RELAUNCHING INVESTMENT IN THE EU IN A CONTEXT OF OVER-INDEBTEDNESS

MARIO NAVA

Director General, DG Employment, Social Affairs and Inclusion - European Commission

Building the EU's future on productivity and its unique social welfare model

Europe has many economic strengths. It has shown a remarkable resilience to a succession of crises, including the COVID-19 pandemic and the energy crisis. This is also reflected in a record low unemployment rate and record high employment participation rate. However, the EU's productivity growth has lagged behind other major economies in recent years. Between 2019 and 2025, on average, annual labour productivity growth reached 0.26% in the EU, compared to 1.5% in the US. This is also linked to the rapid growth of the tech sector and AI in the US. There are significant differences across EU Member States: western European economies showcase the lowest productivity gap with the US, while Member States, who joined after 2004 are still behind but are catching up[1]. In the long run, weak productivity growth weighs on the prosperity, incomes and job quality of EU citizens.

Structural factors – in particular the innovation gap with the US and China and difficulties for EU firms to scale up – have been contributing to slower productivity growth. Moreover, a number of past growth drivers are losing traction. This includes external demand driven by global trade, access to cheap and abundant energy, and the 'peace dividend' provided by relative geopolitical stability, which allowed EU governments to spend on priorities other than defence. Demographic change will also pose increasing economic and social challenges. Europe must leverage its strengths to regain competitiveness and accelerate decarbonisation, reindustrialisation and innovation, as highlighted in the Competitiveness Compass and the Clean Industrial Deal.

The Competitiveness Compass is a strategic framework, underlining three core transformational imperatives to boost competitiveness. First, the EU should close its innovation gap. Second, it should put in place a joint roadmap for decarbonisation and competitiveness, ensuring that the green transition acts as a catalyst for industrial strength. And third, it needs to reduce excessive dependencies on external actors, thereby bolstering economic security and resilience. These imperatives need to be complemented by enablers to underpin competitiveness across all sectors. This includes (i) streamlining the regulatory landscape, reducing burden and favouring speed and flexibility, (ii) unlocking the potential of the Single Market, by removing barriers and exploiting benefits of scale, (iii) mobilizing capital through a Savings and Investments Union alongside a refocused EU budget, (iv) promoting skills and quality jobs while ensuring social fairness; and (v) better coordinating policies at EU and national level.

Addressing the persistent investment and innovation gap also requires a more strategic and effective use of fiscal capacity across the Union. Lessons from the global financial crisis remain pertinent. Prohibitive debt-servicing costs can crowd out productive investment. Thus, stifling the capacity to innovate and compete on the global stage.

The new Economic Governance Framework aims to strengthen Member States' debt sustainability and promoting sustainable and inclusive growth in all Member States through growth-enhancing reforms and priority investments. Public debt can support productive investment when it acts as a catalyst for mobilizing private capital and is underpinned by structural reforms that reduce the cost of doing business. Strengthening debt sustainability through gradual fiscal consolidation should go hand in hand with safeguarding high quality public spending.

To regain competitiveness, the EU needs to preserve and build on the strengths of its social market economy. Recent Commission analysis shows that competitiveness and quality jobs can reinforce each other. A high-productivity economy thrives on a highly skilled, adaptable and well-protected workforce. To operationalize this vision, the Commission has adopted a number of flagship initiatives, including the Union of Skills and the Quality Jobs Roadmap. These strategies will support the development of our Union's human capital to strengthen EU competitiveness. They will also ensure that the benefits from higher productivity are fairly shared by contributing to promoting collective bargaining and quality public services.

Europe has many economic strengths, and we must act now. This is essential to strengthen our economic competitiveness, secure the sustainability of the EU's social model and ensure prosperity for all.

1. *Between 2019 and 2025, labour productivity growth was higher than in the US in 7 countries (Bulgaria, Cyprus, Ireland, Latvia, Poland, Romania and Slovakia). It was lower in the other 20 Member States.*

ALFRED KAMMER
Director, European Department – International Monetary Fund (IMF)

Crowding in 800 billion euros of private investment through reforms

Unlocking investment hinges on completing the single market and improving business conditions to foster firm dynamism. This requires lowering the barriers that fragment Europe's product and factor markets and pursuing ambitious national structural reforms.

Reforms will mobilize investment and raise incomes. Our analysis shows that fully closing EU-level and domestic structural policy gaps to the most growth-friendly settings would lift productivity by about 20 percent over the long term.[1] Higher productivity would, in turn, crowd in up to €800 billion in additional investment in ten years—around 18.5 percentage points above the baseline. With productivity significantly higher and investment rising by this magnitude, GDP per capita could increase by around 35 percent over time.

Raising investment is essential to generate greater dynamism in new and high-growth sectors. Europe's capital stock remains heavily concentrated in mature sectors, and persistently weak private investment risks compounding already limited firm dynamism. Europe has too many small, old, and low-growth firms, with micro firms accounting for twice the share of employment as in the US. At the same time, Europe has far fewer global-leading firms, and those it does have tend to be older. As of late 2024, only 14 EU companies younger than 50 years had a market capitalization above USD 10 billion, compared with 241 in the US. Without renewed investment to fuel innovative firms, Europe risks falling further behind.

The scope for public spending to mobilize investment is limited. While public investment—an important catalyst for private activity—has increased, partly reflecting Germany's welcome multi-year infrastructure package, many countries face tight fiscal constraints. These stem from high sovereign debt and mounting pressures related to population aging and rising defense spending.[2]

Completing the single market would significantly boost investment, firm scale, and productivity. Some argue that Europe's challenge lies in insufficient savings or overly restrictive competition policies that limits mergers. Yet Europe's savings rate is high, and artificially increasing firm size through looser merger rules risks weakening competition by entrenching market power in still-fragmented national markets. By contrast, deeper single-market integration would allow firms to expand organically across borders, increasing scale while preserving contestability. Firms would compete in a larger market under a genuinely level playing field.

