ИНСТИТУТ ЕВРОПЫ РОССИЙСКОЙ АКАДЕМИИ НАУК

125009, МОСКВА, МОХОВАЯ УЛ., 11-3
ТЕЛ.: +7(495)692-10-51/629-45-07
E-MAIL: europe@ieras.ru
WWW.INSTITUTEOFEUROPE.RU

INSTITUTE OF EUROPE RUSSIAN ACADEMY OF SCIENCES

125009, MOSCOW, MOKHOVAYA STR., 11-3
TEL.: +7(495)692-10-51/629-45-07
E-MAIL: europe-ins@mail.ru
WWW.INSTITUTEOFEUROPE.RU

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The Draghi report interrupts the EU silent "family dinner"

Olga Butorina

> *People can be having dinner, just having dinner, and at the same time, their happiness is being secured, or their lives are being destroyed.*
>
> *Anton Chekhov.*

Abstract. *On Sep. 9, 2024, former ECB president Mario Draghi released his long-awaited report on the future of European competitiveness. The document clearly shows that sluggish growth results in a widening GDP gap with the US and increases existential risks for the EU within the changing globalisation paradigm. This paper argues, first, that the European Commission has been suppressing discussions on economic growth since 2019; second, it provides a concise overview of the report's insights and proposals; and lastly, it discusses the prospects of the report being endorsed and implemented by the EU political leadership.*

Keywords: *European Union, European Commission, economic growth, competitiveness, Draghi Report.*

On September 9, 2024, former European Central Bank (ECB) president and ex-Italian prime minister Mario Draghi presented the European Commission (EC) with a 400-page report on the future of European competitiveness.[1] The document consists of two parts: Part A contains a critical

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Author: Prof. Olga Butorina, Doctor of Science (Economics), Corresponding Member of the Russian Academy of Sciences (RAS), Deputy Director for Research, Institute of Europe, Russian Academy of Sciences. Address: 11-3, Mokhovaya St, Moscow, Russia, 125009. E-mail: butorina@ieras.ru

[1] The Future of European Competitiveness. https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead_en#paragraph_47059 (accessed September 12, 2024).

overview of the EU economy and its global standing while Part B offers an in-depth analysis of sector-specific and cross-sectoral issues, providing objectives and proposals for each of them.

Economic growth was a top priority for the EU since its inception. This changed, however, in late 2019 when a new European Commission led by Ursula von der Leyen took office, shifting focus to the European Green Deal (i.e., achieving climate neutrality by 2050), digital transformation and building an economy that works for people.[2]

The EU share of world GDP has been steadily shrinking lately, dropping from 21.8% in 2010 to 17.5% in 2023. In the meantime, the US share rose from 22.5 to 26.0%, and China's share jumped from 9.2 to 17.0%. In 2021, for the first time ever, China overtook the EU by nominal GDP, finishing the year at $17.8 trillion versus the EU's $17.3 trillion.[3]

Green silence

In 2023, the euro area's real GDP grew by mere 0.4%, and it is projected to increase by 0.8% in 2024.[4] Dynamic growth has been a key priority for the EU since the early 1970s, when the collapse of the Bretton Woods system and oil shocks resulted in soaring inflation and unemployment across Europe. In the early 1980s, the European Economic Community (predecessor of the EU) took a number of radical measures to make the European industry more competitive and narrow the technology gap between Europe, on the one hand, and the United States and Japan, on the other. Dynamic growth was the only way Europe could solve its biggest social problem – namely, unemployment.

The two major EU endeavours of recent decades – the European single market and the Economic and Monetary Union – both prioritised economic growth. The plan to establish a single internal market, announced in 1985, aimed to tap into the integration potential by ensuring the free movement of goods, persons, services and capital. According to the Cecchini Report of 1988, these efforts were to add about 5% to the Community's gross domestic product, opening better opportunities for growth, job creation, economies of scale, improved productivity.[5] This extensive program was largely completed by 1992.[6]

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[2] European Commission, Directorate-General for Communication, Leyen, Ursula von der, A Union that strives for more – My agenda for Europe – Political guidelines for the next European Commission 2019-2024, Publications Office, 2019, https://data.europa.eu/doi/10.2775/018127 (accessed September 10, 2024).

[3] UNCTADStat: Gross domestic product total and per capita, annual. https://unctadstat.unctad.org/datacentre/dataviewer/US.GDPTotal (accessed September 12, 2024). In 2023, due to the economic slowdown in China, its economy shrank to $17.8 trillion, falling back behind the EU with its $18.4 trillion.

[4] European Commission. Report on Public Finances in EMU 2023. Institutional Paper 295, September 2024. https://economy-finance.ec.europa.eu/document/download/0aaf8190-b9fe-46b2-9dac912b98bef0da_en?filename=ip295_en_0.pdf (accessed September 13, 2024).

