optimistic.

Following the post-2022 tightening of global monetary conditions, yields on EU bonds rose sharply. Although financing conditions eased somewhat in 2025, interest rates remain structurally higher than initially anticipated in 2020-2021, particularly for long-dated issuances financing the grant component of NGEU. This shift materially alters the budgetary implications of common borrowing.



From 2028 onwards, the annual debt service linked to the non-repayable (grant) component of NGEU is estimated at around €24 billion per year, combining interest payments and the linear repayment of principal. As reported by *Le Monde* (11 February 2026)³³, this would represent approximately 15% of the EU's annual budget. Far from being marginal, NGEU debt servicing would thus become one of the largest rigid expenditure items in the post-2027 Multiannual Financial Framework.

This projected servicing burden has already entered the political debate. In Berlin, officials have explicitly linked the magnitude of these repayments to concerns about fiscal room for manoeuvre and have argued that additional common borrowing would be difficult to justify in the absence of deeper structural reforms and measurable productivity gains.

The debate therefore shifts from the question of financial capacity to that of **growth effectiveness**. Beyond its immediate budgetary implications, the repayment phase reopens a broader structural issue: whether NGEU has generated sufficient productivity-enhancing transformation to sustain its long-term servicing. Unlike the United States' Inflation Reduction Act, which relies heavily on direct tax credits and incentive-based mechanisms rapidly deployed to firms and households, NGEU operates through nationally designed recovery plans, subject to administrative procedures, milestone verification and intergovernmental coordination. This model has reinforced an intra-state allocation logic and has limited the development of large-scale cross-border industrial projects at the Union level.

As debt servicing begins in 2028, the transition from fiscal expansion to repayment thus occurs in a context where productivity performance remains uneven and structural reforms incomplete. The distributive dimension of common borrowing consequently becomes more salient: the issue is no longer whether the EU can raise funds on capital markets, but whether it can generate sufficient long-term growth dividends to stabilise the political economy of its repayment.

These rising costs interact with a structurally asymmetric repayment architecture. While NGEU loans will be repaid directly by beneficiary Member States according to a clearly defined schedule extending from 2028 to 2058³⁴, the servicing of the grant component and its associated interest costs will be borne collectively through the EU budget. In the absence of sufficient and predictable new own resources, this implies a sustained reliance on national GNI-based contributions over several decades, intensifying political sensitivities around burden-sharing and fiscal sovereignty³⁵.

As Didier Cahen has emphasised, this asymmetry exposes a fundamental fragility of NGEU³⁶. While debt issuance has been successfully mutualised *ex ante*, repayment remains politically unresolved *ex post*. Common borrowing postpones, rather than eliminates, the distributive question of who ultimately pays. This tension becomes more salient in a macroeconomic environment characterised by moderating growth dynamics and persistent structural weaknesses across several Member States. As previously shown, the expected productivity dividends of NGEU-funded investment remain uncertain and uneven, raising the question of whether the programme will generate sufficient long-term growth to ease its own servicing burden. Once debt servicing becomes a permanent and visible budgetary obligation, solidarity risks weakening, particularly in a context of competing spending priorities and tighter national fiscal constraints.

In this sense, NGEU illustrates the limits of debt mutualisation without fiscal federalisation: the EU has acquired the capacity to borrow at scale, but not the autonomous fiscal resources required to stabilise this borrowing over time in a context where member states are **unwilling – or unable – to increase their contribution to the EU budget**. This does not even take into account the fact that the national public opinion of Member States are generally not ready to relinquish national fiscal sovereignty.