Yet Europe still has a long way to go in creating a truly integrated single market. Intra-EU trade barriers are estimated to be two to three times higher than those between US states. Labor mobility remains constrained by obstacles such as the recognition of professional qualifications and limited pension portability. Capital markets are also fragmented: Europe has 35 stock exchanges, compared with just three in the US, contributing to a shortage of risk capital. High and volatile energy prices—reflecting a poorly integrated energy market—further limit firms' ability to scale. Much therefore hinges on decisive EU-level action.

At the same time, domestic structural reforms must complement EU efforts. Reforms that improve the business environment can strengthen firm dynamism and amplify the gains from a deeper single market. Investing in human capital and improving labor market functioning would equip firms with the skills needed to seize new investment opportunities. Reducing barriers to production and access to finance—through measures such as product market deregulation and deeper credit markets—would lower the cost of doing business and strengthen incentives to scale.

Completing the single market and domestic reforms could crowd in €800bn of private investment.

Higher growth would also ease fiscal consolidation pressures and create space for higher public investment. In addition, smarter use of existing policy instruments could further expand fiscal space. For example, expanding carbon pricing and partially recycling revenues into green subsidies could significantly lower the net fiscal cost of meeting climate and energy security objectives.

Revitalizing Europe's investment dynamism requires decisive action now: completing the single market, accelerating domestic structural reforms, and safeguarding and scaling up high-quality public investment so firms can grow and compete in fully integrated, competitive markets.

This article was co-authored by Stephen Ayerst and Xin Tang (IMF).

1. *Making European Reforms a Success on the Ground, IMF November 2025.*
2. *How Can Europe Pay for Things That It Can't Afford? IMF November 2025.*

MICHAEL WEST
President – Moody's Ratings

Financing Europe's next decade: enabling capital markets to step up

Europe and other advanced economies are entering a decade defined by rapid technological advances, geopolitical change, demographic shifts and costs associated with climate-related disasters. Each of these pressures would, on its own, require significant investment. For Europe, taken together, they add up to over €7 trillion in funding needs by 2030. Mobilising this scale of funding efficiently and effectively will require deeper and more liquid capital markets.

Meeting EU climate targets will require an extra €477 billion annually through 2030. Climate investment needs will keep rising, driven by factors like a widening insurance protection gap and the growing energy needed to power artificial intelligence. AI is reshaping global competitiveness, and requires physical infrastructure, including investment in new assets like data centers, which we estimate to be at least $375 billion in Europe by 2030, or around 15% of our global forecasts. And even that may prove insufficient to meet demand.

A sharp increase in recurring public spending exacerbates pressures. We expect ageing-related costs on healthcare and pensions to jump by €1.5 trillion by 2030, while raised defence commitments could be an additional €1 trillion during the period. There will be tough choices amid competing demands, while mandatory spending climbs to a projected 76% of public budgets by 2035 from 72% now. This would narrow fiscal space just as strategic investment needs grow.

Where investments are commercially viable, private sector equity and debt providers likely will step in. If commercial returns are not sufficiently attractive but investments bring public good, the extra funding likely will be met with a mix of sovereign, EU borrowing or multilateral development banks like the European Investment Bank. To mobilise private sector capital, given fiscal constraints, we expect even more reliance on guarantees.

However, to expedite deployment of public funds, processes and hurdles need to be overcome. For example, while the Recovery and Resilience Facility provided incentives for reforms to strengthen long-term growth, few governments have delivered more than 30% of planned investments.

Improving financial literacy and incentivizing stronger risk appetite, e.g. by encouraging uptake of private pensions, will be critical to channel Europe's savings into more productive investments. European households save 15% of GDP a year, more than three times that of their American counterparts, but their financial assets are only half that of the US. About a third of European household savings, or around €11.5 trillion, is in cash and deposits, compared with around a tenth in the US. The European Central Bank says up to €350 billion a year – which we estimate is more than half of Europe's private sector investment needs - could be redirected into productive investment if European investment more closely resembled that of the US. And if that capital can enable greater innovation, it could also help address the continent's productivity problem.

Small steps have been taken to deepen capital markets (i.e. the proposed securitisation framework), but broadening liquidity pools will be needed to underpin the level of investments. Together, securitisation and covered bond issuance in the EU has averaged 2.5% of GDP over the last five years, about a third of the US level. Only around half of EU issuance is placed in the market, compared with full placement in the US, where these instruments directly fund investment in the real economy. And more generally, unified regulation would help to create deeper and more liquid pools of capital.

Europe's investment needs through 2030 will require deeper and more liquid capital markets.

Private markets, including private credit, will play a larger role in financing, particularly for infrastructure assets with commercial returns. Demand for private credit is already growing in Europe. The region accounted for about 38% of global private credit fundraising in 2025, reflecting untapped opportunities and attractive valuations.

Private credit is also developing innovative financing structures to meet the investment needs, which can reduce the impact on bank balance sheets and close several broader funding gaps. Transparency, with evidence of good underwriting and valuation, are essential to underpin growth in the sector.

With deeper markets, greater risk appetite for savings, and stronger partnership between public and private sector capital, Europe can continue to reduce its investment gap and build foundations for long-term competitiveness. Failing to meet this challenge could prove far costlier and damaging to Europe's long-term competitiveness and security.

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