[5] Commission of the European Communities (1988), Europe 1992: The Overall Challenge, SEC (88) 524 final. Brussels, April 13. http://aei.pitt.edu/3813/1/3813.pdf (accessed September 12, 2024).

[6] Kondratyeva, Natalia (2020), European Model of Market Integration: Formation and Prospects. RAS, Moscow (in Russian).

The subsequent move to the Economic and Monetary Union and transition to the single currency at the start of 1999 was intended to facilitate integration of financial markets, sharpen competition and improve allocation of resources. New incentives for promotion of productivity and investment were expected to emerge. Presumably, all this together with long-term price stability (maintained by the European Central Bank) and an internationally recognised currency provided favourable environment for long-term growth and employment.[7]

Later the EU adopted three long-term growth strategies: the 2000 Lisbon Strategy, its updated version of 2005 and the Europe 2020 Strategy proposed by the European Commission in March 2010. However, as Draghi points out in his report, "various strategies to raise growth rates have come and gone, but the trend has remained unchanged".[8]

After 2020, the EU abandoned long-term programs. The medium-term Broad Economic Policy Guidelines were discontinued without an explanation – although the Treaty on the Functioning of the European Union requires the Council to formulate broad economic policy guidelines for the member states (Art. 5, p.1). It seemed that Brussels was shifting from the classic growth concept towards modern post-growth ideas, emphasising environmental, structural and social dimensions.[9]

This may be illustrated by facts. The general report on activities of the European Union in 2019 opened, as usual, with an extensive chapter on economic policies.[10] The 2020 report, on the other hand, centred around the COVID-19 response (quite naturally) and a 25-page section on climate neutrality, with a large photo of young people staging an environmental protest.[11] It was followed by a section on protecting people and freedoms, and only after that came the economic section, which was only seven pages long, including photos. The reports published from 2021 through 2023 did not dwell on economic growth at all. Growth was only mentioned occasionally as one of by-products expected from various legislative initiatives proposed by the European Commission, from labour market regulations to corporate taxation practices.[12]

Outside observers had to conclude that Brussels either completely abandoned the idea of having a common economic policy (which used to be one of the two pillars of the Economic and Monetary Union). Or it delegated this work to technocrats, focusing instead on painting a nice picture that would appeal to general public and their voters. It is emblematic that key EU documents have been increasingly bedazzled with flashy illustrations lately, which makes it much more difficult to navigate around them and grasp their meaning.

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[7] European Commission (1995). Green Paper on the Practical Arrangements for the Introduction of the Single Currency, 31 May. COM/95/333 final.

[8] The Future of European Competitiveness, Part A, p. 1.

[9] Tsibulina, Anna (2024). New growth priorities of the European Union's economic policy, *Saint Petersburg University Journal of Economic Studies*, vol. 40 (2), pp. 175–190 (in Russian). doi.org/10.21638/spbu05.2024.202.

[10] The EU in 2019. General report on the activities of the European Union. https://op.europa.eu/en/publication-detail/-/publication/66c4ad7e-6281-11ea-b735-01aa75ed71a1/language-en (accessed September 12, 2024).

[11] The EU in 2020. General report on the activities of the European Union. https://op.europa.eu/en/publication-detail/-/publication/f59f7b32-8084-11eb-9ac9-01aa75ed71a1/language-en (accessed September 12, 2024).

[12] See, for instance, The EU in 2023. General report on the activities of the European Union. https://op.europa.eu/webpub/com/general-report-2023/pdf/the-eu-in-2023.pdf (accessed September 12, 2024).

By declaring the Green Deal, the European Commission adopted a new, catchy agenda untarnished by past failures. The atmosphere at "family dinners" improved, as attendees no longer had to worry about all those nasty deficits, distortions and disproportions.

Draghi's mission

Perhaps no economist in the EU enjoys the same international acclaim as Mario Draghi. He started his tenure as ECB president on November 1, 2011, when the euro zone crisis was heading to its peak. In early 2012, the yield on Portuguese 10-year government bonds soared to 13%, and for Greek bonds, it was almost 30%. Draghi's unorthodox monetary policy rescued the EU banking sector from a potential collapse.

Speaking at the Global Investment Conference in London on July 26, 2012, Draghi gave his famous vow: "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough".[13] Markets believed him, and spreads began to narrow. Not every ECB head can claim that his/her words have such an impact.

This is why the competitiveness report presented by Draghi deserves our full attention. It busts the myth that the green agenda makes growth irrelevant. Speaking with his usual candour, Draghi states in a separate paragraph, "Europe's need for growth is rising." He explains that the EU faces greater competition on global markets today, that it has lost Russia as its key energy supplier, and that it is weak in emerging technologies, in part because it largely missed out on the digital revolution. In addition, the demographic situation looks bleak: by 2040, the EU workforce is projected to shrink by 2 million workers each year.

