Daniel DĂIANU, 21 October 2024

Can the EU decline be prevented?

The Draghi Report is exceptional through its thoroughness and daringness to tackle critical issues for the EU's future. Some of its key messages go much further than what various reports and programs (the Sapir Report, the Monti Report, the Lisbon Agenda, Europe 2020, the recent Letta Report etc.) have highlighted over time, such as institutional incompleteness and suboptimal policies. The big financial crisis made it quite clear, and in subsequent years new institutional constructs and revised rules were enacted, but not in a decisive manner while these were dented by political constraints. A string of major crises (the pandemic, the energy crisis, the impact of climate change, consequences of the Russian invasion of Ukraine) have strained the EU increasingly.

The Draghi Report points out key Union's weak spots: insufficient innovation, a high energy cost handicap, a feeble joint defense capacity. The Report singles out roots of this state of affairs and makes a series of recommendations – reduce fragmentation, develop the capital markets union and the banking union, improve the energy market (where highly volatile prices harm both consumers and producers), reconsider competition policy, foster a EU defense industry, streamline the decision making process, raise investment massively, revise a EU regulatory approach that stymies innovation – though one has to be careful as AI can be both a boon and a curse, and shadow banking and crypto assets are under-regulated.

The focus of the Report is a growing EU' competitiveness gap unless its "economic model changes". This may seem paradoxical as the EU scored current account surpluses for many years now. Only in 2022, a drastic terms of trade worsening (due to strong disruptions in energy markets) made the current account show a deficit. But surpluses have come back afterwards.

The Report gives voice to deep worries which are linked mostly with a concern that the Union is losing ground in technological and economic competition as against the US and China.

But is it a surprise? Just compare American and Chinese juggernauts with EU counterparts, or how much the US and China, each, spend for R&D annually vs. similar spending in the Union. Moreover, The US excels with its entrepreneurial culture, which epitomized by Silicon Valley. China, like other Asian economies, is probably the best case of building competitive advantages over time, via what is now openly rediscovered in the West, conceptually, as Industrial Policy. Parts of such a policy were used in the US for decades in a more or less obvious way, especially in domains that pertain to military strength and security. The EU, too, practiced industrial policy when, for instance, it made Airbus a big European competitor of US firms. But systematic industrial policy has been almost missing at the EU level. The bottom line is that the EU is made up of national states, has fragmented markets, both of which are consequential for collective policies and outcomes. And the French-German axis seems to have been eroded. Industrial policy is in ascendancy in the US as China's technological catching up has become quite worrisome against the backdrop of geopolitical confrontations.

The Report argues in favor of more investment spending, both public and private, annually to the tune of 800 billion euros, or 4-5% of the EU GDP. More investment can clearly help, but it needs to be embedded in a package of deeply going reforms, that may be hard to accomplish. The EU could be helped by an agency that should fund strategic projects and enhance public private partnerships (as DARPA, the Defense Advanced Research Projects Agency, does in the US). Major building blocks of a genuine monetary union have to come into being: EDIS (European deposit insurance scheme), a fiscal capacity, a *safe asset* (which is mentioned by the Report). Making ESMA a genuine EU Authority would be useful. A larger and restructured EU budget could support EU strategic projects, apart from what is undertaken by member states. Securing means to reduce the cost of energy and develop green energy substantially is a must, as well as a way to stimulate decarbonization.

The Draghi Report makes a strong case for further economic and financial integration, even if political developments in not a few member states create new impediments to such an end. The difficulty for those who need to strategize, not as a simple academic exercise, is that tinkering on the fringes on the big issues raised by the Draghi Report does not move things forward. The Zeitgeist does not seem to help in this regard either, as many in Europe and elsewhere are prone to think and act inwardly, be attuned to a defensive stance of a bad sort. Preparedness against a menacing outer world makes sense, but spreading protectionism inside the EU (among member states) is double-edged and can keep it fragmented, cripple its economic strength, and reduce its soft power.

The EU should strive to rescue multilateralism, despite the tendency of emerging trading blocs and proliferating security related restrictions. Dialogue and trade are needed even with geopolitical competitors, for the sake of securing global public goods – such as dealing with climate change, pandemics, avoid the use of nuclear and other high destructive weapons, avert an AI Armageddon and, not least, prevent, or end wars.

The EU needs to think Big and act resolutely toward a state of affairs that helps it be competitive worldwide in a deep sense. It may be that the EU will muddle through for years to come as painful and complicated policy-tradeoffs, a dearth of resources, huge uncertainties will make good choices sort of mission impossible. This does not mean that the Draghi Report cannot help illuminate policy options and tradeoffs; it can help the new Commission and national governments, all European institutions overcome stalemates, improve policies, avoid major blunders.