

# EUROFI

# Macroeconomic Scoreboard

SEPTEMBER 2025

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with the support of Elias Krief**

## Inside

- Widening economic gap between the Euro area and its main global competitors for more than 20 years
- Increasing economic and fiscal divergences between Member States since the creation of the euro
- Economic and Monetary Union at another critical juncture
- Excessive public debt working against productivity growth and employment
- Is NextGenerationEU a game changer?

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Eurofi  
**Macroeconomic Scoreboard**

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## Executive summary

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During the past 25 years, the European Union (EU) has accumulated a significant economic performance gap with the rest of the world, particularly the United States (US). One of the most striking aspects of this disparity, as this scoreboard shows, is the persistent difference in growth, productivity, and investment levels.

The economic policy choices made by many European Member States, most often geared towards increasing demand to the detriment of productive investment – encouraged by persistently low or even negative real interest rates – as well as the inadequacies of certain EU policies and structural problems in Europe (demographic slowdown, energy dependency in particular) explain this economic stall. The Global Financial Crisis of 2008, the subsequent Sovereign Debt Crisis in Europe, the more recent Covid-19 pandemic, and the Russian war in Ukraine have all exposed and exacerbated these underlying issues.

After periods of turbulence and a return to greater coherence, the Monetary Union is once again at a critical juncture. The euro's successes cannot mask its weaknesses.

In 1999, the euro became the single currency of a vast economic entity whose market of 350 million inhabitants is one of the largest in the world. This has allowed for an intensification of trade within the zone and has been an important factor in trade integration through the elimination of the exchange rate risk. The adoption of the euro has also reduced the cost of intrazone transactions. Moreover, the euro has become the second international currency after the dollar.

But the single currency was created without a common economic policy, and the last 25 years have been marked by the failure of many Member States to comply with the rules of the Stability and Growth Pact. Against this backdrop, economic disparities and divergences in living standards between the main Eurozone countries have widened considerably since the creation of the euro.

The Covid-19 crisis and the war in Ukraine hit the Eurozone harder than its main competitors. Since 2020, existing heterogeneities across EU Member States have been revived. It is an illusion to try to solve the structural problems of our economies by increasing public debt or by creating money. Yet, this is what has been too often tried by pursuing lax fiscal, monetary, and economic policies that have inevitably created systemic risks to financial stability and thus to future growth. This Scoreboard also shows that the EU countries with the highest levels of government expenditure as a percentage of GDP are those with the least competitive firms. Furthermore, excessive levels of public debt are not conducive to productivity and employment growth.

The NGEU is an unprecedented joint response to the Covid-19 crisis, making more than €800 billion available to Member States to make them more resilient, mainly by investing in the green and digital transitions. However, in contrast to the impact of the IRA, there has been no boost to productive investment in the European countries that benefit most from these European funds.

As long as it is not sufficiently understood, especially in the highly indebted countries, that excessive debt is a source of under-competitiveness, the economic situation in these countries will continue to deteriorate and will hamper progress in the construction of an economic and financial European Union. In addition, fiscal and economic divergences between EU countries make it more difficult to define a common interest in Europe, encourage a policy of "every man for himself" and create a climate of mistrust between Member States that hampers progress on public and private risk sharing and weakens the Euro area. →

→ If Europe and the Eurozone are to correct their growth disadvantage compared to the United States and China and not remain at the rank of second-rate powers, a major investment effort will therefore be needed in research and development, industrial equipment, decarbonisation, digital technology and improving the education system and the skills of the population. And the sooner the better, the gap continues to widen, requiring ever greater investment and supply-side efforts.

Consequently, the Euro area needs to get on the right track: strengthen fiscal responsibility, curb persistent inflation, implement more supply-side reforms aimed at raising productivity and promote equity financing, as well as take steps to complete the Banking Union and implement the Capital Markets Union. But these steps can only be contemplated if sufficient discipline begins to reverse the trend of ever-increasing economic heterogeneity across Member States.

# 1. The economic gap between the Euro area and its global competitors has widened since the Global Financial Crisis

Over the past 25 years, the Euro area has accumulated a significant economic performance gap with the rest of the world, especially with the United States (US). One of the most striking aspects of this gap is the persistent differences in productivity investment levels and growth.

The global financial crisis of 2008, the subsequent sovereign debt crisis in Europe and the more recent Covid-19 pandemic and Russian war in Ukraine have exposed and exacerbated these underlying problems. This succession of crises has highlighted the EU vulnerabilities, including its heavy regulatory environment, fragmented markets and underinvestment in key areas such as information and communication technologies and infrastructure.

After illustrating the performance gap between the EA and the US in terms of productivity, growth, and investment since 2000, this chapter identifies the underlying causes of the economic gap between the EU and its global competitors, in particular the US. It then shows that this decline in European economic competitiveness has been accompanied by a significant loss in the competitiveness of EU financial actors relative to their US and Asian counterparts.

Three reasons explain Europe's economic lag:

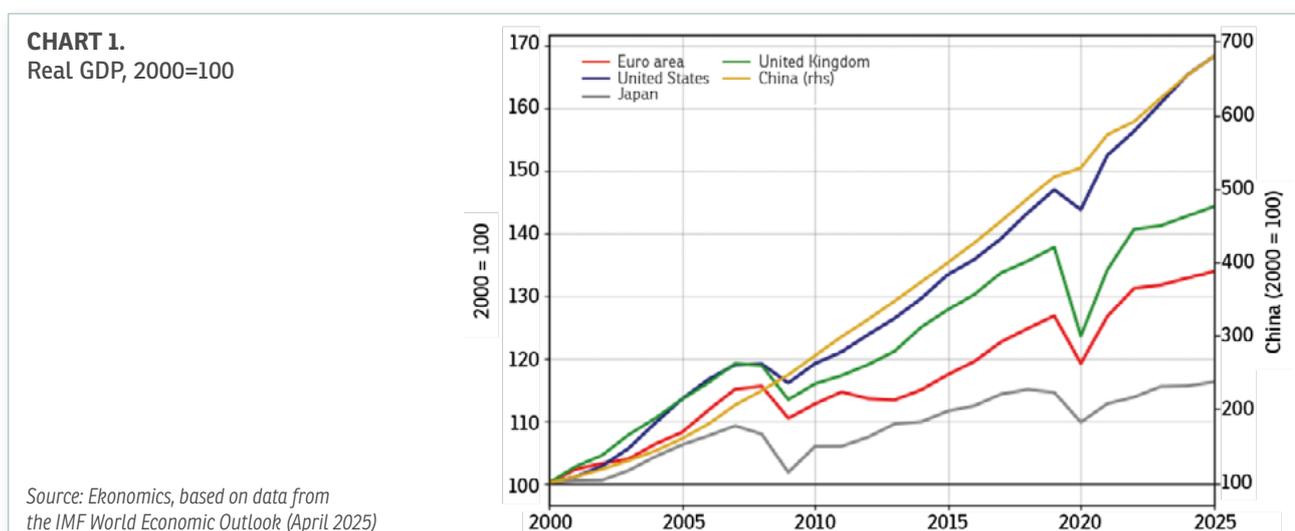
**First, the economic performance gap is the result of different national economic policy choices:** higher investment in research and development and new technologies, a friendlier business environment (including the flexibility of the US labour market), a higher skill level of the US workforce and the existence of a genuine single market for goods and services in the US, as opposed to the fragmented markets that persist in Europe.

**Second, exogenous and cultural factors** – the energy independence of the United States versus Europe's vulnerability to energy shocks (especially after the Russian invasion of Ukraine), the lower risk aversion of American consumers, the high geographical mobility of American workers, the demographic slowdown in Europe in contrast to the expanding working-age population in the United States – have also contributed to the Euro area's economic underperformance relative to the United States and its global competitors.

**The shortcomings of EU policies also explain the economic gap between the EU and the US:** insufficient cooperation and coordination of Member States' economic policies, competition policy that has prevented the emergence of "European champions", available EU resources (NGEU, European Chips Act) that face spending challenges and are slow to produce effects – in terms of increased productivity and investment – in the countries that benefit from them most (e.g. Italy...).

## 1.1 Since the 2000s, the European economy has consistently lagged behind the US in terms of productivity, investment and growth

The difference in economic performance between the EU and the US since 2008, which became even more pronounced after 2020, is undeniable: it is the result of diverging labour productivity growth, mainly due to underinvestment by the European business sector. Lower investment in key areas such as technology, research and development and infrastructure has led to slower productivity growth in the EU than in the US.

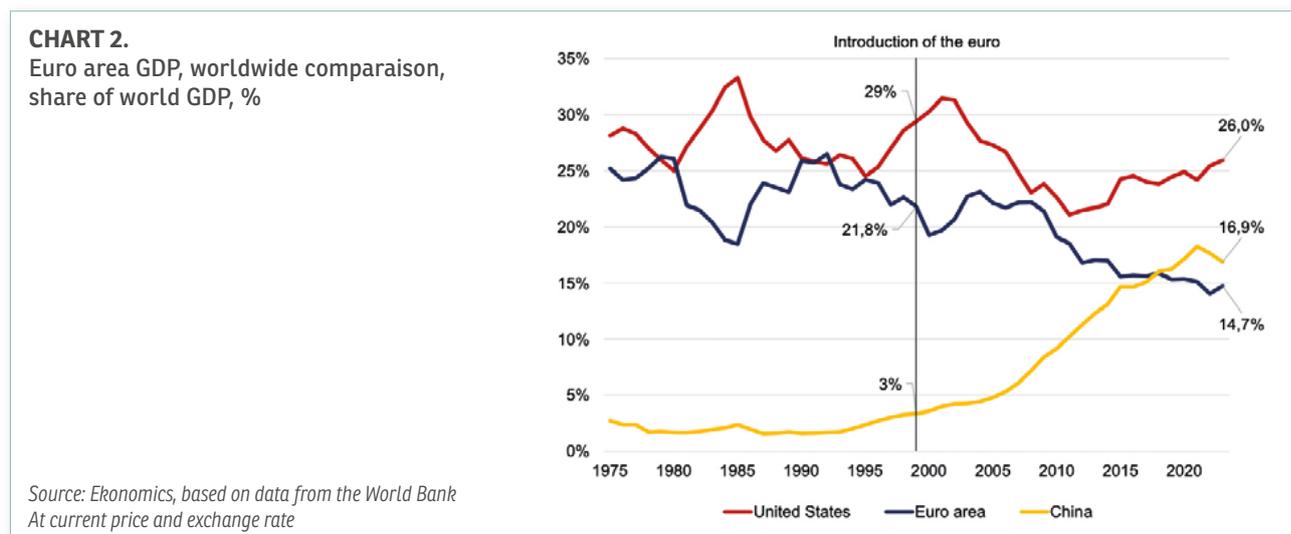


### 1.1.1 Since 2008, the Eurozone real GDP has grown at a rate nearly 2.5 times slower than that of the US

Between 2008 and 2024, real GDP in the Euro area grew at a modest average annual rate of just over 0.9%, resulting in an overall increase of around 15% since the start of the global financial crisis. By contrast, the US economy has grown by around 37.3% over the same period.

The performance gap between the two regions has widened since the pandemic : between the fourth quarter of 2019 and the first quarter of 2025, US real GDP grew by 12.1%, more than double that of the Eurozone (+5.8%).

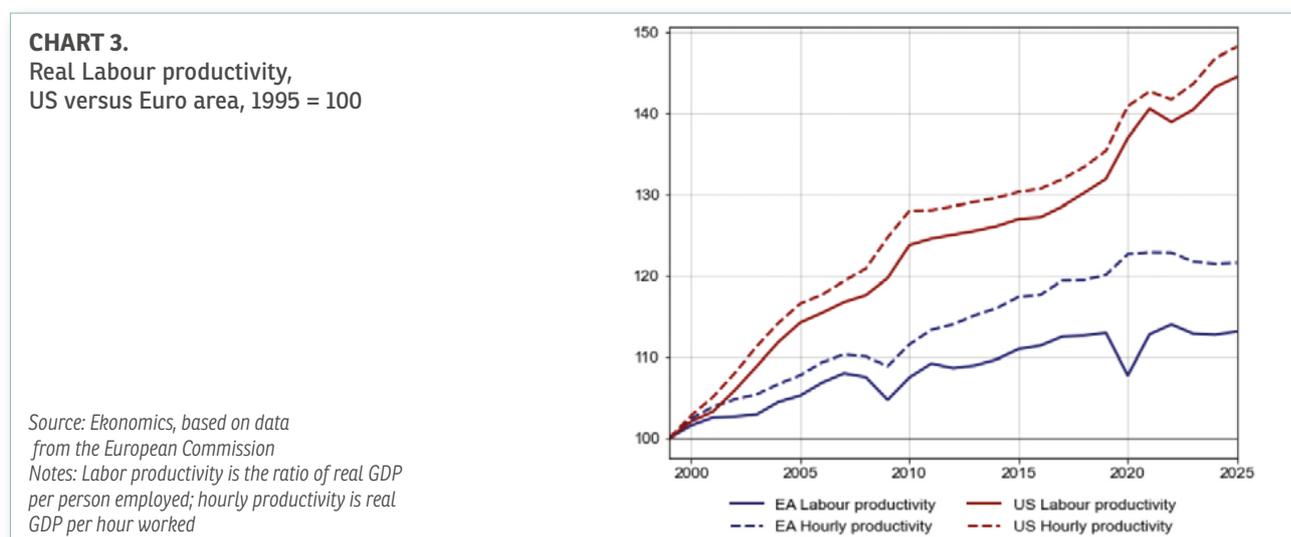
As a result of this relatively weak GDP growth, the Euro area's share of the global economy has declined. According to the World Bank, the EA's share of world GDP was 22.2% in 2007, compared with 24.8% for the US (see Chart 2). By 2023, the EA's share had fallen to 14.7%, while the US share had risen to 26%.



### 1.1.2 Labour productivity growth in the US has been more than double that of the Eurozone over the past two decades

Productivity gains have contributed significantly to the GDP growth differential between the US and the Euro area over the past two decades. Measured as output per hour worked, productivity increased by 48.2% in the US between 1999 and 2025, compared with only 21.6% in the Euro area (see Chart 3).

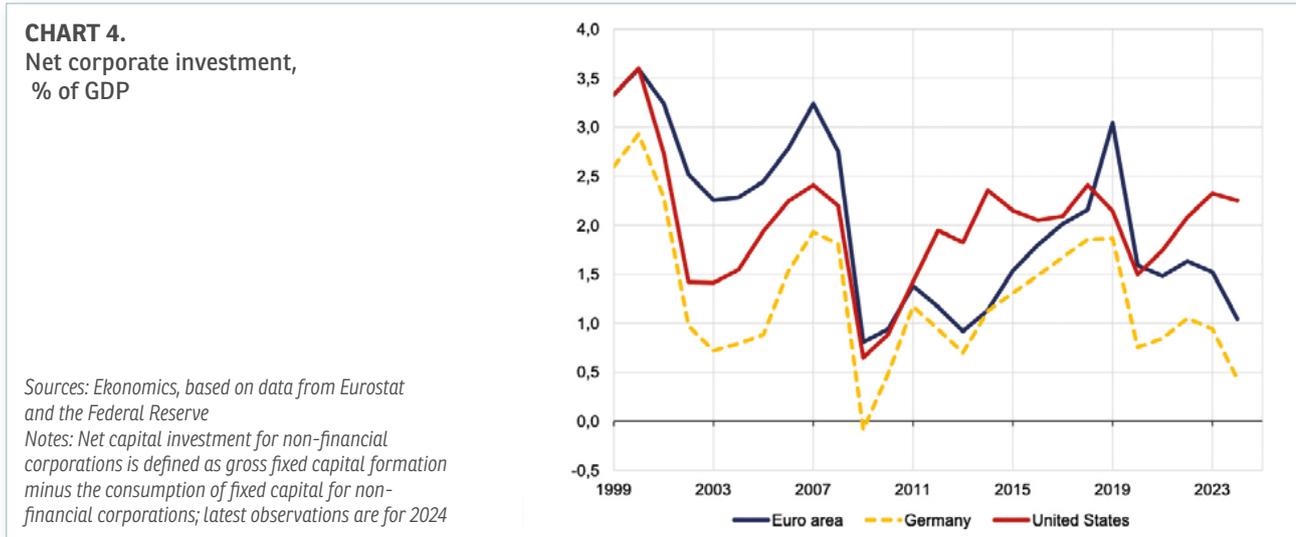
The gap is even wider when looking at productivity per person employed. The latter increased by 44.5% in the US, compared to only 13.1% in the Euro area. Using this measure, the Euro area's productivity level was slightly more than half of that of the US in 2025.



This divergence is evident across all sectors but is most pronounced in the technology sector. Overall, the productivity of US-listed tech firms has increased by around 40% over the past two decades, whereas that of European tech firms has remained stagnant, according to the IMF<sup>1</sup>. This divergence is accompanied by a widening gap in innovation efforts.

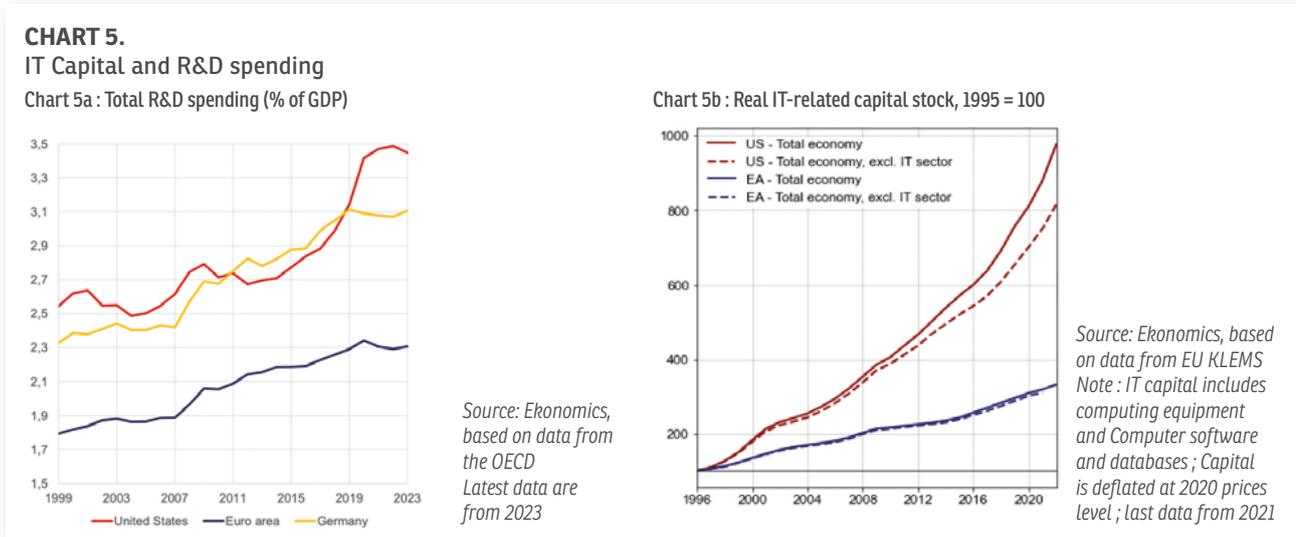
### 1.1.3 European companies have underinvested in equipment and technologies compared to their US counterparts

Investment is essential for competitiveness and productivity. Europe has fallen behind in this area over the past 15 years. While net corporate investment in the Eurozone was slightly higher than in the United States during the 2000s, it fell to almost half a percentage point below US levels in the decade after the financial crisis. Since 2020, the two regions have taken divergent paths: net investment in the US has continued to rise steadily, whereas in the Eurozone it has halved – largely reflecting negative developments in Germany – see Chart 4.



This divergence in overall corporate investment comes together with a widening gap in innovation efforts. As shown in Chart 5a, the US has consistently outpaced the Euro area in R&D spending, and the gap widened in 2020 when it overtook EU powerhouse Germany for the first time since 2008.

As reported by M. Arnold, S. Flemming & C. Jones, the R&D spending of the so-called 'Magnificent Seven' companies – Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla – amounted to more than USD 200 billion in 2023, around half of Europe's total R&D spending across all private and public sectors. Similarly, the top 10 US companies invest three times more than the top 10 European companies.



1. Adilbish, O, D Cerdeiro, R Duval, G H Hong, L Mazzone, L Rotunno, H Toprak and M Vaziri (2024), "Europe's Productivity Weakness: Firm-Level Roots and Remedies", IMF Working Paper, 2025/40, Washington DC.

**As a result, US companies have taken a significant lead in investing in intangibles and technological assets.** Between 1995 and 2021, IT-related capital stock in the US economy increased tenfold in real terms, compared to a threefold increase in the Eurozone. This trend remains broadly similar even when excluding the information and technology sector, a major contributor to intangible capital, in the two regions (see Chart 5b).

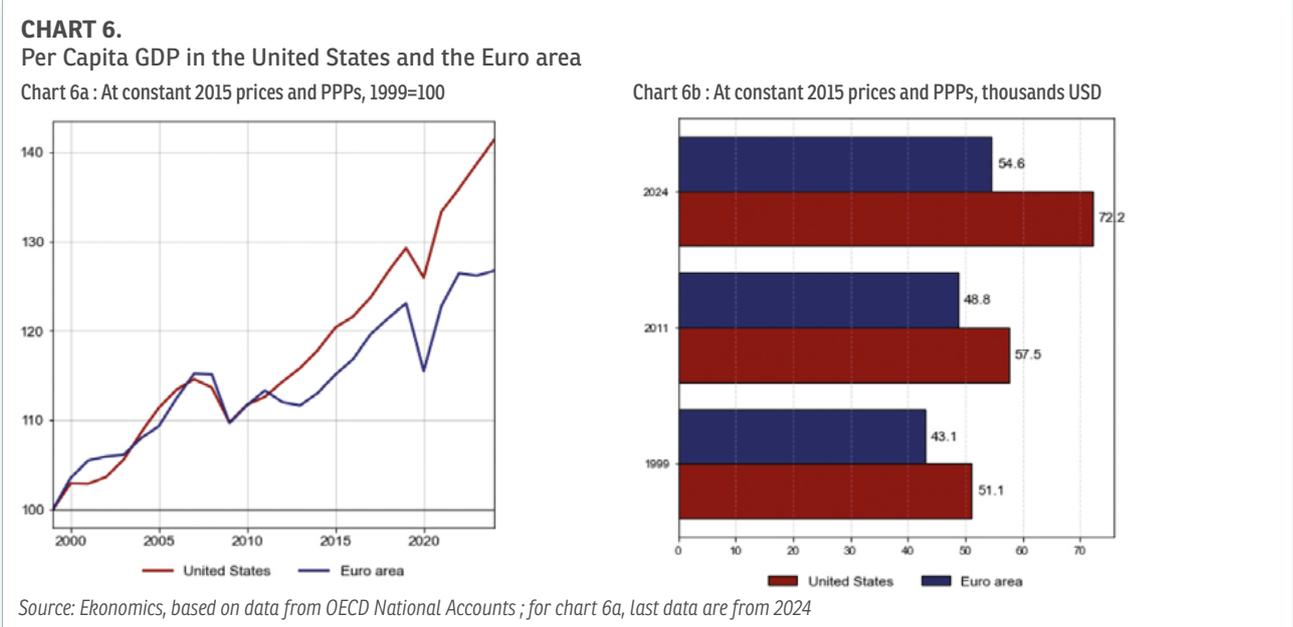
Such a “striking gap in the real IT-related capital stock” between the two regions may have illustrated “Europe’s lost IT revolution” in recent years, as I. Schnabel pointed out in a February 2024 speech<sup>2</sup>. Slow technology diffusion is also a key reason why businesses in Europe have not benefited from the IT revolution.

The report shows that this gap is evident in all sectors except materials and autos, but is particularly pronounced in technology, energy and industrials, including semiconductors. Even in industrials, typically a European stronghold, US companies are spending more.

**1.1.4 Weak productivity growth in the Euro area has had an impact on the living standards of European households, which have fallen sharply behind those of the United States since 2011**

The gap in living standards between European and American households has almost doubled between 2011 and 2024. Until 2011, the real GDP per capita of European households was between \$8,000 and \$9,000 lower than that of their US counterparts.

The gap has only widened since then, with GDP per capita in the Euro area \$13,000 lower than in the US in 2019. The gap has continued to widen since the Covid-19 crisis, reaching \$17,000 in 2024 (see Chart 6).



**1.2 Unlike their European counterparts, US firms operate in a macroeconomic, financial and regulatory environment that is more favourable to investment and innovation**

Most of the reasons for this transatlantic performance gap can be attributed to the different business environments in which companies operate. Compared to their European counterparts, US companies (I) operate in more flexible and less regulated markets; (II) benefit from cheaper and more stable energy prices; (III) face fewer recruitment difficulties thanks to a younger, more dynamic and better educated workforce; (IV) produce on a large scale and can serve a large number of consumers, benefiting from a truly single domestic market; and (V) finance themselves more easily in larger, more liquid and deeper markets.

**1.2.1 US firms operate in a more business-friendly environment, granting them greater freedom than their European counterparts**

Product and labour markets in the Euro area often remain highly regulated. In contrast to the US, the EU imposes

2. I. Schnabel, “From laggard to leader? Closing the Euro area’s technology gap” Speech at the European University Institute (February 2024).

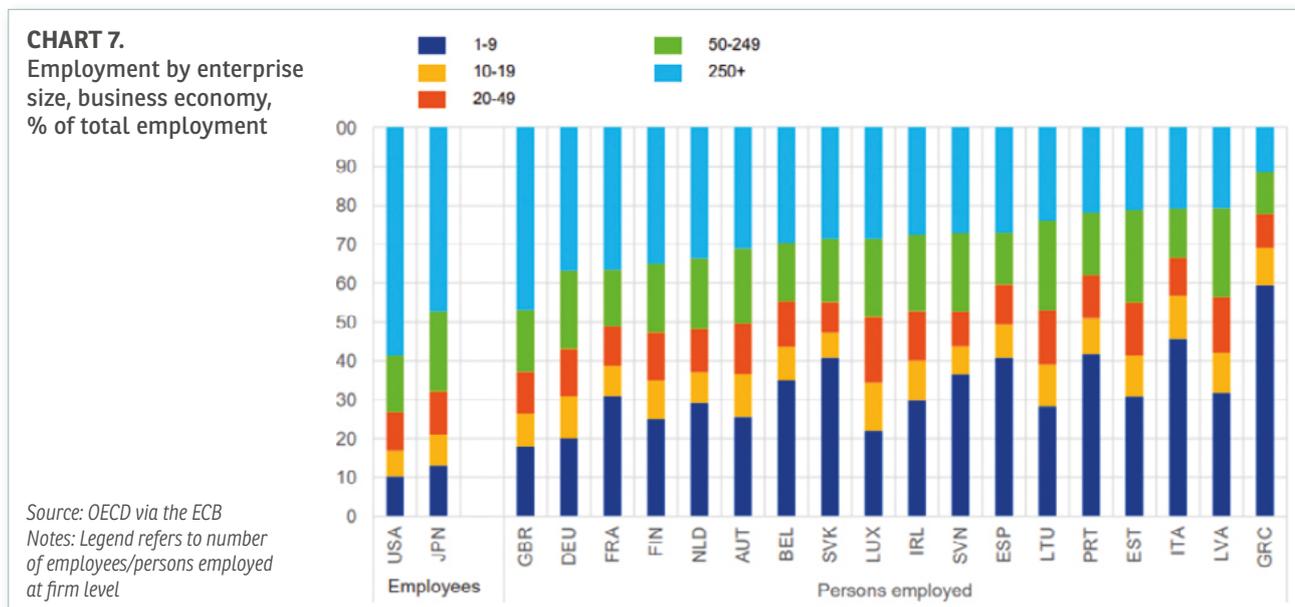
administrative burdens on the creation and expansion of new firms beyond arbitrary thresholds, leading to higher compliance costs.

In addition, taxes and social contributions are higher in Europe due to generous welfare states and high social spending, which hampers the competitiveness of European companies.

The continued expansion of the public sector in some Eurozone countries, such as France, has led to an unwieldy and burdensome system. Maintaining this large public sector requires increasing financial resources, resulting in higher tax burdens for both companies and individuals.

Higher administrative burdens may discourage younger firms from expanding. In France, for example, several labour laws only become binding once a company exceeds the 50-employee threshold.

While larger firms tend to invest more and be more productive, many European firms are too small and constrained by regulation to take full advantage of new technologies. As I. Schnabel notes, firms with more than 250 employees account for almost 60% of private sector employment in the US, but only 12% in Greece and 37% in Germany (see Chart 7).



Without domestic structural reforms to address these supply-side constraints (labour shortages, administrative and tax burdens, high labour costs...) that weaken the competitiveness of European firms, the performance gap between the EU and the US will continue to widen in the long term.

### 1.2.2 US firms benefit from lower and more stable energy prices

Unlike the Euro area, which is almost entirely dependent on energy imports, the US is a net exporter of energy. It became the world's largest producer of oil and natural gas in 2018. According to the EIA, US oil supplies will account for one-fifth of the world's supply in 2022.

Being energy self-sufficient, the US was not as vulnerable to energy supply disruptions as the EU following the war in Ukraine in 2022. In 2023, industrial electricity prices in the EU are almost three times higher than in the US and more than twice as high as in China (see Part 1.3.4 for further details).

### 1.2.3 US firms face fewer recruitment difficulties due to more favourable population dynamics

Demographics reflect both the quantity and quality of workers available to firms in the labour market. The US outperforms the EU on both counts. The US benefits from an abundant labour force, whether measured by the size of the working age population or the total number of hours worked. In addition, US workers are better educated and more attuned to the expectations of firms. As a result, they adapt more easily to the jobs required by the corporate sector.

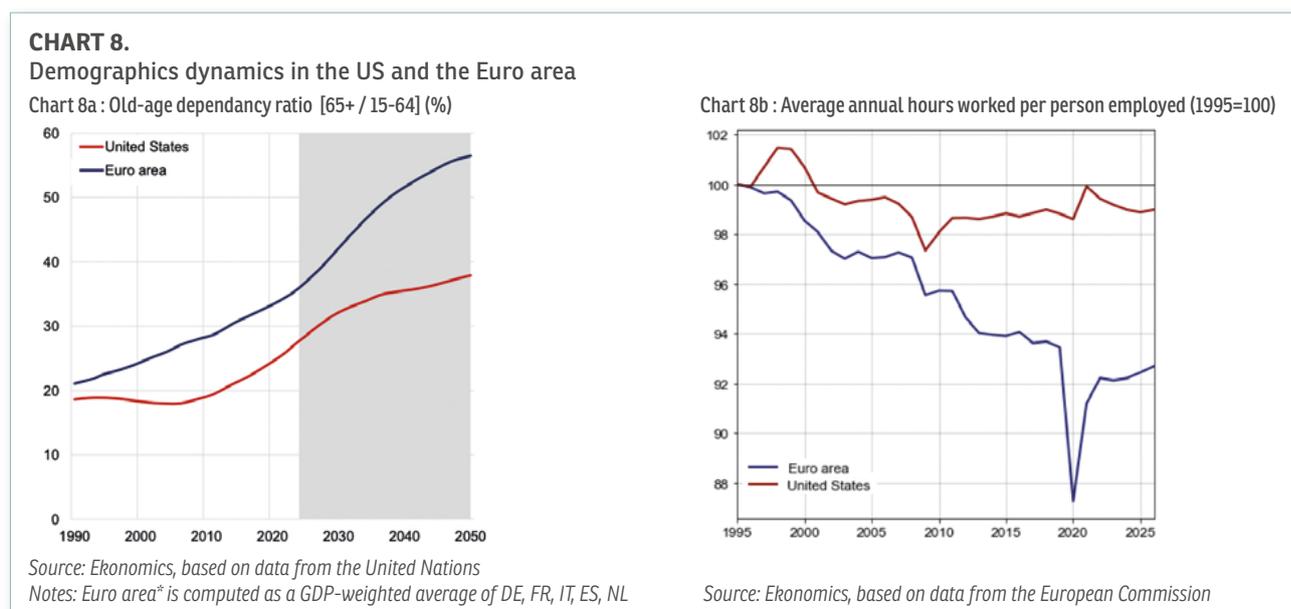
In terms of the size and age structure of the workforce, the US population is younger and growing faster than in Europe. The US working-age population – people aged between 15 and 64 – increased from 150 million in 1990 to 200 million in 2023, an increase of 33%. In contrast, the Euro area's working-age population has increased by only

6% over the same period, rising from 190 million to 203 million. This overall growth, however, masks stagnant or even negative trends in some major Member States, such as Germany (-1.7%) and Italy (+0.6%).

Consequently, older adults are expected to account for a larger proportion of the population than the working-age group in Europe in the years ahead. In the Eurozone, the old-age dependency ratio (the proportion of people aged 65 and over compared to the working-age population) is expected to increase from 35.2% in 2023 to 56% by the middle of the century, according to the United Nations (see Chart 8a). By contrast, in the United States, the increase is expected to be more moderate, with the ratio rising from 26.8% in 2023 to 37.9% by 2050.

Additionally, employed individuals in Europe tend to work fewer hours than their counterparts in the United States. As noted by A. Krammer, "European workers have shorter work weeks and retire earlier than in other regions. On average American works approximately 1,700 hours per year (36 hours per week with four weeks of vacation), roughly 200 hours more than a European, though 500 hours less than a Chinese<sup>3</sup>. The typical working day in the UK, France, and Germany is half an hour shorter than in the US, according to the International Labour Organisation. It should also be noted that the gap in the number of hours worked has widened between the two regions over the past 25 years: while the annual volume of hours worked was roughly similar between the US and the Eurozone in 1995, it is now 10% lower in the Eurozone in 2024 (see Chart 8b).

Separately, American workers are better skilled. America is home to 11 of the world's 15 top-ranked universities and America's economy makes good use of its highly educated workforce. By comparison, the latest OECD PISA scores of EU member states show that European students lag significantly behind compared to other G7 countries. The lack of skilled workers is also visible in the persistence of staff shortages. In 2023, over 46% of EU companies report difficulties in recruiting experts with specialist IT skills, according to Business Europe<sup>4</sup>.



### 1.2.4 Unlike the EU, the US has a genuine single market

The US benefits from a large domestic consumer market and has many multinational companies around the world. As a result, US companies can scale up more quickly because it offers a large market that supports innovation with a common language and regulatory system.

This contrasts with the EU, where companies operate in smaller, less integrated domestic markets. Linguistic, administrative and cultural differences, heterogeneous bankruptcy laws and contract terms, as well as various regulatory barriers and protectionist policies prevent banks and firms from operating easily across borders.

As regards product markets, an IMF study shows that a 10% reduction in existing barriers in the internal market for goods and services could increase European output by 7 percentage points in the long run. This highlights the significant fragmentation of European product markets.

3. Figure quoted in The Economist's study on The American economy published on 17 April 2023.

4. *Op. cite* note 4.

The IMF estimates that the remaining intra-EU trade barriers could be as high as 44% for the average manufacturing sector and 110% for the average service sector. This would severely hinder the ability of large firms to scale up<sup>5</sup>.

Moreover, labour mobility in the EU is weak. Indeed, H. Keith & T. Mayer calculate that the cost of moving between EU Member States is about 8 times higher than between US states.

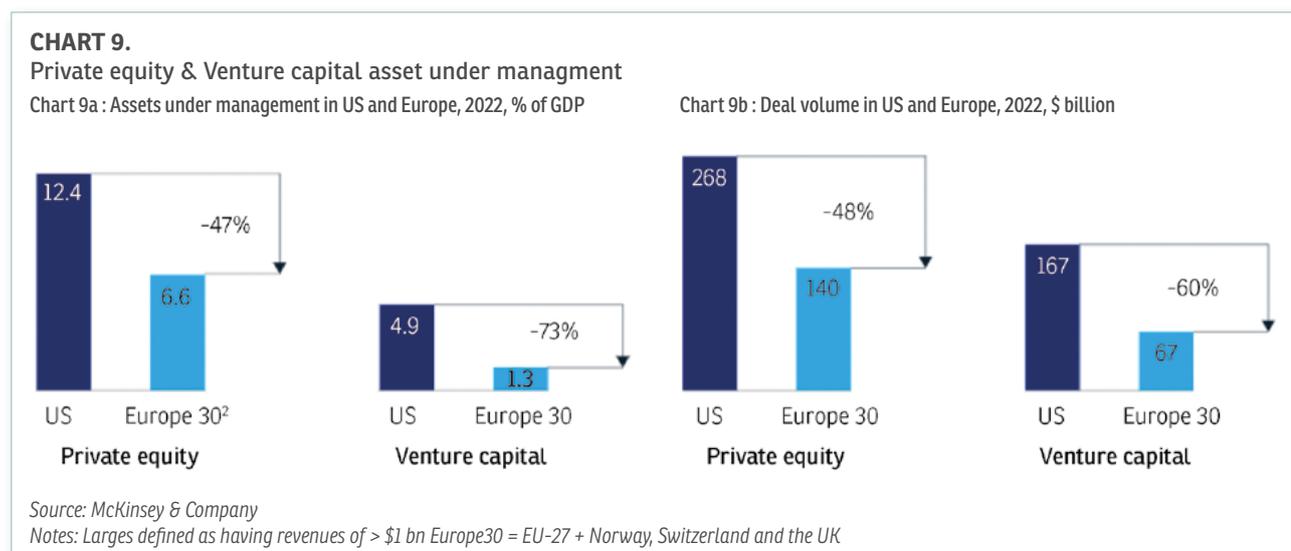
### 1.2.5 Despite abundant savings in Europe, financial markets in the US play a role three times more important in financing the economy than the EU

The US has **the deepest and most liquid financial markets in the world**, providing efficient channels for corporate financing. Stock market capitalisation in the US is 170% of GDP, compared with less than 100% in most other countries. Funding for potentially high-growth start-ups is particularly abundant, with about half of the world's venture capital going to American companies.

In AI alone, venture capital investment in the US has reached \$450 billion over the past decade, almost 10 times that of the Eurozone or the UK, according to V. Romen & C. Smith. Yet in 2023, Europe invested \$1.7 billion in Gen AI, compared with \$23 billion in US venture capital (VC) and private equity (PE), according to McKinsey. The Economist estimates, the market value of America's "Magnificent Seven" tech giants as roughly equivalent to the combined stock market capitalisation of the EU27.

By comparison, the EU attracts only 8% of the US level of venture capital investment, and EU start-ups receive less than half the funding of their US counterparts, meaning that many innovative companies face funding constraints once they have entered the growth phase. As a result, Europe is lagging behind in robotics, big data and artificial intelligence.

In Europe, VC under management as a percentage of GDP is only about a quarter of that in the US. PE assets under management are half those in the US.



There are three main reasons for the lack of investment and innovation in the EU.

The first is **the structure of corporate financing**. In the EU, 75% of corporate borrowing comes from banks and 25% from bond markets, whereas in the US the proportions are reversed. Banks are naturally reluctant to finance long-term investments, given the limits of their lending capacity based on short-term deposits. By contrast, market-based financing, especially equity financing, is better suited to high-growth sectors such as digital and high-tech, where capital is largely intangible. Unfortunately, this type of financing is very limited in Europe.