Draghi and his co-authors are well aware, of course, of Brussels etiquette, so they "garnish" their recommendations in line with the latest trends and serve them under the right "dressing." They point out in the foreword that major investments will be required to digitalise and decarbonise the economy and increase the defence capacity. Specific numbers, though, are only mentioned toward the end of Part A. The EU will need at least 750-800 billion euros a year in additional investment, corresponding to 4.4-4.7% of EU GDP in 2023. This would require the EU's investment share to jump from 22% of GDP today to around 27%, i.e., by five percentage points, "reversing a multi-decade decline across most of large EU economies." In other words, digitalisation and decarbonisation are merely a fashionable "topping".

The report outlines three areas the EU should focus on in order to reignite the sustainable growth.

The first – and most important – objective is to close the innovation gap with the US and China, especially in advanced technologies. Currently, much of research and innovation investment in the EU is concentrated in traditional industries, especially automotive. It was the same in the US in the early 2000s but the situation there has changed. Facing restrictive regulations in the EU,

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[13] Draghi, Mario (2012). "Verbatim of the remarks made by Mario Draghi. Speech by Mario Draghi, President of the European Central Bank at the Global Investment Conference," London, July 26. https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html (accessed September 12, 2024).

successful European start-ups turn to US venture capitalists for funds and relocate to the United States as they scale up. In the era of fast AI development, the European Union cannot afford to remain stuck in technologies of the previous century.

The second objective is to match the EU's climate targets with a clear, coherent plan. Without such a plan, the report says, instead of being an opportunity for Europe, decarbonisation could run contrary to competitiveness and growth. A stunningly candid statement! What this means, translated into plain words, is that the EU embarked on its twin transition without a clear plan, without assessing properly all the costs and benefits. And today, five years on, it still does not have a comprehensive plan of action.

Draghi points out that EU companies face electricity prices that are two or three times higher than those in the US, and natural gas prices that are four or five times higher. The reason for this price gap is not limited to the lack of natural resources in Europe; there are also "fundamental issues" with the EU's common energy market – namely, high taxes and rents captured by financial traders.

The third objective is to increase security and reduce dependencies. The EU economy relies on a handful of suppliers for critical raw materials, including China. It is also hugely reliant on imports of digital technology. This means that the EU needs a genuine "foreign economic policy." This section is rather short and largely repeats key points of the European Economic Security Strategy adopted in the summer of 2023.[14] New additions have to do with the defence industry and space sector.

Implementation tools and prospects

The report clearly states the potential consequences of inaction. Without dynamic growth, the European Union will have to scale back at least some of its ambitions. It won't be able to become a leader in new technologies and climate responsibility, be an independent player on the world stage and finance its social model all at once. But if the EU can no longer provide its people with the opportunities and rights they are entitled to, it "will have lost its reason for being".

While Part A explains what needs to be done, Part B explains in detail how to do it. In-depth analysis is provided for ten specific sectors and five horizontal, cross-sectoral issues. Priority sectors include energy, critical raw materials, digitalisation and advanced technologies, high-speed/capacity broadband networks, computing and AI, semiconductors, energy-intensive industries, clean technologies, automotive, defence, space, pharma and transport. Five horizontal policies are: accelerating innovation, closing the skills gap, sustaining investment, revamping competition and strengthening governance.

The last point clearly addresses the EU institutions. Excessive regulatory and administrative burden makes it harder to do business and affects the EU's competitiveness. To remedy the

[14] European Commission Joint Communication to the European Parliament, the European Council and the Council on the "European Economic Security Strategy", Brussels, 20.06.2003. JOIN (2023) 20 final. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52023JC0020 (accessed September 12, 2024).

situation, the report recommends both traditional tools (more vigorous exercise of the subsidiarity principle and the enhanced cooperation procedure) and a few new ones. The authors recommend simplifying the rules, developing a new Competitiveness Coordination Framework, extending or generalising qualified majority voting in the Council, and streamlining the EU acquis in a systematic way.

What are the prospects of these recommendations being implemented?

Mario Draghi turned 77 a few days before presenting his report. He has had such a stellar career that he can afford now to say what he really thinks. He has nothing to lose. He has good knowledge of economics and deep understanding of integration. Back in 1970, before graduating with honours from the Sapienza University of Rome, he wrote a dissertation on "Economic integration and the variation of exchange rates". Draghi received his Ph.D. from the MIT Economics Department, with his supervisors being the future Nobel laureates Franco Modigliani and Robert Solow.

Later, Draghi met Tommaso Padoa-Schioppa, an Italian economist who was the chief proponent of the Economic and Monetary Union, and they worked together, representing Italy in EMU negotiations.

Draghi knows how the "impossible trinity"[15] works and what might happen if the EU keeps disregarding the issue of growth, which is essential for normal operation of the EMU and, specifically, its economic governance.