This institutional fragility is compounded by adverse financial dynamics. As Didier Borowski³⁷ observes, post-pandemic debt servicing costs are significantly higher than initial projections due to the rise in interest rates since 2022, posing a structural challenge for the European Commission's budgetary planning. With principal repayments scheduled from 2028 onwards, servicing the grant component of NGEU debt will absorb a substantial share of the

33. *Le Monde*, "L'Allemagne et la France affichent désormais leurs désaccords sur les propositions défendues par Macron", 11 February 2026, https://www.lemonde.fr/international/article/2026/02/11/l-allemande-et-la-france-affichent-desormais-leurs-desaccords-sur-les-propositions-defendues-par-macron_6666298_3210.html

34. European Parliamentary Research Service (EPRS), *Future of EU long-term financing – post-2027 needs and how to finance them*, February 2025, https://www.europarl.europa.eu/RegData/etudes/BRIE/2025/767242/EPRS_BRI%282025%29767242_EN.pdf?utm_source=

35. Bob Lyddon, "EU Shadow Debts Start to Become All Too Real", Institute for Research in Economic and Fiscal Issues (IREF Europe), September 10, 2025, <https://en.irefeurope.org/publications/online-articles/article/eu-shadow-debts-start-to-become-all-too-real>

36. Didier Cahen, *The Euro Is in Danger*, Éditions Odile Jacob, 2025, pp. 206–207 and pp. 247 ff.

37. "Remboursement de la dette NGEU : un défi pour la nouvelle Commission européenne". *Option Finance*, <https://www.optionfinance.fr/analyses/remboursement-de-la-dette-ngeu-un-defi-pour-la-nouvelle-commission-europeenne.html>

EU budget in the medium term, underlining the importance of introducing and ratifying new own resources to cover these long-term liabilities.

The post-2028 phase therefore represents a decisive stress test. NGEU will cease to function as a recovery instrument and will instead become a conventional debt item embedded in the EU budget. Whether this transition can be managed without eroding political cohesion will depend less on market confidence, which has so far held, than on Member States' willingness to accept durable fiscal commitments at EU level. The sustainability of EU common debt thus hinges not on its issuance, but on the credibility of its long-term repayment framework.

NGEU: an exceptional instrument exposing the structural limits of EU fiscal governance

NextGenerationEU was conceived as an exceptional response to an exceptional crisis, rather than as a blueprint for a permanent transformation of EU fiscal policy. Its legal and budgetary architecture reflects this logic. NGEU was designed as a temporary top-up to the 2021–2027 Multiannual Financial Framework and integrated into the EU budget through external assigned revenues rather than ordinary budgetary channels³⁸. This construction preserved the formal constraints of the EU's fiscal framework while allowing for a one-off expansion of spending capacity.

While this exceptional design enabled a rapid and sizeable response to the pandemic, it also revealed important governance and integration limits. Implementation under the Recovery and Resilience Facility has largely followed a national logic, with EU objectives operationalised through country-specific plans. Monitoring mechanisms have focused primarily on compliance with milestones and targets, privileging inputs and outputs over longer-term outcomes. As a result, assessing the true structural impact of NGEU-funded spending remains difficult, and the visibility of its European added value has been diluted.

The institutional balance underpinning NGEU has further accentuated these tensions. Executive authority has been reinforced, particularly within the European Commission, while parliamentary involvement in defining priorities and exercising democratic oversight has remained limited. The growing complexity of fund management, combined with overlaps between NGEU and traditional EU instruments, has strained existing control and audit frameworks.

Beyond governance issues, the exceptional design of NGEU also carries long-term budgetary implications. Although conceived as a temporary crisis instrument, the servicing of common debt from 2028 onwards will structurally constrain the EU budget, reinforcing the tension between emergency-driven solidarity and the absence of a permanent fiscal framework.

To conclude, it is worth highlighting several important points:

From 2028 onwards, the programme will cease to operate as a recovery instrument and will instead become a structural commitment embedded in the EU's budgetary framework. Debt servicing will become a visible and politically salient expenditure item, intensifying trade-offs between traditional EU policies, emerging strategic priorities and fiscal discipline within a constrained Multiannual Financial Framework.

This transition will test the political sustainability of common borrowing. As debt repayments become permanent, the focus shifts from mobilisation capacity to growth effectiveness and fiscal credibility. The sustainability of NGEU will depend not only on market conditions, but on the Union's ability to generate durable economic returns and secure stable resources capable of anchoring long-term repayment.