The second is **the remuneration of private savings**. Unlike in the US, long-term nominal interest rates in Europe have been negative for a long time, as a result of the ECB's negative interest rate policy and asset purchase programmes between 2014 and 2022. Inadequate returns on savings discourage productive investment. As a result, economic agents prefer to allocate their savings to liquid instruments rather than to the financing of innovative projects, given the insufficient return relative to the risk taken. As detailed in the Eurofi Monetary Scoreboard, during the period of negative real interest rates, outstanding liquid savings in the main European countries reached record levels.

5. *Europe's productivity weakness: Firm-level roots and remedies*, CEPR.

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In this context, and given the principle of portfolio diversification, European savings are increasingly being diverted to overseas financial markets where returns are more attractive. The ECB recently pointed out that €193 billion, the Euro area's current account surplus, flows to the US every year. This flight of capital from Europe to the US is not surprising given the difference in stock market returns between the two regions: between 1900 and 2020, the average annual nominal return on US equities was 9.6%, compared with 7.2% in Europe.

The third reason is **the fragmentation of the European banking market**. This fragmentation stems from the lack of cross-border capital and liquidity fungibility within individual banking groups, due to the ring-fencing practices of national supervisors, different tax and insolvency regimes and different macro-prudential requirements. In addition, as long as government deficits remain high, the link between sovereign debt and the banking sector cannot be broken.

**The absence of a securitisation market and the heterogeneity of Member States' legal and fiscal frameworks are major obstacles to a Capital Markets Union**, which has made very little progress over the past 25 years. This heterogeneity affects securities regulation, investor protection, bankruptcy laws, tax procedures, market and corporate supervision, accounting standards for SMEs, trading rules (including for short selling) and investment rules for institutional investors such as pension funds, insurance companies and investment funds. It also affects listing requirements, including the languages used for prospectuses. As a result, EU capital markets remain segmented along national borders, with institutional investors showing a significant home bias.

### **1.2.6 Several major EU policy shortcomings contribute to explaining its lagging behind the US**

The introduction of the Euro in 1999 was intended to unify and strengthen the European economy. However, the economic performance of the Eurozone has not lived up to expectations especially when compared to the robust growth observed in the US. As detailed above, several indicators illustrate this growing chasm: real GDP growth rates, labour productivity, and levels of corporate investment. The US has consistently outperformed the EU in these areas, leading to a significant shift in global economic power.

As global competition intensifies, the relative decline in the EU's economic performance has wider implications. It affects not only the prosperity of European nations, but also their influence on global economic policy and their ability to respond to future economic challenges. Understanding the causes of this lag is essential for policymakers aiming at closing the gap and ensuring sustainable economic growth for the EU in the decades to come.

I. The EU Commission faces significant challenges in coordinating economic policies across Member States within the Eurozone.

Despite the introduction of mechanisms such as the Stability and Growth Pact (SGP), the Six Pack and the Two Pack, effective economic governance remains elusive. These frameworks were designed to enforce fiscal discipline and strengthen economic surveillance, but their implementation has often been inconsistent and slow to adapt to crises.

II. The EU's competition policy, focused on preventing market dominance and state aid, has inadvertently stifled the development of European champions capable of competing globally.

The EU's competition policy framework emphasizes maintaining a level playing field within the internal market, often at the expense of fostering large, competitive firms that can scale up internationally. This approach contrasts sharply with the US, where regulatory frameworks are more supportive of mergers and acquisitions that create globally competitive firms. For example, American tech giants such as Apple, Amazon, Microsoft, and Google have benefited from a more permissive regulatory environment, allowing them to dominate global markets. In contrast, the EU has blocked several high-profile mergers, such as the proposed merger between Siemens and Alstom, citing competition concerns. This political stance is preventing the consolidation needed to build companies capable of competing with their American and Asian counterparts.

III. The EU's lack of a coherent industrial policy has left it vulnerable to protectionist measures by other major economies, such as the US and China.

While the US and China have aggressively supported their domestic industries through subsidies, tariffs, and strategic investments, the EU has been slower to respond.

The EU needs to adopt a more strategic industrial policy that promotes key sectors like technology, renewable energy, and advanced manufacturing. This policy should include targeted investments, research and development funding, and measures aimed at protecting critical industries from foreign competition. The recent introduction of the Digital Strategy is a step in the right direction, but more comprehensive and aggressive policies are needed to ensure that the EU remains competitive.

IV. The EU funds are also difficult to disburse and slow to reach the countries that need them most.

The Next Generation EU (NGEU) fund, designed to support economic recovery after Covid-19, has attracted significant financial resources comparable to those in the US. However, its effectiveness has been hampered by bureaucratic complexity and slow disbursement procedures. Countries such as Italy and Spain, which are among the largest beneficiaries, have struggled to make effective use of these funds due to administrative bottlenecks and strict compliance requirements.

The NGEU aims to promote digital and green transitions, but its impact on productivity and investment has been limited. Streamlining the application and approval processes, as well as better coordination at national and EU level, could increase the effectiveness of these funds.

### 1.2.7 The decline in European economic competitiveness has been accompanied by a significant loss of competitiveness among EU financial players compared to their US and Asian counterparts

The decline of the European banking industry has been particularly pronounced, reflecting broader challenges faced by the EU in maintaining its competitive edge in the global financial sector. As the graph below shows:

- I. The share of European banks in global market capitalization has fallen significantly. In 2009, European banks accounted for 34% of global market capitalization, but by 2022, this share had plummeted to 17.5%. By contrast, US banks have increased their share from 23% to 34% over the same period<sup>6</sup>. This shift highlights the growing dominance of US financial institutions and the declining global influence of European banks.
- II. The EU's share of global capital markets has also decreased sharply. In the last 16 years, this share has fallen from 18% to just 10%. This decline is partly due to the more dynamic and better-integrated financial markets in the US and Asia, which offer more attractive conditions for investment and growth
- III. The European asset management sector has experienced an even steeper decline. In 2007, European asset managers accounted for 47% of global funds, and US managers for 51%. By 2022, the European share had dropped to just 22%, compared to 70% for US funds. Only two European asset managers (Amundi and Natixis) are among the world's top 20.

**CHART 10.**

European financial sector relative to the US and the rest of the world

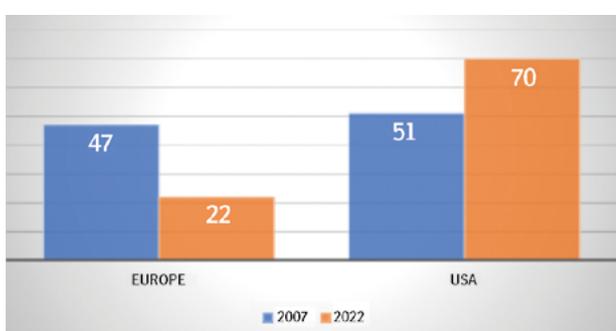
Share of market capitalisation of banks in the world (%)



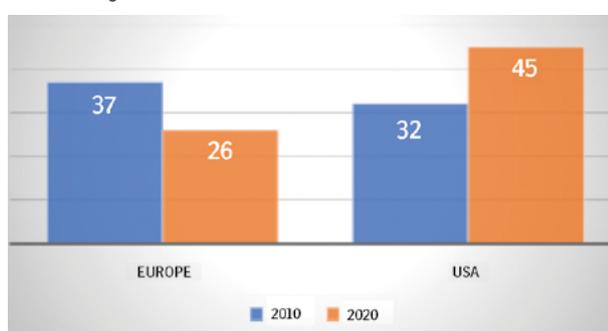
Europe's share in global capital markets (%)



Global funds market share (%)



Share of the global insurance market (%)



Sources: *Competitiveness of European financial services*, Luxembourg Finance, January 2024  
*"L'autonomie stratégique passe par l'Union des Marchés de Capitaux"*, Fabrice Demarigny, January 2024

6. Europe's leading bank BNP Paribas had a market cap of around \$70 bn in 2022. JPMorgan Chase, the US leader, was worth more than \$400 bn. The market capitalization of the 4 largest European banks was about half that of JP Morgan in 2022. Scale is not everything of course. Profitability and efficiency are also vital considerations. But for profit, scale gives the biggest banks a huge competitive advantage. Take the issue of technology – arguably the battleground of the future of financial services. Bank of America spends more than \$10 bn a year on maintaining and building its technology. That's almost double the profits made in 2022 Societe Generale.

IV. The EU's share of the global insurance market has fallen from 37% in 2010 to 26% in 2020. Meanwhile, the US's market share has risen from 32% to 45%. This shift highlights the stronger growth and resilience of the US insurance industry compared to its European counterpart.

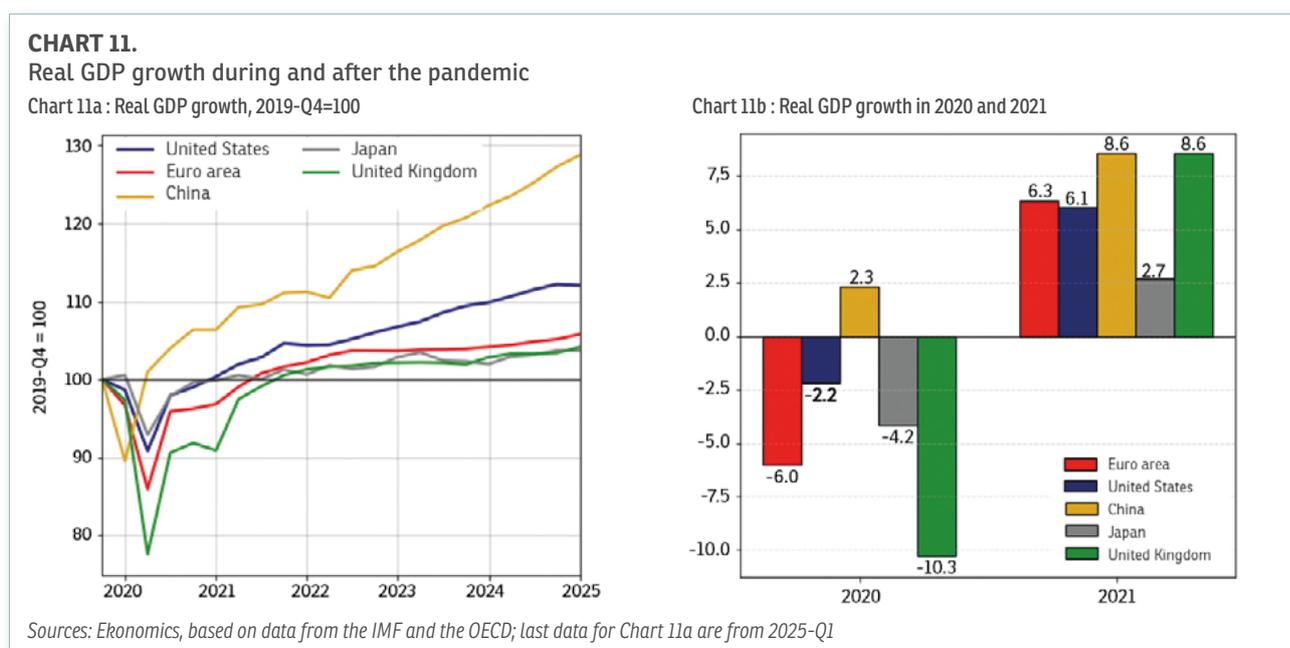
V. In the payments market, American players (Visa, Master Card, Paypal, Apple Pay, Google Pay) dominate in most European countries. This dominance reflects not only the technological superiority of these companies but also highlights the lack of competitive European alternatives. The reliance on American payment systems raises concerns about strategic dependencies and the ability of European firms to innovate and compete in this critical sector.

The decline in the competitiveness of European financial players reflects broader structural and regulatory challenges within the EU. Addressing these issues will require significant policy shifts, greater integration of financial markets, and a more supportive regulatory environment to enable European banks and financial institutions to compete effectively on the global stage. Without these changes, the gap between the EU and its global competitors is likely to widen further, affecting the overall economic performance of the region.

### 1.3 Since the start of the Covid-19 crisis, Europe's competitiveness gap with the rest of the world has widened significantly

#### 1.3.1 In 2020, the Euro area suffered one of the largest GDP contraction among advanced economies

In 2020, the Eurozone GDP fell by 6.0%, almost three times more than the US GDP (-2.2%). Japan (-4.2%) also experienced a smaller output fall than the Eurozone, and China even recorded a 2.3% rise in GDP.



#### 1.3.2 In 2021, Europe recovered at a slower pace than the United States and China

At 6.3%, real GDP growth in the Euro area in 2021 was slightly above that of the United States (+6.1%). However, this performance was insufficient to bring GDP back to its pre-pandemic level: by the end of 2021, the Eurozone's GDP was just 1.6% above its 2019 level, compared to a 4.6% increase in the United States.

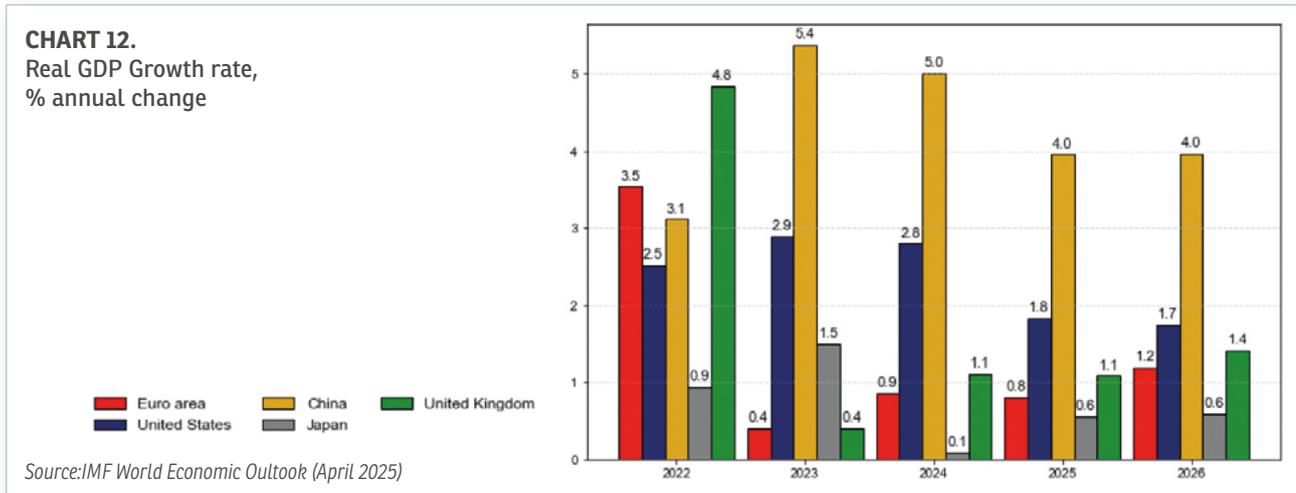
#### 1.3.3 The economic impact of the war in Ukraine has been more damaging in Europe than in the United States or China

The Eurozone real GDP grew by 3.5% in 2022, compared to 2.5% in the US, and 3.1% in China (see Chart 12).

The resilience of the European economy to the 2022 energy shock was partly due to the significant recourse to public spending. Indeed, the recovery coincided with high fiscal deficits across Member States (see Part 3), which mainly supported private consumption.

However, economic activity in the Euro area largely stagnated in 2023, with real GDP increasing by just 0.4% – seven times less than in the United States, where GDP grew by 2.9%.

In 2024, growth in the Euro area picked up to 0.9%, still lagging behind the US growth rate of 2.8%. According to the IMF's April 2025 World Economic Outlook, the Euro area is expected to continue underperforming the United States in terms of growth in 2025 and 2026.

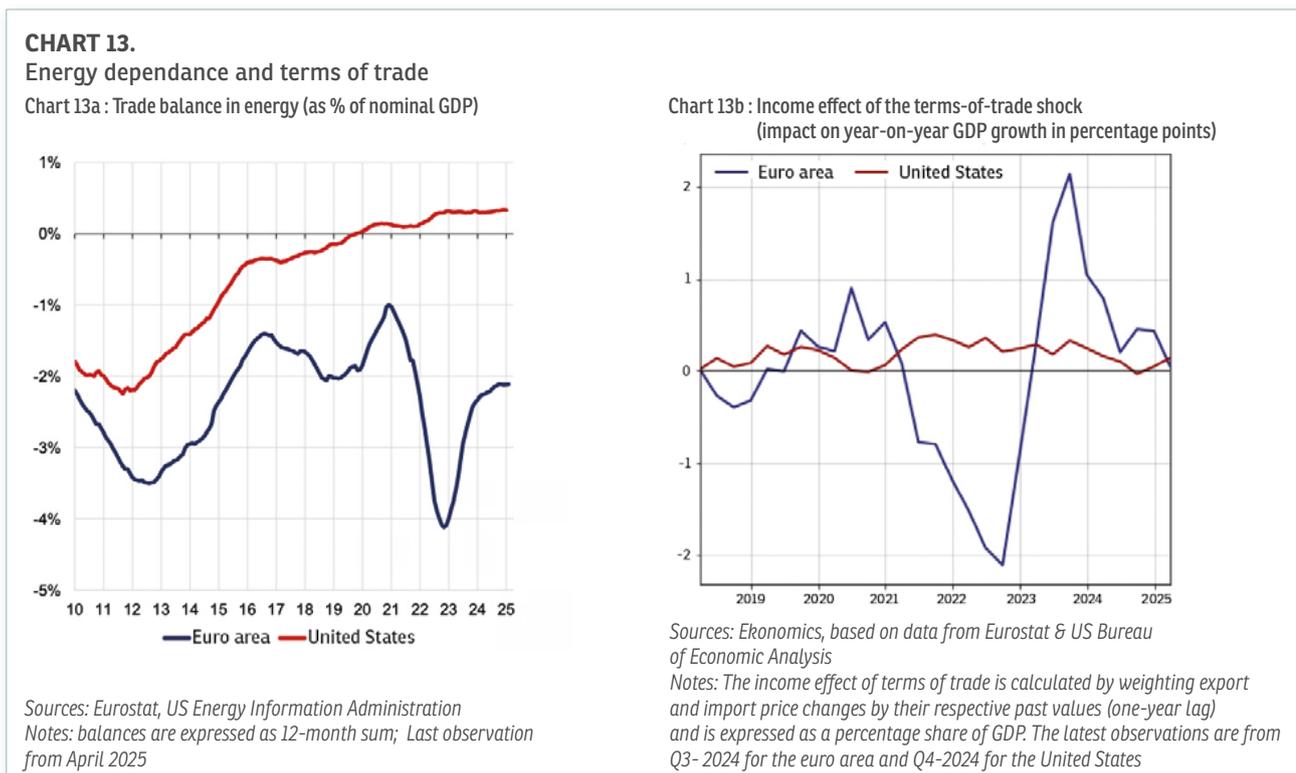


**1.3.4 Unlike the United States, which is energy independent, Europe has been hit hard by the rise in energy prices in 2022**

The war in Ukraine has delivered another negative supply shock to the global economy, with a particularly severe impact on Europe.

The main difference between the United States and the Euro area is that the former produces its energy while the latter has to import it. As a result, the United States, unlike Europe, benefits from an energy trade surplus (see Chart 13a).

The energy crisis has widened the competitiveness gap between Europe and the US for at least two reasons: (I) gas prices have remained higher and more volatile in Europe, while they have rapidly returned to pre-war levels in the US; (II) Europe has replaced its gas and oil imports from Russia with more expensive imports, partly from the US. This transfer of wealth has led to a widening of Europe's energy balance deficit with the United States.

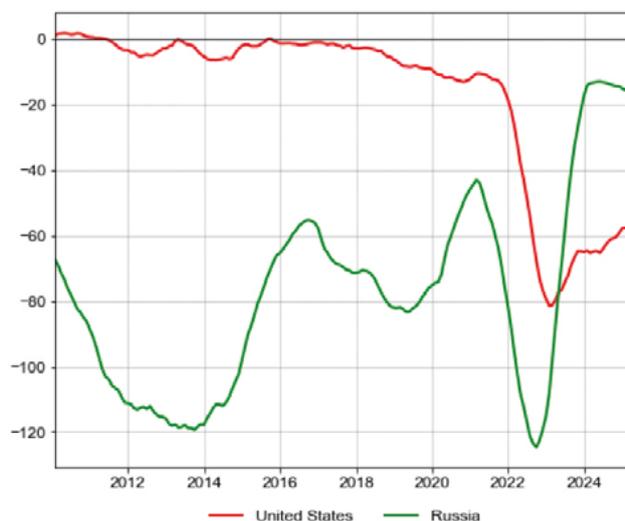


Dependence on energy imports is very costly for the Euro area in 2022: higher energy prices led to a deterioration in its terms of trade, which amounted to 1.9% of GDP in 2022 as a whole. As a net exporter of energy since 2019, the United States did not suffer the economic consequences of the energy shock, as shown by the virtually unchanged level of its terms of trade over this period (see Chart 13b).

The United States emerges as a winner from the EU ban on Russian gas imports. While in 2019 the Euro area imported almost €80 billion worth of energy products from Russia, the value of these imports has fallen significantly since 2022, reaching €15 billion in April 2025. The United States has benefited greatly from this reallocation: before 2019, annual energy imports from the US were worth no more than €10 bn; since 2022, they have exceeded €50 bn per year (see Chart 14).

Indeed, the United States has become the leading supplier of gas to the Old Continent. Europe purchased nearly 64% of US exports of Liquefied Natural Gas (LNG) in 2022, compared to 34% in 2021, according to the US Energy Information Administration<sup>7</sup>. In 2024, Europe remained the main buyer of US LNG, still accounting for 55% of all US LNG exports.

**CHART 14.**  
Euro area's Trade balance in energy with Russia and the United States, EUR bn (12-month sum)

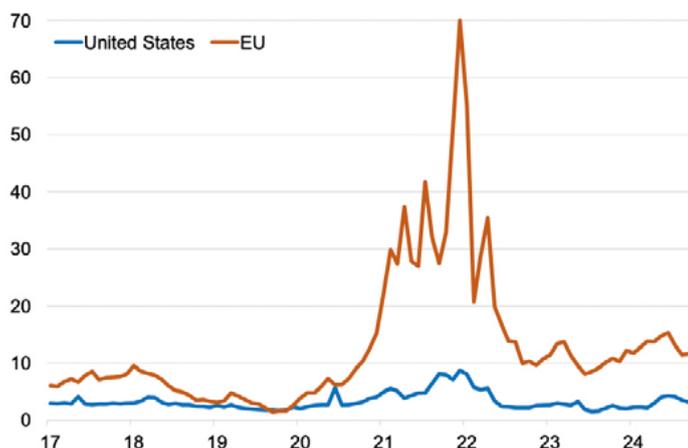


Sources: *Economics*, based on data from Eurostat  
Last observation from April 2025

**Another advantage for the United States is its low and stable gas price compared to Europe.** While they were roughly similar in 2019, gas prices in the two regions diverged sharply from the beginning of 2021 (see Chart 15): in August 2022, when European gas prices peaked at \$70 per MMBtu, US gas prices were eight times lower at \$8.5 per MMBtu.

Despite the decline in energy prices since late 2022, they remain elevated in Europe – both relative to historical levels and compared to the United States. In the first half of 2025, European gas prices averaged \$13.2 per MMBtu, more than twice their 2019 level of \$5 per MMBtu, and over three times higher than the US average of \$3.5 per MMBtu).

**CHART 15.**  
Natural gas prices (U.S. Dollars per Million Metric British Thermal Unit)



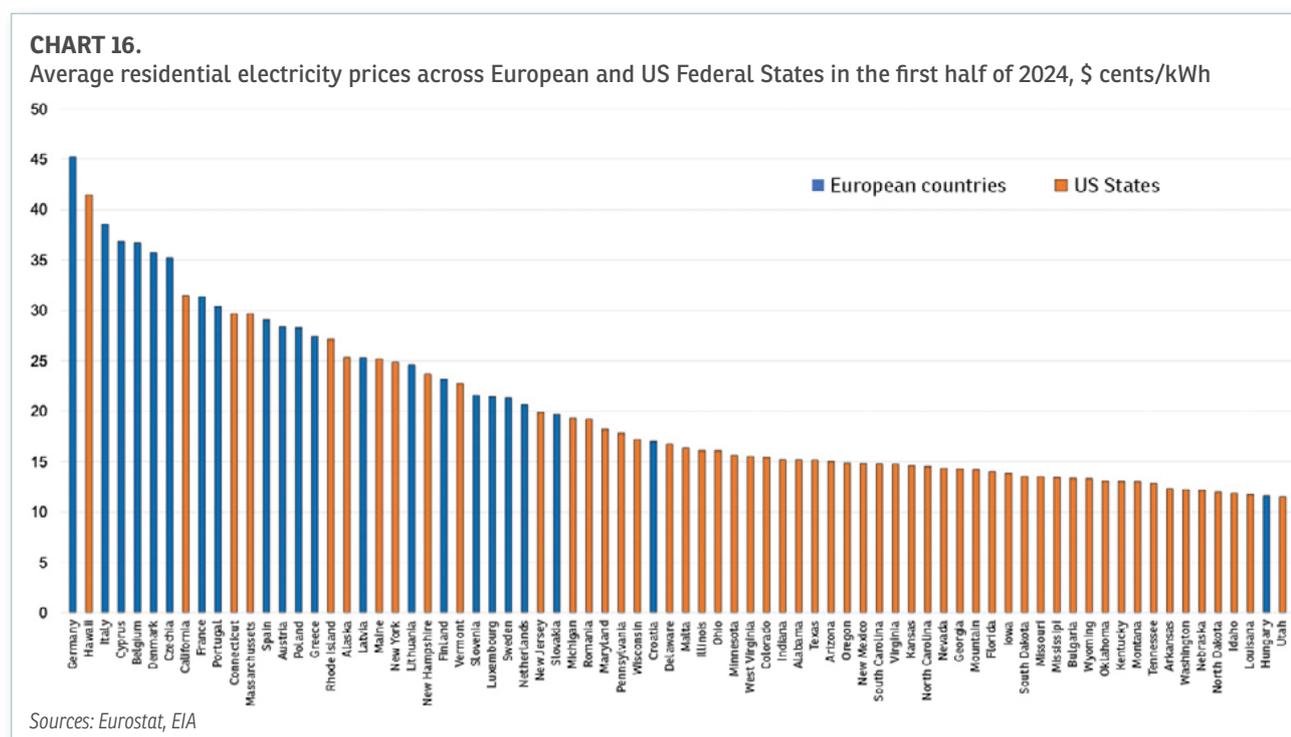
Sources: IMF, EIA  
Last Observation from May 2025

7. "Europe was the main destination for U.S. LNG exports in 2022", Report from the US Energy Information Administration (March 2023).

**Another illustration of the difference in energy costs between the two regions is the price paid by consumers for electricity.** In the second half of 2024, a kilowatt-hour (kWh) of electricity paid by a European household costs 36.7 US cents (29 EUR cents), twice as much as in the US (16.7 US cents).

However, both prices are calculated as global averages for several countries or states, which may mask some heterogeneity between countries in terms of energy mix and consumption. Comparing the 27 EU Member States with the 50 US states (see Graph 15), it can be seen that European countries overall have higher retail electricity prices than the US states: at 45.2¢/kWh, the electricity price in Germany, the highest in Europe, is 4 cents higher than in Hawaii (44¢), the US state with the highest electricity prices. Italy (38.5¢) and Belgium (36.7¢) have higher prices than California and the other 48 US states.

Thanks to nuclear power, France benefits from relatively low prices, averaging 31.35¢/kWh in the second half of 2024. However, this is still higher than 47 US states, including New York (24.8¢), Texas (15.2¢) and Nebraska (12.2¢).



This difference in price levels is sufficiently high to be detrimental to the competitiveness of the European industry and to foster a movement of relocation of energy-intensive companies (chemicals, fertilizers, etc.) to countries where energy is cheaper, such as the United States, especially with the implementation of the Inflation Reduction Act (see Part 6).

## 2. Economic and fiscal disparities between Member States have increased since the creation of the euro

So far, the euro has been a success. It has become the second international currency after the dollar and has enjoyed a high and constant level of support from the Europeans people since its introduction. In 1999, the euro became the single currency of a vast economic entity whose market of 350 million inhabitants is one of the largest in the world. This has allowed trade within the zone to intensify and has made an important contribution to trade integration by eliminating exchange rate risk. It has also reduced the cost of transactions within the zone.

However, the single currency was designed without a common economic policy, and the last 25 years have been marked by increasing heterogeneity in the economic and social policies pursued by the Member States, and the failure of some large Member States to comply with the rules of the Stability and Growth Pact. Moreover, the European Commission has proved powerless to enforce the rules of the Stability and Growth Pact due to a lack of leadership that the Council has found difficult to accept.

In this context, economic disparities between Member States have widened significantly since the creation of the euro. This chapter illustrate these divergences in terms of productivity, economic growth, per capita GDP, public debt and current account imbalances over the past 25 years. The elimination of exchange rate risk and the move towards a single market allowed the countries that joined the monetary union to exploit their comparative advantages. However, this increased the heterogeneity of productive specialisation among Euro area countries and led to diverging living standards across Euro area countries.

Cross-border capital flows between EU Member States have not recovered since the European Sovereign Debt Crisis, with excess savings in countries like Germany and the Netherlands no longer financing investment projects in lower GDP per capita Member States.

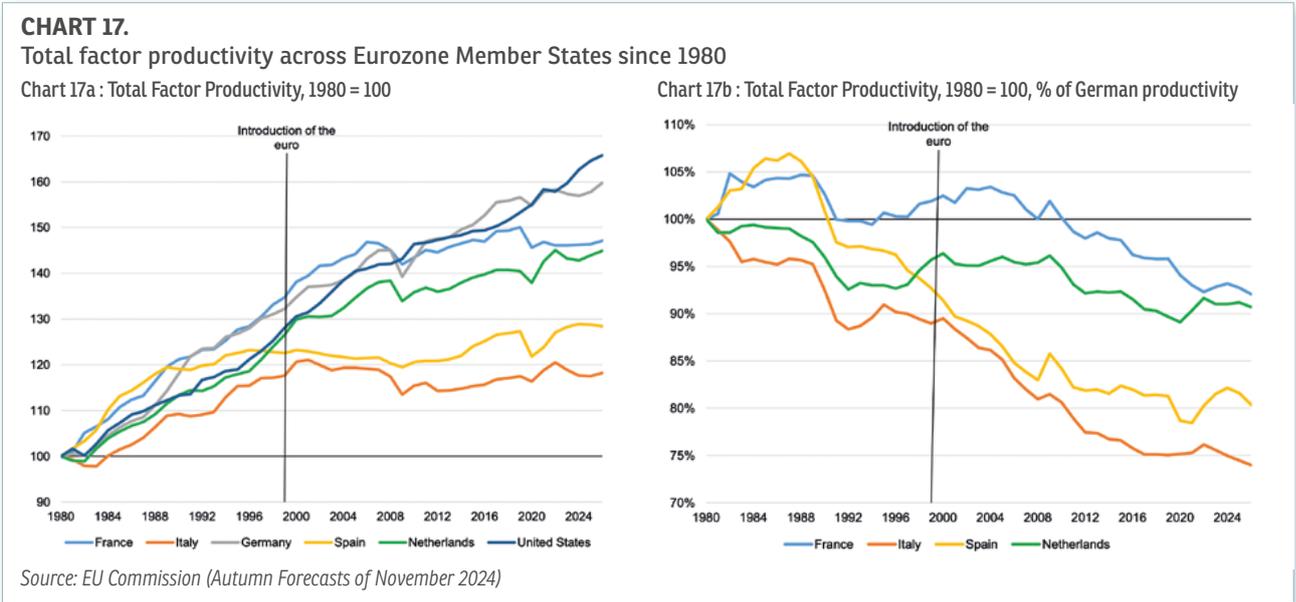
As a consequence, Target 2 imbalances have been on the rise since 2015. Today, they reflect differences in Europe's financial markets more than market tensions, interbank market fragmentation, or capital flight.

### 2.1 Divergences in terms of productive performance among the Eurozone Member States have been increasing since the late 1990s

#### 2.1.1 From 1980 to the late 1990s, total factor productivity gaps between Germany and other Eurozone countries remained relatively contained

During this period, the countries participating in the European Monetary System achieved a degree of economic convergence. Indeed, the Charts 17a and b highlight that:

- France and Germany exhibited similar productivity growth rates, which were higher than those of the United States.
- In Spain: TFP's level fluctuated between -5% and +5% relative to Germany.
- In Italy, TFP's level was consistently about 10% lower than in Germany.



### 2.1.2 Since the introduction of the euro, there has been a striking coincidence: the productivity gap between EU countries has widened considerably

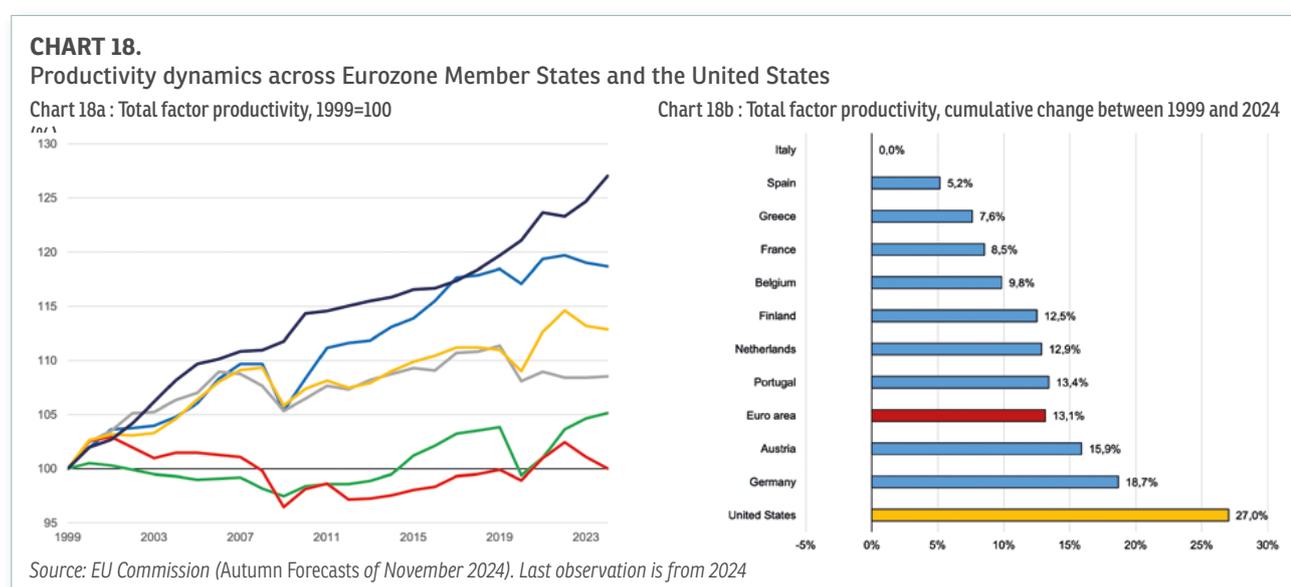
Since 1999, the productivity gap between EU countries has widened markedly, notably compared to Germany.

Productivity growth has been three times higher in Germany than in Spain. Indeed, TFP in Germany has grown at an average annual rate of 0.7% over the past 25 years while it has stagnated in Spain with a mere 0.2% average annual growth. In Italy, productivity did not increase between 2000 and 2024.

As a result, productivity gaps have widened considerably across Member States. In 1999, Italian and Spanish productivity levels were respectively 89% and 93% of the German's level. By 2024, they had dropped to 82.1% for Italy and 85% for Spain.

In France, TFP growth has been half the Euro area average since the introduction of the euro. Initially, TFP in France grew faster than in Germany until 2010. However, the trend was reversed, leading to a continuous deterioration, and by 2024 French productivity was 7% lower than in Germany, compared to 2% higher in 1999.

Portugal stands out among the southern countries with a remarkable productivity performance of 13,4% between 1999 and 2023, mainly due to the fiscal consolidation and structural reforms implemented since 2012.



## 2.2 Since 1999, the Eurozone has been marked by substantial disparities in terms of economic and fiscal performances

Over the past two decades, the dynamics of real GDP growth and public debt and per capita GDP have become increasingly heterogeneous among Eurozone Member States.

### 2.2.1 Differentiated Economic Growth in the Eurozone

Real GDP growth over the past 25 years reveals three distinct groups (see Chart 19):

- “Lagging” countries: Greece and Italy, with cumulative growth of around 10%.
- “Intermediate” countries: Germany, France, Austria, and Finland, with growth of 30-40%.
- “High growth” countries: The Netherlands, Spain and Belgium, each with more than 45% growth. However, these countries still grew by 10-15 percentage points less than the United States (+66.2%).

However, the evolution of Spanish growth deserves some comment:

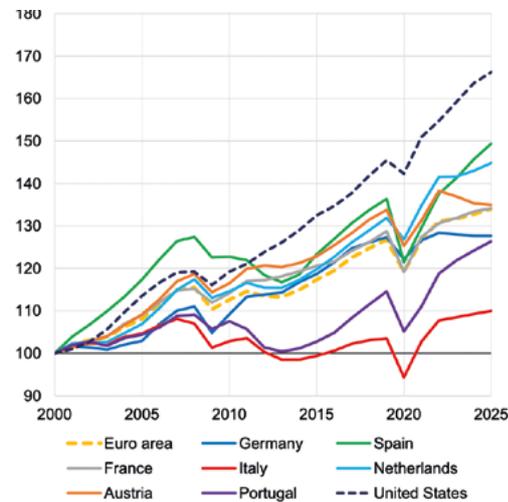
- 2000-2008: As A.-V. Robert notes, low real interest rates in the southern European countries (Greece, Spain, Portugal, Italy) encouraged borrowing. In Spain in particular, this led to a speculative bubble in real estate and financial assets, given the lack of productive investment opportunities due to stagnating productivity. The development of this bubble was at the expense of increased productive investment, reinforcing the slowdown in productivity growth during this period.

- 2012-2023: Spain's economic performance has been driven by the tertiary sector, especially tourism, which includes low-skilled and low value-added jobs. Productivity gains have been minimal, with TFP increasing by only 5.2% between 1999 and 2024, one of the lowest in the Euro area.

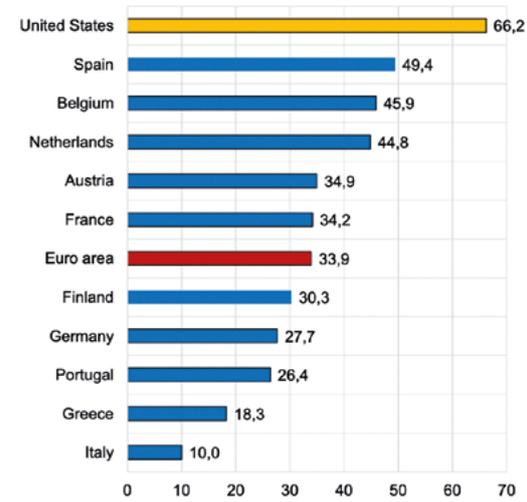
**CHART 19.**

**Real GDP growth dynamics across Eurozone Member States and the United States**

Chart 19a : Real GDP trends, 1999=100



19b : Real GDP trends, cumulative change between 1999 and 2024 (%)



Source: EU Commission (Autumn Forecasts of November 2024). Last observation is from 2024

**2.2.2 Developments in the debt-to-GDP ratio reflect economic divergences between the main EMU countries and insufficient coordination of economic policies within the Euro area**

In 2000, France, Spain and Germany had similar levels of public debt, close to the 60% Maastricht threshold, with ratios of 59.7%, 57.8% and 58.8% of GDP respectively.

