Draghi proposes a European industrial policy as a driving force to address the challenges of the coming decades

On 9 September, Mario Draghi presented his long-awaited report on the future of the EU economy and its competitiveness. This new exercise of strategic proposals for the EU, complementing the Letta report on the single market published in May, gives a stark diagnosis of the current state of the European economy. It also proposes a reorientation of its production in order to develop the industry necessary for the ecological transition and strategic autonomy, as well as ways to mobilise the investment needed to achieve this goal. The report lays the foundations for re-industrialisation in Europe, combining sweeping actions with a menu of specific proposals for 10 strategic sectors.

As for the diagnosis of the problem, the report exposes how the gap between GDP per capita in the EU relative to the US has widened in recent years due to lower European productivity – which is also explained by a composition effect, since the most productive sector in recent decades has been the technology sector, which is less present in the EU – and the fewer number of hours worked compared to the US. In addition to this comparatively worse economic performance, the slowdown in the trade of goods and the reconfiguration of supply chains render the EU's current export-oriented economic model vulnerable.

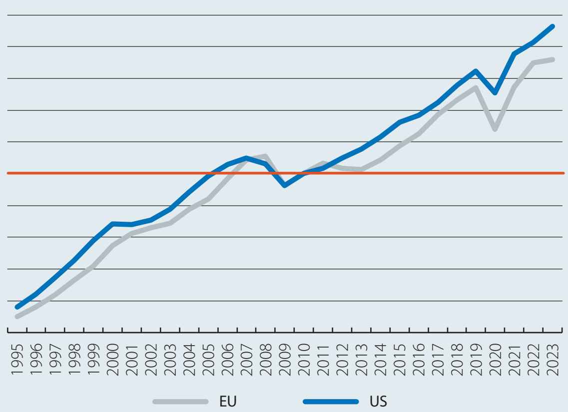
The challenge that the EU faces is considerable, because if it is not able to increase its productivity and potential growth in the context of an ageing population, its social model and the well-being of its citizens may be compromised. For the report, a key way to overcome this challenge is to offer opportunities to unlock the large volume of savings that households and other economic players in the EU have hoarded and to channel it towards greater investment in the most productive activities as a means to escape the current situation, which is described as an «intermediate technology trap».[1]

Draghi proposes a Copernican Revolution of the EU in this process: to develop an industrial policy at the European level. Industrial policy, a function which has hitherto fallen to individual Member States, must also become the guiding axis of European economic policy. Moreover, this revised economy policy must serve as the guide for both trade and competition policy (two of the main functions of the EU ever since the creation of the common market). Developing a European industrial policy must also facilitate the achievement of the EU's two main objectives for the coming decades: the decarbonisation of the economy and greater European autonomy, in terms of both the economy and security.

1. Described as a situation of low industrial buoyancy, low innovation, low investment and low productivity growth.

EU and US: real GDP per capita

Index (100 = 2010) in PPP terms



Source: *CaixaBank Research, based on data from the IMF (WEO).*

Three major transformations that the EU economy needs

The first course of action – and the enabling vector for all the others – is to boost innovation in Europe, making it easier for ideas that are already emerging here not to die so often on their path to commercialisation before they are implemented (due to inefficiencies in the single market or a lack of funding). To this end, some of the measures proposed include improving coordination between Member States of public investment in R&D, adopting a unitary patent system and improving access to financing for innovative companies. In order to achieve the latter goal, it is important to improve the European capital market, as discussed below, in order to nurture the development of financial institutions that are more conducive to financing innovation, such as venture capital funds. In Europe, moreover, the majority of business financing to date has been obtained through the banking sector, and this sector has the handicap of having to face a greater regulatory burden than its US counterpart. Not only does this red tape act as an additional hurdle for financing innovation, but it is also a hindrance to the sector's profitability.

As for the second major objective, decarbonisation, Draghi suggests that the EU should refocus its support towards the manufacture of clean technologies, focusing on those where it is a leader or where building capacity is considered a strategic priority (such as batteries). One of the measures that stand out in this sphere is the need to reduce energy prices for the final consumer, as this is one of the burdens that European industry faces relative to the industries of other markets. To achieve this reduction, the report proposes a series of options ranging from lower taxation to a change in the pricing mechanism that will allow the low cost of renewable energy to have a positive impact on the whole economy. Another of the ideas that is touched on throughout the report is reflected in this sphere, namely ensuring that the EU leverages its important role in the international economy to ensure it can purchase all kinds of inputs at the best possible price. In terms of energy, this would involve making joint purchases of oil and gas, as well as developing common strategies in times of emergency or crisis (such as the surge in gas prices after the outbreak of Russia's war against Ukraine) in order to avoid an array of different national measures that could distort the single market.

The ultimate objective and lever for boosting competitiveness is to reduce dependence on the outside world and to boost security, given the turbulent geopolitical environment we are living in. Once again, the idea of making joint purchases could play an important role in this sphere, in this case commodities that are critical to the ecological transition. On the other hand, developing a more autonomous defence policy will also require an industrial impetus that enables the development of trans-European companies similar to Airbus, as well as greater standardisation of defence equipment and systems across Member States.

Reforms in EU governance to unlock growth potential

In order to make progress in these three spheres, two major sweeping reforms will be needed. The first involves creating an environment that is more conducive to investment, both public and private. While most of the capital needed for this productive transformation has to come from the private sector, as has traditionally been the case, the public sector has to accompany and encourage these investments. One of the flagship proposals of the report is, in fact, that the public investment required should be carried out through the regular issuance of pooled safe assets (i.e. Eurobonds that extend what has already been achieved with the NGEU programme) in order to facilitate investment in pan-European industrial projects.

The development of Eurobonds should be complemented by deeper and more comprehensive capital markets and banking unions, as well as a greater boost to pension systems. This ought to unlock the large amount of pent-up savings that exists in the EU and allow investment to flow between all Member States. In addition to Eurobonds, another way to achieve such extremes would be to facilitate the securitisation of banking assets, such that financial institutions can free up capital and increase their lending capacity.

According to the European Commission, the investment required is estimated at least 800 billion euros per year (a volume equivalent to almost 5% of EU GDP in 2023, which would bring the total investment to around 27% of the EU's GDP, compared to 22% today). That said, it remains to be seen whether the productive sectors of the economy would be able to absorb this amount of funds. If this is achieved, the report estimates that GDP would increase by 6% in 15 years (relative to a scenario where no investments are made), with limited and temporary inflationary pressure. The report also considers that the high level of public investment will have a limited impact on fiscal sustainability if productivity increases are achieved.

The second major sweeping reform involves improving European governance at various levels. At the budgetary level, the report proposes designing a more flexible budget, with greater capacity to reallocate expenditure, given its long time span, and with fewer categories and a consolidation of priorities around the objectives set (i.e. reoriented to the needs of industrial policy in order to tackle the three major challenges described). At another more «constitutional» level, the report proposes speeding up decision-making through the extended or generalised use of majority voting, as opposed to the unanimity required in the EU Council.

Although the report has been well received by the European authorities, it remains to be seen how they will deal with the reluctance shown by some Member States towards the proposals, especially those which have been around the longest without being successfully implemented (such as the proposal for Eurobonds or the completeness of the banking and capital markets unions).

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