At the same time, NGEU's macroeconomic impact has proven uneven and more backloaded than initially anticipated. Administrative bottlenecks, limited sub-national capacity and long implementation cycles for capital-intensive green and digital projects have slowed delivery in several Member States. The comparison with the United States' Inflation Reduction Act highlights differences in implementation speed and incentive design. Whereas the IRA relies heavily on direct, tangible and rapidly deployable tax incentives, NGEU operates through nationally mediated plans, often subject to procedural complexity and fragmented execution.

The issue is therefore not primarily one of financial scale, but of transmission and coordination. If common borrowing is to remain politically viable, it must be associated with visible convergence effects across Member States. The sustainability of shared fiscal commitments ultimately depends on economic convergence: the more growth paths and productivity performances align, the more stable the political economy of common debt becomes. Absent such convergence, distributive tensions may resurface as solidarity shifts from expansion to repayment.

38. European Parliamentary Research Service (EPRS), Future of EU long-term financing – post-2027 needs and how to finance them, February 2025. https://www.europarl.europa.eu/RegData/etudes/BRIE/2025/767242/EPRS_BRI%282025%29767242_EN.pdf

Conclusion

For a more dynamic economy in the Eurozone

The euro has weathered almost a quarter century of crises and storms without sinking. But the euro's successes cannot mask its vulnerabilities.

A Monetary union alone does not create economic convergence. This Scoreboard underlines that economic disparities and differences in living standards between Euro area countries have widened considerably since the launch of the euro. As we have observed, many Member States have relaxed their macroeconomic discipline over the past twenty-five years, and those who played the fiscal vigilance card have emerged as the winners. The Covid-19 crisis and the energy crisis, exacerbated by the war in Ukraine, have exacerbated these existing heterogeneities among EU member states.

Over the past two decades, several EU Member States have opted for an economic model that is detrimental to the supply-side of the economy. This policy stance has contributed to a loss of economic vitality in Europe, which now finds itself well behind the United States in terms of growth, productivity, and investment. Indeed, productivity gains have faded in Europe since the 2008 Global Financial Crisis, as most Member States have systematically focused on stimulating private demand through public spending. As for fiscal policies, they have most often sought to preserve household consumption at the expense of productive investment.

The ECB's persistent pursuit of an accommodative monetary policy right up to 2022 – in the form of negative interest rates and asset purchase programs that have pushed its balance sheet up to 70% of EA GDP – has only facilitated the financing of public deficits, discouraged structural reforms, and massively favoured the expansion of debt – not to finance productive investment as a priority, but rather to foster speculative and real estate transactions (without creating new value).

As long as it is not sufficiently understood, especially in the highly indebted countries, that excessive debt is a source of under-competitiveness, the economic situation in these countries will continue to deteriorate, thus making the construction of an economic and financial union all the more challenging. Indeed, the intensity of fiscal and economic divergences between EU countries not only makes it increasingly difficult to define a what the "common interest" of Europe actually is, it also encourages an "every man for himself" mentality. This inevitably sows a climate of mistrust between Member States which hinders any progress in terms of public and private risk sharing, further weakening the Euro area.

A monetary union can only work if a minimum of fiscal discipline is guaranteed by all states. This has not been the case for 25 years. Ultimately, the fate of the euro will depend on the political will to achieve genuine cooperation amongst participants. If the fiscal and economic drift in the Eurozone continues, the 'virtuous' countries will end up paying the price. That is the definition of an uncooperative game, in which most players try to evade their obligations by passing on the costs to those who respect the rules. We must therefore take control of the Union's destiny and not let it drift. If we do, the logical consequence could well be another inevitable crisis in the Eurozone.

It is economic growth that ultimately solves debt problems. The only way to promote robust and sustainable growth in the EU is to implement fiscal discipline and ambitious supply-side structural reforms in all Member States. "This means fostering competition, increasing labour and product market flexibility and promoting innovation. It also means a judicious use of scarce public resources to support the economy's adjustment to the new realities³⁹." Any demand-driven stimulus financed by increasing deficits and taxes in highly indebted countries can only harm business competitiveness.