By 2024 the situation had changed dramatically: Germany's debt remained relatively stable at 63% of GDP. In France, on the other hand, the government debt increased to 113.1% of GDP, exceeding the 60% threshold by 51.3 points. In Spain the government debt increased to 101.8% of GDP in 2024, 41.8 points above the threshold. Italy entered the Euro area with a government debt ratio of 109% of GDP. By 2024, the latter had risen to 136.6%, 76.6 points above the Maastricht Treaty threshold.

**CHART 20.**

**Gross public debt across Member States**

Chart 20a : Gross Public Debt, % of GDP

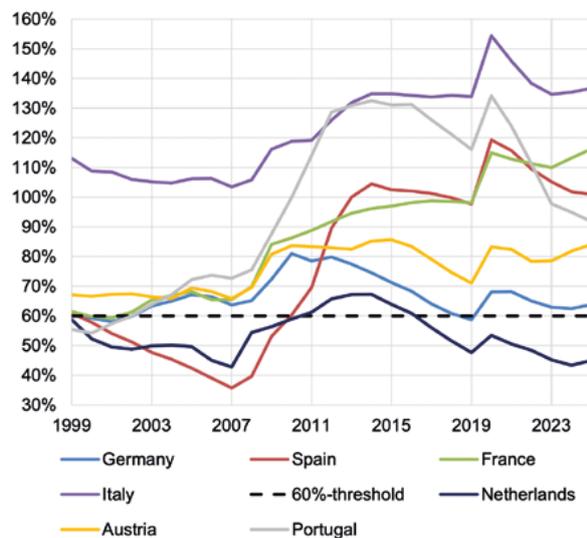
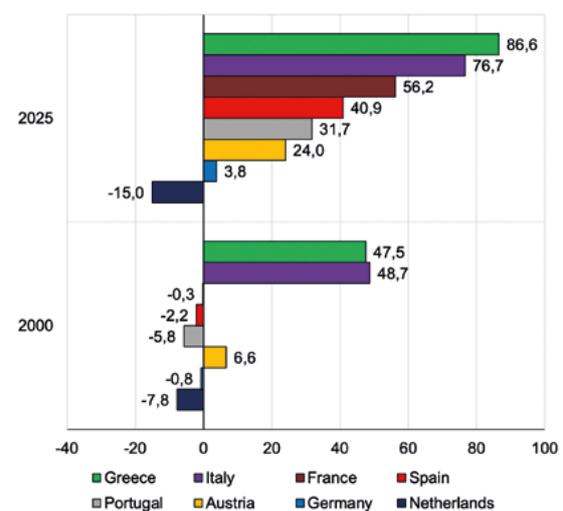


Chart 20b : Deviation from 60%-threshold (pts%)



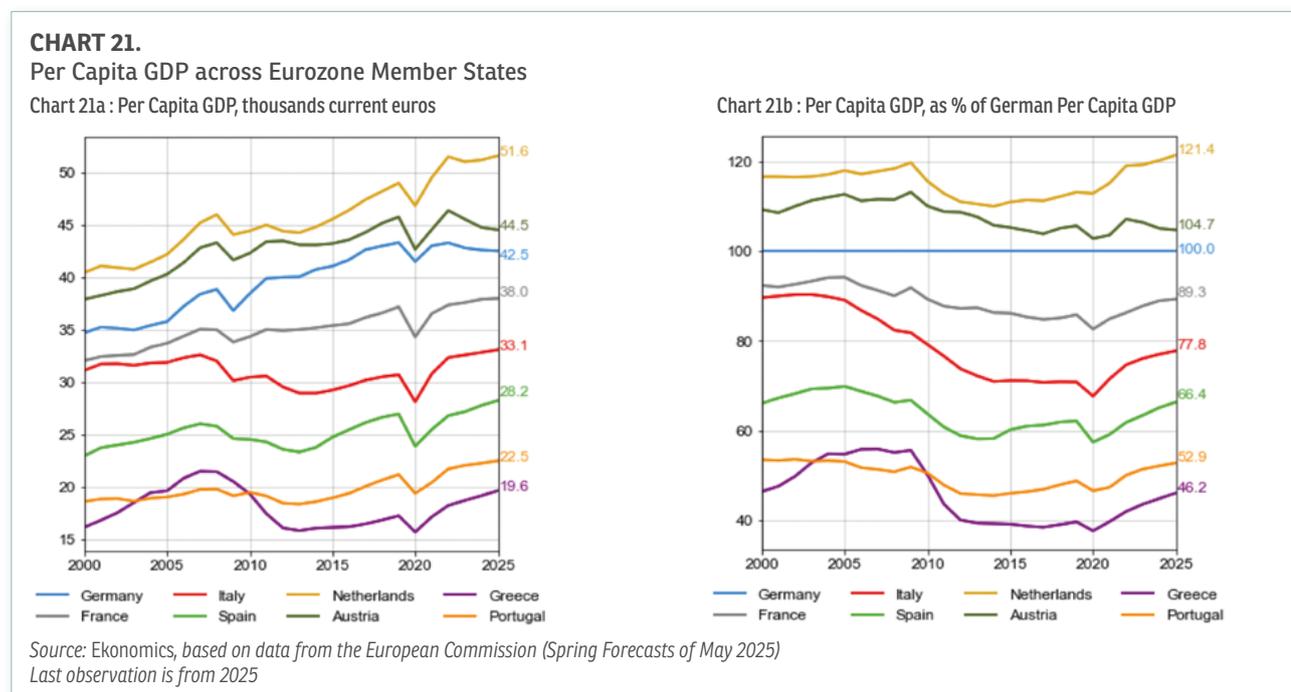
Source: Economics, based on data from the European Commission (Spring Forecasts of May 2025)

Lecture: While France's public debt ratio was just below the 60% threshold in 1999, it is now 56.2 points above the Maastricht standard for 2025

Source: European Commission (Spring Forecasts of May 2025)

### 2.2.3 Divergent Per Capita Income Growth (2000-2024)

Real GDP per capita has grown in all Eurozone countries since 1999, with more rapid growth in Northern Europe than in the South. Between 1999 and 2024, it grew only by less 9.6% in Italy, half the pace of Germany (26.3%). The Netherlands and Austria experienced stronger GDP per capita growth than Germany between 1999 and 2024. While it was only 4% lower than Germany's in 2004, France's GDP per capita was 10% lower in 2024.



With such disparities in GDP per capita between its member states, the Euro area is much more heterogeneous than the United States. In the US, the per capita income of the poorest state is almost 80% of the national average. In Europe, on the other hand, eight countries have a per capita income below 80% of the EU average.

### 2.3 The elimination of the exchange risk in the monetary union and progress toward the single market have increased the heterogeneity of productive specialization, particularly benefiting competitive Northern European countries

The euro has strengthened the more industrialised countries at the expense of those experiencing a deeper industrial decline. The completion of the European single market is an essential objective, but the progress made in recent years has not reduced the heterogeneity of economic performance across Member States. Positive results would only be achieved if all Member States progressed with structural reforms at roughly the same pace.

#### 2.3.1 Countries that enjoyed a highly effective economy before the introduction of the euro have benefited even more from the external value of the single currency

##### 2.3.1.1 The external value of the euro appears undervalued in Northern Countries...

The northern countries (especially Germany and the Netherlands), which are less prone to inflation and have competitive industries, have benefited from a euro that has depreciated in real terms, as it is an average, which has strengthened their export competitiveness. Indeed, the external value of the euro represents an average for the entire economic area and appears undervalued relative to their economic performance, giving these countries an additional competitive advantage. Without the euro, their national currencies would otherwise have appreciated.

For example, the CEPII estimated in 2017 that the German exchange rate was undervalued by 10-20% in terms of a real effective exchange rate relative to the Euro area. Its correction would arithmetically imply an annual inflation rate of 2% in Germany and 0% in the other countries for a decade, which would be unrealistic and probably misunderstood.

In other words, thanks to the euro, competitive countries have been able to avoid the appreciation of their currencies that would have occurred in its absence and which would have reduced their exports to Europe.

### 2.3.1.2 ...and overvalued currency in Southern Countries

In parallel, the euro has prevented the currency depreciation in southern countries which tended to be more inflationary and that would have occurred in its absence. Indeed, without the euro, their currencies would have undergone repeated devaluations, which would have been detrimental to their populations (lower purchasing power in the event of currency depreciation). These devaluations would have reflected market forces and promoted competitiveness, provided that domestic demand was properly managed to contain inflationary pressures and reduce the propensity to import. However, this stability comes at a price: reduced competitiveness for southern countries and increased competitiveness for northern countries.

### 2.3.2 Divergent inflation rates between Eurozone countries, which were particularly pronounced until the European sovereign debt crisis, contributed to differences in competitiveness between countries

With the introduction of the euro in 1999, inflation differences between the southern countries (Greece, Italy, Spain) and Germany increased. By 2008, these nominal divergences widened competitiveness gaps between Member States, leading many (Spain, Greece, Italy, Portugal) to run significant current account deficits. Between 2000 and 2010, the average annual deficits for Spain and Portugal were -6.5% and -9.5% of GDP respectively.

Since 2012, competitiveness gaps have narrowed as a result of the adjustment policies these countries have had to implement following the sovereign debt crisis.

### 2.3.3 Growing heterogeneity in productive specialization

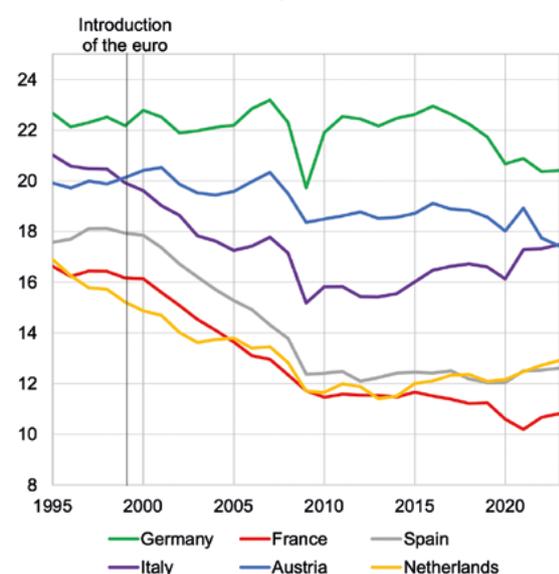
As is normal in a currency area, the Euro area Member States have different sectoral specialisations, with consequences for relative productivity and potential growth rates. The elimination of exchange rate risks tends to encourage specialisation within the monetary union; it mainly benefits net exporters, *i.e.* those that have specialised in tradable products for which they are highly competitive.

Moreover, as noted above, countries that were already performing well before the introduction of the single currency were further favoured by the external value of the euro and lower inflation rates.

In this context, the northern countries of the monetary union (in particular Germany and the Netherlands) have been able to maintain a competitive industry, while the southern countries (in particular Greece, France and Spain) have gradually experienced deindustrialisation. The northern countries have gained market shares in world trade, while the southern countries have experienced the opposite.

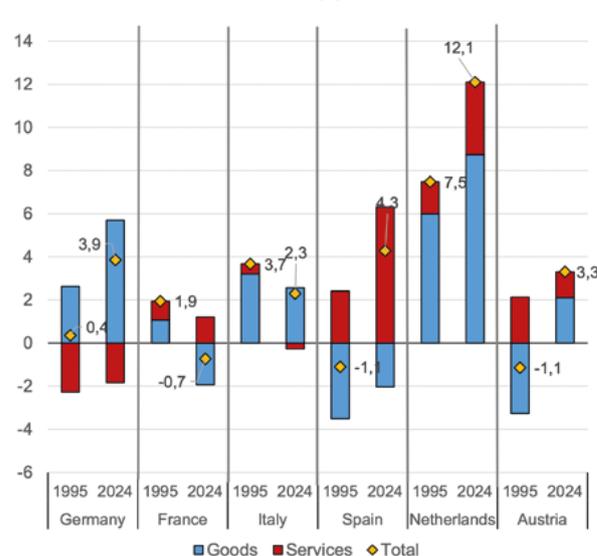
**CHART 22.**  
Sectoral specialisation across Member States

Chart 22a: Share of manufacturing in total value added



Source: OECD

Chart 22b: Trade balance, breakdown by goods and services, % of GDP



Source: Economics, based on data from the European Commission

Charts 22a and 22b illustrate the divergent trends in industrial specialisation across Member States since the introduction of the single currency: in several southern European countries, as well as in France, the share of manufacturing in value added has fallen sharply, while the trade balance relies mainly on services exports. However, the latter are struggling to compensate for the imports of goods, a situation that is particularly marked in France. Conversely, trade surpluses strengthened in Germany and the Netherlands during this period. Austria went from a deficit to a surplus.

Chart 24a illustrates the deindustrialisation of France over the last two decades, in contrast to Germany and Austria, for all the reasons mentioned in Chapter 4: the level of the tax burden and labour costs are too high due to the excessive weight of public expenditure in relation to GDP and the insufficient level of non-residential investment.

This deindustrialisation has led to a fall in productivity gains and corporate income, which in turn has led to an increase in public expenditure to compensate ("vicious circle of public debt" J67).

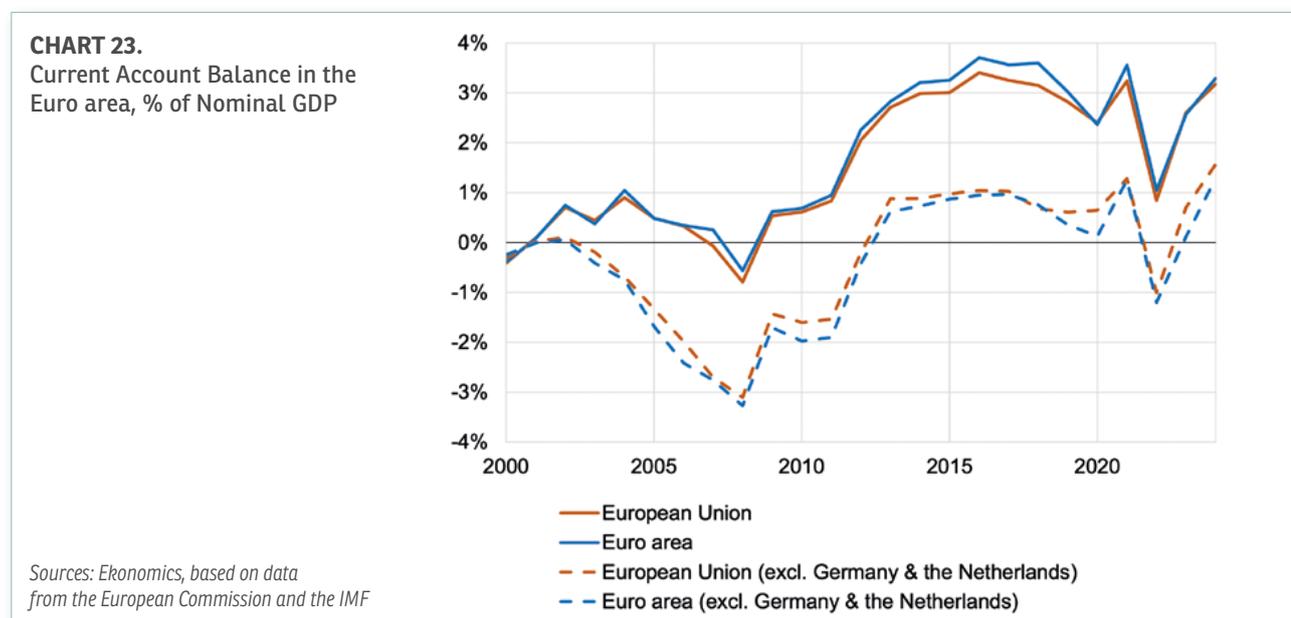
## 2.4 The current account imbalances resulting from these divergences have been significant and have not been corrected, as illustrated by the scale of positions within Target

### 2.4.1 Persistent divergences in the current account imbalances in the Eurozone despite improvements in peripheral countries since the EU Sovereign Debt Crisis

Despite the return to balanced current account positions in peripheral countries since 2012 (Italy, Spain, Portugal), significant divergences remain within the Eurozone.

Since 2012–13, Spain and Italy have recorded current account surpluses, both averaging 1.9% and 1.5% of GDP per year between 2012 and 2024. However, these performances are significantly lower than those of Germany and the Netherlands, where surpluses average 7.3% and 8% of GDP per year respectively.

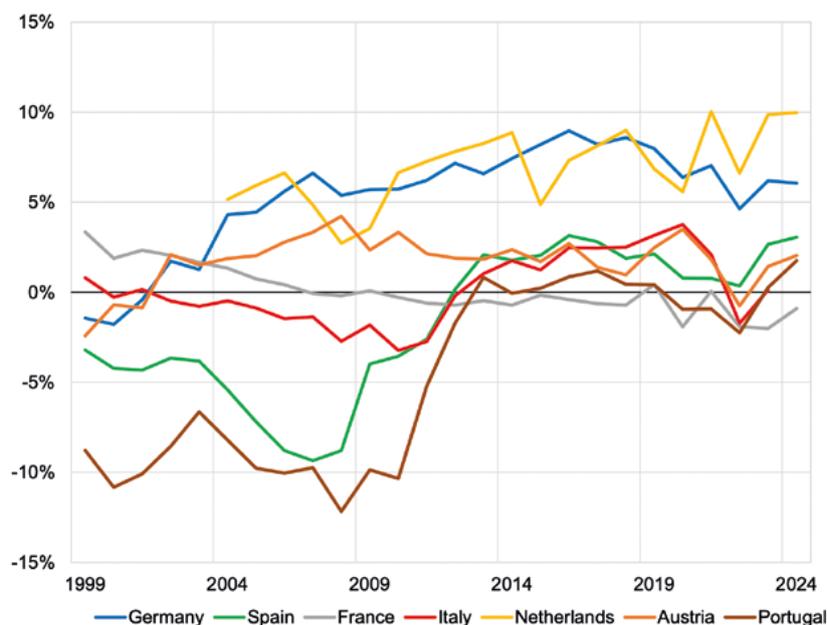
The external performance of these two countries was the main contributor to that of the Eurozone as a whole. Excluding Germany and the Netherlands, the Eurozone's current account would have been around 2 points lower it has been since the launch of the euro (see Chart 23).



Charts 23 and 24 underline the existence of significant differences between Member States in terms of current account imbalances. Surpluses in Germany and the Netherlands averaged 8.2% and 7.5% of GDP respectively over the period 2014–2019, while France recorded a permanent deficit of 0.4% on average between 2014 and 2019.

In 2023–24, the heterogeneity remains significant: according to the EU Commission's forecasts (November 2024), Germany and the Netherlands have surpluses of 7.1% and 11.1% respectively, while France has a deficit of 0.5% (see Chart 26).

**CHART 24.**  
Current Account Balance  
among the main EA Member  
States, % of GDP



Source: European Commission's  
Spring Forecasts (May 2025)

#### 2.4.2 Countries with large current account surpluses together with countries showing persistent current account deficits threaten the coherence of the EMU

In principle, imbalances are not a cause for concern in a genuine union. But at present the Euro area is not a genuine union; national budgets coexist, as do bilateral current account balances.

If the Eurozone was the equivalent of a nation, such current account discrepancies would not only be acceptable, they would hardly matter.

Since there would be only one balance of payments for the entire zone, as in the US, for example, rebalancing adjustments would take place automatically through capital and labour mobility and automatic fiscal transfers. Sub-regions with high current deficits (and therefore overvalued "currencies") would win because they could "import" cheap goods from surplus sub-regions, the latter contributing to the adjustment of the deficit zone through this implicit subsidy.

In reality, however, EMU is made up of countries with their own balance of payments and national budgets. Macroeconomic imbalances in relation to the "best performing economy" are not a matter for the Union to correct. These issues are entirely a matter for national economic policies.

Since countries cannot adjust their nominal exchange rates to maintain their competitive position, this takes place through internal devaluations – *i.e.* through price and wage adjustments – which reduce domestic demand and incomes.

Of course, the objective is not to unify all balances of payments within the EU. Some countries need to catch up from very low living standards, which inevitably entails some current account deficits. However, EMU should reduce rather than increase this heterogeneity.

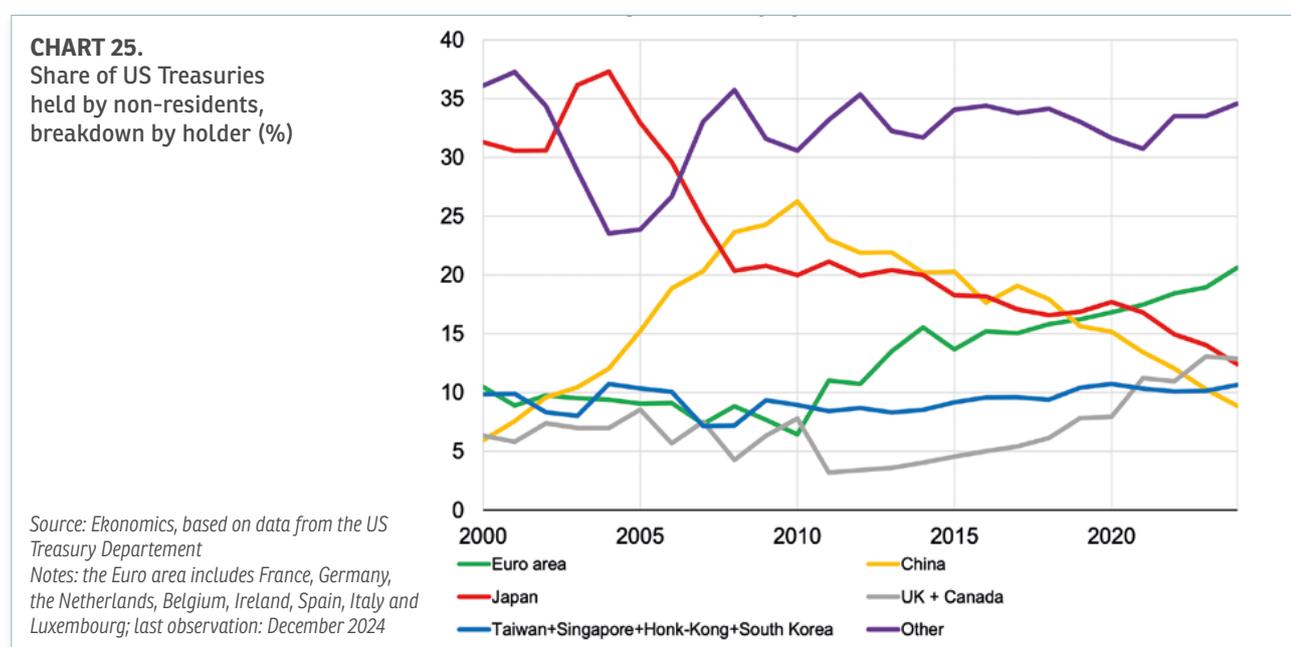
Until 2008, European cross-border capital flows mainly fuelled unproductive asset bubbles. Since the EU sovereign debt crisis (2011-2012), member states with excess savings (especially Germany and the Netherlands) no longer finance investment projects in countries with lower GDP per capita (Spain, Italy, Portugal, Greece). This is mainly due to the difference in interest rates and return on assets between the US and Europe (risk is better remunerated in the US than in Europe) and the insufficient number of investment projects in Europe. These limited cross-border capital flows in the Euro area reflect the persistent doubts of investors in northern Europe about the solvency of governments and companies in other countries, as well as the lack of a genuine banking union and integrated financial markets.

The fact that Germany and the Netherlands' current account surpluses are no longer lent to other Member States reduces the capacity of peripheral countries to invest, as well as their potential growth and contributes to increasing the heterogeneity of per capita income in the Euro area.

As a result, the Euro area has a savings surplus of €500 bn (or 3.3% of GDP) in 2024, which is being redistributed to the rest of the world. An important part is in the form of bond purchases, notably for US Treasuries (see Chart 64).

Between 2000 and 2023, the volume of US federal debt held by Euro area residents increased tenfold, from \$145.2 bn to \$1513.5 bn, while US public debt outstanding increased fivefold over the same period. Within the Euro area, all countries with a positive current account balance lent to the US (see Chart 27), financing the US external and fiscal deficits. These include Germany (\$87.3 bn in 2023), the Netherlands (\$73.5 bn), Luxembourg (\$370.7 bn), Spain (\$53.9 bn), Belgium (\$314.4 bn) and Italy (\$45.5 bn). Despite running an average current account deficit, France and Ireland also hold significant amounts of US government debt, with \$236.7 bn and \$331.5 bn owed to the US Treasury in 2023 respectively.

The development of cross-border financial flows within the Euro area is essential. The real objective of a currency area is to allow savings to flow to finance the most productive investments within it. Indeed, in a monetary union, the elimination of currency risk allows savings from countries with a high level of capital per capita (Germany, the Netherlands, France) to finance investment in countries with a lower level of capital per capita and a higher marginal productivity of capital (e.g. Spain, Italy, Portugal). Thus, income convergence usually results from the transfer of savings from countries with high per capita income to countries with low per capita income. However, as mentioned above, such transfers disappeared after the 2008-2010 period.



This phenomenon is here to stay. In fact, the Euro area is not a true monetary union. We have to take into account a structural feature, which is the increasing industrial specialisation of the surplus countries. Success breeds success. Aided by the implicit devaluation resulting from favourable cost developments, the surplus countries' exports are becoming more profitable.

It would be illusory to believe that the structural advantages of German exports could be transferred and copied by southern or eastern European countries, which have a different industrial history and cannot become little Ruhr (whereas the Ruhr can and is becoming stronger).

### 2.4.3 Higher returns on financial assets in the United States than in the Euro area

The main cause of capital outflows from the Euro area to the rest of the world, and in particular to the United States, is the low return on financial assets in the Euro area compared with the United States.

P. Artus<sup>8</sup>, highlights that this higher return concerns bonds, equities, and participations in companies (see Chart 26)

8. P. Artus, "Will the European capital markets union keep savings in the Eurozone?", Flash Economics, Natixis, 7 June 2024.

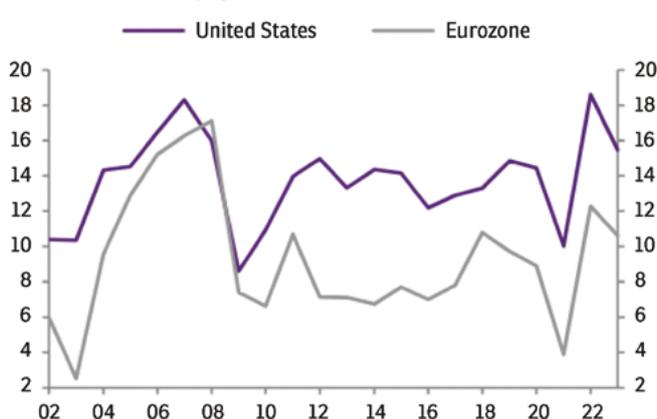
**CHART 26.**

Yields differential between European and US assets

Chart 26a : 10-year sovereign bond yields, %



Chart 26b : Return on equity



Source: OECD, Natixis

H. Tran<sup>9</sup> also underlines that investment flows to the United States are driven by higher returns on US equity markets compared to those in the EU. Specifically, over the period 1900–2020, the average annual nominal return on US equities was 9.6% compared to 7.2% for Europe. As long as this remains the case, savings from the EU and the rest of the world will continue to be attracted to the US, where foreign investors own 40% of the stock market.

According to McKinsey<sup>10</sup>, corporate Europe's return on invested capital were four percentage points lower than in the US between 2015 and 2022. Over that period, large public companies in Europe had a Return on invested capital of about 14%, compared with about 18% in the US. Europe's lower returns undermine investment at a time when capital is becoming scarcer. The gap is widest in technology hardware, software services and pharmaceuticals.

The EU therefore needs both reform and investment: structural reforms that make its economy more efficient and its firms more profitable will create more investment opportunities to use European savings at home – while more investment could help improve the EU's productivity and growth prospects. So while it makes sense to find ways to increase investment in the EU, the problem is more fundamental than just the efficiency of capital markets.

#### **2.4.4 Target 2 imbalances in the Eurozone have increased with the ECB's asset purchase programs (2015-2022)**

Since the creation of the euro, Target 2 balances have gone through several distinct phases. Before 2008, balances were practically zero: current account imbalances between euro-area countries were settled through interbank liquidity transfers. After the 2008 financial crisis and the 2012 Sovereign Debt Crisis, Target 2 balances rose dramatically due to tensions on the interbank market and a flight of deposits from "peripheral" countries (Italy, Greece, Spain, Portugal, Ireland) toward "core" countries (Germany, Netherlands, Luxembourg), before gradually declining. Total Target 2 national surpluses in these countries amounted to €900 billion in mid-2012, before gradually declining and stabilising at around €600 billion at the end of 2014.

Since 2015, the ECB's asset purchase programmes have led to an increase in balances. Since the mid-2010s, the main countries with the highest Target 2 liabilities (in bn euro) have been Greece, Ireland, Portugal, Spain and Italy, and the countries with the largest surpluses have been Germany, the Netherlands, Finland and Luxembourg.

The net Target 2 liabilities of the Bank of Italy and the Bank of Spain are quite high, amounting to €371 bn and €429 bn respectively in April 2025 (equivalent to 19.4% of GDP for Italy and 32.3% for Spain). Conversely, the Bundesbank has a net Target 2 credit of €1,075 bn in April 2025 (27.8% of German GDP).

Today, Targets' balances reflect the legacy of Quantitative Easing (QE) bond portfolios and will fall steadily as the ECB reduces its balance sheet. In January 2017, in a letter to members of the European Parliament, Mario Draghi wrote<sup>11</sup> that "if a country were to leave the Eurosystem, its national central bank's claims on or liabilities to the ECB would need to be settled in full."

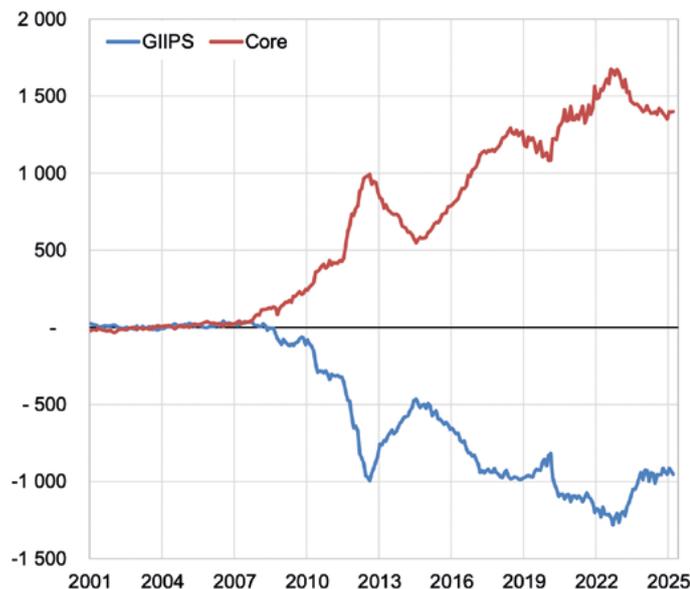
9. H. Tran, "The Enrico Letta Report and the state of the EU's Capital Market Union", Atlantic Council, 7 May 2024.

10. McKinsey Global Institute, "Investment: Taking the pulse of European competitiveness", June 20, 2024.

11. Letter from Mario Draghi to the members of the European Parliament Marco Valli and Marco Zanni, January 2017.

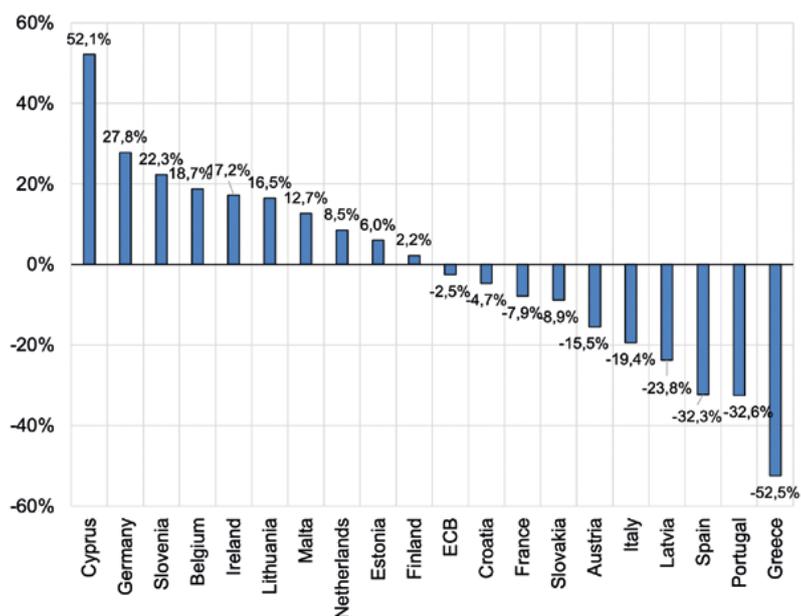
**CHART 27**  
Target 2's imbalances  
in the Euro area

Chart 27a : GIIPS's liabilities versus Core's claims, EUR bn



Source: Economics' calculations based on Euro Crisis monitor  
For chart 29.a, GIIPS = Greece, Italy, Ireland, Portugal, Spain ; Core = Germany, Netherlands, Luxembourg  
Last observation from April 2025

Chart 27b : Target 2 imbalances as of December 2024, % of GDP



Source: Economics' calculations based on Euro Crisis monitor and Eurostat

According to B. Drut<sup>12</sup>, "At least three problems would arise in the event of the exit from the Euro area of countries with significant net Target 2 liabilities:

- I. For several countries (Spain, Italy, Portugal), the Target 2 liabilities are very large when taken as % of GDP, which implies that the amounts needed to settle the commitments would be colossal,
- II. In the event of the exit of the Euro area from a relatively weaker country from an economic point of view, its new currency would probably be weaker, which would further increase the settlement to be made,
- III. Would a country leaving the Eurozone necessarily want to settle all its commitments? We have seen in the case of Brexit that some British politicians were totally opposed to the divorce bill."

Ultimately, the Target 2 imbalances – and the potential losses in the event of an exit from the Euro area and the non-settlement of Target 2 balances – could strengthen the bargaining power of debtor countries in the event of tough negotiations with core countries.

12. B. Drut, "Target 2 imbalances, again at the center of attention", CPR, 2018.

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Target 2 imbalances should decline as the ECB reduces its asset purchase programmes and, more generally, as progress is made on the Banking Union and the Capital Markets Union to the extent that cross-border flows become more north-south than south-north.

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A reading of this chapter shows that the Member States have not taken their destiny into their own hands by ensuring the minimum coordination that could have made the system work better.

The current intensity of fiscal and economic divergences between EU countries makes it more difficult to define in Europe a common interest, encourages a current policy of "every man for himself", and creates a climate of mistrust between Member States which hinders any progress in terms of public and private risk sharing and weakens the Eurozone. Consequently, it is not easy to achieve global objectives (*e.g.*, green transition, digitalization, defense, social redistribution, migration...) including monetary stability, while maintaining such divergent fiscal policies.

As long as it is not sufficiently understood, especially in highly indebted countries, that excessive debt is a source of uncompetitiveness, the economic situation in these countries will continue to deteriorate and it will be all the more difficult to make progress in Europe towards more public or private risk sharing.

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### 3. After periods of turbulence and a return to greater coherence, the monetary union is once again at a critical juncture

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The euro has weathered almost a quarter of a century of crises and storms without sinking. But this success cannot mask the internal divisions within the monetary zone.

A close look at the euro reveals that, unlike other currencies, it is far from being a reflection of national unity. The euro experienced dramatic turbulence during the Sovereign Debt Crisis and is regularly a source of discord between Member States.

Why is this? There are several reasons:

- First, there are as many fiscal policies as there are members of the Eurozone, and these national economic policies have never been sufficiently coordinated, which has hampered the adoption of reasonable solidarity mechanisms.
- Second, there are heterogeneous perceptions of inflation (northern countries are less prone to inflation than southern countries).
- Third, the euro key interest rate is the same for all members of the monetary zone. It is an average which, by definition, is inadequate for countries with highest inflation rates.
- Fourthly, since the 1960s, the Union has moved from structural European policies (competition in industry, agriculture, energy, etc.) to a single market without Community preferences and with strong national tendencies.

In other words, the management of the single currency is the subject of ongoing discussions between the members of the ECB and the Eurogroup. Since the EU is not a single nation but a confederation of national states, we have to accept that it seeks compromises to optimise national objectives. But a monetary union can only work if there is a minimum of fiscal discipline in the member states, which has not been the case for the past 25 years. The single currency has not brought all the expected benefits because some Member States have not complied with the economic discipline required for a monetary union.

The history of the Euro area from its creation to the present can be divided into three periods. After a decade of economic divergence (2000–2010) that led to the euro 'sovereigns' crisis, the European economic system improved over the following decade. However, since the Covid-19 crisis and the energy crisis triggered by the war in Ukraine, economic disparities between the major member states have been widening, threatening the future of the euro.

#### **3.1 2000-2010: a phase of economic divergence leading to the European sovereign debt crisis (2010-2012)**

From the very beginning of monetary union, the different countries in the Euro area made use of their economic policy freedom. The heterogeneity of economic policies in the Euro area increased during the first ten years of its history. While the northern European countries focused on strengthening their industrial base, decentralising wage bargaining and keeping public finances under control, the southern European countries (Greece, Portugal, Italy and Spain) favoured credit, consumption and social redistribution without worrying about the consequences for their public finances or their external imbalances.

##### **3.1.1 As soon as the euro was introduced, the Maastricht criteria were no longer respected by large Member States**

The Monetary Union got off to an inauspicious start. It is true that the public debt ratios of France and Germany were close to 60% of GDP in 1999 and their public deficits were limited (1.5% of GDP in 1999). But already in 2002, fiscal deficits began to exceed the 3% threshold.

In 2003, these countries successfully lobbied for an exemption from the rules of the Stability and Growth Pact. Thus, on 25 November 2003, the Eurogroup, against the advice of the European Commission, Austria, the Netherlands, Finland and Spain, decided to set the Union's two leading economic powers less ambitious fiscal consolidation targets for 2004 than those recommended by the Commission. As requested by Paris and Berlin, the Eurogroup also agreed to suspend the automatic enforcement of the articles of the Pact that would have ensured that deficits would fall below the 3% of GDP limit by 2005.

The transition from a mechanical and almost automatic application of the various articles of the Stability and Growth Pact to a henceforth political management ruined its effectiveness. This bad example opened the door to fiscal excesses in several southern European countries (Greece, Italy, Portugal), as shown in the table below.

