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Europe has an investment problem

Decades of underinvestment and regional disparities have left Europe divided. What is needed is a continent-wide investment strategy

Europe has an investment problem — and it is also a regional one.

In his speech accepting this year's Charlemagne Prize, economist and former Prime Minister of Italy Mario Draghi pointed out that Europe's annual investment needs have risen from an estimated €800 billion in additional strategic spending to almost €1.2 trillion, largely because of the new defence commitments of recent years. At the G7 Leaders' Summit in France in June, the world's economic imbalances were also high on the agenda, with economic experts advising the French presidency that Europe's best contribution should be to tackle its persistently low levels of productive investment.

But increasing investment alone will not be enough. Europe also needs to ensure that investment is distributed widely around the continent.

Today's regional inequalities are, in large part, the result of yesterday's investment shortfalls. Decades of negligible overall levels of net public investment mean that in parts of Europe the social fabric itself is fraying and coming apart. Economic stagnation since the financial crash of 2008, plus divergences between prosperous and non-prosperous regions, have created fertile ground for political discontent. Together, these conditions have helped fuel political discontent and the rise of the far right.

Europe therefore needs a strategy that not only invests more, but invests differently: directing a greater share of new investment towards the regions where it is most needed.

Long-term problems

In 1956, when the foundations of today's European single market were being laid, the Spaak Report explained that it was not true that, when regions with unequal levels of economic development were suddenly

brought together, the less favoured region would automatically catch up. Italian unification after 1860 and the experience of the United States after the Civil War showed that gaps could cumulatively increase without public action to improve essential conditions like roads, ports and communications infrastructure, systems of drainage, irrigation and land management, schools and hospitals. Positive collective action would be needed to help both the regions needing development in Europe and the regions already favoured. The latter would participate in the increased economic activity while avoiding downward pressure on wages and living standards as the different regions were brought together.

The fact that this point has largely been ignored by European governments in the past explains many of the difficulties facing Europe today.

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The UK became Europe's most regionally unbalanced large economy by not having any national public investment plan or strategy at all, for almost 50 years. Public investment was concentrated in prosperous London and the wider south-east of England, reinforcing existing areas of growth, while fast-growing places moved to the front of the queue for further public investment. In 2019, an inquiry led by a former head of the civil service found that, after decades of divergence between London and the south-east and the rest of the country, the UK was 'decoupling' and, on most measures, was more regionally unequal than even post-unification Germany. It concluded that significant sums needed to be spent on regional development – about 0.5 per cent of national GDP annually over 25 years – and that infrastructure investment should rise from about one per cent to at least three per cent of GDP a year.

In Germany too, reunification after 1990 created large regional inequalities. At the time of unification, most of the capital stock in the former GDR was obsolete compared to that of the Federal Republic, and average productivity was only about one third as high. Very large sums were spent on funding reunification – up to about €2 trillion between 1990 and 2018 – but most went on social transfers, such as pension and unemployment benefits, rather than investment. After years of deterioration in Germany's public infrastructure in the 21st century, a

further €500 billion Special Fund for Infrastructure and Climate Neutrality was launched in 2025, to invest over the next 12 years in areas like transport, hospitals, energy, civil protection, education, science and housing — equivalent to about one per cent of GDP a year.

In France, meanwhile, the immediate postwar boost to investment was not just for reconstruction, but also to deal with long-term underinvestment going right back to before the First World War. To counterbalance the economic dominance of Paris, policies for spatial and territorial planning were introduced from the 1960s onwards, but became difficult to sustain after the crises of the 1970s. Measured in terms of productivity, France today has levels of regional inequality almost as high as the UK.

In Italy, unification in 1861 did indeed set the terms for today's regional differentials. Piedmont, to the north, was already modernising by investing in railways and promoting industry and commerce before unification, at which point the rest of Italy effectively merged with it. By the time of unification, of just over 1 800 kilometres of railways constructed in the Italian peninsula, 1 372 (or 76 per cent) were in the north. Where investment went before unification, therefore, largely determined which parts of Italy would prosper afterwards.

A long-term solution

To remedy these problems, action on a continental European scale is needed. The EU's own Cohesion Policy, under which about a third of the EU budget is used to reduce regional disparities, is helpful but not designed or set up to increase investment in the manner required.

A dedicated Investment Community could provide such a framework, raising both public and private investment rates. Starting from an overall balance sheet of needs and resources, it should provide strategic direction on behalf of its members; create a pipeline of necessary public investment projects; mobilise finance from a wide range of sources; and bring it to bear on the areas needing attention.

Increasing net investment – which takes account of depreciation and wear and tear of existing assets – by just one per cent of Europe's GDP each year over five years is achievable and would make a big impact, provided a proportion is allocated to the underinvested regions. The kinds of investments Europe actually needs – from large-scale decarbonised energy production and transmission networks to modern transport and communications systems and decentralised clusters of research, development and innovation around cities – lend themselves to

being spread around widely.

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Unfortunately, at present, Europe's financial system is geared to pushing up the prices of existing assets – in particular real estate and property – rather than to new investment that creates growth. Inflated property prices contribute to Europe's housing crisis and create economic barriers, curbing people's mobility to move from region to region. In an Investment Community, by contrast, bank credit for productive investment could be increased by permitting cooperation between competing banks where this contributes to improving the production of goods or promoting technical and economic progress, rather than merely creating price bubbles in existing assets such as property. A long-term capital market, owned by Investment Community members themselves, should aim to match the long-term investment needs of Europe's companies with long-term institutional savings, like pension and insurance funds.

Even if most investment comes from the private sector, the public sector will need to lead the way. An Investment Community would be like a large-scale public-private partnership, giving the private sector the certainty and financial resources needed to invest within a long-term framework set by the public interest, while remaining answerable to the citizens of Europe for the regeneration of their continent.

Today has distinct echoes of the dark 1930s, following the crash of 1929 — but also of an earlier turbulent period. Historian Christopher Clark, in his book *Revolutionary Spring* (2023), describes in vivid detail the wave of revolutions that swept Europe in 1848, impelled by serious economic distress and political discontent. The revolutions failed, but post-revolutionary governments everywhere turned to active policies to stimulate economic growth, and public spending on domestic investment surged. Across Europe, cities like Berlin, Paris, Vienna and Madrid, which had witnessed street fighting and barricades in 1848, saw programmes of urban transformation and improvement in the 1850s; and states developed railway systems, telegraph networks, tunnels, canals, ports, schools and bridges, connecting peripheral regions to metropolitan centres, and unifying and strengthening national economies.

Economic distress and political discontent have returned to haunt Europe once again. Pre-emptive action through a programme to invest in mutual construction now would be much better than doing too little, too late.



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.