If Europe and the Euro area are to close their growth gap with the United States and China, a substantial investment effort will be required in research and development, industrial capacity, decarbonisation, digital technologies, stronger equity financing, education and skills, and in attracting highly qualified workers through targeted immigration. Furthermore, scale matters more than ever. The completion of the single market must therefore be a permanent objective based on an EU industrial policy.

We must understand that our future – non-inflationary – depends on the elasticity of supply and thus on sufficient investment and a well-trained workforce. Anything that encourages the channeling of savings into liquid assets at the expense of long-term capital investment must be opposed.

As explained by Jacques de Larosière⁴⁰, "One day we will have to understand that the narrowing of the output gap between potential and observed growth cannot be reduced to the mere fight against the restoration of production

39. BIS, Annual Economic Report, June 2024.

40. J. de Larosière, "Putting an end to the reign of financial illusion", Odile Jacob, September 2022.

chains, but requires the activation of all the sources that ultimately constitute our eco-system: productive investment – penalized for 20 years by lasting very low interest rates –, the development of training, the recovery of the share of wages in income, the revitalization of competition... To revive productive investment, refrain from administratively setting (“or guiding” the market) long term interest rates and accept to let the market remunerate savings in the medium and long term according to supply and demand without which there can be neither productive investment nor productivity gains.”

Monetary policy can erase spread differentials but cannot address structural issues, notably the lack of confidence and the persistence of structural discrepancies, which explains the limited capital flows from North to South. Europe benefits from a large pool of savings which could contribute to financing long-term investments, especially those related to the green and digital transition, provided that such savings are not taxed but remunerated.

However, these savings and currently leaving the EU and financing the rest of the world (in particular the United States). Indeed, since the EU sovereign debt crisis (2011-2012), Member States with excess savings (Germany and the Netherlands in particular) are no longer financing investment projects in countries with lower GDP per capita (Spain, Italy, Portugal, Greece). This is due in particular to the interest rate differential between the US and Europe. The US is home to higher returns on equity when compared to the EU (risk-taking is more rewarded in the US than in Europe)

These limited cross-border capital flows in the Euro area highlight the lack of a genuine Banking Union and integrated financial markets as well as persistent doubts of some Northern European investors in the solvency of states and companies in weaker countries.

Consequently, the Eurozone must embark on the right course: heightened fiscal responsibility and more supply reforms geared to increase productivity. It must fight persistent inflation, as well as take the necessary steps to complete the Banking Union and implement the Capital Market Union. But these steps are only conceivable if sufficient discipline is applied in order to reverse the trend of ever-growing economic heterogeneity among member states.

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Ultimately, the paradox of the Euro is that a single currency and national economic policies coexist without a strong cement of coordination. Ultra-accommodative and asymmetric monetary policies have been used to overcome the contradictions of this paradox, but the price of this permanent rescue is costly. To make the euro sustainable, it is essential to ensure the convergence of fiscal and structural policies. To be viable, the Eurozone needs:

- **National budgets under control in all parts of the Union.** No responsible state can be expected to durably finance current public deficits generated by other Eurozone members that do not follow the rules. The future – and notably the solution to market fragmentation – depends on a consolidation of present weak fiscal positions (primary surpluses) and a shift towards quality expenditure and investment. We do not need more redistributive expenses. We must rein them in and allow adequate space for public investment. We have to recognise that the shift towards more investment will require a substantial political effort; at present, public investment accounts for only about 4% of GDP, while current – unproductive – expenditure accounts for almost all public spending. As much as we need to tackle unproductive spending, we can encourage the financing of infrastructure spending (including research). The implementation of the revised Stability and Growth Pact is of paramount importance in this respect. Unfortunately, the agreement reached by the Ecofin Council in December 2024 states that countries subject to the excessive deficit procedure (total public deficit above 3% of GDP) will be exempted from the rule requiring them to reduce their public debt by an average of 1% per year until their deficit falls below 3%, which is far from the best way to encourage the worst performers to reduce their debt to GDP ratio!
The case of Portugal shows that a healthy economy goes hand in hand with sound public finances. After receiving financial assistance following the sovereign debt crisis, Portugal undertook ambitious reforms. These measures have allowed the Portuguese economy to recover and become one of the best performers in the Euro area in terms of growth, productivity, competitiveness and fiscal consolidation.
Despite persistent structural weaknesses (rigidities in the labour market, complexity and lack of transparency in the tax system, lack of human capital), the Portuguese case demonstrates to all indebted countries that a healthy economy depends on sound public finances.