**TABLE 1.**  
Government Budget Balance across the main EA Member States, (2000-2010), % of GDP

	2003	2004	2005	2006	2007	2008	2009	2010	Average
<b>Germany</b>	-3,8%	-3,4%	-3,4%	-1,8%	0,2%	-0,3%	-3,2%	-4,4%	-2,5%
<b>France</b>	-4,1%	-3,6%	-3,5%	-2,7%	-3,0%	-3,5%	-7,4%	-7,2%	-4,4%
<b>Italy</b>	-3,2%	-3,5%	-4,1%	-3,6%	-1,3%	-2,6%	-5,1%	-4,2%	-3,4%
<b>Spain</b>	-0,4%	-0,1%	1,2%	2,1%	1,9%	-4,6%	-11,2%	-9,5%	-2,6%
<b>Netherlands</b>	-3,2%	-1,8%	-0,5%	0,0%	-0,3%	0,0%	-5,1%	-5,3%	-2,0%
<b>Austria</b>	-1,8%	-4,9%	-2,6%	-2,6%	-1,4%	-1,6%	-5,4%	-4,5%	-3,1%
<b>Belgium</b>	-1,8%	-0,2%	-2,7%	0,2%	0,1%	-1,1%	-5,4%	-4,1%	-1,9%
<b>Greece</b>	-8,0%	-9,1%	-6,3%	-6,1%	-6,8%	-10,3%	-15,4%	-11,4%	-9,2%
<b>Portugal</b>	-5,7%	-6,2%	-6,1%	-4,1%	-2,8%	-3,8%	-9,9%	-11,4%	-6,3%
<b>Euro area</b>	-3,1%	-2,9%	-2,7%	-1,6%	-0,7%	-2,3%	-6,3%	-6,3%	-3,2%

Source: EU Commission

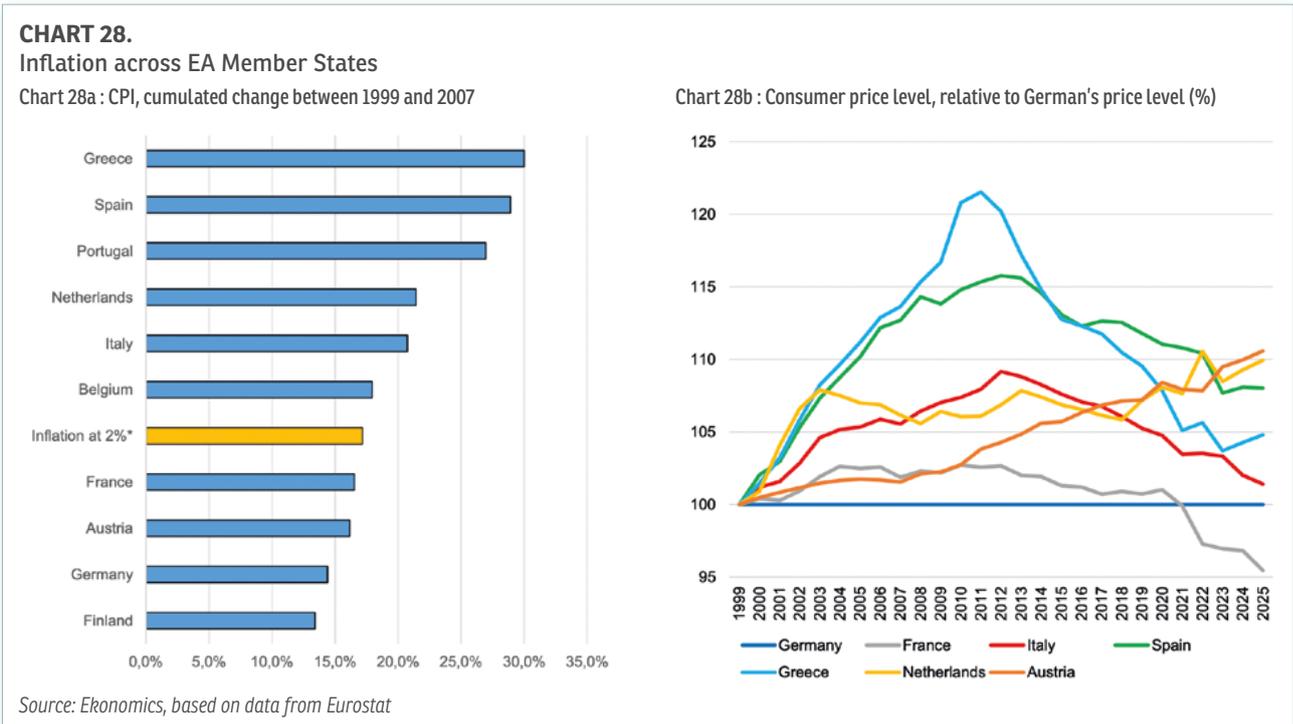
Germany improved its public finances between 2004 and 2007, with the fiscal deficit moving from -3.4% of GDP to a balanced position. But such a virtuous fiscal path did not materialize everywhere. For instance, despite a favourable economic climate between 2004 and 2007 (2.5% average annual growth over these 3 years), France continued to record public deficits above 3% of GDP (except in 2006), thereby abandoning the economic discipline it had adopted to join the Eurozone.

Following the Global Financial Crisis of 2008, France recorded deficits above 7% of GDP for two years. In 2009, the budget deficit exceeded 10% of GDP in Spain (-11.3%), Portugal (-9.9%) and Greece (-15.3%), while it remained below 4% in Germany (-3.2%).

**3.1.2 The introduction of the euro has been accompanied by a significant disparity in inflation rates, widening the competitive gap between Member States**

After the introduction of the euro, production costs in the peripheral Member States increased much more than in the “northern” countries.

Between 1999 and 2007, the consumer price index rose by more than 25% in Spain (+28.9%), Greece (+30%) and Portugal (+27%), almost twice as fast as in Germany (+14.4%), France (+16.5%) or Austria (+16.2%).



Focusing on hourly labour costs between 2000 and 2008, Germany (+9%), Austria (+4%) and Sweden (+8%) improved their competitiveness by reducing their labour costs relative to the EU average. Conversely, western industrialised countries such as Belgium, Denmark, Finland, France and the Netherlands experienced only a slight deterioration in their labour cost position relative to the EU average – between -2% and -8%. The picture is very different for the southern European countries and Ireland. Greece (-22%), Ireland (-40%), Italy (-12%), Portugal (-25%), Spain (-13%) and Cyprus (-29%). Such disparities are unsustainable in the long term.

**3.1.3 In the peripheral countries, the fall in real interest rates has led to a surge in private sector debt, encouraging property bubbles**

As there is only one key interest rate in a currency zone, real interest rates (after deducting inflation) in the peripheral countries became lower than in the northern countries, or even negative after joining the euro (see Chart 29a). This increased the incentive to borrow. The easing of financial conditions stimulated the distribution of credit (particularly real-estate mortgages) in southern Europe and Ireland, leading property prices to soar. As a percentage of GDP, outstanding credit to the private non-financial sector almost doubled between 2000 and 2007 in Spain and Greece. In Italy and Portugal, it increased by more than a third over the same period (see Chart 29b).

**CHART 29.**  
Real interest rates and credit dynamics across Euro area Member States (2000-2012)

Chart 29a : 10-year sovereign bond yields, adjusted for inflation in selected periphery Member States (%)

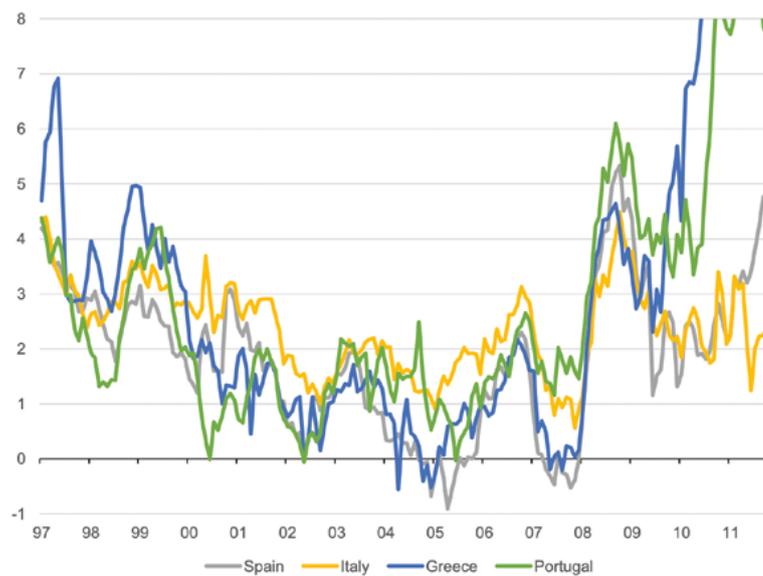
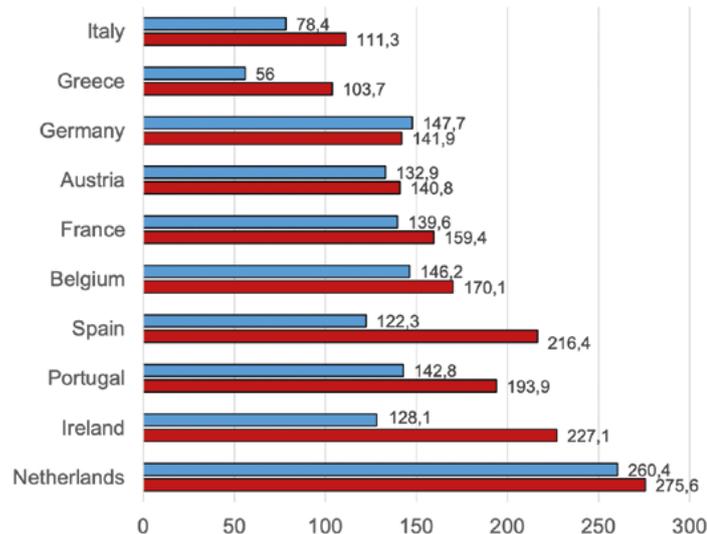


Chart 29b : Credit to non-financial private sector, % of GDP



Source: Economics, based on data from the BIS and the OECD

During this decade (2000 to 2010) there was a high degree of capital mobility within the Euro area. However, most of it was the result of interbank financing, which supported the financing of inefficient investments (e.g. in real estate bubbles, sub-optimal business ventures and infrastructure projects, especially in Spain, Italy, Portugal, Ireland and Greece) and contributed to massive current account deficits.

One way of correcting this imperfection could have been the introduction of corrective policies that restrict credit in countries where monetary runaway was threatening, and the support for countries with below-average inflation rates to develop domestic demand. This is what is known as differentiated macroeconomic management.

But nothing was done. As a result, economic disparities between Eurozone countries have widened. This is a major flaw in the management of the Eurozone's monetary policy. Far from being an optimal zone, the Eurosystem has generated unsustainable inflationary disparities due to heterogeneous and uncontrolled credit expansion, with all the attendant consequences for the balance of payments. It's a textbook case.

The experiment has been very dangerous and risky. Monetary policy was conducted in an inconsistent manner. It is worrying. Does monetary policy have to be conducted in such a disastrous way? Neither the European Commission nor the ECB carried out their role of macroeconomic surveillance. The concept was wrong, the safeguards non-existent. The best way to ensure disaster.

### 3.1.4 ...and created current account imbalances in several EU countries

The fiscal deterioration and widening inflation differences resulted in have been accompanied by widening current account deficits in the Eurozone's peripheral countries as shown in Table 2.

**TABLE 2.**

Current Account Balances across the main EA Member States, (2003-2010), % of GDP

	2003	2004	2005	2006	2007	2008	2009	2010	Average
Germany	1,3%	4,3%	4,4%	5,6%	6,6%	5,4%	5,7%	5,7%	4,9%
France	1,7%	1,3%	0,7%	0,4%	-0,1%	-0,2%	0,1%	-0,3%	0,5%
Italy	-0,8%	-0,5%	-0,9%	-1,5%	-1,4%	-2,7%	-1,8%	-3,2%	-1,6%
Spain	-3,8%	-5,4%	-7,2%	-8,8%	-9,4%	-8,8%	-4,0%	-3,6%	-6,4%
Netherlands	0,0%	5,2%	5,9%	6,6%	4,8%	2,7%	3,5%	6,6%	4,4%
Austria	1,5%	1,9%	2,0%	2,8%	3,3%	4,2%	2,3%	3,3%	2,7%
Belgium	6,0%	4,9%	3,9%	4,2%	4,5%	1,7%	2,8%	2,1%	3,7%
Greece	-10,2%	-8,9%	-9,8%	-11,5%	-14,3%	-14,9%	-11,8%	-10,3%	-11,5%
Portugal	-6,6%	-8,2%	-9,8%	-10,0%	-9,7%	-12,2%	-9,9%	-10,3%	-9,6%
Euro area	0,4%	1,0%	0,5%	0,3%	0,3%	-0,6%	0,6%	0,7%	0,4%

Source: European Commission

The most striking cases are those of Greece, which recorded an average annual current account deficit of -11.5% of GDP between 2003 and 2010, followed by Portugal (-9.6%) and Spain (-6.4%). These unsustainable deficits inevitably lead to crises when external financing dries up.

The expansion of private credit has contributed to the development of external imbalances in the peripheral countries of the Eurozone. Indeed, the use of credit stimulated domestic consumption, which in turn accentuated the rise in imports. Between 2002 and 2008, consumption increased in Greece, Portugal, and Spain as a result of the expansion of credit to the private sector. In Greece, Portugal, and Spain, consumption grew by an annual average of 4.1%, compared with 1.8% for the Eurozone as a whole.

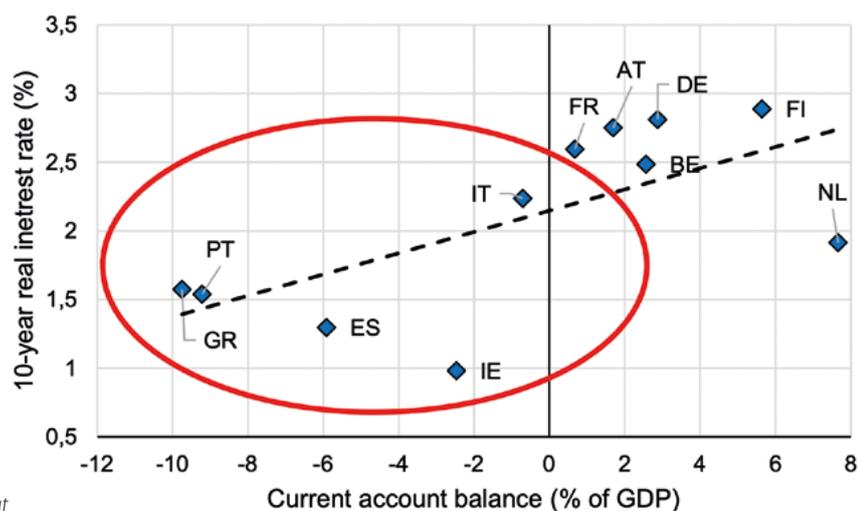
France and Italy recorded persistent current account deficits between 2005 and 2010 (France -1.5% on average per year, Italy -2.5%), reflecting the loss of competitiveness (in particular due to rising wages) in countries with high budget deficits (see Part 3.1.2 above). Unit labour costs rose by 3.4% and 2.8% per annum in Greece and Italy respectively over the period 2000-2010, compared with 0.4% in Germany and 2.1% in France. In contrast, Germany recorded an average annual current account surplus of 5.1% over the same period.

Growth in countries that have lost competitiveness has therefore been driven mainly by increased domestic consumption rather than by growth in exports or productive investment.

As J. de Larosière points out<sup>13</sup>, "since exchange rate adjustments are by definition impossible in a monetary union, such current account imbalances should have destabilized the financial markets and led to higher interest rates in overheating countries. This did not happen."

13. J. de Larosière, "Les 10 préjugés qui nous conduisent au désastre économique et financier", Odile Jacob, 2018.

**CHART 30.**  
Real interest rates and current account balances across EA Member States, average 2000-2007



Source: *Economics*, based on data from Eurostat

### 3.1.5 The existence of monetary union, as it has been managed, has encouraged these divergences

The financial markets behaved as if all the Euro area Members formed a single bloc. From 2000 to 2007, countries with serious imbalances did not experience an increase in their spreads, and therefore their sovereign interest rates remained virtually identical to those of Germany.

These virtually zero risk premiums encouraged a number of governments to embark on high levels of public spending and deficits. They also facilitated the expansion of private credit in countries such as Ireland and Spain, where property could be financed at low interest rates, since monetary policy was, by definition, unique and, in fact, too accommodating for such countries.

These construction booms increased tax revenues and, as a result, did not increase budget deficits. Before the crisis, Ireland and Spain were praised for running budget surpluses. But these surpluses were, of course, fragile and dependent on the credit boom.

During these ten years, Europe experienced a system with a single monetary policy, but with national fiscal and economic policies that were uncoordinated and poorly supervised by the European Commission. This system, with the help – or blindness – of the markets, eliminated external constraints on debtor countries. It therefore allowed them to borrow more and more and to spend more than they produced.

Two models coexisted during the 2000s: export-led economies (Austria, Germany, the Netherlands, etc.) and import- and consumption-led economies ('peripheral' members).

In a 'no bailing out' system like the Maastricht Treaty, the balance of payments remains national. But the markets did not take this into account until 2008-2009. In fact, the markets and rating agencies behaved as if there was an implicit bailout mechanism. When it became clear that no such mechanism existed, reality took its revenge and spreads soared, leading to the outbreak of the so-called sovereign debt crisis in Europe. Countries then had no choice but to reduce their external imbalances.

### 3.2 2012-2019: economic divergences narrow, although public debt remains a concern in some member countries

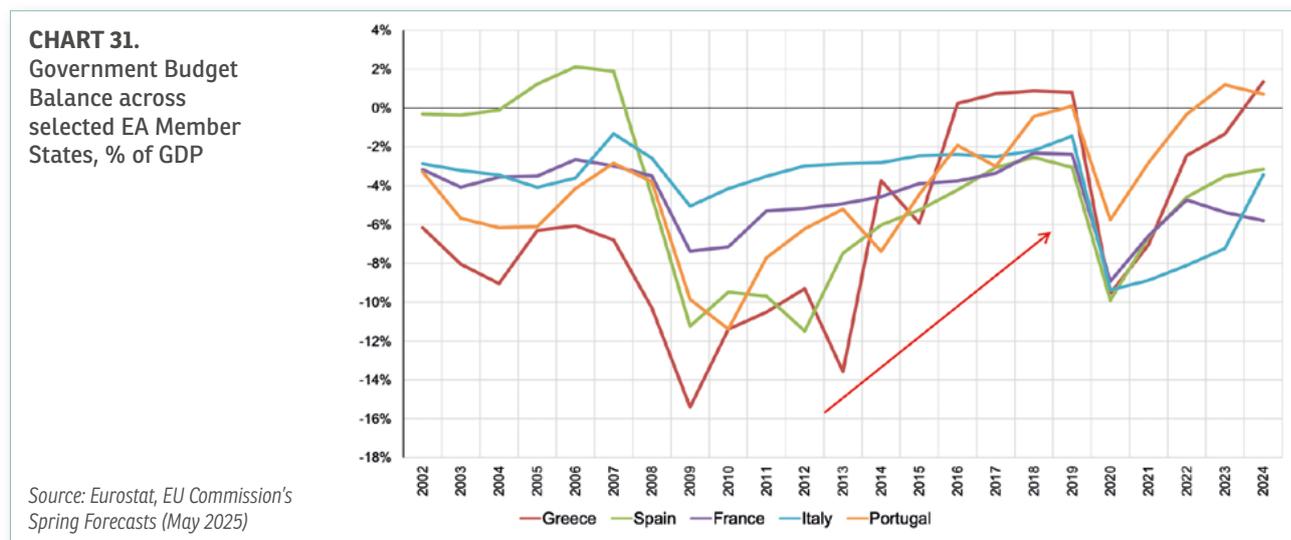
After 10 years of divergence, the European economic system has gradually become more coherent. Efforts have been made to improve Europe's economic governance, with the creation of the European Stability Mechanism in 2012, the introduction of the Macroeconomic Imbalance Procedure in 2011, and the reform of the Stability and Growth Pact in 2011/2012 through the Six Pack, the Two Pack and the Treaty on Stability, Coordination and Governance (TSCG).

Monetary policy has also allowed interest rate differentials within the Euro area to narrow, albeit at the expense of financial stability.

But the picture was still far from perfect on the eve of the pandemic outbreak (2020). The system had not yet been fully repaired, the "fundamental imbalances" of countries with excessive current account surpluses had not been addressed, and the government debt remained a cause for concern in a number of countries.

### 3.2.1 After 2012, the peripheral countries all improved their public accounts

In 2019, the Eurozone countries, including the peripheral countries, had all improved their public accounts compared with their 2010-12 levels.

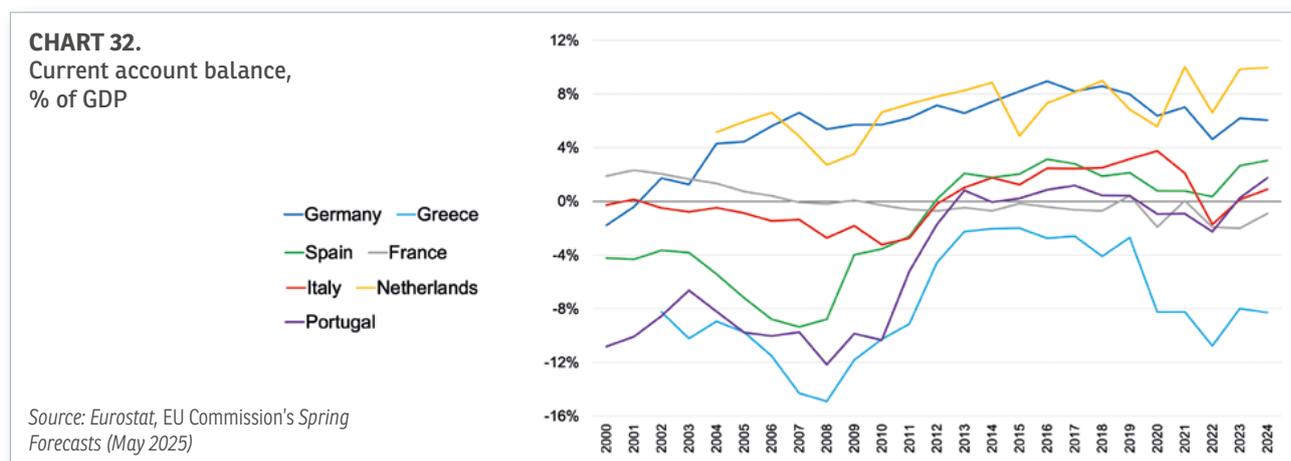


- The **Italian** deficit fell below 3% of GDP from 2015 onwards, fluctuating between 1.5% and 2.5% of GDP. The fiscal efforts can be seen in the achievement of primary surpluses over the period (an average of 1.6% between 2014 and 2019), although insufficient to offset the much higher interest burden (3.9% of GDP on average).
- Still with a deficit at 5.9% of GDP in 2015, the **Greek** fiscal balance moved into surplus the following year, fluctuating around 0.8% of GDP until 2019. Before interest payments, the fiscal surplus averaged 2.2% of GDP over this period.
- The consolidation of government finances has also been visible in **Portugal**, which achieved its first primary surplus in 2015 (+0.1%). By 2019, the latter reached 3.1% of GDP.
- The fiscal adjustment was less pronounced in **Spain**, where the deficit was only once below 3% of GDP between 2012 and 2019. In 2019, the deficit was still 3.1% of GDP, up from the previous year (-2.5%). Unlike Italy, Greece, and Portugal, Spain never recorded a primary surplus between 2012 and 2019.

### 3.2.2 Current account balances – which express relative competitiveness – have become more consistent over the period 2012-2019

The table below shows that the Eurozone has become much more coherent in the wake of the European sovereign debt crisis.

In fact, in 2016-2017, most of the countries in the Monetary Union – except France and Greece – managed to eliminate their current account deficit.



**TABLE 3.**

Current Account Balances across the main EA Member States, [2012-2019], % of GDP

	2012	2013	2014	2015	2016	2017	2018	2019	Average
<b>Germany</b>	7,2%	6,6%	7,4%	8,2%	9,0%	8,2%	8,6%	8,0%	7,9%
<b>France</b>	-0,7%	-0,5%	-0,7%	-0,2%	-0,4%	-0,6%	-0,7%	0,4%	-0,4%
<b>Italy</b>	-0,2%	1,0%	1,8%	1,2%	2,5%	2,4%	2,5%	3,2%	1,8%
<b>Spain</b>	0,2%	2,1%	1,8%	2,0%	3,1%	2,8%	1,9%	2,1%	2,0%
<b>Netherlands</b>	7,8%	8,3%	8,9%	4,9%	7,3%	8,1%	9,0%	6,8%	7,6%
<b>Austria</b>	1,9%	1,8%	2,4%	1,7%	2,7%	1,4%	1,0%	2,5%	1,9%
<b>Belgium</b>	1,0%	1,2%	1,0%	0,7%	-0,3%	-0,2%	-1,5%	0,1%	0,3%
<b>Greece</b>	-4,6%	-2,2%	-2,0%	-2,0%	-2,8%	-2,6%	-4,1%	-2,7%	-2,9%
<b>Portugal</b>	-1,7%	0,8%	-0,1%	0,2%	0,9%	1,2%	0,4%	0,4%	0,3%
<b>Euro area</b>	2,3%	2,8%	3,2%	3,3%	3,7%	3,6%	3,6%	3,0%	3,2%

Source: EU Commission

This period also saw a return to more significant shifts in relative labour costs<sup>14</sup>. There were further improvements in the countries hit particularly hard by the financial and economic crisis. Cyprus (+18%), Italy (+10%), Portugal (+7%), Spain (+7%), Ireland (+6%) and Greece (+5%) achieved the largest increases in competitiveness as measured by relative labour costs between 2012 and 2019. In Germany, labour costs relative to the EU average rose again for the first time, resulting in a slight loss of competitiveness (-3%). This is similar to Denmark (- 5%), Finland (- 0%), Austria (- 7%) and the United Kingdom (- 2%), but somewhat lower than in Belgium (+ 3%), France (+ 2%), the Netherlands (+ 3%) and Sweden (+ 5%).

But the picture is far from perfect: the current account surpluses in Germany and the Netherlands (over 8% of GDP on average over the% period) reflect a situation of “fundamental imbalance” in IMF terms.

As J. de Larosière points out<sup>15</sup>, German exports have stood up well to global competition and have also benefited from the additional competitiveness conferred by the euro compared with a situation where each country had an equilibrium exchange rate.

“From this collective point of view, Germany must commit – in particular by investing in infrastructure, by supporting internal demand, and by accepting European solidarity mechanisms – to using the “abnormal” part of its structural surpluses for the benefit of the Union overall growth.

This is not about tax redistribution or a “Union of transfers”. It is about correcting a “fundamental imbalance” that risks jeopardizing the survival of the Union if nothing is done to remedy it.

Indeed, we cannot expect the countries of the South – which have balanced their current accounts – to be the only ones to adjust their incomes downwards indefinitely to offset the growing surpluses of the countries of the North.

It is time to introduce a symmetrical adjustment mechanism in which structural surpluses are adjusted in the same way as deficits. Countries with long-term surpluses should modify their economic policies by agreeing to increase their investment in infrastructure and to encourage some wage shifting.”

If these efforts are not made quickly, he wrote in 2018, “it is to be feared that the unleashing of populism will threaten the survival of the EU.”

The Macroeconomic Imbalance Procedure has never been amended to remedy this situation. The design and implementation of a symmetric adjustment mechanism, where surpluses are treated in the same way as deficits, has never been undertaken, and this procedure has been limited to address the problems of countries with current account deficits.

### 3.2.3 Growth resumed in peripheral countries, albeit at a slower pace than in the previous decade

Real GDP growth resumed in all EU countries after 2012, but at a slower pace than before the crisis: Spanish real GDP grew by an average of 2.6% between 2014 and 2019, compared with 3.7% between 1999 and 2007.

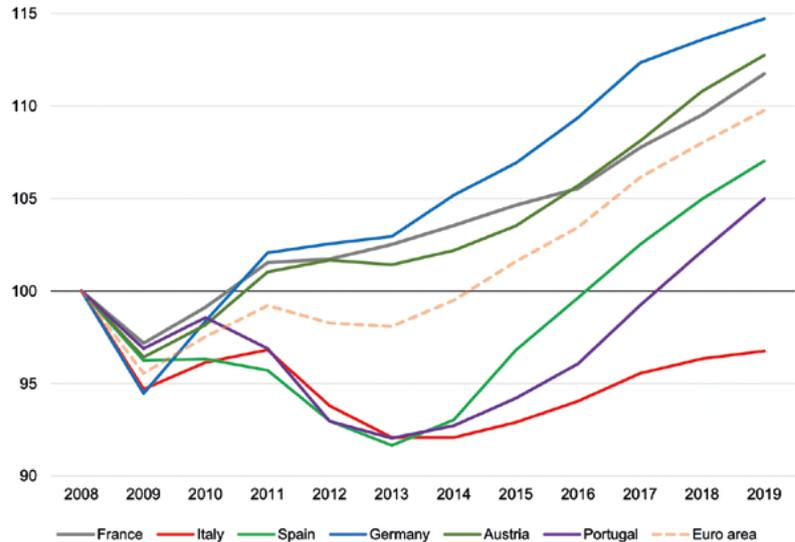
The French GDP growth fell from an average of 2.4% between 1999 and 2007 to an average of 1.4% between 2014 and 2019.

However, in 2019, the Italian real GDP had not returned to its 2007 level, while Spain and Portugal exceeded it in 2017 and 2018 (see Chart 33).

14. see the article by M. Beck quoted above.

15. J. de Larosière, “Les 10 préjugés qui nous conduisent au désastre économique et financier”, Odile Jacob, 2017.

**CHART 33.**  
Real GDP growth dynamics  
across EA Member States,  
2008 = 100



Source: EU Commission

With budget deficits above 3% of GDP and current account deficits throughout the period, France stands out as an exception

France was one of the few countries in the Eurozone, along with Finland and Slovakia, to have maintained public and external accounts deficits between 2012 and 2019, despite a favourable economic climate.

- Between 2012 and 2019, **the French government deficit** has only been below 3% for two years. Unlike all the other major Member States, and following the example of Spain, France has never recorded a primary surplus during this period.
- With the exception of 2019, **France's current account balance** remained negative between 2012 and 2019, while Italy's, Spain's, and Portugal's returned to balance in 2013. While these three countries improved their external balances thanks to adjustment policies to correct their external imbalances, moving from a deficit in the previous decade to a surplus, France experienced the opposite trend. From a surplus between 2000 and 2006, the French current account balance became structurally negative throughout the following decade.

**CHART 34.**  
External & Fiscal balances in France between 2012 and 2019

Chart 34a : Current account balance, Total Budget Balance and 3%-threshold Maastricht threshold in France (% of GDP)

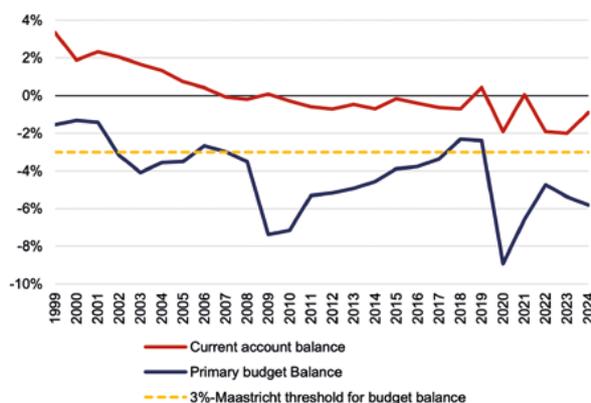
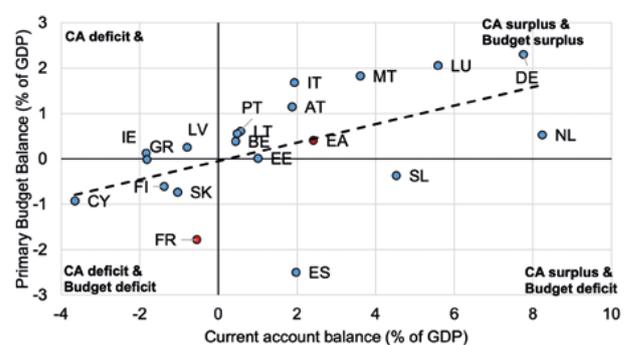


Chart 34b : Current account balance vs Primary Budget Balance across EA Member States, average 2012-19



Source: EU Commission

### 3.2.4 Despite improved budget balances, public debt remains a concern in some countries on the eve of Covid-19

In 2019, seven Member States had a public debt ratio above 90% of GDP. The ratio exceeded 100% of GDP in Greece (183.2%), Italy (133.9%) and Portugal (116.1%). It exceeded 90% in France (98.2%), Spain (97.7%), Belgium (97.6%) and Cyprus (92.3%).

In Italy and Greece, the primary surpluses recorded were not sufficient to prevent the increase in their debt ratios, which rose by 19 points and 6.4 points respectively between 2012 and 2019. On the other hand, they were beneficial to Portugal, where public debt fell by 12.5 points over the same period.

In France and Spain, which both ran primary deficits throughout the period, the government debt ratio increased by 6.4 and 8.1 points respectively between 2012 and 2019. The deterioration of public finances in France and Spain contrasts sharply with the fiscal efforts made by Germany, the Netherlands and Austria, where the public debt ratio declined by 21.1, 18.1 and 11.9 points respectively between 2012 and 2019.

While some Member States (Spain, Portugal and Belgium) moved, slightly, closer to the 60% threshold between 2012 and 2019, Italy, France and Greece moved further away from this threshold over the same period (see Chart 37b).

**CHART 35.**  
Gross Public Debt & deviation to Maastricht threshold in 2012-2019

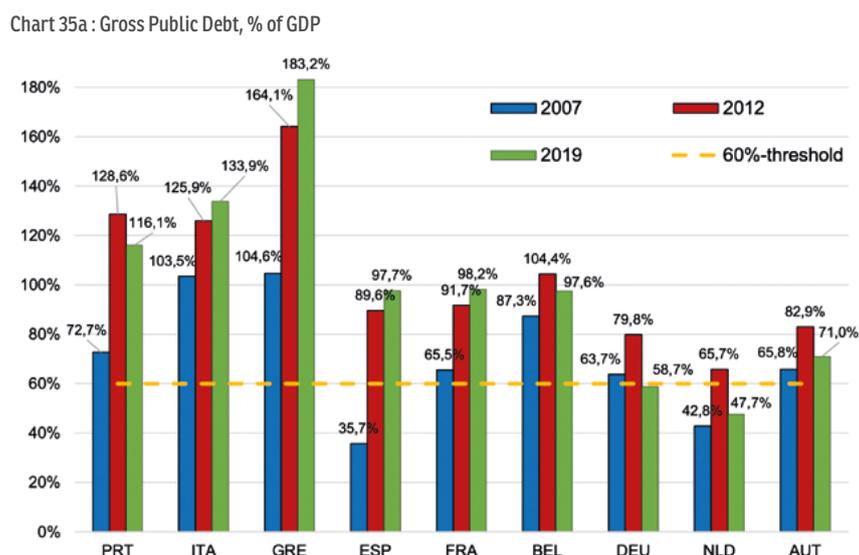
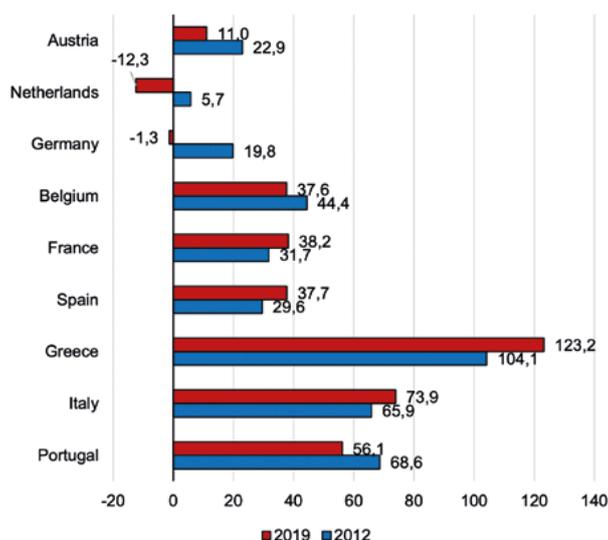


Chart 35b : Deviation relative to the 60%-threshold, percentage point



Source: *Economics*, based on data from the European Commission

### 3.3 2020-2024: economic and budgetary disparities exacerbated by the Covid-19 crisis (2020) and the energy crisis (2022)

The economic consequences of the Covid-19 crisis (2020), exacerbated by the energy crisis triggered by the war in Ukraine (2022), have revived economic disparities, particularly between the countries of northern and southern Europe. Northern countries, such as Germany and the Netherlands, have been able to rely on healthy public

finances to mitigate the economic impact of these shocks. In France and southern countries such as Italy and Spain, debt levels increased significantly due to a lack of sufficient reforms in the years leading up to these shocks. Against the background of rising interest rates to combat inflation and stagnant growth, the divergence in public debt levels between Member States has become a major concern in the Euro area.

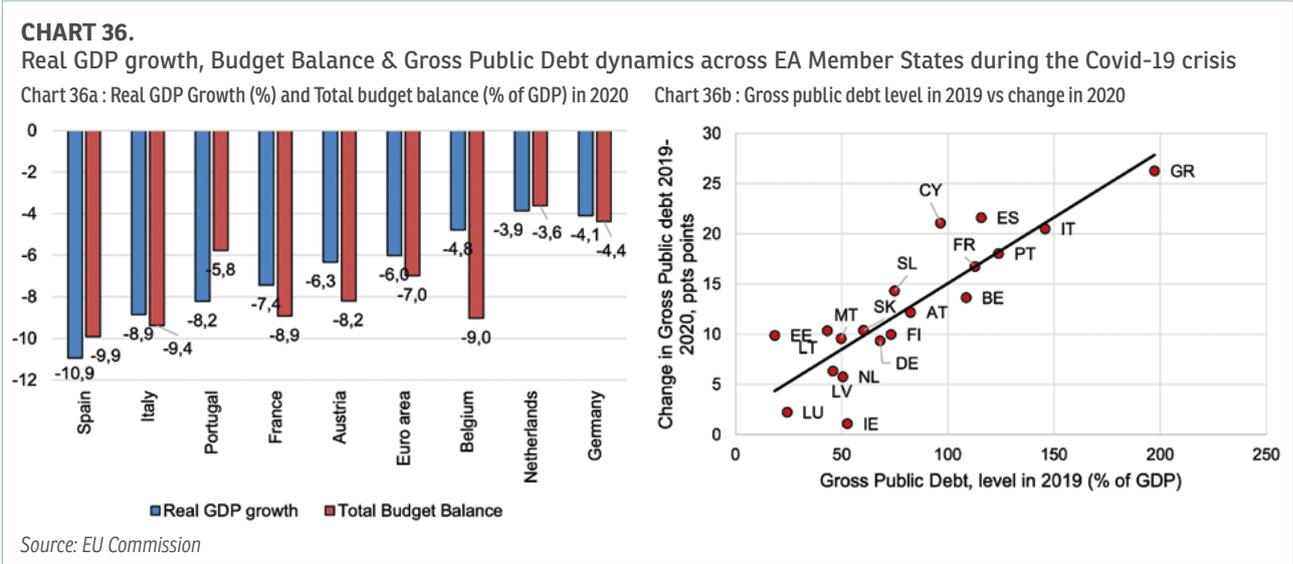
**3.3.1 In 2020, the impact of the crisis on public accounts and economic growth was greatest in the countries with the worst public finances in the pre-Covid-19 period**

The EU countries that managed their public finances best after the Global Financial Crisis (2008) and the EU Sovereign crisis (2011-13) are those that suffered the least from the Covid-19 shock.

