Nice ideas, Mr Draghi—now who will pay for them? (economist.com)

Charlemagne

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From "whatever it takes" to "whatever the cost"

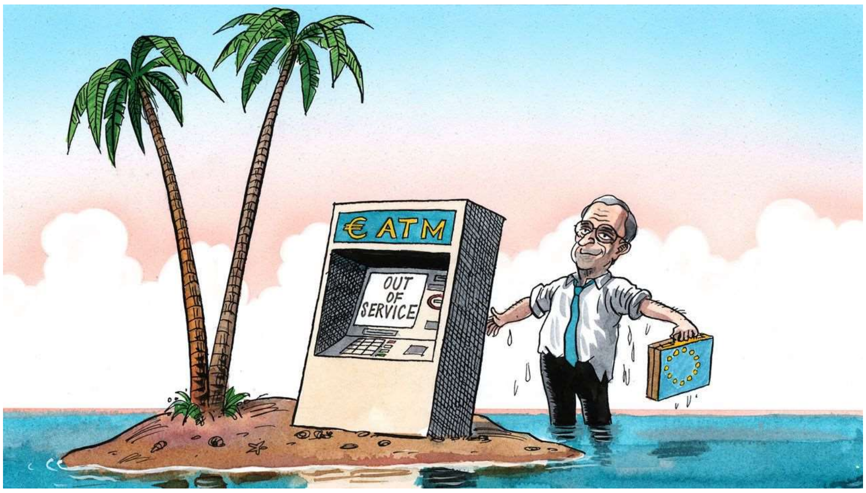

Illustration: Peter Schrank

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An old joke haunts economists. A chemist, a physicist and an economist are stranded on a desert island with a tin of beans but no implement to open it. The chemist suggests corroding the container with sea water, but concludes it would take years. The physicist proposes a method to prise the tin open that turns out to be equally impractical. The economist is delighted that only she has the right answer: "Assume a tin-opener."

Mario Draghi, himself an economist of some renown, this week unveiled a report on how to revive Europe's flagging economic prospects. His answer: "Assume €800bn" (close to $900bn). That is the annual investment the former boss of the bloc's central bank thinks is required to prevent the European Union's economy falling ever further behind America's. The problem is that money on that scale is as elusive in Europe as a tin-opener on a desert island. Establishing blueprints for spending money is the easy bit. But given EU countries are trillions of euros in debt beyond what the club's own rules are meant to allow, finding the cash is likely to prove as hard as coming up with a funny joke involving economists.

A tension afflicts the EU. On the one hand, as Mr Draghi has spelled out in a 400-page report for the European Commission, it needs to invest lots to face up to challenges facing the continent. The to-spend list is daunting. More needs to be shelled out on defence, obviously. A bob or ten are required to decarbonise the economy. Improving digital networks is as necessary as it is expensive. Ageing will send welfare bills ever soaring as fewer workers support more pensioners. There is an urgent need to invest in innovation and skills to boost productivity, the better to build the Apple-like corporate Goliaths that are so sorely lacking in Europe. And derisking trade, for example by stemming dependence on hostile foreign powers for vital commodities (Germany's recent reliance on Russian gas, for example), will prove expensive too. The Marshall Plan spent 1-2% of GDP per year after the second world war to rebuild rubble-strewn bits of Europe; Mr Draghi thinks annual investment by business and governments needs to jump by 5% of GDP compared with now.

Alas, the other hand, the one with the money, is empty. In a rose-tinted world, rewiring the economy could help lead to the private sector coming up with a goodly chunk of the €800bn extra investment needed year after year. Extending the EU single market that works well for goods to bank accounts and stockmarkets could make viable a slew of new investments, for example. But such a "capital markets union" was first proposed over a decade ago and has proved elusive. Achieving it would involve taking on many entrenched interests.

The obvious footers of Mr Draghi's proposed bill are the EU's 27 national governments, which do most of the taxing and spending in Europe. (The EU has a small budget, at just 1% of GDP, over a third of which is spent on farm subsidies.) But there has been too much spend and not enough tax of late. European fiscal rules adopted ahead of the creation of the euro stipulate that no EU country is meant to have a government-debt burden of over 60% of GDP, nor an annual deficit of over 3%. How quaint that seems these days. Over half the EU's 27 member states exceeded the debt figure at last count. France, Italy and Spain, ie, three of the EU's four biggest countries, all have debt-to-GDP ratios above 100%. That is the kind of level where investors get jittery about public finances drifting further out of balance (as Liz Truss, a British prime minister who resigned after markets balked at her announcement of tax cuts, found out in 2022). Taken together, the debt over and above the 60% threshold amounts to €4.8trn, equivalent to a third of the bloc's GDP. Sadly, it cannot simply be assumed away.

Whereas Mr Draghi sees the need to splurge, the very commission that asked for his report wants national governments to tighten their belts. EU debt and deficit rules suspended during covid-19 are being reinstated, with slight tweaks. Nobody thinks they will prevent the kind of profligacy that was tolerated in the past, but appearances must be maintained. France is heading for a deficit above 5%, and has said it will miss an upcoming EU deadline to submit its budget plans for 2025. Another six countries are in an "excessive deficit procedure" which will force them to trim spending. Germany, ever the virtuous fiscal pupil, has hacked spending to meet self-imposed rules far stricter than budgetary edicts from Brussels. A fight over every *pfennig* routinely threatens to blow up its governing coalition. €800bn a year, was it, Mr Draghi?

Money for nothing, Mario's tips for free

Reading between the lines, there is no doubt where the former Italian prime minister thinks much of the money ought to come from: the EU should borrow it, issuing its own debt over and above what national governments already owe. A precedent for this was set after covid, when EU countries agreed to a €750bn recovery plan underpinned by money borrowed jointly. It was meant to be a one-off, as skinflint Germans and Dutch, worried that their thriftiness ends up paying for southern profligacy, rarely fail to mention. Their respective finance ministers shot down the idea of more EU debt implicit in Mr Draghi's wish-list within hours of its release.

Perhaps the exalted economist's pleas will unclog the debate on joint debt: there is, for example, a good argument that some defence spending should be financed by EU bonds. But even if a deal on joint borrowing can be reached, it is unlikely to arrive before German elections next year, says Shahin Vallée of the German Council on Foreign Relations. By then all eyes will be on France and its presidential vote in 2027; then something else no doubt. Mr Draghi paints a sobering portrait of Europe's challenges. That there is no way to pay for a solution is the truly worrying bit. ■