- **Domestic structural measures aimed at enhancing business dynamism and increasing growth potential should be encouraged and monitored.** We have seen that the economic and financial model based on monetary abundance, under-remuneration (taxation) of savings, financialisation as a response to structural insufficiencies, systematic short-termism, and increases in the – essentially speculative – valuation of financial assets, does not meet the needs of our society. These needs require long-term investment, a response to climate and digital challenges, and an adequate return on savings and wages. Without such a reorientation of our policies, it seems difficult to achieve the “common good” and to correct the major current imbalances. Raising potential growth requires increasing the productivity of the system, which requires in turn more competition and long-term investment.
- **To keep inflation under control.** The most pressing monetary policy task is to achieve low and stable inflation. The history of high inflation episodes tells us that if central banks loosen too quickly before the problem is really addressed, then another inflation wave is bound to follow, which inevitably triggers another wave of interest rate hikes. This would be a worst-case scenario. Last but not least, it is necessary to refrain from administratively fixing (“or directing” the market) long-term interest rates. Our leaders must accept that the market should reward medium and long-term savings according to supply and demand – without which there can be no productive investment or productivity gains.
- **An active banking and integrated capital market in Europe.**

Finally, it’s high time to return to a more pragmatic conception of Europe. The Union must be strengthened by allowing global groups to emerge, promoting European preference as advocated for by Maurice Allais and by working on “projects in Europe” rather than on “a greater Europe.”

Most of the necessary remedies can be implemented by the Member States and the European Union themselves: fiscal discipline, expansion of SMEs, the completion of the Savings and Investment Union, design of selective Community preference framework. But this requires political will, leadership, impeccable intellectual support and sensible supporting EU-wide policies. In sum, members of the Monetary Union must act together to make it work and not behave as passive individual bystanders hoping that things will turn out fine. Ultimately, the fate of the euro will depend on the political will to achieve genuine cooperation within the Euro area.

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We need to be very careful about our economic choices in the current circumstances. To name but just a few: France is going through a budgetary and political crisis Germany’s economy is weakening and its population is declining, inequalities are growing all throughout the EU, nationalism is on the rise, democracies are weakening, and transatlantic relations are slowly breaking down, etc. Overall, economic performance varies widely across countries, state capacity is highly uneven, and cooperation remains limited.

In order to solve the economic issues facing many EU countries, some are tempted to call for a federal EU and confer the powers of a state upon it. If one were to follow this line of thinking to its logical conclusion, a transformation shift would be required. All matters pertaining to the economy, public finances as well as military and diplomatic sovereignty would have to be transferred to a new centralized state.

It’s an old tendency to take refuge in this doctrine of European unification! Ah, if there were only one state, only one financial system, only one market, only one army, how much happier we would be!

But this idea of turning the Union into a state has never been realized. Why not?

Because the states (and their citizens) do not want it. At their request, Europe was not built on the federal principle after the Second World War. The construction of Europe was based on the sovereignty of the nation states, and the progress made in Europe, even if rooted in a federal dimension and logic, was based on compromises between the divergent interests of the member states.

As P. Herzog points out⁴¹: “Today our nations want a Union that protects them, but very few support the idea of a political community” The European Union has been a great political innovation in creating understanding between states, but it has done so without sharing sovereignty and by making competition a veritable sacrament to the detriment of public goods, for which responsibility is being returned to the nation states.”

41. P. Herzog, “Un nouveau récit pour l’Europe”, Les Entretiens européens, 2024.

Promoting a single European state now means forgetting that there are currently two distinct economic and financial Europes:

On the one hand, there is the relative equilibrium of the northern states who respect the minimum discipline required by a monetary union. On the other hand, there is the massive imbalance of a number of over-indebted states, whose budgets have no room for maneuver, and which are contributing to the weakening of Europe.