Thanks to the fiscal discipline achieved since 2013, Germany and the Netherlands largely contained the shock induced by the Covid-19 crisis. At 4.4% and 3.6% of GDP respectively, their budget deficit in 2020 remained below the Euro area average of 7%. These results contrast with the almost double-digit deficit ratios experienced by France (-8.9% of GDP), Spain (-9.9%) and Italy (-9.4%).

During the Covid-19 crisis, France, Italy, and Spain were the most severely hit in terms of output shortfall in the Euro area. In 2020, GDP fell by 10.2% in Spain. In Italy and France it fell by 8.9% and 7.4% respectively.

With public finances already deteriorating on the eve of the pandemic, these three countries are among those with the largest increase in their public debt-to-GDP ratio between 2019 and 2020. Spain experienced the largest increase (+21.6 percentage points, against 13 pp for the Euro area). Italy and France follow, with their government debt increasing by 20.5 pp and 16.7 pp respectively.



**3.3.2 The energy crisis exacerbated by the war in Ukraine in 2022 was quickly overcome by the Eurozone, which returned to a positive current account balance the following year**

Following the war in Ukraine, the economies of the European Union suffered a loss of income in 2022 due to the rise in the prices of energy and other imported goods. Since the end of 2022, the fall in energy prices and the appreciation of the euro have reversed the negative effects of the terms-of-trade shock, allowing the Euro area current account to return to surplus in 2023.

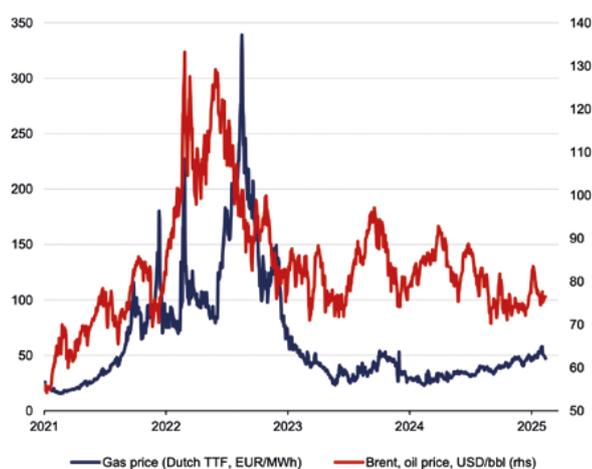
**The Russian war in Ukraine has caused energy prices to soar in 2022, but a substantial reduction in European gas prices occurred after its peak since end-2022**

From just over €10/MWh in early 2020, the price of natural gas delivered in Europe rose to €80/MWh before the start of the war in Ukraine. It spiked in February 2022 and peaked at €339 in August 2022. It has stabilised at around €50 since January 2023, helped by demand restraint, the diversification of supply sources and an exceptionally mild weather.

The decline observed between mid-2022 and the second quarter of 2023 is explained by the diversification of gas supply and its storage, which was higher than expected, as well as the mild winter temperatures, energy savings and weak industrial activity.

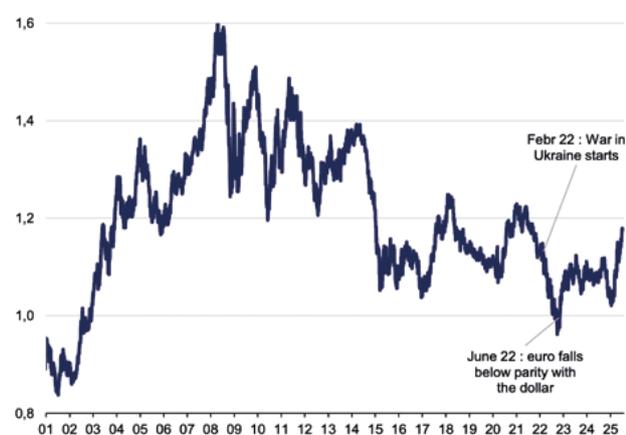
**CHART 37.**  
Energy prices & EUR/USD exchange rate

Chart 37a : Oil and gas prices since January 2021



Source: Refinitiv, St Louis Fed  
Last data from 21 February 2025

Chart 37b : US Dollar vs Euro exchange rate



Source: ECB  
Last data from 11 July 2025

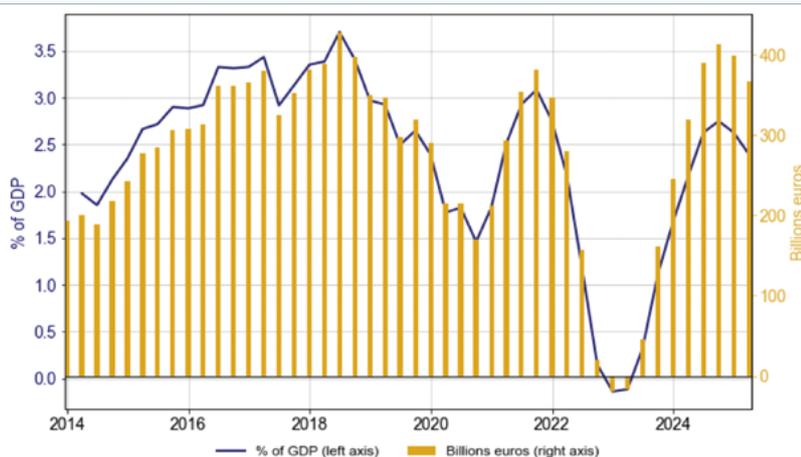
The depreciation of the euro in 2022 also contributed to higher import costs, as monetary policies diverged between the Euro area and the United States between January 2022 and September 2022. Over this period, the euro depreciated by 13.3% against the US dollar, reaching its lowest level since 2002 (see Chart 37b).

**International price movements triggered significant wealth transfers between net commodity importing and exporting countries.** From the point of view of European economies, this resulted in a real income shock that reduced household purchasing power and corporate profit margins, while reducing the competitiveness of exporting firms.

**High energy prices and lower exports to China have weighed heavily on the Euro area current account in 2022.**

After recording a surplus of 347 billion euros (2.7% of GDP) in 2021, the Eurozone's current account shifted to a deficit of 19 billion euros (-0.1% of GDP) in 2022 – see Chart 40.

**CHART 38.**  
Current Account Balance  
in the Euro area  
Cumulated figure for  
the 4 previous quarters



Source: Eurostat  
Last observation from Q1-2025

Europe's energy bill has risen in different ways depending on Member States dependence on fossil fuels and their industrial specialization. Energy imports have increased in the Euro area countries as follows:

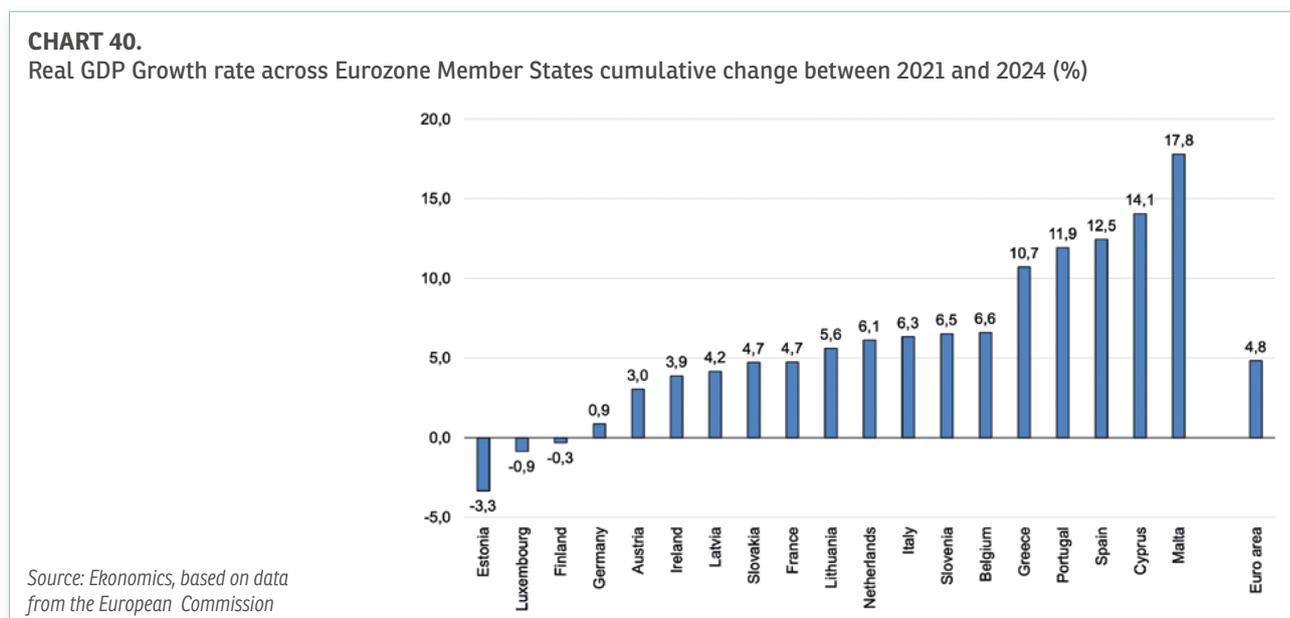
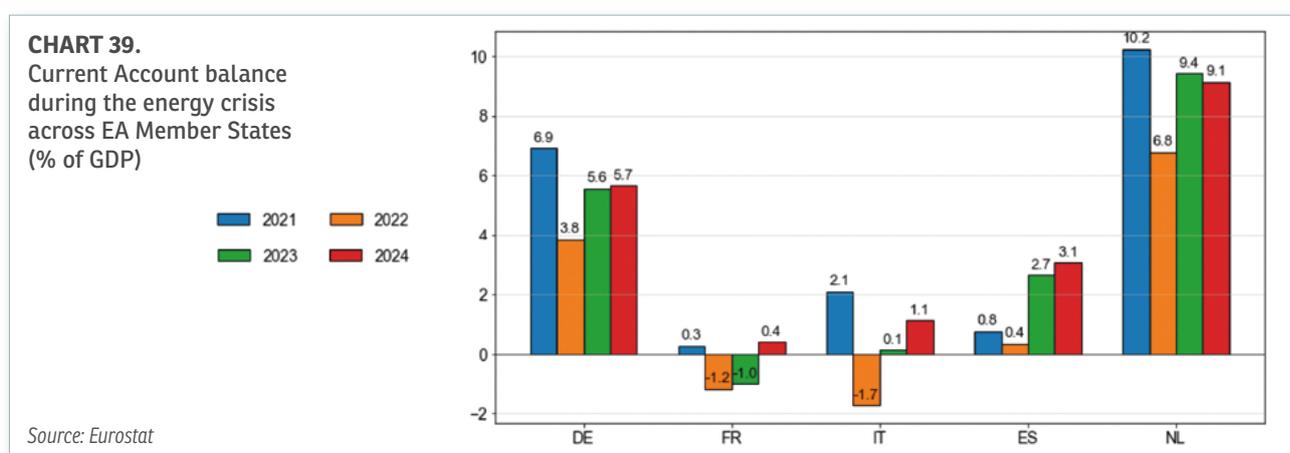
- From €40 to 50 bn in France in the years 2019–2020 and 2021 (2% of GDP), it rose to €100 billion in 2022 (i.e. 4% of GDP)
- In Italy and Spain, the cost of energy imports reached respectively €100 bn (5.3% of GDP) and €47 bn in 2022 (6% of GDP), compared with an average of €30 before the war (i.e. 2% of GDP in these countries).

- The Italian current account surplus has turned into a deficit, joining France and Belgium which have also reached a current account deficit.
- Germany and the Netherlands have lost most of their current account surpluses due to the sharp rise in energy bills.

This improvement was mainly driven by the trade balance in goods, which recovered by €300 bn between 2022 and 2023 as a result of falling energy import prices and an easing of supply disruptions. The trade balance in services, in particular tourism also played a role in the recovery of the current account balance.

The current account surplus reached 5.6% of GDP in Germany and 2.4 % in Spain in 2023, rebounding from respectively 3.8% and 0.4% in 2022. In Italy, the current account returned to equilibrium in 2023, following a deficit of 1.7% in 2022. In France, the deficit narrowed to 0.1% of GDP in 2023, from 1.2% in 2022.

However, as global energy prices are expected to remain high, weighing on import prices, EU countries' current account balances should remain well below their pre-pandemic levels. At 5.6% of GDP in 2024, Germany's current account surplus remained below its 2014-19 average of 7.9%. According to the European Commission's projections, it should remain below 6% in 2025 (5.3%) and 2026 (5.3%).



### 3.3.3 Nevertheless, the shock was managed differently by the Member States, which increased the economic and budgetary divergences between them

These divergences can be seen in the dynamics of GDP growth and the size of the fiscal deficits between countries.

Although 2022 was still a year of strong growth, driven by the post-pandemic recovery, the effects of the energy shock became evident from 2023. That year, six Eurozone countries entered recession, including Germany (-0.3%),

Austria (-1.0%), and Finland (-1.0%). In 2024, GDP continued to contract in these three countries, with declines of -0.2% in Germany, -1.2% in Austria, and -0.1% in Finland.

By contrast, eight countries recorded growth exceeding 2% in 2023 – slower than the previous year, yet still above pre-pandemic levels for most. Among them were Spain (+2.7%), Portugal (+2.6%), and Greece (+2.3%). These three countries maintained growth above 2% in 2024 as well.

Between these two groups lie the intermediate economies, which saw more modest growth of no more than 1.5% in both 2023 and 2024: France, Italy, Belgium, and the Netherlands.

According to the IMF, the sectoral composition is one explanation for the growth differential in 2023-24. Advanced European economies dependent on manufacturing (e.g. Germany) have suffered more from the energy shock, while countries dependent on services and tourism have fared better (e.g. Portugal and Spain), largely due to the ongoing normalization of travel activity since the Covid-19 crisis.

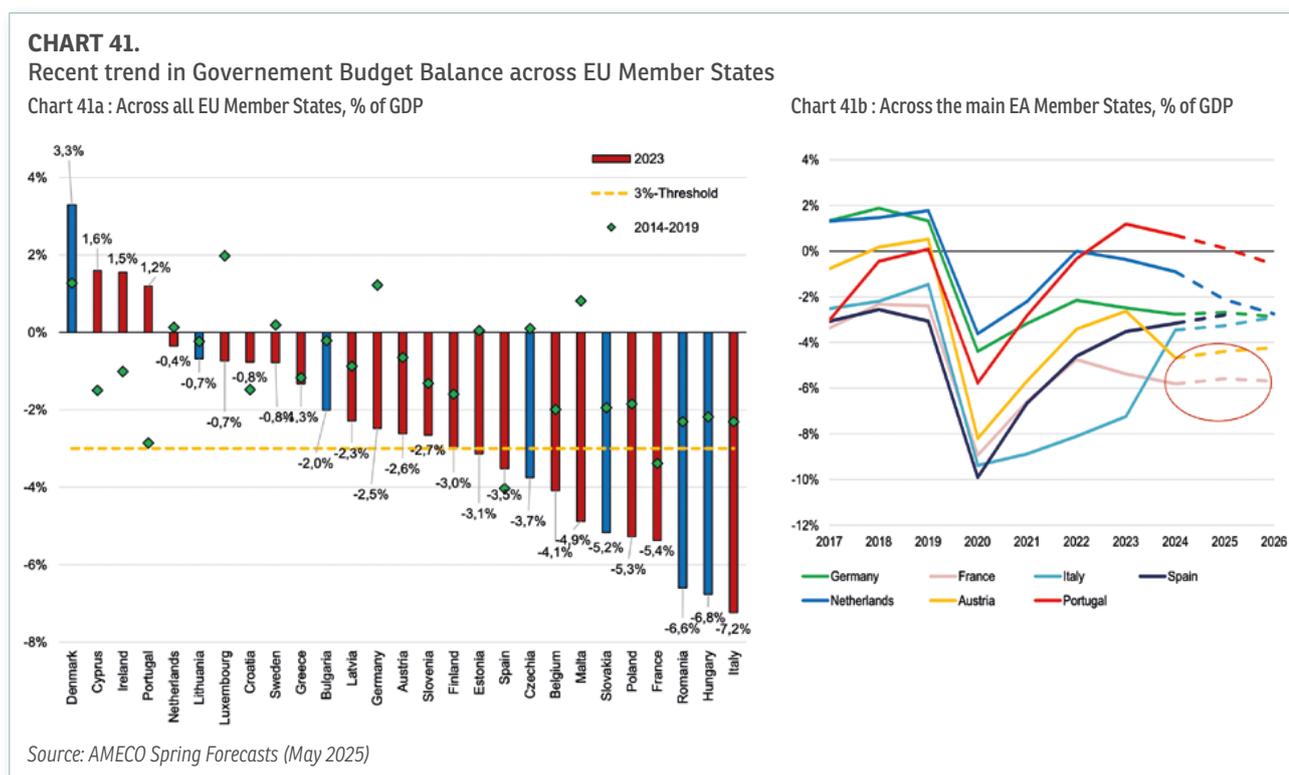
**In 2023, France and Italy recorded budget deficits exceeding 5% for the third consecutive year, leading them to trigger the excessive deficit procedure.**

In addition to the sectoral composition, the extent of fiscal expansion also helps explaining growth differences across countries. In particular, France and Italy stand out from the rest of Europe in terms of budget deficits. For the third year in a row, the deficit in both countries was above 5% of GDP in 2023, at 7.2% in Italy and 5.4% in France. Belgium (4.1%) and Spain (3.5%) also remain above 3% of GDP in 2023.

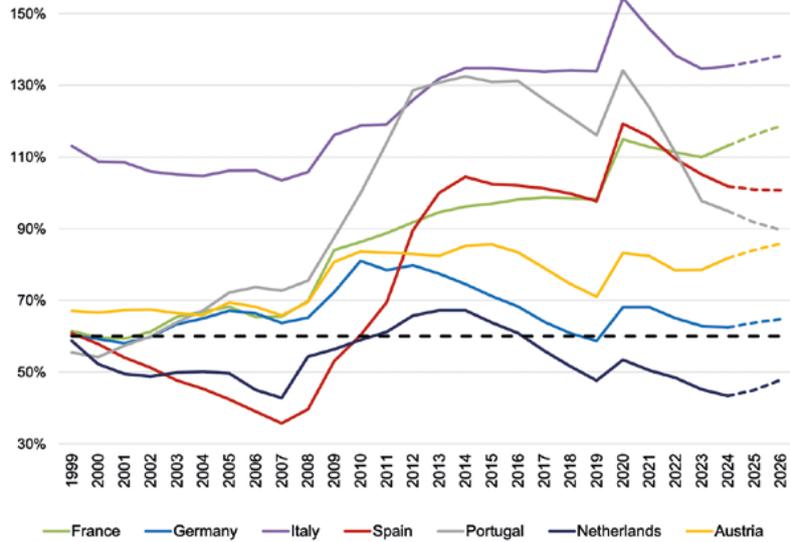
Germany, Portugal, and the Netherlands managed to maintain relatively balanced fiscal positions – occasionally even posting surpluses.

**Although high inflation contributed to a reduction in public debt from 2021 onward, persistent high primary deficits, rising interest costs, and slower GDP growth reversed this trend in 2024 in several highly indebted countries. In 2025, the gross public debt in these countries is expected to increase further.**

Until 2023, the persistence of high primary deficits combined with the increase in the debt burden was more than offset by nominal growth, which in turn was largely fueled by inflation. This mechanism has been particularly favourable for the most heavily indebted countries, which have seen their debt ratios fall from 2021 onwards. In Spain, the government debt ratio has fallen by 14.1 points, from 119.3% of GDP in 2020 to 105.1% in 2023. In Italy, the government debt ratio decreased to 134.6% of GDP in 2023, from 154.4% in 2020. In France, the ratio has fallen by 5.0 points, from 114.9% in 2020 to 109.9% in 2023.



**CHART 42.**  
Gross Public Debt across  
the main EA Member States,  
% of GDP

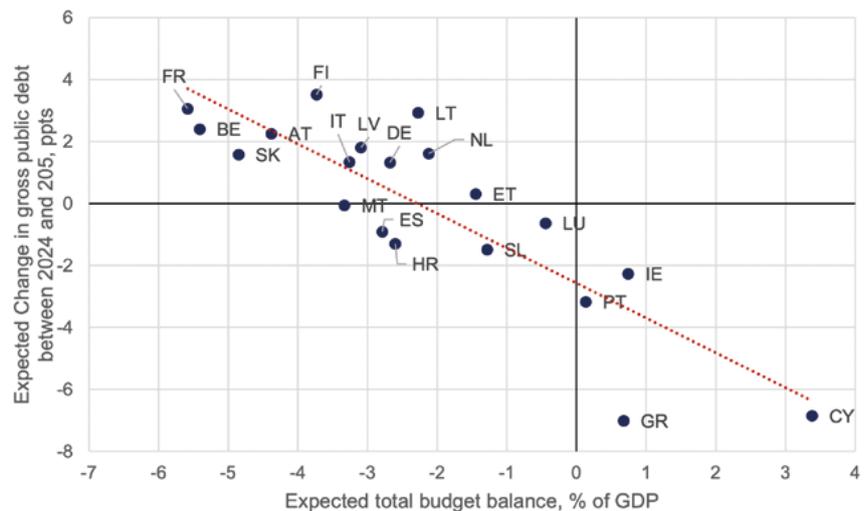


Source: AMECO Spring Forecasts  
(May 2025)

However, this trend has reversed in 2024. The decline in nominal growth, combined with rising interest charges and persistently high primary deficits has led to an increase in the debt ratio in some Member States. In France and Italy, the ratio rose from respectively 109.9% of GDP and 134.6% in 2023 to 113.1% and 135.3% in 2024. Unlike in France, where the primary deficit rose from 3.5% of GDP in 2023 to 3.7% of GDP in 2024, the increase in Italy's public debt was essentially linked to the rise in the interest burden, which was not offset by the return of the primary surplus (+0.4% in 2024 vs -3.6% in 2023).

Thanks to continued primary surpluses in 2024, the government debt ratio continued to fall in Portugal (97.7% to 94.9%) and Greece (163.9% to 153.6%). Combined with nominal growth still above 5%, the reduction in Spain's primary deficit also contributed to the reduction in the government debt ratio in 2024 (101.8% in 2024 vs 105.1% in 2023). Despite their encouraging trends, the government debt ratios of Spain, Greece and Portugal in 2024 were still well above those of Germany (62.5%) and the Netherlands (43.3%).

**CHART 43.**  
Expected change in public debt versus expected deficit across EA Member States in 2025



Source: European Commission's Spring  
Forecasts (May 2025)

Looking ahead to 2025, the European Commission forecasts<sup>16</sup> even greater divergences among indebted Member States. While the public debt-to-GDP ratios of France and Italy will continue to rise to 116.6% and 136.7% respectively, Spain (100.9%), Portugal (91.7%) and Greece (146.6%) should continue their downward trend. The

16. European Commission's Spring Forecasts of May 2025.

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divergence in the trajectory of government debt essentially mirrors that of deficits: as shown in Chart 43, the countries with the highest deficits in 2025 are expected to record the largest increases in government debt.

**One major uncertainty continues to weigh on the future of the euro: the sustainability of the public debt of major Eurozone countries (France, Italy, Belgium).**

Continued fiscal stimulus since the pandemic has led to a deterioration in these countries' public finances. Their public debt ratios exceed 100% of their GDP.

It is important to understand that as public debt ratios deteriorate, the problem of debt sustainability becomes more acute.

Historically, a **negative** "r-g" difference<sup>17</sup> does not eliminate sustainability problems. First, growth and interest rates are not independent of debt levels. The higher the level of debt, the greater the tendency for market interest rates to rise and for the economy to become more vulnerable, which is why we need to be extremely cautious about the risks to debt sustainability in Europe. We need to understand that creating money and buying government bonds will not always solve this problem. The Maastricht Treaty sets limits on monetary financing of public finances, and opinions on this issue are far from unanimous.

Second, even with a negative "r-g", their debt ratio will increase as long as their primary deficit is higher than the "stabilizing deficit", which depends on growth and the level of interest rates, the level of public debt.

Against this background, over-indebted countries urgently need to improve their fiscal balances, at the risk of exposing themselves to a market correction. Securing primary surpluses over a long period of time (as Portugal has done in recent years) is the only credible solution for reducing public debt, especially in an environment where the r-g is becoming less favourable.

Ultimately, the fate of the euro will depend on the political will to achieve genuine cooperation within the zone. If the fiscal, inflationary and economic drift in the Eurozone continues, the 'virtuous' countries will end up paying the price. That would be the definition of an uncooperative game, in which most players try to evade their obligations by passing on the costs to those who respect them. Public decision makers must therefore take control of the Union's destiny and not let it drift. If we do not, the logical consequence could well be another inevitable Eurozone crisis.

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17. With r, the apparent interest rate (debt service cost/government debt at t-1); and g, the nominal GDP growth rate.

## 4. The EU countries with the highest levels of government expenditure as a percentage of GDP have the least competitive companies

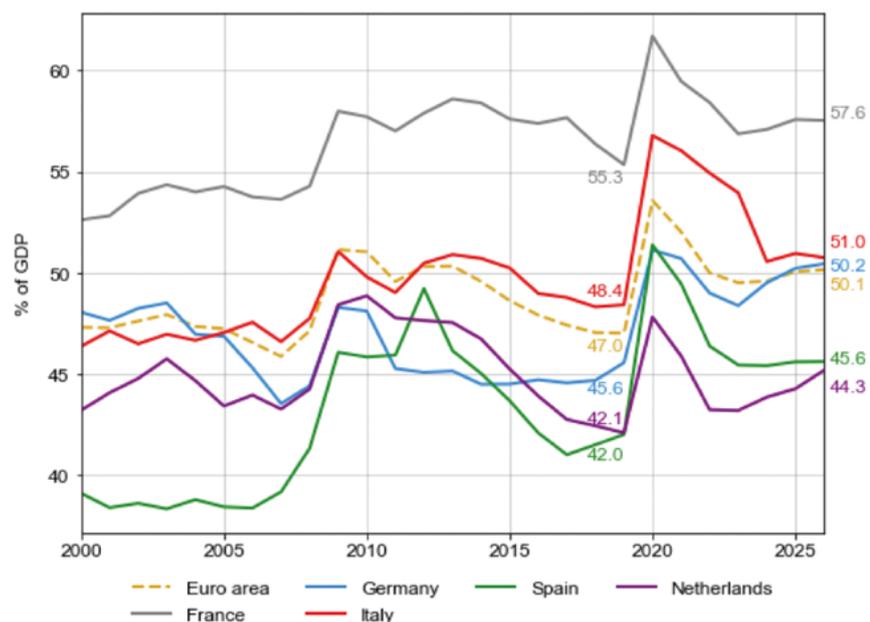
### 4.1 Projected at 57,6% of GDP in 2025, France holds the record for the highest level of public spending in the EU

Public spending in the European Union has generally increased between 2000 and 2025, rising from 47.4% to 49.6% of GDP. However, this overall trend masks significant disparities among member states. In 2025, four countries recorded public expenditure exceeding 55% of GDP: France, Austria, Finland, and Belgium.

They stand in stark contrast to the 17 countries with public spending below 48% of GDP in 2025. Notable examples in this group include Denmark, Greece, Spain, Portugal, and the Netherlands – all of which experienced significant reductions in public spending over the past decade. Among the countries most affected by the sovereign debt crisis, Greece and Portugal managed to cut their public expenditures by more than 5 percentage points between 2014 and 2025. These countries are also among the few in the EU where public spending to GDP ratio in 2025 was below that in 2019.

A third group of countries occupies a middle ground, with public spending hovering between 50% and 51% of GDP in 2025. Germany and Italy fall into this category, though their fiscal trajectories have diverged over the past five years. Traditionally below the European average, Germany has seen its public spending rise since 2024 and is expected to continue on this path due to new military and infrastructure investment programs announced in 2025. In contrast, Italy's public spending, which remained above 52% until 2023 due to the 'Superbonus' scheme, is now converging back towards 50% of GDP.

**CHART 44.**  
Total Public Expenditure,  
as % of GDP



Source: EU Commission Spring  
Forecast (May 2025)

### 4.2 High public spending implies high tax pressures on firms, increasing their production costs and deteriorating their competitiveness

The countries with the highest public spending relative to GDP also have the highest tax burdens in the EU. As mentioned previously, the four countries with public expenditure exceeding 55% of GDP in 2025 – France, Belgium, Finland and Austria – all had tax revenues at least two percentage points above the EU average (see Chart 45).

The reverse is also true for countries with the lowest levels of public spending. Portugal, Spain, Greece and the Netherlands are all projected to have tax-to-GDP ratios below the European average in 2025.

**CHART 45.**

Real GDP Growth rate across Eurozone Member States, cumulative change between 2021 and 2024 (%)

Chart 45a : Current tax burden, % of GDP

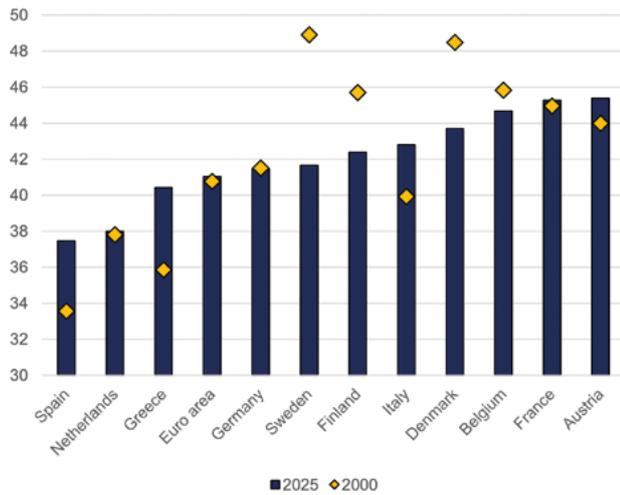
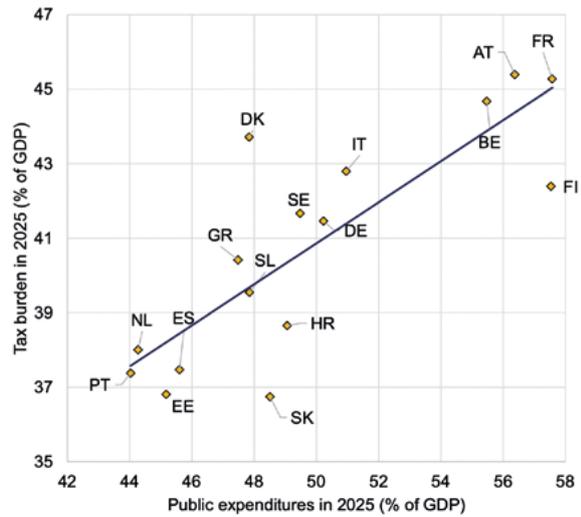


Chart 45b : Public expenditures vs current tax burden in 2025

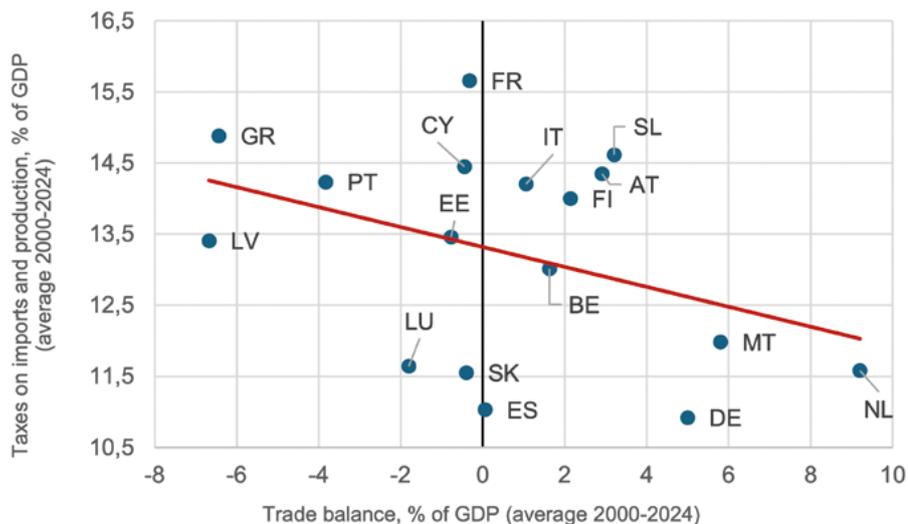


European Commission Spring Forecast (May 2025)

**Excessive taxation contributes to the erosion of the competitiveness of domestic firms.** With a level of taxes on production and imports that exceeds the Euro area average by 3.4 points in 2023 (see Chart 46), France has been suffering from a permanent deficit in its trade balance and, more broadly, its current account balance since 2007 (see Chart 48). Within the EU, eight other Member States have a negative current account balance on average between 2014 and 2019. Among them, Cyprus has the highest deficit (-3.9% of GDP), followed by Romania (-2.5%) and Greece (-1.6%).

**CHART 46.**

Corporate taxation and competitiveness across Euro area Member States



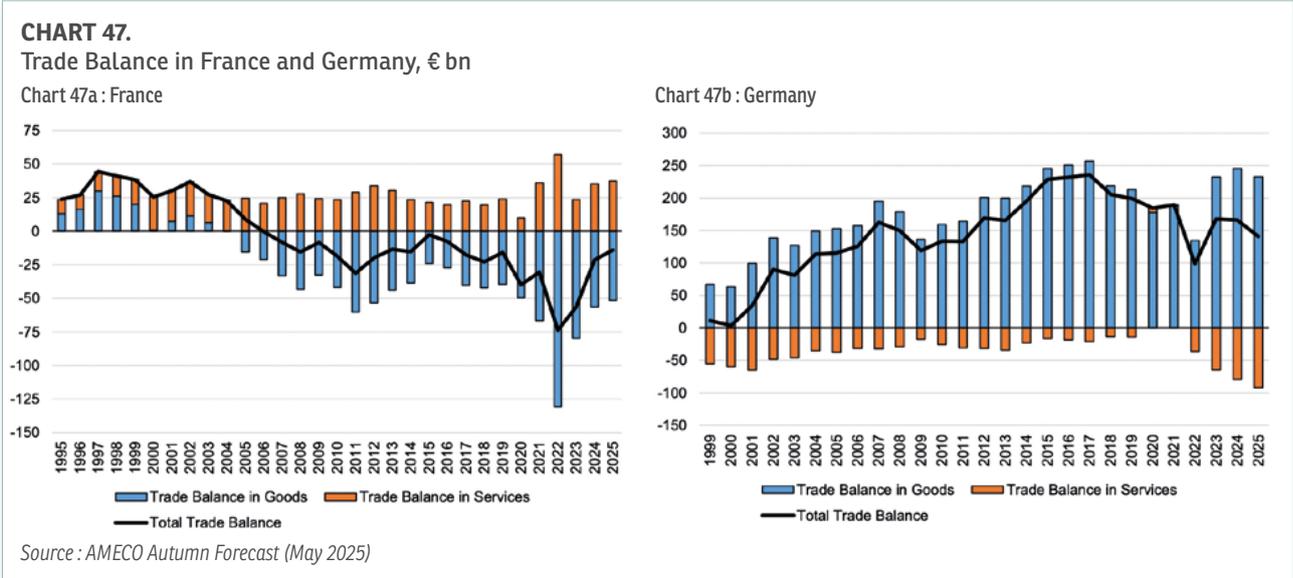
Source: *Economics*, based on data from the European Commission

Conversely, **countries with tax levels below the Euro area average are home to the most competitive firms in the Euro area.** With taxes on production and imports amounting to 10.3% of GDP in 2023, Germany has the third highest current account surplus after the Netherlands, which also has a relatively low tax burden (11.5% of GDP). As shown in Chart 48, the Euro area countries with the highest overall trade deficits over the last 25 years are also those with the highest corporate tax rates.

The trajectory of the French and German trade balances illustrates the inverse relationship between competitiveness and tax levels in the Eurozone over the last 25 years.

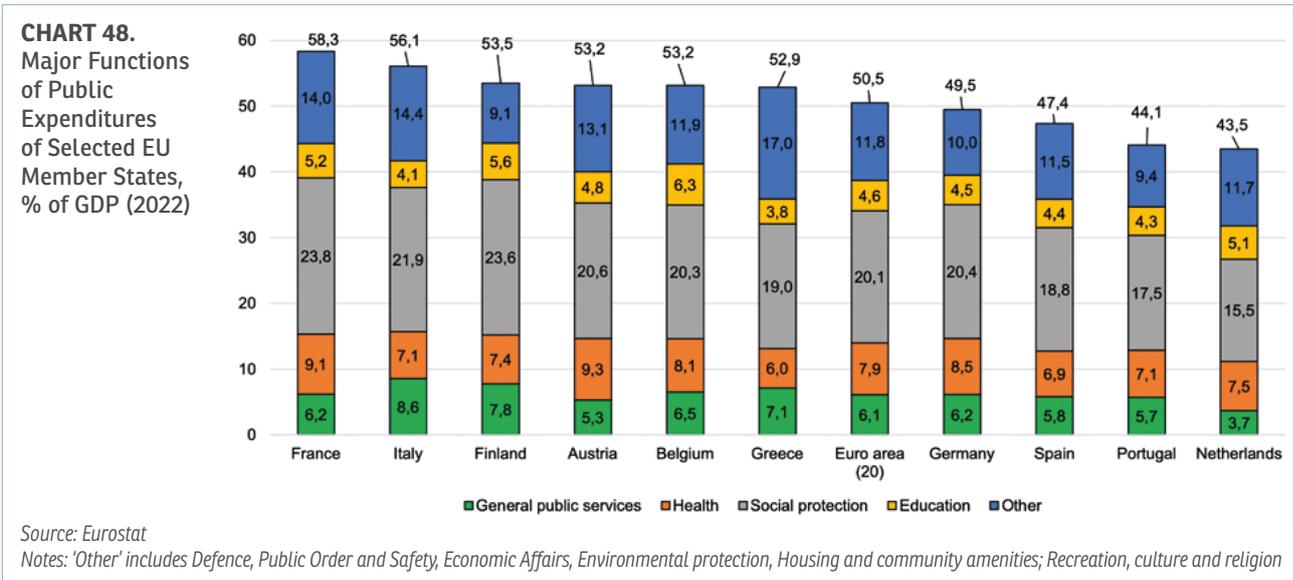
The evolution of the French and German trade balances illustrates the inverse relationship between competitiveness and tax levels in the Euro area over the last 25 years.