But Draghi's expertise and candour are met by a force of a different nature. Judging by her first term, it seems that the European Commission led by Ursula von der Leyen chose not to deal with all the economic problems they inherited. The green agenda provides the EU with the glamour of a new brand, modern and convenient, highlighting the EU's leadership position in the world and its regulatory power. Draghi's report dissonates with this nice picture. Hence, some will definitely try to downplay its importance. Such is human nature, and one should not underestimate it.

Implementation of the program will face a number of practical obstacles. The first and most obvious one is it's unclear where these 750-800 billion euros a year will come from. The member states that are net contributors to the EU budget are reluctant to take on additional financial commitments, especially now, when public debt levels are high. Attempts to augment the EU budget have often resulted in bitter disputes between member states, and achieving significant progress in this matter would be a miracle. Securing such a substantial amount from national budgets, international funds or private sources will be equally problematic.

The second obstacle is less obvious. It has to do with the "birthmark" of European integration originating in the political compromise between Germany and France. Germany got an opportunity to revitalise its industry, but the price imposed by France was steep. The EEC adopted the protectionist Common Agricultural Policy. To this day, CAP contains mechanisms that clearly

[15] The impossible trinity is a concept stating that it is impossible for a state to pursue three macroeconomic policies at the same time: (1) monetary sovereignty; (2) free capital flow; and (3) fixed exchange rate. Market mechanisms allow pursuing two of these policies simultaneously but not all three.

don’t agree with the free market and consumes a disproportionate share of the EU budget, up to 30%. Having a common agricultural policy is a key factor that keeps France interested in European integration. The fact that the Draghi report does not touch the subject of agriculture at all may be an indication of how serious the problem is. However, once the EU starts redistributing its common budget to foster innovation, the question of agricultural subsidies will inevitably come up sooner or later.

The third obstacle may come in the form of green lobbyists who are unlikely to welcome the emergence of a new priority. With less importance given to the climate agenda, they would have to cut back on financial, human, political and administrative resources. There are a lot of officials within the EU bureaucracy who have been working on the Green Deal for the last five years, and their well-being and career prospects are closely linked to this policy.

Lastly, the fourth obstacle is the rigidity of governance mechanisms. EU institutions are, on the one hand, very prolific (judging by the number of legislative acts they produce and the speed with which they put them out), but, on the other hand, they are hard to reform. Draghi’s proposal to extend or generalise qualified majority voting will affect a small yet extremely controversial group of economic issues. At present, the Council acts unanimously when it adopts decisions related to the harmonisation of indirect taxation (which may affect e-commerce), to the fiscal aspects of the EU energy policy and to the system of the Union’s own resources, i.e. common budget.

Does it look like the plan might succeed? Yes, it does. A lot has changed in Brussels over the last five years, while the European Commission was preoccupied with the green agenda. Old disputes among member states over various aspects of the economic policy have been forgotten; many of the officials who were embroiled in those disputes are gone. Debates over budget rule violations have subsided. Memories of the euro zone crisis have faded, and nations no longer point fingers at each other, arguing whose fault it was, who was hit the hardest and who rescued whom. The European Commission’s Directorate-General for Economic and Financial Affairs, which for decades shaped the European economic policy and oversaw its implementation together with ECOFIN, has taken a back seat.

This would be a good time to rearrange the fragmented elements of the EU economic governance system and configure them in a way that would be best suited for the Union’s current needs and the new global paradigm. If this happens, it would mean that the policy of downplaying economic issues that we observed in recent years was an act of creative destruction with far-reaching and masterfully concealed ramifications. In this scenario, the European Commission will save their face in front of the general public, including environmental activists. They can always say that this desperate pursuit of growth was not their idea; they only do it because the growth is necessary in order to preserve the EU social model, which is in jeopardy due to increased competition from Europe’s two global rivals – one in the East and one in the West.

Conclusion

The Draghi report being released now, at the beginning of a new political cycle, presents the European Commission with a tough dilemma. Should the EC focus on growth and making EU manufacturers more competitive (through massive investment) now? Or should it save the reforms for later? The latter would mean giving up on growth and losing Europe's global standing along with the Green Deal and the European social model. Implementing the recommendations contained in the report would require overcoming a number of obstacles: lack of obvious sources for investment; limited EU budget, largely reserved for other needs; opposition from the green lobby that has gained significant clout in recent years and rigidity of decision-making procedures.

Nevertheless, there is a chance that the European Union does embark on a quest to revamp its economic policy, because the years spent pursuing the twin transition (decarbonisation and digital transformation) brought new faces to the governing bodies and bitter disputes over economic issues are largely forgotten. Within a year, we will know better whether this scenario is likely: if we see the EU creating the governing bodies recommended in the report, it will be an indication that the plan was given the green light.

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