It's like water and oil: they don't mix.

The debt-ridden countries of the South may be tempted to take refuge in the illusion that Europe will take care of everything. But realism does not favour such a solution. We must be aware that a number of European countries have now overstepped all the boundaries and yellow lines of the economic discipline they have chosen and ratified.

Those who advocate taking refuge in the idea of a paternal European state offering salvation do not take into account the need for the over-indebted states to return to a norm that has been jointly decided. This blindness does not bode well. The failure to highlight the importance of the problem caused by the massive heterogeneity of fiscal situations is worrying. This blindness undermines the credibility of a unified budget, which by some miracle could help eradicate untenable and unsustainable national situations.

It is time to correct this error and look at things as they are: what is sustainable is sustainable; what is unsustainable is unsustainable. To this end, the European Commission should encourage over-indebted countries to put their public finances in order. Unfortunately, the particular interests of individual states prevail.

We will never eliminate the excesses of debt by calling for fiscal and financial unity. The only way to move towards a financial union is to repair what is unsustainable, because, as the 18th century saying goes: "you should never put money into a bad fund."

The weakness of the argument criticised above is that no one is asking the most fundamental of questions: who will pay? The huge European loans envisaged by the proponents of the single finance thesis require a guarantor. The market will ask what procedures will reassure lenders. What will happen if certain states are unable to contribute to the repayment of a common debt? Will their obligations be shifted onto the stronger shoulders of states that have performed better from a budgetary point of view?

The guarantee problem is never mentioned in the reports calling for fiscal union, which is quite inconceivable.

Moreover, trying to solve the problems at hand by claiming that the fiscal rules have become "obsolete" or by attempting to change the thermometer (to the extent that military expenditure would be excluded from the calculation of the public deficit in relation to GDP) would only aggravate the situation of the most indebted countries and weaken the euro.

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One of the clearest thinkers of our time, Raymond Aron, has shown us the way: "Internal consolidation is a prerequisite for international integration⁴²."

Consequently, all Member States must actively work together to improve the economy of Europe as a whole. In other words, they must start by respecting the fiscal and economic commitments they have made in a spirit of solidarity.

For how long can a collective whose founding rule (a minimum of budgetary discipline must be respected) is repeatedly violated by a number of Member States be credible? But more importantly, for how long can such behaviour be considered acceptable? We must stop believing that the permanent violation of budgetary commitments ratified by national parliaments is a solution. The law prosecutes individuals who break it. When it comes to the state, the same principles should apply.

The truth is simple. If we want to revive the European economy, there are not several methods, but only one: work more and invest more. It is these two weaknesses that explain Europe's economic decline.

Instead of calling for illusory European funding and with the continuance of easy monetary and budgetary policies, we need to start rolling up our sleeves. We need to get our public finances back on track in order and get back on the road of economic convergence in Europe. This cannot be achieved without a shift from an economy

42. R. Aron, "L'Unité économique de l'Europe", *La Revue libre*, n°2, October 1952.

based on the permanent stimulation of domestic demand to one in which productive investment stimulates supply.

What is certain is that we must ensure that the return on savings in the Euro area is at least equal to that in the United States and that a climate of confidence is created in order to encourage individual initiative. The current interest rate differential between Europe and the United States is glaring and must be corrected.

Easy money will not solve everything, but productive investment – the basis of future growth – will. That's what needs to be encouraged. Excessive tax burden (due to accumulated budget deficits and public debt) and abusive regulation cannot be allowed to further discourage and inhibit productive investment.

Advocates of easy European money admit that "Europeans are poorer than Americans but save twice as much." We need to draw the right conclusion from this observation: keeping interest rates in the eurozone much lower than in the United States will certainly not encourage long-term saving in Europe. On the contrary. Experience shows that artificially and permanently low interest rates discourage productive investment and prevent governments from undertaking structural reforms.

Every effort must therefore be made to improve the profitability of companies and their equity financing so that the return on capital in our continent is at least equal to that in the United States.

Notes

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