Germany's trade balance in goods has always been positive over the last two decades, while France has gradually turned into a deficit since 2004. This poor performance is the result of deindustrialisation and the expansion of the less export-oriented service sector that began in the late 1980s (see Part 5). As a result, France has recorded an average annual trade deficit in goods of approximately €50 billion since 2006, whereas Germany has consistently posted a surplus exceeding €200 billion.



### 4.3 Most government expenditures are allocated to social protection, health and public services

On average, Euro area countries allocated 39.7% of their public spending to social protection, corresponding to 20.1% of GDP in 2022 (see Chart 50). As a percentage of GDP, France has the highest share at 23.8%, followed by Finland (23.6%). Health is another prominent function of public spending in the Euro area (15.6% of total expenditure in 2021), followed by general public services<sup>18</sup> (12%).



18. According to Eurostat, "general public services" cover the financing of administration, operation or support of executive and legislative organs, foreign economic aid, general services provided by the public sector, as well R&D spending made by public administrations – see Manual on sources and methods for the compilation of COFOG statistics – Eurostat (2019), for further details.

**Public pensions** represent the largest component of social protection expenditure. Accounting for 11.9% of the Eurozone's GDP in 2023, their level is closely linked to the average age of effective exit from the labour market (see *Chart 49*). In most EU countries, the earlier people of working age retire, the higher the total cost of pensions. France, where the average exit age from the labor market is one of the lowest in the EU (62.6 years), is the country that spends the most on pension schemes: 14.1% of its GDP in 2019, compared with an Eurozone average of 11.9%.

The issue is even more worrying in the context of an ageing population, characterized by a growing number of elderly people compared to a shrinking working-age population. By 2030, the share of the population aged 65 and over will rise to 23.7% (from 21.4% in 2023), while the share of the working age population (25-64) will fall to 35.6% (from 36.5% in 2023).

In Italy, despite the relatively high average effective retirement age in the EU, the pension system remains one of the most costly for the government in terms of GDP. There are three main reasons for this:

- **The generosity of the system.** The replacement rate – *i.e.* the percentage of an individual's annual earned income that is replaced by pension income – was 15 percentage points higher than the EU average in 2022 (59.3% in Italy against 44.2% in the EU).
- **The persistently low employment rate.** In 2019, 64.8% of people aged 20-64 were employed. This is the second lowest employment rate in the EU, just above Greece (66.3%) and almost 10 percentage points below the EA average (74.1%).
- **The ageing population.** Italy's demographic decline is one of the most pronounced in the EU. In 2023, 24.2% of the Italian population will be aged 65 or over. This is the highest in the EA (where the average is 21.8%). This contributes to a further deterioration in the old-age dependency ratio, which is the number of dependent persons aged 65 and over in relation to the working population (20-64). The ratio will be 41.3% in 2023 (compared with 37.3 in the EA) and is expected to reach 48% in 2030 (compared with 43.3 in the EA).

**CHART 49.**

**Public Pensions Spending and Labour Market exit age in selected EU Member States**

Chart 49a : Gross Public Pensions, as % of GDP in 2023

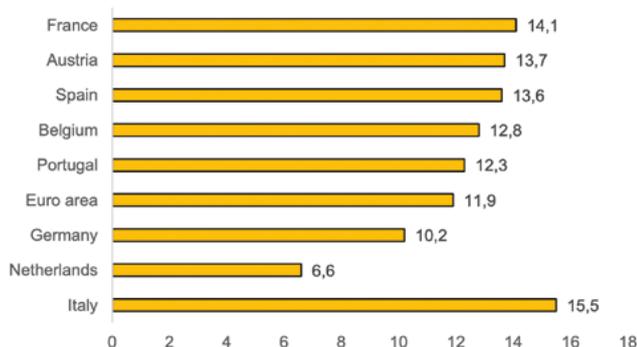
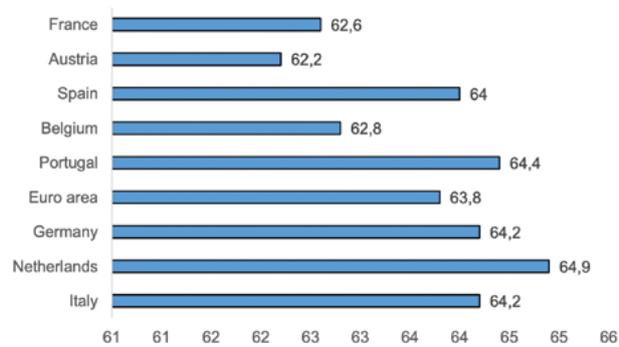


Chart 49b : Average effective labour market exit age, 2023



Source: EU Commission Ageing Report (2024)

#### 4.4 This level of public spending has been achieved at the expense of productive investment, hence its limited contribution to gross capital formation

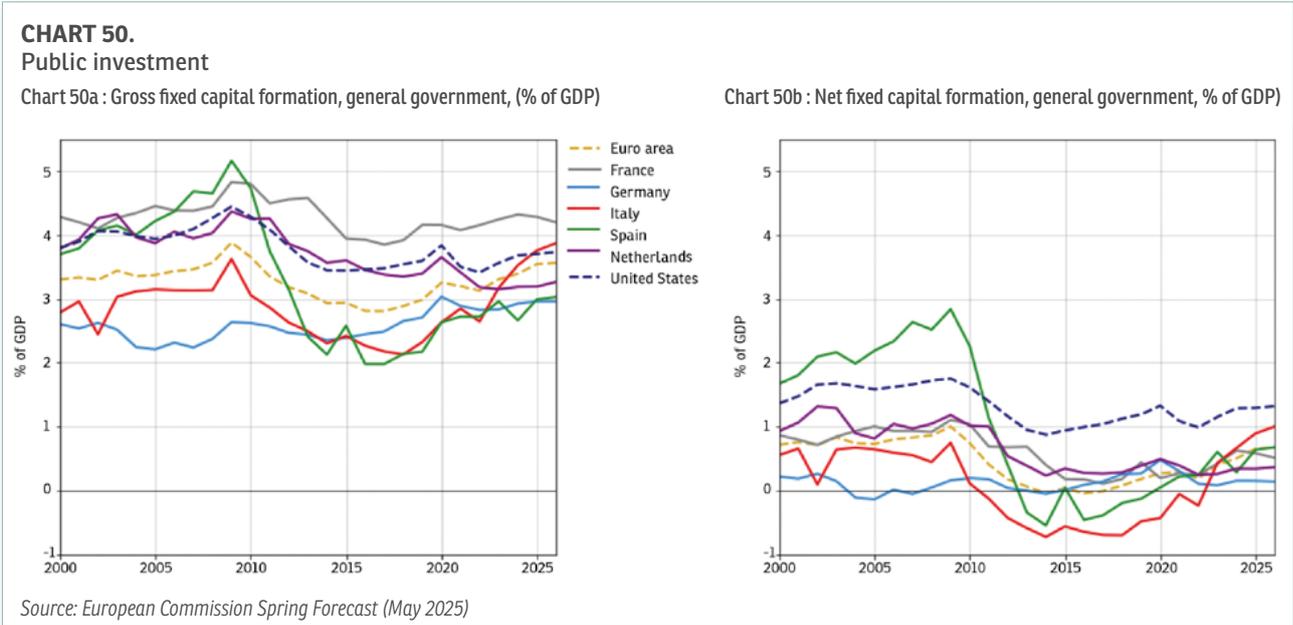
Apart from periods of crisis, the share of public investment<sup>19</sup> has never exceeded 3.5% of GDP in the Euro area since 1996<sup>20</sup>. Moreover, against the backdrop of rising public expenditure, the share of public investment in total public spending fell in several Member States between 2007 and 2024.

After reaching 3.4% of GDP in 2007 – its highest level outside the crisis period – the ratio of public investment to GDP in the Euro area gradually declined to 2.8% in 2017 (see *Chart 52*) before rising slightly to 3% in 2019. At an average of 2.8% of GDP between 2014 and 2019, public investment in the Euro area remained below that of the United States (3.5%) during this period.

19. For government, gross fixed capital formation includes transport, office buildings, housing, school and hospital infrastructures.

20. 1996 is the first available year recorded by Eurostat.

This under-investment at the EU level can be attributed to Germany, where the latter never exceeded 2.7% of GDP between 1995 and 2019. The Spanish and Italian governments also contributed to this decline, both investing less than 2.5% of GDP between 2012 and 2018.

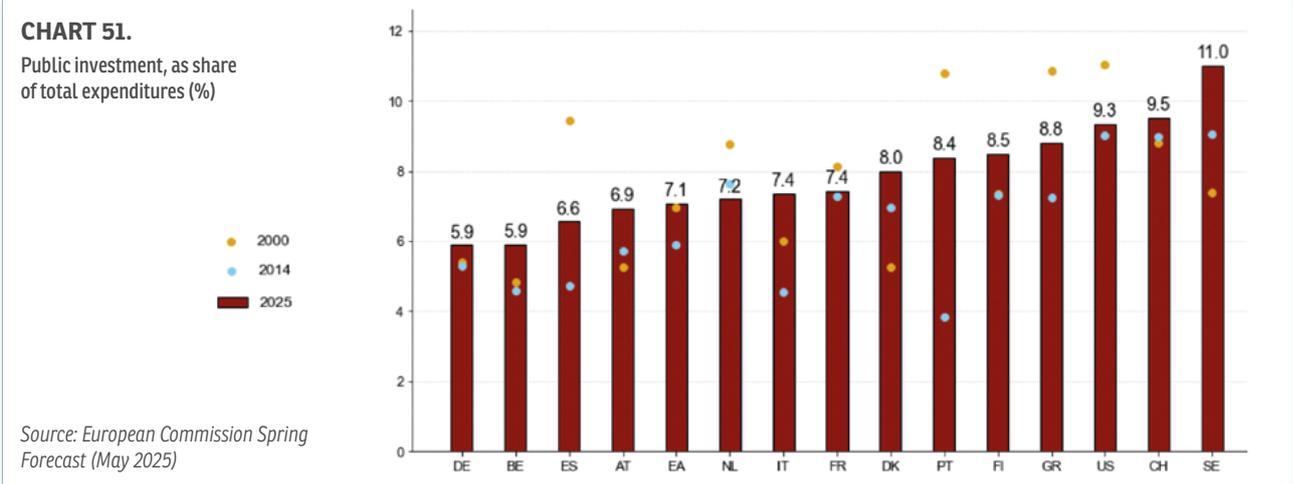


While France has a relatively high level of gross investment compared to its neighbors, this difference disappears when net investment is considered. Adjusted for the consumption of fixed capital required to compensate for capital depreciation, the flow of new investment (aimed at increasing the capital stock) in France has been quite similar to that in Germany – averaging 0.2% of GDP per year between 2014 and 2019, and slightly higher than in Germany (0.1%) – see Chart 50.

At the Euro area level, net public investment was close to 0% of GDP between 2014 and 2019. While it has recovered to 0.3% of GDP in the post-Covid-19 period, it remains almost a full percentage point lower than in the United States (see Chart 50b).

The story is even bleaker for some Southern European countries, where net investment was negative in the years following the sovereign debt crisis, meaning that the level of investment was so low that it did not even compensate for the depreciation of the public capital stock, and therefore contributing to its decline.

**Although current expenditure has increased in some key EU Member States, the share of public investment in total public expenditure declined overall** by around 0.5 percentage points between 2007 and 2024 at the EA level, from 7.6% in 2007 to 7.1% in 2025. With an average of 6.1% between 2014 and 2019, the share of public investment in the Euro area is one of the lowest among other advanced economies, such as the United States (9.3%) and Switzerland (9.5%).



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Among the largest EU Member States, Germany, Belgium have increased the share of public investment in total government expenditure in the past 25 years, although their level of gross fixed capital formation remains among the lowest in Europe.

The most indebted Member States have seen the sharpest decline in the share of expenditure devoted to public investment over the last two decades. While France allocated on average 8% of its total expenditure to investment in 2000, this share fell to 7.4%. It also fell markedly in the southern countries, such as Italy, Spain, Portugal and Greece.

In other words, these data show that the countries with the highest public debt are the ones that invest the least to increase their growth potential and thus prepare for the future. As the EU Commission states, such a decline in the highly indebted countries suggests that "the accumulation of public debt has not resulted in a higher capital stock, indicating that deficit spending has not been channeled into investment but into financing consumption."<sup>21</sup>

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21. S. Langedijk et al. "The role of the fiscal framework to foster public investment, including in light of the green and digital transitions" Quaterly report on the Euro area, vol 21 n°4 (2022), February 2023.

# 5. Excessive level of government debt does not boost productivity growth and employment

## 5.1 The most indebted countries of the Eurozone have achieved the lowest productivity growth performance over the last two decades

Since 1999, Member States with the highest public debt-to-GDP ratios have had the weakest performance in terms of total factor productivity growth<sup>22</sup>. In fact, the countries where public debt increased the most between 1999 and 2024 are those where productivity grew by less than 5% over the period. Most of these countries have public debt levels well above 90% of GDP, such as France, Italy – where productivity has fallen over the past 25 years – and Spain.

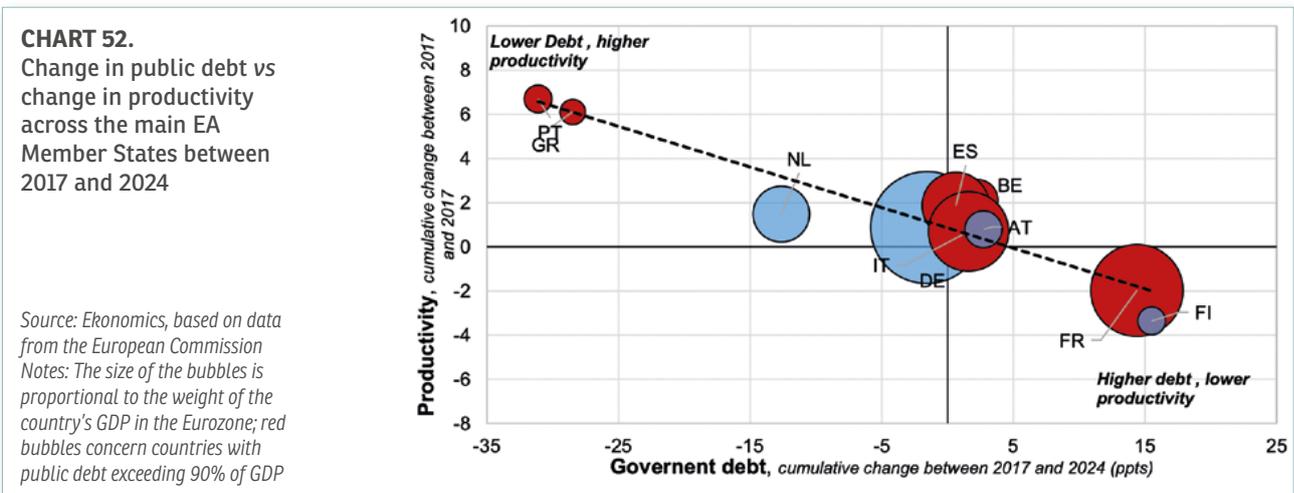
By comparison, productivity gains have been almost twice as high in countries where public debt has risen moderately, or even fallen, over the 1999–2024 period. These are essentially Member States where public debt did not exceed 80% of GDP in 2024, such as Austria, the Netherlands, and Germany.

Such a negative relationship between public debt and productivity gains also shows the extent to which excessive recourse to public debt can damage the supply side of the economy by undermining incentives for undertaking long-term investment and innovation. This is detrimental to productivity.

These productivity differences result in differences in living standards across the Euro area. K. Knot, Governor of De Nederlandsche Bank (DNB), stated that this issue is worrying<sup>23</sup>, “because it threatens the coherence of the Economic and Monetary Union [...]. Resilience is about balance [...]. If you put more pressure on one leg than the other, you are bound to get some serious health problems at some point. That is not what the patient needs [...]. What the patient needs is some care to wean it from its dependence on debt and to bring back balance in economic growth.”

The inverse relationship between productivity change and public debt is even more pronounced in the 2017–2024 period, during which economic and fiscal divergences have widened (see Part 3). In particular, France, Italy and Spain have experienced an increase in public debt accompanied by a decline in productivity. However, this relation cannot be generalized to all highly indebted economies: despite their public debt still exceeding 90% of GDP, Greece and Portugal have achieved cumulative productivity gains of more than 5% between 2017 and 2024.

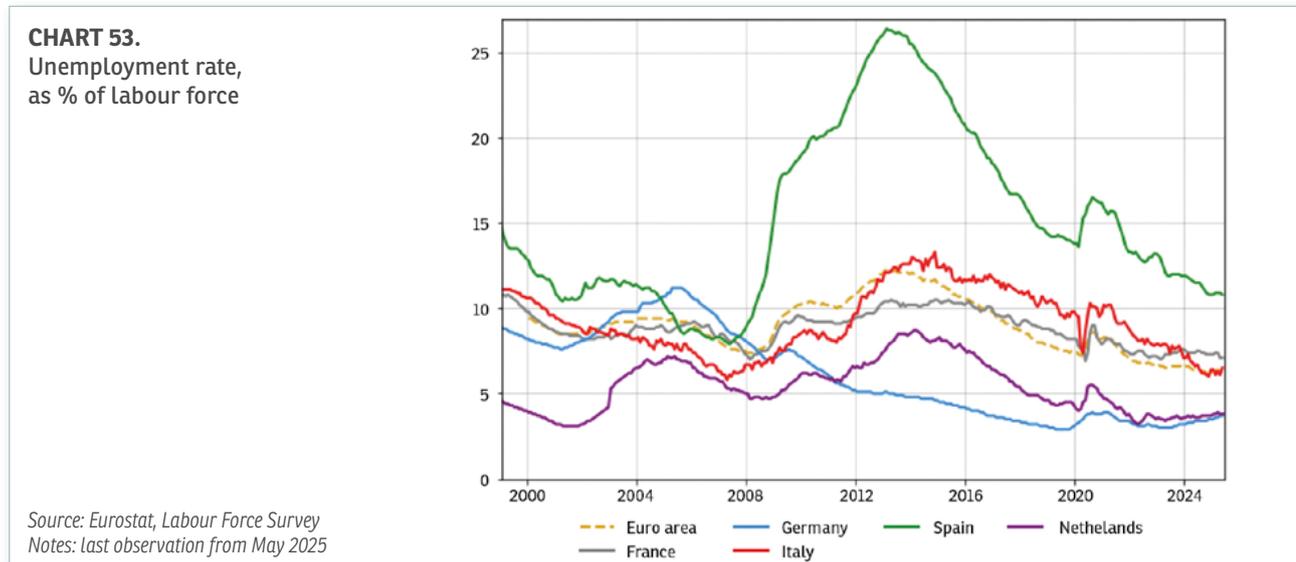
These gains coincide with a significant reduction in their public debt of more than 25 percentage points. The Greek and Portuguese cases over the past seven years thus demonstrate that, far from being recessionary, public debt reduction can go hand in hand with improved fundamentals and thus serve as a model for other indebted economies.



22. To quote the OECD: The indicator reflects the “overall efficiency with which labour and capital inputs are used together in the production process. Changes in Multifactor Productivity Growth reflect the effects of changes in management practices, brand names, organisational change, general knowledge, network effects, spillovers from production factors, adjustment costs, economies of scale, the effects of imperfect competition and measurement errors.”  
23. K. Knot, “Rebuilding resilience: meeting the challenges beyond Covid-19”, Eurofi Forum, 11 September 2021.

## 5.2 The highest unemployment rates in the EU since 2007 have been reached in the most indebted EU countries

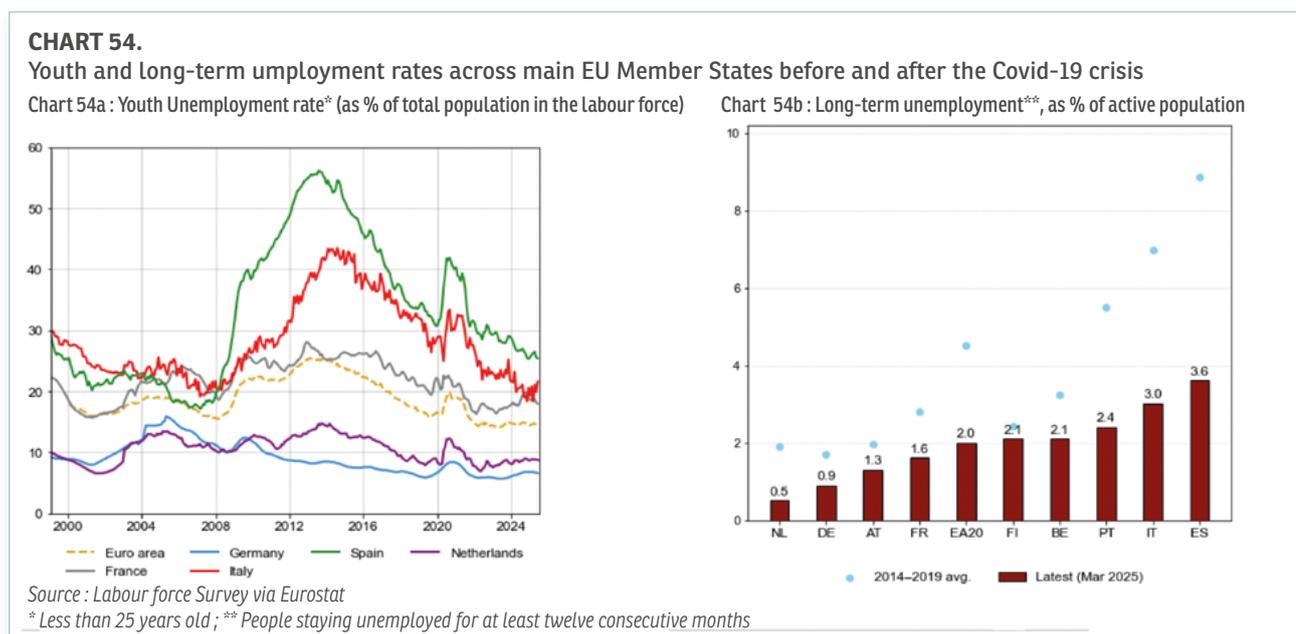
Since the sovereign debt crisis, the Eurozone has been divided into two distinct groups of countries in terms of unemployment rates. On one side are countries such as Germany and the Netherlands, where unemployment remains below 4% of the working population. On the other side are countries like France, and Italy, where it consistently exceeds 6% and Spain, where it exceeds 10%.



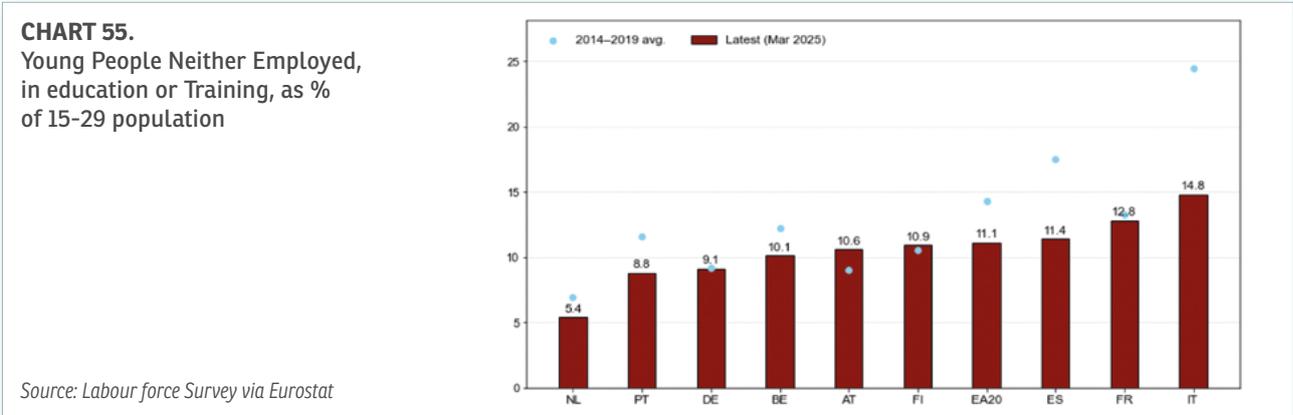
Despite a positive trend since the end of the pandemic, unemployment in these latter countries appears to be structural in nature, as reflected in persistently high levels of both youth and long-term unemployment.

As of May 2025, Spain and Greece had the highest unemployment rates for people aged 15–29 in Europe (25.4% and 19.9% respectively). Despite record spending on education and job training (5.2% of GDP in 2022, compared with 4.6% in the Euro area), France is also the worst affected (18% youth rate of unemployment, compared with 14.4% in the Euro area). By contrast, less than 10% of active youth were unemployed in Germany (6.6%) and the Netherlands (8.8%) in May 2025.

In most southern Member States, a higher proportion of the unemployed struggle to find a job for longer. In the first quarter of 2025, the share of people unemployed for more than 12 months in the active population stood at more than 3% in Spain and Italy (see Chart 54b).



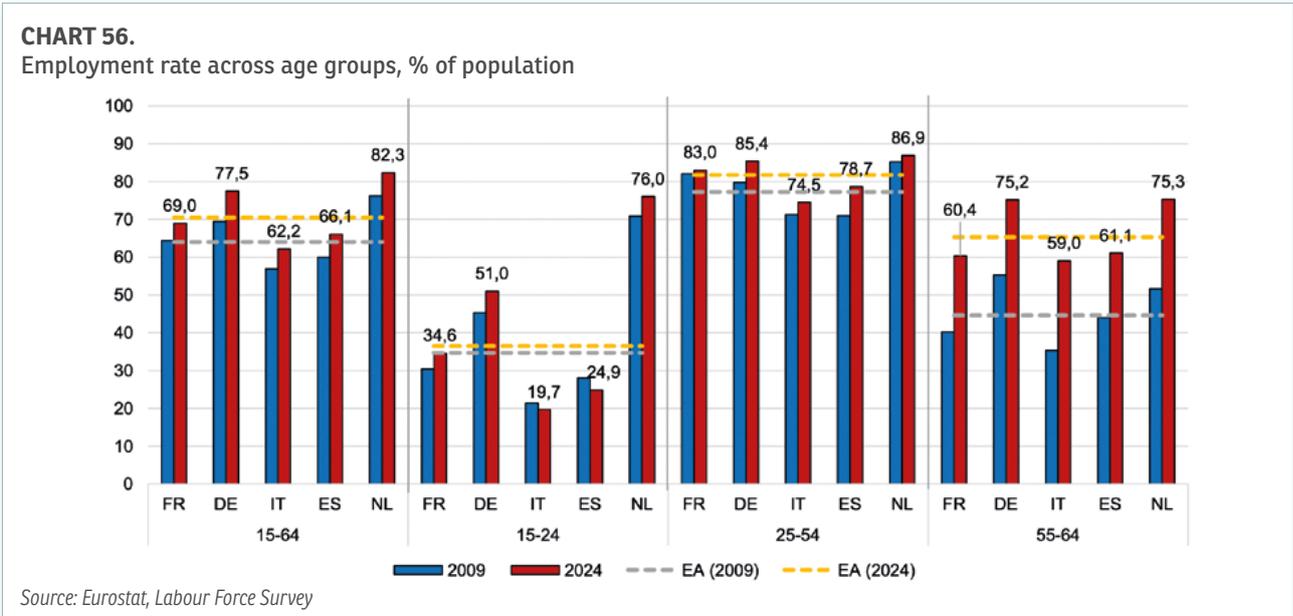
The significant share of the youth unemployment rate in some EU countries illustrates the existing difficulties in joining the labour market. Such failures favor the proliferation of Youth 'NEET' (young people who are neither in employment, education or training). In Italy, 14.8% of young people aged between 15 and 29 were in this situation in the first quarter of 2025, the highest share among EU countries (see Chart 59).



### 5.3 The employment rate in France, Spain, and Italy is almost 10 percentage points lower than in Germany and the Netherlands

Two distinct groups of countries emerge within the Euro area:

- On the one hand, there are the economically “virtuous” nations where the **employment rate** – defined as the share of employed individuals in the working-age population – exceeds 70%. This includes the Netherlands, Germany, and Austria, and, since 2021, Portugal.
- On the other hand, certain countries have seen **their employment rate remain below 65%**, such as Italy and Spain. As illustrated in Chart 56, the disparity between northern and southern Euro area nations is largely due to weak labor market integration among young people (aged 15–24) and older workers (aged 55–64).



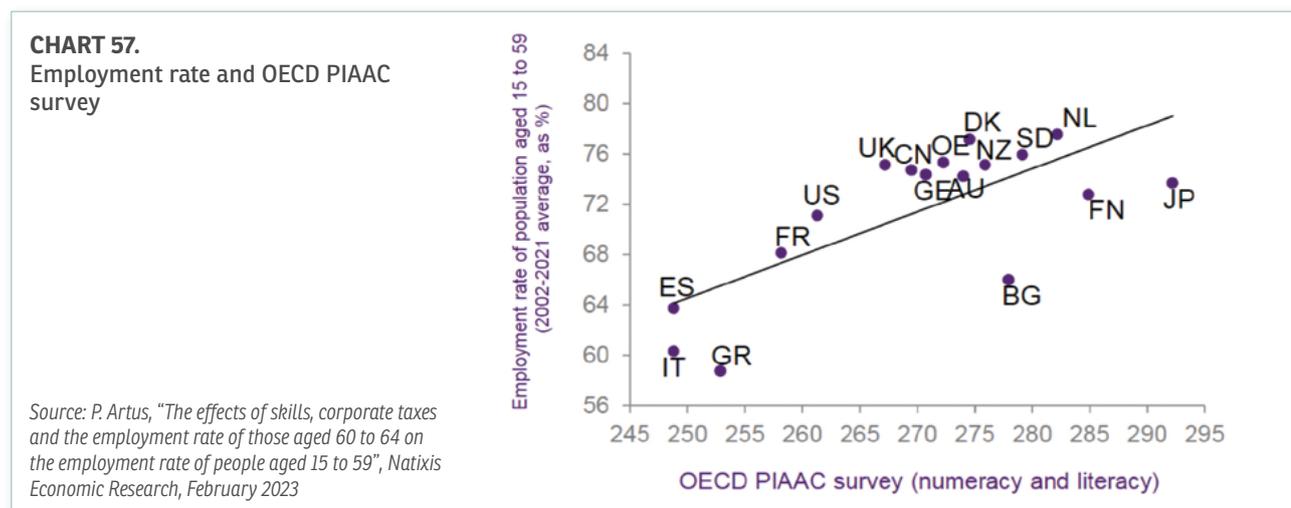
At the end of 2024, 69% of people aged 15 to 64 were employed in France, compared with 77.5% in Germany.

The employment gap between France and Germany is mainly due to the fact that the employment rate of people aged 60–64 was 35% in France in 2021 compared to 62% in Germany. As the effective retirement age is lower in France (see part 4), workers leave the labour market earlier than in Germany.

In addition to the nature of the pension system, the reasons for the persistent employment gap between France and Germany lie in (I) the lack of appropriate skills in the workforce, and (II) the tax burden on companies, which forces them to make trade-offs such as relocating their activities at the expense of domestic employment and investment.

According to P. Artus, the skills of the workforce account for 53% of the gap in employment rates between OECD countries, while the burden of corporate contributions and taxes on production explain 35%.

As highlighted by P. Artus<sup>24</sup>, the employment rate is the lowest in countries with a low-skilled labour force (see *Chart 60*). France is in the bottom quarter of OECD countries in terms of the skills of adults and in the bottom quarter in terms of the scientific skills of young people. France has also the highest tax burden on production in Europe after Sweden, (17% of GDP against 13.2% in the Euro area in 2022, see Part 4). This overall weakness in skills and this high tax burden largely explain the low employment rate in France.



The persistently low employment rate is closely linked to public finances and inequality. With fewer people employed and therefore paid, and with fewer firms producing domestically, public revenues – a source on which the government can rely to finance long-term public investment – are reduced. Since tax revenues are linked to potential output, which in turn is linked to the employment rate, an increase in the employment rate would increase tax revenues and thus create fiscal space.

There is a negative correlation between income inequality (before redistribution) and the employment rate. This relationship is even more pronounced in countries undergoing deindustrialization, where job quality and remuneration have deteriorated. This is because workers' living standards have fallen in line with per capita productivity, and wages in manufacturing are relatively higher than in the rest of the economy.

#### 5.4 "Bad jobs" are more prevalent in deindustrializing economies and are concentrated in low-skilled and precarious activities

Although employment rates have risen over the past decade, job quality has deteriorated in some EU Member States over the same period. This deterioration is due in particular to the sectoral reorientation of these economies towards services at the expense of manufacturing.

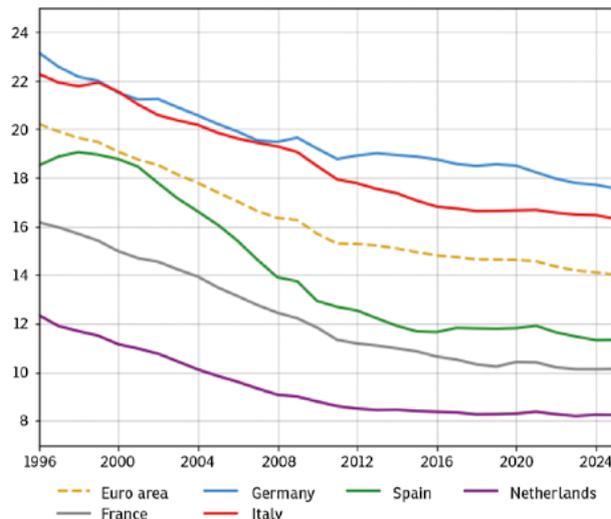
In France, for example, employment in manufacturing has fallen by more than 35% since the 1980s, while employment in services has risen by more than 60%. As a result, employment in the services sector reached 81% of total employment in 2022, well above the Euro area level of 76.7% (see *Chart 58*). As a result, the share of employment in manufacturing in France has fallen significantly from 18.5% in 1985 to 9% in 2022, a level below that of the Euro area (12.9%).

Among the other large EU Member States, the shift towards a service-oriented economy was particularly pronounced in Spain and the Netherlands, where respectively 79% and 83.5% of the workforce was employed in services in 2023 compared to 65.3% and 76.4% in 1995.

24. P. Artus, "France: is public spending the answer?", Flash Economics, Natixis (09 May 2022).

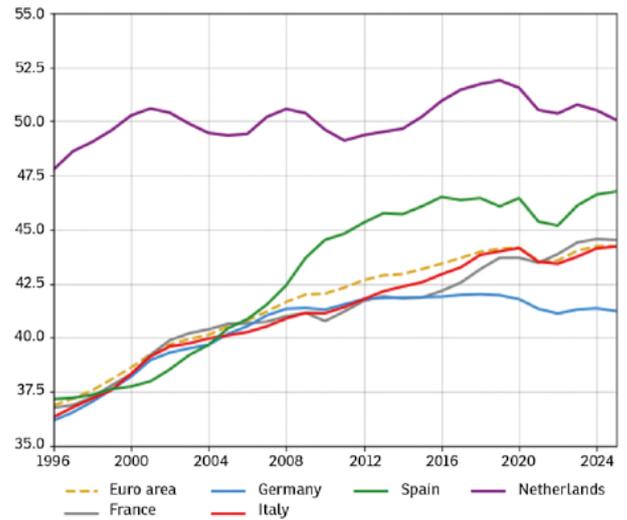
**CHART 58.****Employment in manufacturing and services activities, as % of total employment**

Chart 58a : Share of employment in manufacturing activities



Source: Eurostat

Chart 58b : Share of employment in private services activities 2025



The bulk of job creation in services is concentrated at the extremes of the skill ladder: high-skilled jobs (finance, information and technology, complex business services, etc.) and low-skilled or unskilled jobs (hotels and restaurants, distribution, transport, leisure, personal services). This polarisation of the labour market has led to a decline in the share of medium-skilled workers, which used to be dominant in manufacturing. There has also been an increase in the number of low-skilled or "bad jobs", which are poorly paid and characterised by a high degree of precariousness and hardship.

## 6. Is Next Generation EU (NGEU) a game changer?

The Covid-19 crisis hit economies worldwide. On 21 July 2020, the EU Council agreed upon a massive and unprecedented recovery plan – Next Generation EU (NGEU) – to kick-start the European economy and support the energetic and digital transitions, making Europe more resilient and better adapted to future challenges. The announcement of this program also aimed at reassuring markets about the EU's stability and strength, through increased solidarity among Member States.

NGEU, which officially entered into force on 19 February 2021, consists of a massive subsidy plan focused on the EU Member States and financed by common debt. Based on Member State requests for funding under the Recovery and Resilience Facility and the funding needs of other programs supported by NGEU, the EU expects to raise €712 billion (out of a maximum program envelope of €806.9 billion) by 2026<sup>25</sup>. Combined with the 2021-2027 EU budget, the total funding exceeds €1,800 billion, representing 12.4% of the EU's 2021 GDP.

However, despite being an innovative initiative grounded in sound principles, such as a performance-based approach, NGEU remains significantly underutilized compared to its initial plans and ambitions. Its deployment is suboptimal, and NGEU procedures are proving to be slow, complex, and highly bureaucratic.

This section proposes an overview of the NGEU program, assessing the current status of its implementation as well as its effectiveness, and delves into a comparative analysis with the US, particularly examining whether the Inflation Reduction Act (IRA) might widen the gap between the US and the EU.

### 6.1 NGEU is an unprecedented joint response to the Covid-19 crisis, making over €800 bn available to Member States to become more resilient, mainly investing in the green and digital transitions

#### 6.1.1 NGEU encompasses several instruments to achieve its objectives: green and digital transitions, structural reforms to recover from the pandemic, and economic resilience in all parts of the EU

NGEU builds on earlier initiatives such as the temporary Support to mitigate Unemployment Risks in an Emergency (SURE), the European Investment Bank's Guarantee Fund, and the European Stability Mechanism's Pandemic Crisis Support.

NGEU is part of a broader movement toward CO2 neutrality and strategic autonomy. It complements initiatives like the European Green Deal (EGD), which aims to strengthen the EU regulatory framework with the Fit for 55 energy and climate package.

NGEU encompasses several instruments (see Chart 74). The centrepiece is the Recovery and Resilience Facility (RRF) – an instrument that offers grants and loans to support reforms and investments in the EU Member States. The RRF represents 5.2 % of the EU-27 2019's GDP<sup>26</sup>. At least 37% of RRF funds are dedicated to combating climate change, supporting the EU's goal of CO2 neutrality by 2050. Additionally, 20% of RRF funds are allocated to the digital transformation, including cybersecurity, artificial intelligence, and supercomputing.

