ECONOMY AND ECOLOGY 23.10.2025 | David Harrison

Decline by design

Europe's underinvestment isn't just slowing growth — it's fuelling inequality and aiding the far right gain ground. Changing course is still possible

Europe is underinvesting in its own future. The result is slower growth, wider inequality and rising economic discontent — a combination that feeds the appeal of the far right. Reversing this trend means investing more and spreading that investment everywhere.

The Draghi report suggests that to regain competitiveness, the EU requires unprecedented additional investments amounting to almost 5 per cent of GDP — more than under the Marshall Plan for postwar reconstruction.

NATO allies have also agreed to invest at least 3.5 per cent of national GDP for core defence and military purposes by 2035; and 1.5 per cent for protecting critical infrastructure, defending networks, ensuring civil preparedness and resilience, enhancing innovation and strengthening the industrial base.

Putting Europe at risk

Low investment afflicts not just EU states, but the wider 'Europe 30', including Norway, Switzerland and the UK. The important measure here is *net* fixed capital formation – after subtracting depreciation and impairment (i.e. the 'wear and tear' or loss of value) of existing assets – not gross fixed capital. This is because only net additions to the capital stock, not their replacement, drive capital deepening, productivity and wealth. You can think of it as follows: if a country spends €100 billion on investment, but €80 billion of that just goes towards replacing old machinery, the net gain is only €20 billion. That €20 billion is what truly increases the capital stock — the total productive capacity of the economy. According to the McKinsey Global Institute, in 1995, net investment in both the US and Europe 30 was about 6 per cent of GDP, but since then, Europe has been consistently below the US, halving after the 2008 crash, and averaging only 3.3 per cent of GDP from 2009 to

2022.

As the article 'Investment: Taking the pulse of European competitiveness' puts it, a region that is not investing cannot be competitive, and a region that is not competitive will not attract domestic or foreign investment — a vicious circle. Failing to increase investment thus puts Europe's prosperity, way of life and place in the world at risk.

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However, despite widespread agreement on the need to invest more, Europe still lacks a clear strategy for how to pay for it. As Draghi himself recently remarked in Brussels, 'Our growth model is fading. Vulnerabilities are mounting. And there is no clear path to finance the investments we need.'

To increase investment, joint action is needed. Net public investment in both Europe 30 and the euro area has been poor — averaging only about 0.6 per cent of GDP for the former between 1995 and 2022, and zero or negative for the latter between 2013 and 2019. Nor do today's financial markets, favouring short-term speculation over the volatile prices of currencies, commodities, real estate and stocks, provide the long-term investment companies need to keep competitive.

But there could be many possible ways of financing additional investment in a coordinated European programme.

Increasing investment

For public investment, a first step is to create *in advance* a pipeline of good and technically viable European public investment projects, ready for execution, drawing on the best available expertise. Draghi report priorities include decarbonisation, clean energy technology and transport; defence and security; digital technology; and innovation to boost productivity. To which some NATO projects could be added, and – to spread investment widely – items like public housing.

Doing this would assist in raising finance, create economic momentum and ensure that money is used wisely.

One option for public investment is to self-finance. Revenues from underexploited publicly-owned assets – like land and property – can finance new investment. An example is the Copenhagen City and Port

Development Corporation, operating one of the largest urban development projects in Europe, where publicly-owned, privately-run firms regenerate districts, obtain value from underutilised public land, and use revenues to finance new transport and other infrastructure.

The rules on government financing of investment then need re-examining. If a government deficit in the EU exceeds a set threshold, the European Commission engages the excessive deficit procedure. The rules do allow some flexibility, with the Commission taking into account whether that deficit exceeds government investment expenditure. If a large part of the deficit is for investment, it may be treated more leniently. But under the Treaties, this means *gross* fixed capital formation, not the *net* investment which adds to future growth. Government financing of net public investment should not be counted in the gross figures for the excessive deficit procedure.

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Third, Treaty rules prohibit the EU and member states from assuming one another's public commitments, but mutual financial guarantees for the joint execution of specific projects are permissible. For a pipeline of public projects, one source of guarantees is an updated version of the New Community Instrument (or 'Ortoli Facility') of the 1970s, when the Commission issued loans on capital markets to back investment projects. Others are the EU's central budget and the European Investment Bank. And two or more national authorities could provide financial guarantees for investment projects of European benefit.

Fourth is to tap Europe's high level of household savings. Only a small proportion is held in the form of financial securities, with some €10 trillion of EU savings in bank deposits. If households in Europe will not entrust savings to private financial products, public authorities could offer a simple retail savings instrument for public investment, similar to national savings and investment bonds, in areas of obvious European interest — for decarbonisation of energy, or public transport, or defence and security.

Fifth is to issue bonds not to households but to institutional investors, in the form of common European debt. Unlike the post-Covid Recovery and Resilience Facility of 2021, an advance pipeline of investment projects would assure issuers and investors alike of benefits to the European economy and address criticisms by the Court of Auditors

about the running of the facility.

Sixth, to unify the procurement of defence items – so they may be used widely and effectively in the defence of Europe – additional finance could be raised by a new financial institution empowered by government members to fund such items by multiplying the capital subscribed to it, on the model of the European Investment Bank, set up in 1958, and the European Bank for Reconstruction and Development, set up in 1991.

Seventh, where public investment for security and defence is vital to preserve European democracy and cannot otherwise be financed, the practice of quantitative easing by central banks needs re-thinking. Central banks have bought large proportions of national public debt issued by the biggest European states (Germany, France, Italy, Spain and the UK). To avoid flooding financial markets with more public debt, a modified policy could permit central banks to purchase debt for investment via swap arrangements (e.g. the Bank of England to purchase euro area issues, and vice versa). Bonds could then be released to market investors at a later stage, once essential defence requirements have been met.

Not just a public challenge

Europe's investment challenge is not just public. Private investment, too, has been weak since the 2008 crash — almost a quarter lower across OECD countries than before. But here, too, there are financing possibilities.

Companies could use their own retained earnings for investment, rather than devote profits to share buy-backs, once confidence is instilled in a European long-term programme.

Finance by credit from the banking system could be improved by applying to flows of capital the distinction in competition law between concerted practices permissible because, by financing investment projects, they improve the production of goods and promote technical and economic progress; and those creating price distortions and bubbles in existing assets, like real estate, which have no wider benefits and should therefore be prohibited.

And to provide long-term capital in the form of equity, a jointly-owned European institution, operating like an item of international infrastructure, could match the long-term investment needs of companies with long-term institutional savings, like pension and insurance funds. The initial focus should be on capital-intensive

companies — like those in defence, infrastructure, transport and energy.

Increasing investment is an economic necessity for Europe. In a world of trouble, how it is organised could also become a positive political project for shaping the future.



David Harrison

David Harrison is a lawyer, former diplomat and speechwriter, author of several books on European economic and financial questions and a member of the Institut Jean Monnet.