Name of the instrument	Amount of the instrument	Purpose of the instrument
<b>Recovery and Resilience Facility</b>	€672.5 bn (€312.5 bn in grants + €360bn in loans)	Supporting the implementation of structural reforms, investing in green and digital transitions, and enhancing the resilience of national economies
<b>React-EU</b>	€47.5 bn	Supporting investments and reforms, focusing on mitigating social and economic of the Covid crisis, especially through employment
<b>Just Transition Fund</b>	€10 bn	Assisting regions that are heavily dependent on fossil fuels in addressing challenges associated with the green transition
<b>Rural Development</b>	€7.5 bn	Supporting the vibrancy and economic viability of rural areas through funding and actions that support rural development
<b>InvestEU</b>	€5.6 bn	Mobilizing private and public investment by providing guarantees and technical assistance to support sustainable infrastructure projects, R&D, and SMEs
<b>Horizon Europe</b>	€5 bn	Strengthening the impact of R&D in developing, supporting and implementing EU policies while tackling global challenges
<b>RescEU</b>	€1.9 bn	Protecting citizens from disasters and managing emerging risks
<b>Total</b>	<b>750</b>	

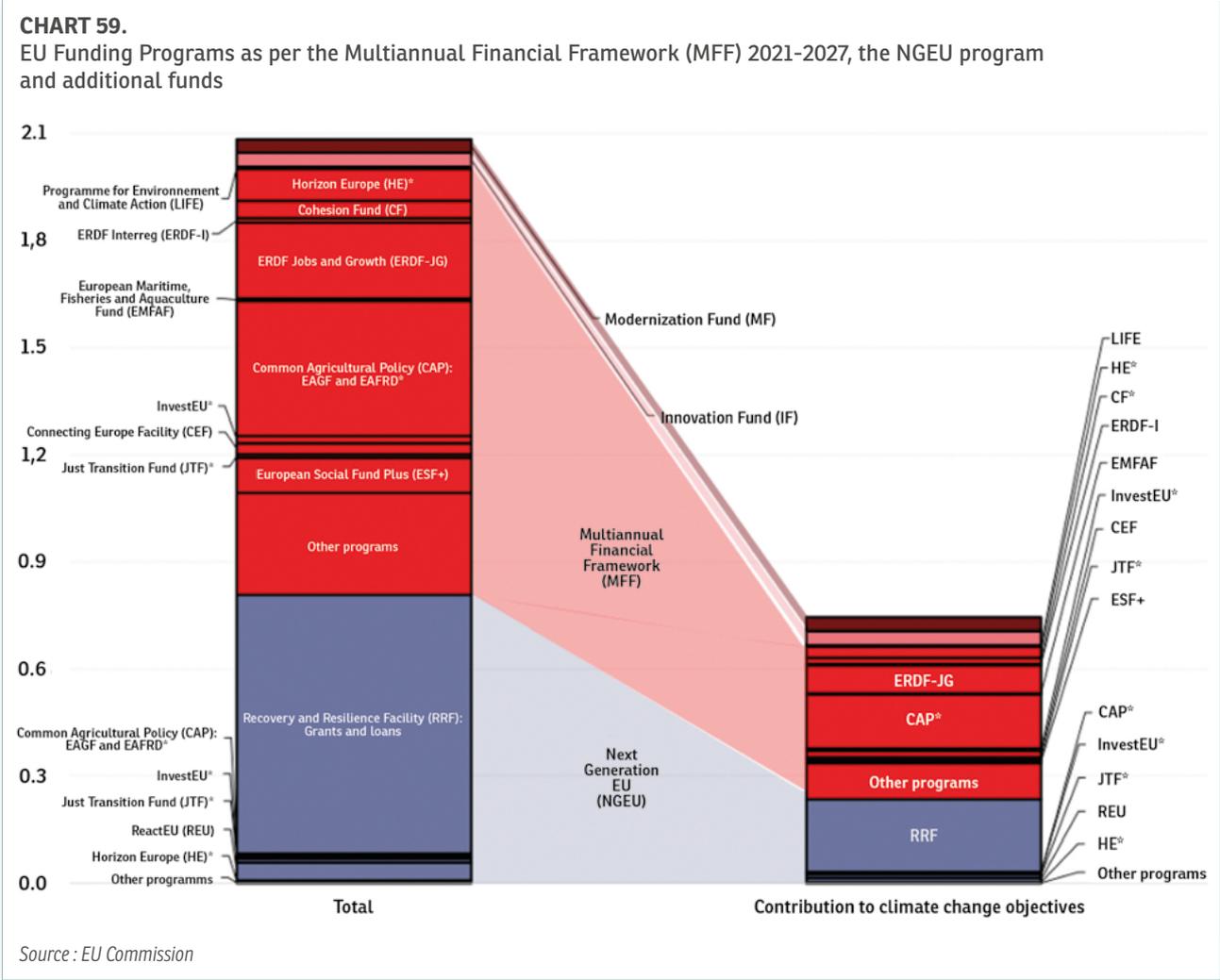
Sources: NGEU tracker, European Council  
Notes: figures are expressed at 2018 prices

25. European Commission, "The EU as an issuer – the NextGenerationEU transformation", EU budget policy brief, July 2022.

26. "NGEU delivery – How are the Member States doing?", European Parliament (EGOV), April 2024.

Apart from the RRF, NGEU encompasses the REPowerEU plan, launched in October 2022 in response to the Ukrainian crisis, aims to phase out Russian fossil fuels and encourage clean energy production in Europe. REPowerEU is based on three pillars: energy savings, renewable deployment and supply diversification.

In addition, up to €77.5 billion of NGEU funds (at 2018 prices) are being used to reinforce several existing EU programs, such as React-EU (which provides additional funding for cohesion policies and recovery from the pandemic), the Just Transition Fund (which supports regions most affected by the transition to a green economy), Rural Development (aims to improve the quality of life and economic prosperity in rural areas), Horizon Europe (the EU's largest research and innovation program), InvestEU (which stimulates investment in sustainable infrastructure, research, and innovation) and RescEU (which enhances EU disaster response capabilities).



**6.1.2 With a dedicated envelope of €648 billion, the Recovery and Resilience Fund (RRF) is the centerpiece of Next Generation EU, with a focus on the green and digital transitions**

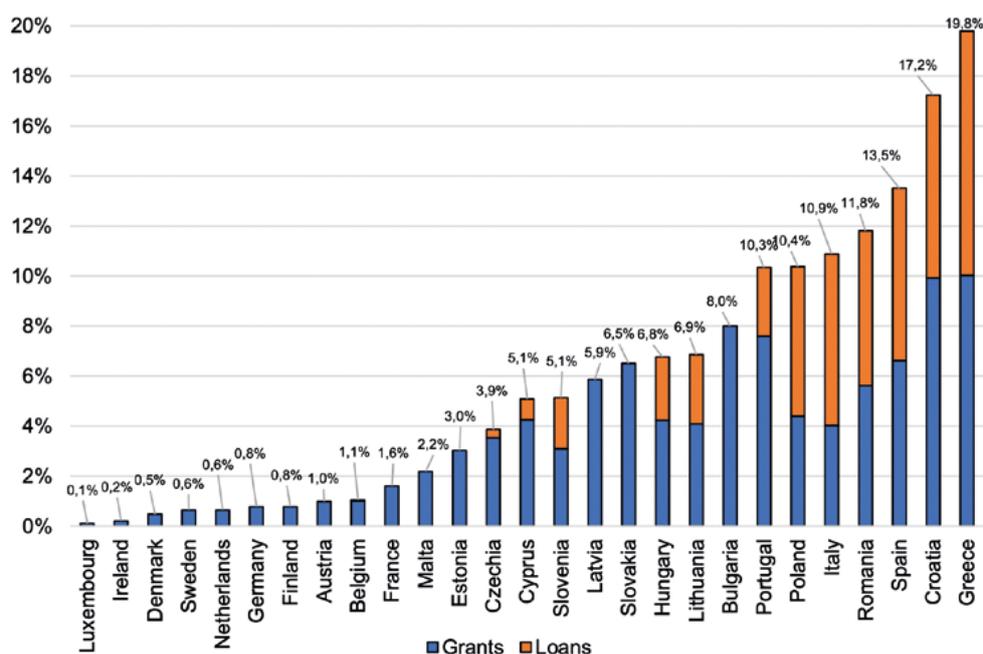
With up to €357 billion in grants and €291 billion in loans (at 2022 prices) available to Member States from 2021 to Q3 of 2026, the RRF is the centrepiece of the NGEU program.

The RRF is a performance-based instrument. It offers grants and loans to Member States which are not linked to the eligibility of a beneficiary, specific project, or declared costs, unlike other EU spending programs. Instead, payments are based on the satisfactory achievement of predefined milestones and targets submitted by Member States to the EU Commission – national plans, contingent on delivering specific reforms and investments. The allocation of grants also considers factors such as population, GDP per capita, and average unemployment rates.

Additionally, as a preventive action, if the Commission discovers deficiencies, it can interrupt or suspend payments to Member States until the problems detected are resolved. The Commission can also take action after payments have been made by introducing financial corrections if it identifies failures at a later stage.

**CHART 60.**

RRF funding (loans and grants) to be received by EU Member States, % of GDP



Source: EU Commission, NGEU tracker

### 6.1.3 Italy and Spain are the main recipients of the RRF

Italy and Spain are the largest beneficiaries of the RRF. Italy is set to receive €194.4 billion (of which €71.8 billion in grants and €122.6 billion in loans), representing 10.9% of Italy's 2021 GDP and 26.1% RRF<sup>27</sup>. While the overall amount remains unchanged as of July 2025, Italy continues to face difficulties in fully executing its plan, with only around 50% of available funds effectively spent, mainly due to administrative bottlenecks and complex project pipelines<sup>28</sup>.

Spain follows with a revised plan totaling €163 billion ( €79.8 billion in grants and €83.2 billion in loans), equating to 13.5% of Spain's 2021 GDP<sup>29</sup>. In June 2025, the European Commission approved Spain's fifth payment request, worth €23 billion<sup>30</sup>, confirming the completion of several key milestones related to tax reform, digital infrastructure, education and the green transition. However, two milestones have not yet been met, one related to the local digital agenda and another on fiscal reform, so the Commission decided to proceed with a partial disbursement, suspending the remaining tranche until these targets are fulfilled<sup>31</sup>.

#### 6.1.3.1 Spain's plan is considered one of the most advanced among EU member states

By July 2025, Spain had received €47.96 billion in grants, which is 60.1% of its total initial grant amount (€79.8 billion)<sup>32</sup>. The inclusion of loans in the revised plan from October 2023 marks a significant increase in the plan's value to €163 billion. Though, as of July 2025, €340 million in RRF loans have been disbursed so far, amounting for only 0.2% of the amount requested. The Spain's National Recovery and Resilience Plan (NRPP) exceeds the RRF's targets, with 39.9% of funds allocated to the green transition and 25.9% to digitalization. Besides, according to the European Commission's latest data (July 2025), Spain's RRP is expected to contribute 51.69% (€7.11 billion) of its funding towards the green transition and 25.47% (€4.86 billion) towards digital transformation, when accounting for both primary and secondary policy assignments. These figures reaffirm Spain's ambition to exceed the minimum thresholds of 37% and 20% for climate and digital targets respectively.

27. NGEU delivery: "How are the Member States doing?", European Parliament, April 2024.

28. Reuters. 2025. "Italy Failing to Speed Up Sluggish Spending of EU Recovery Funds, Data Shows". Reuters, March 27, 2025. <https://www.reuters.com/markets/europe/italy-failing-speed-up-sluggish-spending-eu-recovery-funds-data-shows-2025-03-27/>

29. European Commission. 2025b. Spain's Recovery and Resilience Plan. Accessed July 21, 2025. [https://commission.europa.eu/business-economy-euro/economic-recovery/recovery-and-resilience-facility/country-pages/spains-recovery-and-resilience-plan\\_en](https://commission.europa.eu/business-economy-euro/economic-recovery/recovery-and-resilience-facility/country-pages/spains-recovery-and-resilience-plan_en)

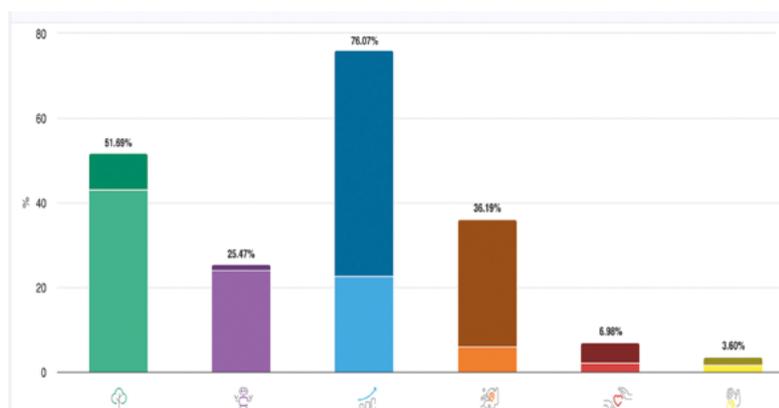
30. European Commission. 2025c. "Commission Approves Spain's Fifth Payment Request under NextGenerationEU". Press Release, IP/25/1761, June 20, 2025. [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_25\\_1761](https://ec.europa.eu/commission/presscorner/detail/en/ip_25_1761)

31. IndustryIntel. 2025. "European Commission Approves €23B Payment to Spain under NextGenerationEU; Country Must Complete Tax Reform and Digital Investments for Full Disbursement". June 20, 2025. <https://www.industryintel.com/news/european-commission-approves-23b-payment-to-spain-under-nextgenerationeu-country-must-complete-tax-reform-and-digital-investments-for-full-disbursement-171683259408>

32. [https://ec.europa.eu/economy\\_finance/recovery-and-resilience-scoreboard/country\\_overview.html?lang=en](https://ec.europa.eu/economy_finance/recovery-and-resilience-scoreboard/country_overview.html?lang=en)

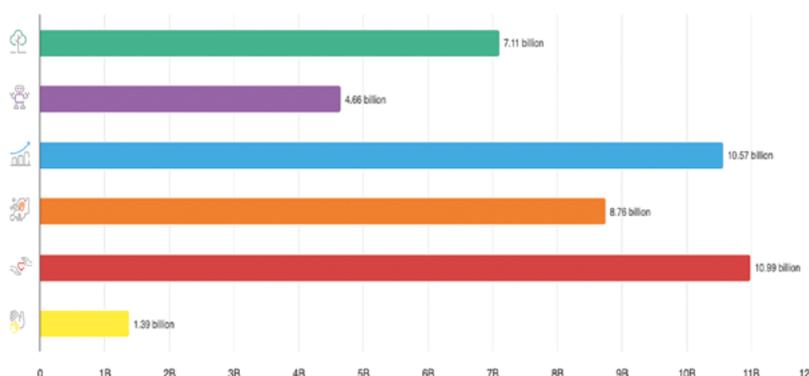
**CHART 61.**  
Spain's RRP expenditures

Chart 61a : Share of the plan's estimated expenditure contributing to each policy pillar



This graph displays the share of the recovery and resilience plan's estimated contribution to each policy pillar. As each measure contributes towards two policy areas of the six pillars (primary and secondary assignments), the total contribution to all pillars displayed in the graph amounts to 200% of the RRF funds to the Member State.

Chart 61b : Disbursements per pillar



08 May 2024: The data in the 'Disbursements per pillar' graph was revised due to a technical issue. Each disbursement reflects progress in the implementation of the RRF, across the six policy pillars. This graph displays how disbursements under the RRF relate to the pillars. The amounts were calculated by linking the milestones and targets covered by a given disbursement to the pillar tagging (primary and secondary) of their respective measures. Over time, the pre-financing that Member States have received is offset with each payment that is disbursed. Therefore, the amounts per pillar in the above graph reflect the gross payments, i.e., the actual disbursements under each instalment together with the corresponding shares of pre-financing that has been cleared, i.e., set off with each paid amount. The amounts are updated after each payment.

Source: European Commission

In terms of allocation, the "Smart, sustainable and inclusive growth" pillar accounts for the largest share of Spain's recovery and resilience plan, contributing an estimated 76.07% of the plan's total expenditure. It is followed by the "Green transition" with 51.69%, "Social and territorial cohesion" with 36.19%, and "Digital transformation" with 25.47%. The "Health, and economic, social and institutional resilience" pillar represents 6.98%, and "Policies for the next generation, children and youth" (including education) accounts for 3.60%. These estimates reflect both primary and secondary policy assignments, and as such, their combined total exceeds 200%. This structure highlights the cross-cutting nature of many reforms and investments. The high estimated contributions to the green and digital pillars confirm that Spain continues to exceed the RRF's minimum spending requirements (i.e. 37% for climate and 20% for digital objectives)<sup>33</sup>. However, despite these strong formal commitments, the actual disbursement figures by mid-2025 remain uneven across pillars. Green and digital projects, while well funded on paper, tend to have longer implementation timelines, and a significant portion of the expenditures related to these areas are expected to materialise in the second half of the RRF implementation period.

33. European Commission. 2025. Recovery and Resilience Scoreboard. Accessed July 21, 2025. [https://ec.europa.eu/economy\\_finance/recovery-and-resilience-scoreboard/index.html](https://ec.europa.eu/economy_finance/recovery-and-resilience-scoreboard/index.html)

According to Fernández Llera et al.<sup>34</sup>, despite Spain's comparatively high absorption rate and project volume, delays in execution timelines, cost inflation, and limited local implementation capacity, especially at the municipal level, have constrained the real economic effects of disbursed funds. A significant portion of projects are still in early implementation stages, while the green transition agenda remains hampered by regulatory fragmentation and a lack of regional coordination (*ScienceDirect*, 2025). Moreover, Fernández Llera et al. (2025) demonstrate that the regional impact of the RRF varies significantly: Northern and coastal areas of Spain have seen more effective absorption and initial returns, while interior provinces face greater bottlenecks and fewer projects per capita. The synthetic control method employed highlights that Andalusia and Extremadura lag behind in real GDP contribution relative to baseline scenarios (Fernández Llera et al., 2025).

Using a synthetic control method, Fernández Llera et al. (2025) compare real economic indicators with counterfactual scenarios. They highlight that while Catalonia and the Community of Madrid approach their synthetic GDP benchmarks (29.2 vs 28.7; 33.8 vs 33.3), regions like Andalusia (18.3 vs 18.2) and Extremadura (17.9 vs 18.2) underperform slightly even in GDP per capita terms despite heavy funding allocations. These discrepancies point to structural bottlenecks beyond mere fund absorption.

Spain's plan includes 11 policy levers, with a strong focus on modernising and digitalising industry and SMEs, particularly through PERTEs (Proyectos Estratégicos para la Recuperación y Transformación Económica). These public-private partnerships are designed to foster projects of common European interest, with 29% of the PERTE budget already awarded or opened to calls as of mid-2025.

### **6.1.3.2 Still Late, Despite Catching Up: Italy's National Recovery and Resilience Plan (NRRP) Disbursements Outpace the EU Average, but Green and Digital Targets Lag Behind**

In 2022, Italy achieved only 10 out of 27 goals and spent €12 billion of the planned €40 billion. The Commission temporarily froze the third Italian instalment in March 2023 due to missed milestones. Despite these setbacks, Italy's revised NRRP was adopted in September 2023, and as of July 2024, €41.54 billion in grants and €60.94 billion in loans had been disbursed to Italy<sup>35</sup>, with a sixth payment request of €8.5 billion submitted.

As of July 2025, Italy had spent €65.7 billion of its €194.4 billion NRRP allocation, which amounts to 33.8% of the total EU resources available. In terms of disbursement, the country had received €46.47 billion in grants (64.7%) and €75.68 billion in loans (61.7%), bringing the total received to €122.15 billion, or 62.8% of the total, significantly above the EU average of 48.8%. Italy, once considered behind, has now caught up with and even surpassed Spain in the volume of EU recovery funds received<sup>36</sup>.

In terms of ventilation, while Italy's National Recovery and Resilience Plan (NRRP) initially pledged to allocate 39.5% of its total EU recovery funding to climate objectives and 25.5% to digitalisation, actual disbursements remain significantly below those targets. As of July 2025, €19.00 billion had been disbursed for the green transition, accounting for only 15.06% of the total disbursed funds, despite the higher estimated share of 48.77%. Similarly, digital transformation received €14.35 billion, or 11.7% of actual disbursements, while its estimated share stood at 28.98%. In contrast, the largest share of actual payments has gone to smart, sustainable and inclusive growth (€29.81 billion), followed by health, economic, social and institutional resilience (€24.25 billion), and social and territorial cohesion (€20.39 billion). These discrepancies highlight a persistent implementation gap between Italy's strategic commitments and its spending reality, although climate and digital targets may still be met by the 2026 deadline if acceleration continues.

The sixth tranche of the NRRP, disbursed in December 2024, financed several strategic reforms and investments, including the construction of the Adriatic gas pipeline (under the REPowerEU chapter), the issuance of 69,900 Transition 4.0 tax credits to support digitalisation and green innovation in businesses, the awarding of rail infrastructure contracts in southern Italy (e.g. Orte–Falconara and Taranto–Metaponto–Potenza–Battipaglia), and the closure of illegal waste dumps. The revised plan now includes 68 reforms (9 more than in the original version), divided into horizontal reforms (justice, public administration, taxation), enabling reforms (e.g. procurement simplification), and sectoral reforms (education, labour, energy, waste). To date, Italy has fulfilled 270 out of the 614 milestones and targets (44%), with the seventh payment (€21 billion) positively assessed by the Commission on 1 July 2025, which is expected to raise the fulfilment rate to 54%. Italy also submitted an eighth payment request (€14.7 billion), which is currently under review. Governance is coordinated at multiple levels, with the

34. Aparicio-Pérez, Daniel, et al. "On the Impact of next Generation EU Funds: A Regional Synthetic Control Method Approach". *Papers in Regional Science*, vol. 104, no 2, avril 2025, p. 100082. DOI.org (Crossref), <https://doi.org/10.1016/j.pirs.2025.100082>.

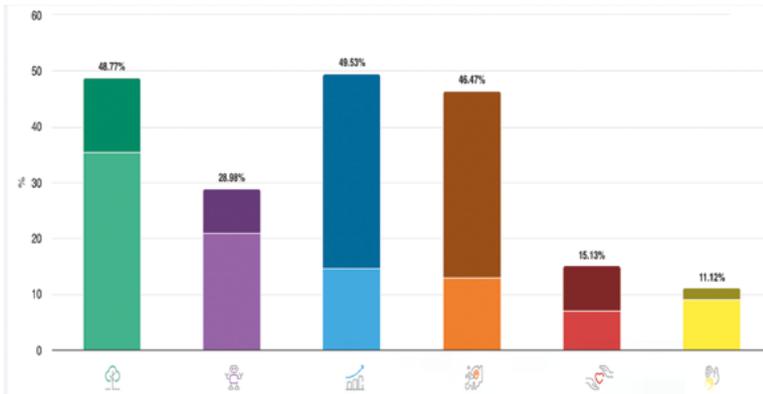
35. [https://ec.europa.eu/economy\\_finance/recovery-and-resilience-scoreboard/country\\_overview.html?lang=en](https://ec.europa.eu/economy_finance/recovery-and-resilience-scoreboard/country_overview.html?lang=en)

36. European Parliamentary Research Service. China's Belt and Road Initiative – A Human Rights Assessment. EPRS Briefing 2021/698847, European Parliamentary Research Service, European Parliament, July 2025. [https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/698847/EPRS\\_BRI\(2021\)698847\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/698847/EPRS_BRI(2021)698847_EN.pdf).

Minister for European Affairs and the NRRP leading implementation<sup>37</sup>, supported by a national Steering Committee, the ReGiS IT platform<sup>38</sup>, and an independent audit body. Nonetheless, persistent challenges remain, notably delays in Missions 4 (Education), 5 (Inclusion and Cohesion), and 6 (Health), a lack of staffing in monitoring and control bodies, a heavy reliance on tax incentives (such as Ecobonus and Transition 4.0, which account for over 40% of expenditures), and questions around the post-2026 sustainability of projects, particularly for local authorities.

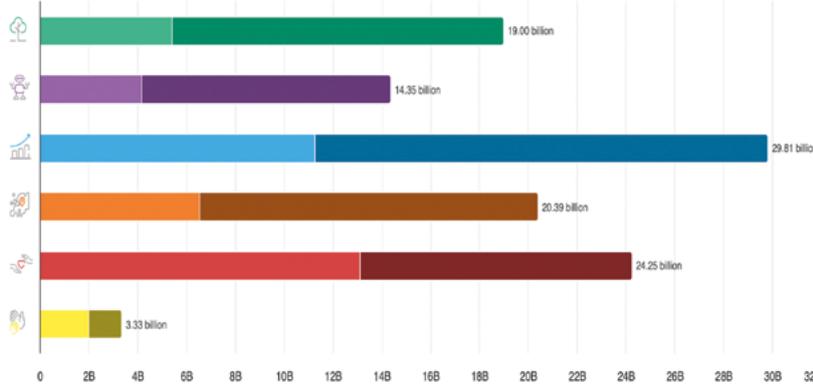
**CHART 62.**  
Italy's RRP expenditures

Chart 62a : Share of the plan's estimated expenditure contributing to each policy pillar



This graph displays the share of the recovery and resilience plan's estimated contribution to each policy pillar. As each measure contributes towards two policy areas of the six pillars (primary and secondary assignments), the total contribution to all pillars displayed in the graph amounts to 200% of the RRF funds to the Member State.

Chart 62b : Disbursements per pillar



08 May 2024: The data in the 'Disbursements per pillar' graph was revised due to a technical issue. Each disbursement reflects progress in the implementation of the RRF, across the six policy pillars. This graph displays how disbursements under the RRF relate to the pillars. The amounts were calculated by linking the milestones and targets covered by a given disbursement to the pillar tagging (primary and secondary) of their respective measures. Over time, the pre-financing that Member States have received is offset with each payment that is disbursed. Therefore, the amounts per pillar in the above graph reflect the gross payments, i.e., the actual disbursements under each instalment together with the corresponding shares of pre-financing that has been cleared, i.e., set off with each paid amount. The amounts are updated after each payment.

Source: European Commission

The Italian Court of Auditors and the Bank of Italy have called for stronger administrative capacity and better financial planning, while the Centro Studi Confindustria has expressed concern over the effectiveness of the Transition 5.0 measure and the risk of underspending by the deadline<sup>39</sup>.

37. European Commission, Recovery and Resilience Scoreboard – section "Implementation overview – Italy" [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_25\\_1696](https://ec.europa.eu/commission/presscorner/detail/en/ip_25_1696)  
 38. Corte dei Conti (2025). Relazione sullo stato di attuazione del PNRR. <https://www.italiadomani.gov.it/content/sogei-ng/it/it/home.html>  
 39. Banca d'Italia. 2025. Economic Bulletin No. 2/2025. Rome: Banca d'Italia. [https://www.bancaditalia.it/media/notizia/economic-bulletin-no-2-2025/?com.dotmarketing.htmlpage.language=1&utm\\_source=c](https://www.bancaditalia.it/media/notizia/economic-bulletin-no-2-2025/?com.dotmarketing.htmlpage.language=1&utm_source=c)

## 6.2 Where is the EU at with the Next Generation EU?

### 6.2.1 The 27 national plans have been approved by the Commission and adopted by the EU Council, but only 49% of the grants and 38% of the loans had been spent by the end of May 2025

All 27 Member States' National Recovery and Resilience Plans (NRRPs) have been approved by the Commission and adopted by the EU Council. By January 2024, all 27 Member States had submitted amendments to their plans, primarily to include REPowerEU chapters aimed at enhancing energy independence and addressing administrative capacity issues. These amendments are intended to improve the absorption capacity of RRF and other EU funds.

By the end of February 2025, disbursements under the Recovery and Resilience Facility (RRF) had reached €315 billion, or 49% of the total €650 billion envelope (updated from 47.1% in earlier assessments). According to the European Commission's mid-term evaluation (2025), this includes €197.5 billion in grants (57% of the total grant allocation) and €108.7 billion in loans (38% of the total loan envelope), disbursed in exchange for 2,218 fulfilled milestones and targets across 1,145 reforms and 1,073 investments<sup>40</sup>.

**TABLE 6.**

RRF funds available and disbursed as of end-February 2025

	Total RRF	RRF Grants	RRF Loans
Available (EUR bn)	650	359	291
Disbursed (EUR bn)	315	197.46	108.7
Percentage disbursed	49%	55%	38%

Source: EU Commission

Notes: amounts are expressed in 2022 prices. The €359 billion in grants is split in €338 billion of original RRF grants, €19 billion in ETS grants and €2 billion in BAR (Brexit Adjustment Reserve) grants.

While €66 billion had been disbursed in the second half of 2024, the first five months of 2025 saw only €9.5 billion disbursed, a notable slowdown at a critical moment when implementation must accelerate to meet the final deadline of 31 August 2026.

According to Commission tracking, more than €335 billion in RRF funds still need to be disbursed, and over 4,300 milestones and targets remain to be completed across Member States. As of early 2025, 13 payment requests were under evaluation by the Commission, with 30 more expected by the end of the year (European Commission, 2025<sup>41</sup>).

In total, 2024 saw €95 billion in disbursements, and cumulative RRF payments since 2021 had reached approximately €315 billion by February 2025. Updated projections suggest total disbursements for 2025 could range between €80 billion and €100 billion, depending on progress in milestone implementation and Commission assessments in the second half of the year (EPRS, 2025; *Commission Recovery and Resilience Scoreboard*, July 2025).

### 6.2.2 NGEU is financed by common debt and national resources

#### 6.2.2.1 NGEU is by far the largest EU bond-financed program ever

NGEU is financed primarily through common debt, a historic first for the EU. It is the first time such a substantial common borrowing and, to a certain extent, risk-sharing mechanisms have become characteristics of an EU budgetary plan.

To issue the common debt, the Commission resorts to multiple instruments: a combination of medium – and long-term debt issuance across different maturities via EU-Bonds (both regular and green bonds) and short-term via EU-Bills.

The borrowing strategy to finance NGEU relies on the safety and cost-effectiveness of the way money is raised. The European Commission borrows on capital markets, allowing low-rated countries to benefit from its high credit rating which helps obtain more favourable financial terms<sup>42</sup>. To protect this credit rating, the EU is using the

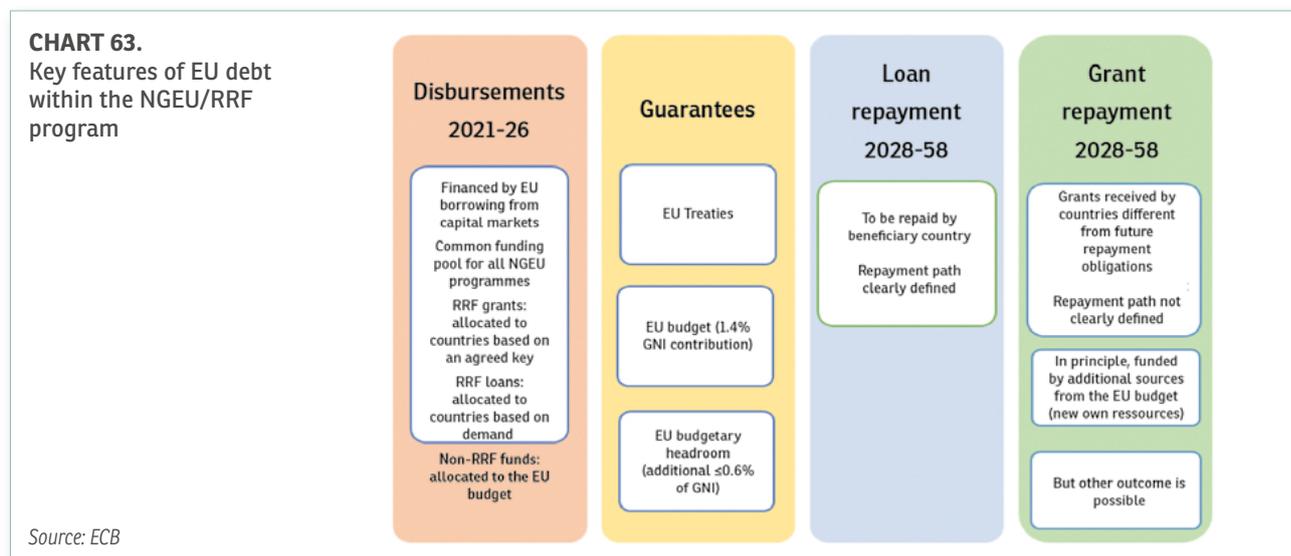
40. European Commission, NextGenerationEU – The Road to 2026, COM(2025) 310 final, Strasbourg, 8 juillet 2025, PDF, 1–48, [https://commission.europa.eu/document/download/ad5f00c9-4101-41a0-9d8f-e78f06c0c7ed\\_en?filename=COM\\_2025\\_310\\_1\\_EN\\_ACT\\_part1\\_v8.pdf](https://commission.europa.eu/document/download/ad5f00c9-4101-41a0-9d8f-e78f06c0c7ed_en?filename=COM_2025_310_1_EN_ACT_part1_v8.pdf).

41. European Parliament, "The EU Climate Transition Index: Assessing Member States' Alignment with Greenhouse-Gas Reduction Targets" (IDAN ECTI/2025/764391, Strasbourg, 2025), PDF, [https://www.europarl.europa.eu/RegData/etudes/IDAN/2025/764391/ECTI\\_IDA\(2025\)764391\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2025/764391/ECTI_IDA(2025)764391_EN.pdf).

42. The EU's credit rating (AAA by Fitch and Moody's) is better than the rating of 22 out of the 27 EU Member States.

EU budget headroom<sup>43</sup> as a guarantee. In order to protect the borrowing under NGEU, the EU headroom is 0.6 percentage points higher than the standard one for the period ending in 2058, as the debt will be gradually reimbursed by the borrowing Member States over the period 2025–2058<sup>44</sup>. Indeed, the average maturity of EU securities is 11 years, and payback deadlines are spread out between 2025 and 2058<sup>45</sup>.

Additionally, the ceiling on resources that each country must contribute to the EU budget was temporarily raised by 0.6 percentage points of GNP, to 2% of EU GNP. EU resources will also be increased.



The SURE and NGEU programs have allowed the EU to massively issue bonds on the markets. Despite rising interest rates since 2022, which have affected all sovereign issuers including the EU, the issuance of EU bonds to fund the RRF continued successfully, attracting steady investor demand even amid market volatility.

In less than four years, the total volume of EU bonds has grown from less than €50 billion to €578 billion at the end of 2024, and reached €695 billion by June 2025<sup>46</sup>. By 2026, when the NGEU program concludes, the EU is expected to have issued between €800 billion and €950 billion, making it the fifth-largest sovereign issuer in the EU, after France, Italy, Germany, and Spain. By mid-2025, the European Commission had already issued €90 billion in EU-Bonds<sup>47</sup>, as planned for the first half of the year, with further issuances scheduled in the second half. These include both auctions and syndicated transactions across maturities from 3 to 30 years. The funds support NGEU, Ukraine assistance, the Reform and Growth Facility, and Macro-Financial Assistance. Total issuance by the end of 2025 is expected to reach around €160 billion, in line with the funding strategy.

Green bonds play a major role in the EU's borrowing strategy. By late 2024, over €65 billion of NGEU green bonds had been issued, with around €73 billion outstanding by early 2025. The EU plans to finance up to 30 % of NGEU, *i.e.* around €240 billion through green bonds. These instruments are exclusively allocated to eligible green measures, such as clean energy, energy efficiency, biodiversity, and sustainable transport.

The first issuance of EU green bonds took place in October 2021, raising €12 billion with a 15-year maturity, the largest green bond ever issued at the time, and was heavily oversubscribed, with demand reaching €135 billion. According to EGOV, this strategy positions the EU as one of the largest issuers of euro-denominated debt (averaging €150 billion per year) and the world's biggest green bond issuer, in line with its diversified funding strategy<sup>48</sup>.

43. The headroom is the difference between the maximum amount of revenue that the EU can raise for the EU budget and the actual spending from the EU budget.

44. *I.e.*, Member States agreed to a temporary increase in the maximum amount of revenue the EU can call from Member States per year (adding an allocation of 0.6% to the basic own resources ceiling of 1.4% of EU Gross National Income) until all NGEU liabilities have ceased to exist. (source: EU Budget Policy Brief).

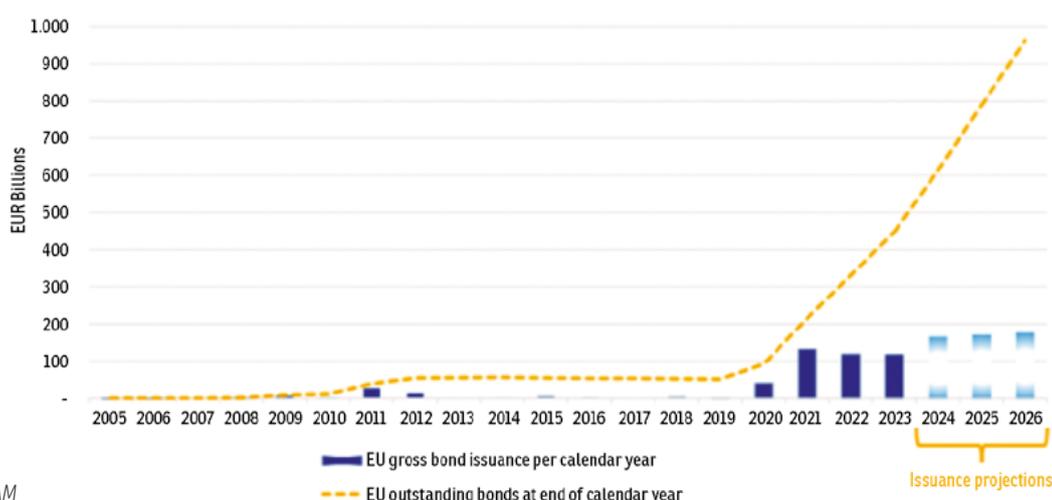
45. European Commission. EU Investor Presentation, April 2025. Investor Presentation. Luxembourg: European Commission, April 2025. PDF. [https://commission.europa.eu/document/download/9cbfa1da-2198-4ad7-9846-233eca7397a8\\_en?filename=EU%20Investor%20Presentation\\_April\\_2025.pdf](https://commission.europa.eu/document/download/9cbfa1da-2198-4ad7-9846-233eca7397a8_en?filename=EU%20Investor%20Presentation_April_2025.pdf).

46. S&P Global Ratings. RatingsDirect: European Union and European Atomic Energy Community. Rapport, 30 juin 2025. PDF. Commission européenne (Luxembourg/Strasbourg). [https://commission.europa.eu/system/files/2025-07/RatingsDirect\\_EuropeanUnionandEuropeanAtomicEnergyCommunity\\_3398360\\_Jun-30-2025.pdf](https://commission.europa.eu/system/files/2025-07/RatingsDirect_EuropeanUnionandEuropeanAtomicEnergyCommunity_3398360_Jun-30-2025.pdf).

47. European American Chamber of Commerce (EACC), "European Commission to issue €90 billion in long-term EU-Bonds in the first half of 2025", 11 décembre 2024, communiqué, <https://eaccn.eu/european-commission-to-issue-e90-billion-in-long-term-eu-bonds-in-the-first-half-of-2025/>

48. European Commission, "eGovernment and digital public services", page web, Shaping Europe's digital future, dernière mise à jour inconnue, <https://digital-strategy.ec.europa.eu/en/policies/egovernment>

**CHART 64.**  
EU Commission's issuance (EUR bn)



Source: UE, Ostrum AM

### 6.2.2.2 The NGEU faces significant uncertainties regarding the repayment of its common debt

While the repayment schedule for loans provided under NGEU is well-defined stretching from 2028 to 2058 the pathway for repaying the grants portion remains significantly more ambiguous. To ensure the sustainability of this unprecedented common debt, the European Commission has proposed a package of new EU own resources intended to cover the reimbursement of grants without overburdening national contributions. These include revenues from the Carbon Border Adjustment Mechanism (CBAM), the EU Emissions Trading System (ETS), and a proposed digital levy. Combined, these instruments are expected to generate revenues equivalent to around 0.2% of the EU's annual GNI, which would be sufficient to service the repayment of NGEU grants without jeopardising the EU budget or forcing cuts to other spending programmes.<sup>49</sup>

However, the actual implementation of these new resources has faced political and procedural delays. Since all new resources require unanimous agreement among the 27 Member States, the approval process has been both slow and contentious. Disagreements persist regarding the design, national impact, and governance of these instruments particularly the digital levy and the use of ETS revenues. As of mid-2025, only the CBAM-based revenues are expected to begin yielding significant funds by 2026. The Commission's February 2025 report and the Parliament's mid-year EPRS briefing underline that the uncertainty surrounding these own resources poses a risk to the long-term stability of NGEU debt repayment and EU financial credibility.<sup>50</sup>

Compounding this issue, the cost of servicing the debt has increased substantially. When NGEU was designed in 2020, borrowing costs were forecast to remain between 0.55% and 1.15% over the 2021-2027 period. However, the reality has diverged sharply from these assumptions. Following global inflationary pressures and interest rate hikes across advanced economies, the EU's average bond yield reached 3.2% in June 2024 for 10-year issuances. Even though the ECB began lowering key rates in early 2025 leading to a slight easing of yields to 2.5-2.8% by mid-2025, EU borrowing costs remain significantly higher than expected, especially for long-dated issuances used to finance the grants portion of NGEU.<sup>51</sup> As a result, the financial burden of servicing the NGEU debt is now projected to be considerably higher than initially budgeted. Originally, the European Commission expected interest payments to cost no more than €15 billion per year. However, updated projections indicate that annual servicing costs could rise to between €22 billion and €27 billion by 2030, when both interest and capital repayments will peak. The repayment of principal on the €390 billion in grants is scheduled to begin in 2028, with annual capital repayments amounting to approximately €13.9 billion, and total interest costs estimated at €222 billion over the entire period.<sup>52</sup> This situation could result in a financing gap of €15 to €25 billion over the 2025-2027 budgetary

49. European Commission, Commission Staff Working Document: A dynamic EU budget for the priorities of the future: the Multiannual Financial Framework 2028–2034, SWD(2025) 570 final (Brussels, 16 July 2025), PDF, [https://commission.europa.eu/system/files/2025-07/RatingsDirect\\_EuropeanUnionandEuropeanAtomicEnergyCommunity\\_3398360\\_Jun-30-2025.pdf](https://commission.europa.eu/system/files/2025-07/RatingsDirect_EuropeanUnionandEuropeanAtomicEnergyCommunity_3398360_Jun-30-2025.pdf) – this reference PDF is hosted via the Commission's document repository

50. Clare Ferguson et Katarzyna Sochacka, Plenary round-up – July 2025 (EPRS | European Parliamentary Research Service, Plenary AT A GLANCE, PE 775.871, Strasbourg, juillet 2025), PDF, consulté le 20 juillet 2025, [https://www.europarl.europa.eu/RegData/etudes/ATAG/2025/775871/EPRS\\_ATA\(2025\)775871\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/ATAG/2025/775871/EPRS_ATA(2025)775871_EN.pdf)

51. European Central Bank. Economic Bulletin, Issue 3/2025. Francfort : BCE, avril 2025. <https://www.ecb.europa.eu/press/economic-bulletin/html/eb202504.en.html>

52. Giedo Claeys, Christopher McCaffrey et Lukas Weislau, "What will it cost the European Union to pay its economic recovery debt?", Bruegel, 9 octobre 2023, <https://www.bruegel.org/analysis/what-will-it-cost-european-union-pay-its-economic-recovery-debt>

framework, and additional strain beyond 2028 if new own resources are not operational in time. As noted by several analysts, including B. Bayard<sup>53</sup> and the Bruegel Institute, the EU risks either increasing GNI-based national contributions, scaling back other EU programmes (e.g. Horizon Europe or cohesion funding), or incurring political damage by renegotiating the financial rules underpinning the NGEU repayment mechanism<sup>54</sup>.

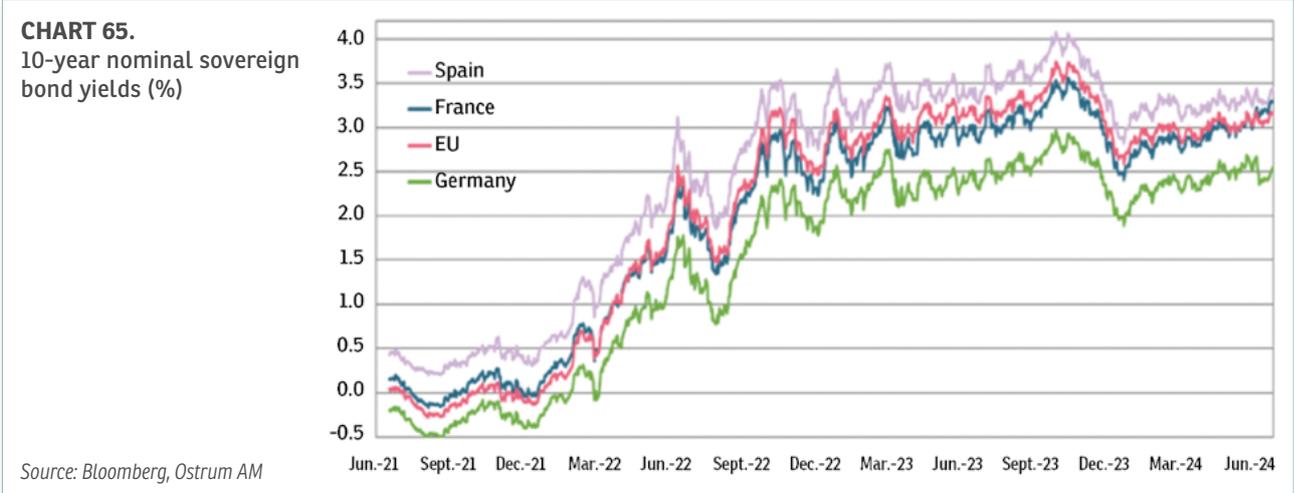
The challenge is therefore twofold: managing higher-than-expected interest costs due to market conditions, and ensuring that new own resources are approved, legally implemented, and effectively collected before principal repayments begin. Despite the European Commission’s proactive strategy and favourable credit rating, the long-term success of the NGEU framework hinges on Member State political will and fiscal solidarity to finalise a robust repayment strategy.

**6.2.2.3 Is EU common debt a fantasy?**

The EU is among the safest issuers in the Eurozone. EU debt is rated AAA by Fitch and Moody’s (Aaa) and AA+ by S&P. This very high quality is linked to EU debt being backed by the European budget. This allows the EU to finance itself at rates lower than the weighted average rate of the EU countries.

This premium is a liquidity premium. It is not equivalent to that of the German and French bond markets. Despite massive issuances across the entire yield curve, even in the short term, and significant transactions on the secondary market, the yield spread between bid and ask on the secondary market is larger for EU bonds than for those of Germany and France.

This is attributable to the fact that the EU yield curve is recent and, above all, to the limited duration of the NGEU program. Net issuances end in 2026, which creates uncertainty for investors beyond this date. Repayments will end in 2058. MSCI did not include EU bonds in its sovereign bond indices in June 2024 and reaffirmed this classification in mid-2025<sup>55</sup>. EU bonds are thus classified in the indices as supranational bonds (like those of the European Investment Bank) rather than sovereign bonds. MSCI will review this issue again at the end of 2025.



Some indicators can lead to wonder if the common debt issued under NGEU is indeed a first step towards a European safe asset. As explained by the Banque de France, “a genuine European safe asset would have several benefits for financial stability and European integration and would facilitate the financing of public policies by reducing borrowing costs.”

However, the current situation is different: After three years of issuance, and even though the EU has not faced significant issues in getting funds, the EU debt turned out to be less attractive for investors than that of its main Member States for two reasons:

- Even if the EU budget provides a strong guarantee, it does not have the sovereignty over its debt as other sovereign states do. Indeed, Europe is not an independent state and does not have the power to levy taxes.

53. B. Bayart, “Il n’y a plus d’argent magique européen”, Le Figaro, 27 mars 2024.  
 54. Charles Grant et Edoardo Letta, Thinking European first and its implications, Bruegel, avril 2025, PDF, 36 p., <https://www.bruegel.org/sites/default/files/2025-04/thinking-european-first-and-its-implications-10730.pdf>.  
 55. European American Chamber of Commerce New York, “ECB: The Euro area Bond Market”, accessed July 2025, <https://eaccny.com/uncategorized/ecb-the-euro-area-bond-market>.

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In other words, the EU does not currently have the resources to repay its debt. It is therefore the Member States that will have to transfer funds to pay the creditors when the bonds mature.

- The fact that NGEU is a unique and temporary initiative implies that EU securities are not going to remain on markets forever, which can have a deterrent effect for investors looking for liquid and easily tradable assets. Though liquidity has improved with the introduction of the unified funding approach in January 2023, the current market of EU common debt remains narrow and not deep enough, and so, insufficiently liquid.

As highlighted by Ostrum in its weekly analysis on July 1, 2024, the inclusion of EU debt in sovereign indices would allow EU bonds to be treated as sovereign bonds.

### **6.3 Is the Next Generation EU efficient?**

#### ***6.3.1 Billed as a 'game changer' with highly ambitious goals, the RRF has so far had a relatively limited impact on the economic growth of Member States***

In 2020, the European Commission estimated that recovery support would add an average of 1.9% to GDP by 2022, in reality, the boost was much smaller, at only 0.4%. Analysis by Goldman Sachs suggests that for the top four EU economies: Germany, France, Italy, and Spain, the impact of recovery grants on output was minimal and expected to turn negative as the fund tapers off<sup>56</sup>. According to figures published in the midterm evaluation of the RRF in February 2024, the Commission estimates that the EU's real GDP is going to increase by up to 1.4% in 2026 due to the NGEU. Further report published by the European Central Bank in December 2024, has shown less ambitious, suggesting that the public expenditures and structural reforms linked to NGEU have the potential to increase the level of Euro area GDP by around 0.4–0.9% by 2026 and 0.8–1.2% by 2031.

Many governments backdated investments, effectively replacing national expenditure with EU funds, which reduced the additional growth effect. "Some of the projects allowed in the recovery fund are investments that governments would have done anyway", said Peter Vanden Houde, chief economist for Belgium and Luxembourg at ING. In other cases, including Belgium, reforms proved to be a stumbling block and held up payments. "Even a very efficient public administration would not be able to spend all of this money, especially when it is investments rather than transfers, in a relatively short amount of time", declared Tito Boeri, a professor of economics at Bocconi University. As time pressure mounts, there is concern that it could negatively affect the quality of expenditure and increase the risk of fraud.

#### ***6.3.2 NGEU is a slow and complex process that faces Member States' limited capacity regarding the absorption capacity of European funds***

##### ***6.3.2.1 The implementation of NGEU, including the RRF, has encountered significant administrative burdens, impacting its effectiveness***

Despite its innovative performance-based approach, NGEU's deployment has been slower and more complex than initially anticipated. It has encountered numerous challenges that jeopardize its effectiveness and timely execution, including delays in preliminary assessments, bureaucratic complexities, administrative burdens, and disagreements over necessary reforms.

The European Commission has faced delays in preliminary assessments for disbursement requests, further complicating the timely allocation of funds. This backlog raises concerns about the Commission's capacity to manage the heavy workload required for assessing and approving funding requests efficiently.

The NGEU program involves seven different funds and is intertwined with other plans like REPowerEU, leading to a cumbersome bureaucratic process. The dual funding systems (RRF and regular EU funds) have strained administrative capacities, resulting in complex and burdensome procedures.

Moreover, disagreements between Member States and Brussels over necessary reforms have delayed payments, and inflation has forced many investments to be downsized. The fund's complex structure, which requires countries to meet specific reform and investment targets to receive grants and loans, has led to further delays and complications. For instance, changes in government, as seen in Italy, have resulted in lengthy renegotiations of national plans. Additionally, in June 2022, the Commission's retroactive adjustment of grant allocations based on countries' actual economic performance caused further disruptions, exemplified by Belgium's significant reduction in funds.

This led to the downsizing or removal of several projects. Moreover, the fund's audit systems, while necessary to prevent fraud, have imposed a high administrative burden on implementing authorities. A national official

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56. "Is the EU's Covid-19 recovery fund failing?", Financial Times article, February 2024.

criticized these measures as using “a bazooka to control things that are very restricted in scope”, indicating that the administrative processes are disproportionately cumbersome. The dual system of managing both the RRF and regular EU funds has resulted in “nightmarish” procedures, contributing to a negative outlook on the fund’s practical implementation.

In June 2024, Valdis Dombrovskis, Executive Vice President of the European Commission, stressed the urgency of addressing bottlenecks before the 2026 deadline, noting that “the clock is ticking”.<sup>57</sup>

As a consequence, implementation delays can be observed in virtually all Euro area countries, albeit to varying degrees. As of December 2024, the sum of the delays in the submission of individual RRF payment requests is as high as 23 quarters in some countries (*Chart 20*). For instance, Sweden only submitted its first payment request in December 2024, and the disbursement was still pending as of June 2025<sup>58</sup>. Apart from submission delays, some countries have also seen disbursement delays. Such delays may arise if a country initially provides the European Commission with insufficient documentation. Disbursement delays can be approximated by the number of quarters between the submission of a payment request and the corresponding disbursement (minus one-quarter to account for the standard review process). Disbursement delays, while particularly evident in Italy, are generally shorter than submission delays.

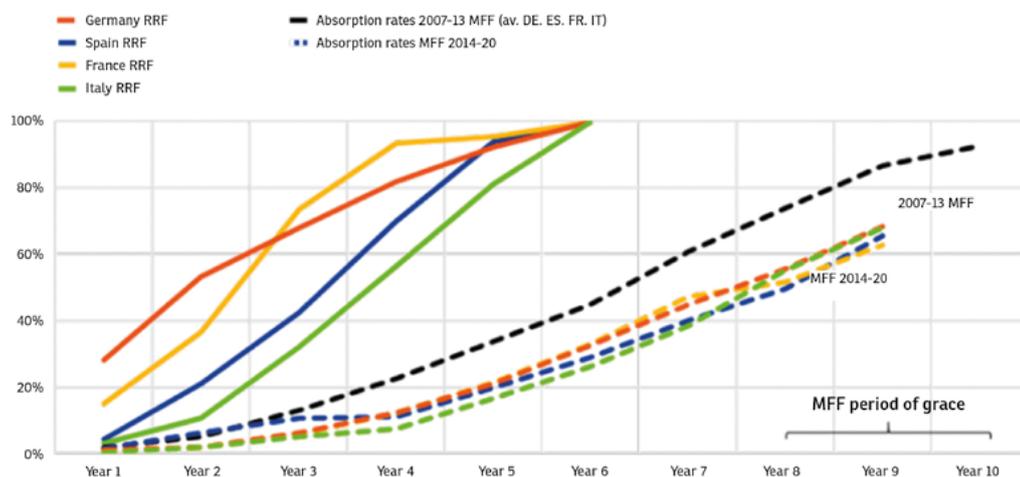
### 6.3.2.2 Member States struggle with the capacity to absorb the allocated funds efficiently

This difficulty is not unprecedented; historical data from the 2014–2020 multiannual financial frameworks (MFF) indicate a persistent issue with fund absorption. During this period, even the largest and most economically robust Member States managed to absorb only 60–70% of the allocated funds over nine years. This limited absorption capacity raises concerns about the feasibility of fully utilizing the NGEU funds within the stipulated timeframe.

Unlike the previous MFF, which had a longer implementation period, NGEU demands full absorption of the allocated funds in just five and a half years. This compressed timeline amplifies the existing challenges faced by Member States in fund utilization.

**CHART 66.**

Projected cumulative absorption rates of RRF funding compared with realized absorption rates of past EU multiannual financial frameworks  
(x-axis: year of programme; y-axis: absorption as cumulated percentage of total envelope)



Source: Dorrucchi and Freier (2023), based on European Commission data and estimates of the Working Group on Public Finance of the European System of Central Banks. For France cash pay-outs under RRF according to Coeuré report (2021).

Notes: The solid lines refer to the foreseen absorption of RRF funds in Germany (DE), France (FR), Italy (IT) and Spain (ES) over the RRF period (2021–26). The dotted lines refer to the actual absorption by these four countries of past EU resources made available under the EU’s multiannual financial framework (MFF). The absorption rate is the amount paid to a Member State as a percentage of the total EU budget made available to that country. Year 1 is the first year of the respective programme, i.e., 2007 for the 2007–13 MFF, 2014 for the 2014–20 MFF, and 2021 for the RRF. Pre-financing under the RRF is included in Year 1. The absorption rate of the 2007–13 MFF (black dotted line) is shown as average of the four countries and includes the European Regional Development Fund (ERDF), the Cohesion Fund (CF) and the European Social Fund (ESF), while the 2014–20 MFF includes only the ERDF and the CF. Data under the 2014–20 MFF are provisional for the year 2021 (Year 8 in the Chart)

57. Remarks by Executive Vice-President Valdis Dombrovskis at the ECOFIN press conference, 21 June 2024.

58. European Parliament Research Service (EPRS), Recovery and Resilience Facility: Implementation Update, PE 764.391, June 2025. [https://www.europarl.europa.eu/RegData/etudes/IDAN/2025/764391/ECTI\\_IDA\(2025\)764391\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2025/764391/ECTI_IDA(2025)764391_EN.pdf)

Several factors contribute to the difficulties in fund absorption, among which the bureaucratic complexity mentioned above. Moreover, many large-scale infrastructure projects, which form a significant part of EU funding allocations, require extensive planning and long lead times. The shorter NGEU timeline puts additional pressure on project readiness and execution.

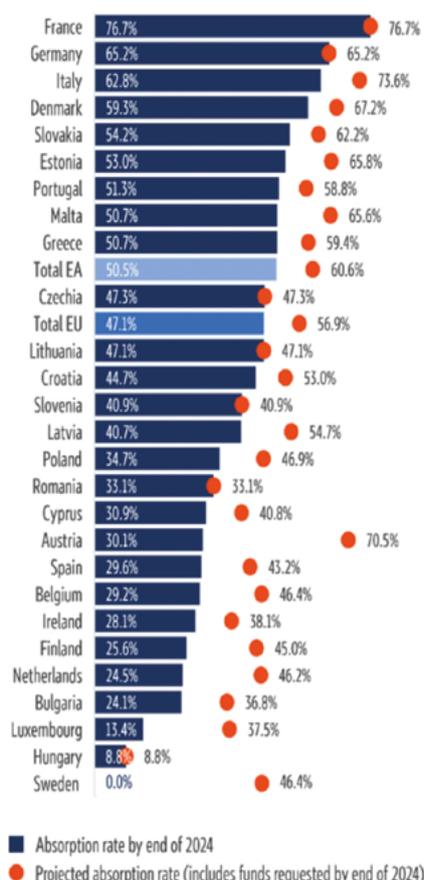
EU funding often requires co-financing from national budgets. Economic strains from the pandemic have left some Member States with limited fiscal space, making it challenging to meet these co-financing obligations.

Since such difficulties of absorption are well-known, the payment structure under the RRF Regulation allowed for pre-financing of up to 13 % of the initial allocation for Member States. This ensured that funds could be disbursed rapidly at the start of the RRF, effectively supporting the recovery following the Covid-19 crisis.

The absorption rate represents the ratio of disbursed funds to the total allocated amount. By the end of May 2025, total disbursements under the RRF had reached EUR 315 billion, corresponding to 49 % of the overall envelope. In the Euro area, the absorption rate was slightly higher, at 52.7 %. This performance reflects both the acceleration in the implementation of reforms and investments, and the impact of pre-financing<sup>59</sup>.

The highest absorption rates to date have been recorded in France (76.7 %), Germany (65.2 %), and Italy (62.8 %), reflecting steady implementation and early submission of payment requests. In contrast, the lowest absorption rates have been observed in Sweden (0 %), which has not yet received any disbursements but has submitted its first payment request, currently under evaluation by the Council<sup>60</sup>. Other countries with particularly low absorption levels include Hungary (8.8 %), due to ongoing rule of law conditionalities that block disbursements beyond the initial pre-financing, Luxembourg (13.4 %), and the Netherlands (24.5 %). Assuming that the Commission positively assesses the pending payment requests, the highest projected absorption rates will be in France (76.7 %), Italy (73.6 %), and Austria (70.5 %). Conversely, the lowest projected rates are expected in Bulgaria (36.8 %), Romania (33.1 %), Hungary (8.8 %), and the Netherlands (24.5 %).

**CHART 67.**  
Absorption rate by Member States



Source: EPRS, based on RRF Scoreboard data

59. European Commission, NextGenerationEU – The Road to 2026, COM(2025) 310 final, Strasbourg, 8 juillet 2025, PDF, 1–48, [https://commission.europa.eu/document/download/ad5f00c9-4101-41a0-9d8f-e78f06c0c7ed\\_en?filename=COM\\_2025\\_310\\_1\\_EN\\_ACT\\_part1\\_v8.pdf](https://commission.europa.eu/document/download/ad5f00c9-4101-41a0-9d8f-e78f06c0c7ed_en?filename=COM_2025_310_1_EN_ACT_part1_v8.pdf).

60. European Parliament Research Service (EPRS), Recovery and Resilience Facility: Implementation Update, PE 764.391, June 2025. [https://www.europarl.europa.eu/RegData/etudes/IDAN/2025/764391/ECT1\\_IDA\(2025\)764391\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2025/764391/ECT1_IDA(2025)764391_EN.pdf)

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Several factors contribute to the difficulties in fund absorption, among which the bureaucratic complexity mentioned above and the resulting insufficient administrative capacity in many Member States (Bulgaria, Croatia, Cyprus, Czechia, Greece, Ireland, Italy, Poland, Portugal, Romania, Slovakia, Slovenia and Spain).

Moreover, many large-scale infrastructure projects, which form a significant part of EU funding allocations, require extensive planning and long lead times. Combined with a severe underestimation of the time needed to implement measures and the shorter NGEU timeline, additional pressure on project readiness and execution is put.

EU funding often requires co-financing from national budgets. Economic strains from the pandemic have left some Member States with limited fiscal space, making it challenging to meet these co-financing obligations. Changes in external circumstances, including increased inflation, supply shortages or changes in the political context for reforms in the Member State have also hampered the absorption rates.

Finally, uncertainties regarding specific RRF implementation rules have slowed absorption rates. Even though the Commission provided technical guidance, the novel condition of the DNSH (Do No Significant Harm) principle made its implementation particularly challenging for national authorities. Additionally, differences in interpretation between the Commission and Member States on what constitutes 'satisfactory fulfilment' of milestones and targets led to delays in processing payment requests.

### ***6.3.2.3 Both at the national and EU levels, there is a shortage of skilled and efficient workforce to manage and deploy the funds, hindering the speed and effectiveness of the program's implementation***

The complexity of managing EU funds requires a workforce equipped with specialized skills in areas such as financial management, project planning, regulatory compliance, and strategic investment. Many Member States, however, face significant skill gaps in these crucial areas, which can delay project approval and fund disbursement processes.

Moreover, effective management of NGEU funds requires seamless coordination and collaboration between various levels of government and across different sectors. The shortage of a skilled workforce can impede these collaborative efforts, resulting in fragmented and inefficient fund deployment.

Attracting and retaining qualified personnel is a persistent issue. The public sector often competes with the private sector for skilled professionals, and the former may struggle to offer competitive salaries and career advancement opportunities. This can result in high turnover rates and a lack of continuity in fund management roles.

Investment in the continuous training and development of personnel responsible for managing EU funds is often inadequate. Without ongoing professional development, the workforce may struggle to keep pace with the evolving requirements and best practices associated with fund management and deployment.

### ***6.3.3 NGEU case studies: Italy has struggled with NGEU funds, while Spain has used them more efficiently***

#### ***6.3.3.1 Italy's NRRP implementation has been hampered by bureaucratic inefficiencies and a lack of skilled workforce***

Italy's initial NRRP was highly ambitious, targeting comprehensive reforms and investments across various sectors. "We are in an absolutely positive phase despite the spending difficulties that characterize our country", commented Raffaele Fitto, Minister of European Affairs responsible for the implementation of the NRRP, in July 2024<sup>61</sup>. "I will soon launch an assessment of the 69 objectives of the seventh tranche, which represents 18.5 billion euros. The significant increase in investments in public works, which in the South recorded a growth rate of over 50% during 2023, confirms that we have fully entered phase 2 of the NRRP. This phase involves the concrete anchoring of investments to shape the Italy of tomorrow."

However, the government's enthusiasm contrasts with the evidence of persistent implementation challenges. It highlighted the difficulties in launching and completing projects to meet the deadline set by Brussels for June 30, 2026<sup>62</sup>. As of December 2023, only €45.6 billion had been effectively spent, 23% of the total resources allocated to Italy. The Ministry of Transport, for instance, had used just 15% of the funds made available to it. By February 2025, spending had increased to €65.7 billion, equivalent to 33.8% of the total envelope, while Italy had already

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61. "Giorgia Meloni bâillonne la Cour des comptes italienne, trop critique", Les Échos, juillet 2024.

62. See footnote 59.

received 62.8% of its NRRP allocation<sup>63</sup>. This persistent gap between disbursement and execution highlights structural bottlenecks within Italy's public administration. The complexity of coordinating multiple reforms and investment programs across different levels of government has continued to hinder implementation<sup>64</sup>.

One of the critical areas where Italy faced issues was in the house refurbishment sector. In May 2020, the Italian government, led by Giuseppe Conte, introduced substantial tax deductions for the "sustainable" refurbishment of residential properties through the Relaunch Decree. This initiative, the Superbonus scheme, offered a 110% tax credit for work aimed at improving energy efficiency and a 90% tax credit for seismic retrofitting of facades. The measure has been immensely popular among households, with renovation work qualifying for a 110% tax credit<sup>65</sup>. While the scheme spurred construction activity and gained strong public support, it rapidly inflated costs, created speculative behavior, and enabled widespread fraud. By mid-2025, its cumulative fiscal impact had reached €215 billion, far exceeding the original estimate of €35 billion<sup>66</sup>. These deferred tax revenues are now materializing as additional public debt, putting pressure on Italy's fiscal position.

According to the European Commission's Spring 2025 Economic Forecast, Italy's debt-to-GDP ratio is expected to increase from 134.6% in 2023 to 136.7% in 2025 and 138.2% in 2026, even as the budget deficit gradually narrows from 3.4% in 2024 to 2.9% in 2026. Although this outlook is more contained than some earlier projections, it still reflects the weight of past fiscal decisions on medium-term sustainability. Maintaining access to NGEU funds and preserving eligibility for the European Central Bank's Transmission Protection Instrument (TPI) depends on sustained progress in both fiscal discipline and structural reform.

On the reform front, progress has been uneven. Some areas, such as public procurement, digital infrastructure, and judicial reform, have advanced, but others remain underdeveloped. Labour market reforms still fall short of the EU's country-specific recommendations, while investment in education and upskilling has been insufficient to meet the goals of the green and digital transitions<sup>67</sup>. OECD and CEPS analysts also warn that the temporary hiring of public sector staff, intended to support implementation, may undermine the long-term effectiveness and institutional legacy of the plan.

Professor Jean Pisani-Ferry believes that the large scale of Italy's plan is a suitable response to the country's challenges, emphasizing that Italy's debt issues are due to a lack of growth rather than fiscal irresponsibility<sup>68</sup>. He suggests that although the plan may not resolve all of Italy's structural economic weaknesses, its success will hinge on whether it can boost productivity. Pisani-Ferry argues that the outcomes of Italy's National Recovery and Resilience Plan (NRRP) will significantly influence future economic discussions within the EU. Similarly, the European Council on Foreign Relations (ECFR) views the NRRP as a pivotal chance for Italy to initiate a long-term development strategy, with its results expected to impact EU integration over the coming years.

Whether the NRRP can correct this trajectory remains uncertain, but its success – or failure – will have EU-wide implications. Italy's performance is likely to shape future debates on EU fiscal integration and the legacy of NGEU. Moreover, compliance with NRRP milestones and fiscal targets is now a key factor for eligibility under the European Central Bank's Transmission Protection Instrument (TPI). The Italian government's stated aim is to exit the EU's excessive deficit procedure by 2026, but this depends on sustained implementation, macroeconomic resilience, and renewed investor confidence.

### **6.3.3.2 As opposed to Italy, Spain has demonstrated a more efficient use of NGEU funds**

The Spanish success can be attributed to its strategic focus on high-impact projects and efficient processes. The Spanish NRRP includes major investments in green energy and digital technologies, aligning with the EU's overarching objectives. For instance, Spain has prioritized projects that not only meet immediate economic recovery needs but also lay the groundwork for long-term sustainable growth. This ability to quickly mobilize and utilize funds has set a positive example within the EU.

The PERTE projects are a key element of Spain's strategy to efficiently utilize the NGEU funds. Notable PERTE projects include:

- PERTE Chip: This project aims to bolster Spain's microelectronics and semiconductor industries with a public

63. European Parliament Research Service, National Recovery and Resilience Plans: Latest State of Play, February 2025, <https://eprthinktank.eu/2022/02/03/national-recovery-and-resilience-plans-latest-state-of-play/>.

64. European Commission, *Recovery and Resilience Scoreboard – Italy*, accessed July 2025, [https://ec.europa.eu/economy\\_finance/recovery-and-resilience-scoreboard](https://ec.europa.eu/economy_finance/recovery-and-resilience-scoreboard).

65. "Italy: is the government debt at the mercy of superbonus effects?", Natixis Research, 16 May 2024.

66. Corinex, "Italy's Superbonus and Its Impact on the Grid and Public Debt", April 2025, <https://www.corinex.com/articles/italy-superbonus-tax-credit-growth-grid-debt>.

67. OECD, *Italy – Economic Outlook*, June 2025, <https://www.oecd.org/economic-outlook/italy>.

68. "NGEU delivery - How are the Member States doing?", European Parliament, April 2024.

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investment of €12,250 million by 2027. It focuses on the entire value chain, from research and development to the manufacturing of advanced microchips, and aims to position Spain as a significant player in the global semiconductor market. In January 2025, a second funding call of €110 million was launched to support additional projects. However, the implementation has encountered challenges. The withdrawal of large-scale investment projects (e.g., by Broadcom) illustrates the structural difficulties in attracting major semiconductor players to Spain.

- PERTE ERHA (Renewable Energies, Renewable Hydrogen, and Storage): This project mobilizes around €16,370 million and focuses on several thematic areas such as biogas, wind, photovoltaic, hydrogen, and energy storage. It aims to enhance Spain's renewable energy capacity and reduce its reliance on fossil fuels. As of June 2025, Spain allocated €1.223 billion to seven hydrogen valleys across five regions, aiming to support over 2,290 MW of electrolyser capacity. However, structural delays of 2–3 years are expected in the deployment of hydrogen infrastructure, particularly in large-scale projects like H2Med, according to Enagás. These delays pose risks to meeting 2030 climate goals.
- PERTE Aerospace: This initiative plans to mobilize approximately €4,533 million between 2021 and 2025, combining public and private investments. The project targets advancements in aeronautical technologies to reduce environmental impacts and increase the efficiency of future aircraft.

However, despite its high growth in recent decades, GDP per capita in Spain is still below the EU average. Low productivity and R&D investments are the main obstacles to growth and to accelerate its convergence with the EU. Its low productivity, only slightly above that of Italy's, in both labor and capital factors, is a main vulnerability of the Spanish economy and it has not changed since Covid-19.

Indeed, from 2016 to 2024, slowing productivity gains can be observed in Spain. One of the explanations for this stagnation in labor productivity is the inefficiency of the Spanish labor market. A mismatch between labor supply and demand has a negative impact on labor productivity. In 2016, what stands out is that 20% of jobs are occupied by overqualified people and 21.3% by underqualified people. These very high figures (both are above the OECD average) are possible factors for the stagnation of productivity since production factors are not used optimally. This explanation is also combined with low geographical mobility of the labor force, a poor integration of young workers and the continuation of a strong immigration.

Finally, Spain's economic difficulties reside in its lack of investment in R&D. Spain is the country with the lowest percentage of R&D expenditure among large Eurozone countries, averaging 1.3% of GDP per year, 1.7 percentage points less than Germany (see Chart 11)

### **6.3.3.3 The awaited fiscal impacts of RRF-funded expenditures are still mostly to come as they are highly dependent on absorption rates.**

Analysis published in December 2024 from the European Central Bank highlights the critical importance of assumptions on both the absorption of RRF funds and the productivity of RRF expenditure, with absorption being particularly decisive. In the low-absorption scenario, where implementation continues at the slow pace previously observed, the output gains are halved compared with the main scenario with medium productivity. In this case, low absorption leads to governments missing much of the potential benefits of NGEU. Productivity assumptions also significantly influence the final outcomes, with the low and high productivity scenarios differing noticeably from the central case.

The economic benefits from the NGEU programme are mostly still to come, depending on how quickly its implementation catches up. Data shows that the programme has been slower to roll out than previously expected. As a result, the benefits seen so far have been relatively small. However, since a large portion of the funds is yet to be used, significant investments are expected in the coming years. If these funds are effectively absorbed and spent within the remaining timeframe, the economic impact could be nearly twice as large as what has been observed so far.

### **6.3.4 Concerns about the quality and potential fraud in the implementation of the RRF are becoming increasingly prominent**

As the fund's expiration date looms, there is growing anxiety among observers and officials that the time pressure to disburse funds could lead to inefficiencies and raise the risk of fraudulent activities. One national official highlighted the pervasive worry, stating that "observers and officials worry that time pressure, while acting as an incentive for governments to keep on schedule, could affect the quality of expenditure negatively and, in some cases, increase the risk of fraud."

This concern is particularly relevant for countries like Spain and Italy, which have historically struggled with the

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efficient absorption of EU funds. A Financial Times article from February 2024 notes that “because they have the lowest absorption rates of regular EU funds, the amount of their entitled budget that they spend, it raises questions about their capacity to spend huge amounts of additional money efficiently and safe from graft.”

The Italian experience with its tax credit scheme for building renovations illustrates these challenges. Originally projected to cost €35 billion over fifteen years, the tax incentive had already cost the government €219 billion by early April 2024<sup>69</sup>. The country allocated nearly €14 billion of its recovery funds to this initiative, which has a total cost of €100 billion. While the scheme stimulated a construction boom, its long-term benefits are questionable, and it has been marred by fraudulent activities, as reported by Italy’s tax authority.

To mitigate the risk of graft, EU countries have implemented audit systems, though these come with significant administrative burdens. The high cost of these audits has drawn criticism, with one national official remarking, “To reduce the risk of graft, all EU countries have an audit system in place, but countries lament the high administrative burden it places on implementing authorities”, notes the FT article. Another official emphasized the mismatch between the tools used and the risks managed: “This is not proportionate to the risk. There are important risks of fraud and corruption, but we must use the right tools to fight this, and here we’re using a bazooka to control things that are very restricted in scope.”

The complex and often cumbersome procedures associated with the fund’s implementation have fostered a negative sentiment among those responsible for managing it. One official described the situation as “nightmarish”, stating, “The mood is reluctantly negative towards the practical implementation of the instrument”, adding that they sometimes face “nightmarish” procedures.

These challenges have significant implications for the future of EU funding mechanisms. The ability of member states to use the Recovery and Resilience Facility effectively is seen as a crucial test for the viability of future common funding initiatives. As the article concludes, “The willingness among EU countries to repeat such an exercise relies on the ability of member states to prove the instrument has been a success.”

**To conclude this section, it is worth highlighting several important points:**

**To date, the main issue in the EU is not essentially one of financing, but of carrying out investments that could consequently give rise to a need for financing.**

With €370 bn of excess savings in 2023, Europe has significant financial resources to engage in the green and digital transitions but lacks adequate investment projects despite the different EU plans that have been launched over the past years. In other words, the additional financing needs assumed according to the Commission’s calculations for additional investments in the climate transition (+€350 m/year) and digitalization (+€150 bn/year), have not materialized, as investments have remained stagnant.

Concerning the ecological transition, all public and private reports confirm that the EU is still a long way from the levels of investment required to meet commitments (FF55). Roughly speaking, to successfully achieve the transition, the investment efforts should be multiplied by 2 to 3. For this to work, a positive investment-financing feedback loop would have to be triggered. This is what the US has achieved with the IRA. What is puzzling is that they have even attracted European companies to their territory – all the more since energy prices are cheaper on the other side of the Atlantic.

The multiplication of European investment plans over the past years underlines the EU’s standardization effort. In addition, the RRF is a well-designed innovative performance-based instrument that combines reforms and investments, emphasizing the effort of the Commission to get results. Nonetheless, external factors tend to limit the speed and the impact of the program. The solidarity and ambition demonstrated in NGEU are undermined by the Recovery and Resilience Plan being fragmented along national lines. Indeed, 27 national plans have been submitted to the Commission with no enhanced cross-border dimension, even though Member States have similar needs regarding the digital and green transitions.

Furthermore, the RRF offers one more advantage to Member States: expenditure financed by RRF grants does not add to national debt and deficits and thus provides important support to high-quality investments and reforms without subtracting from the available fiscal space.

**When qualitatively comparing NGEU and the American IRA (2022-24), one thing is striking: the American funds are easily and quickly accessible and work as an incentive to achieve the adopted objectives, whereas national and European bureaucracies make the process of spending NGEU funds cumbersome and rely heavily on prohibitive rules.** In that respect, some experts also pointed out to the fact that the EU does not have the fiscal

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69. “Italy: is the government debt at the mercy of superbonus effects?”, Natixis Research, 16 May 2024.

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means of the US, and therefore needs to rely much more on the approach of ETS combined with a well-designed subsidy/industrial support.

The speed of deployment of the IRA and the whopping number of companies that have announced investments on American soil testify to the success and the simplicity of the IRA one year in. By contrast, the deployment of NGEU has been slower, impeded by the lack of skilled workforce and the burden of bureaucracy.

Furthermore, NGEU does not reap the full benefits of the European single market. This is less attractive for investors than the vast and unified American single market which offers significant opportunities and economies of scale. As a result, only a third has been spent halfway through the lifetime of the project. Additionally, some European companies have been attracted by the IRA and have thus shifted investment to the US, including Total Energies, MBW and Northvolt.

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## Conclusion

### For a more dynamic economy in the Eurozone

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The euro has weathered almost a quarter century of crises and storms without sinking. But the euro's successes cannot mask its vulnerabilities.

Monetary union alone does not create economic convergence. This Scoreboard underlines that economic disparities and differences in living standards between Euro area countries have widened considerably since the launch of the euro. As we have observed, many Member States have relaxed their macroeconomic discipline over the past twenty-five years, and those who played the fiscal vigilance card have emerged as the winners. The Covid-19 crisis and the energy crisis, exacerbated by the war in Ukraine, have exacerbated these existing heterogeneities among EU member states.

Over the past two decades, several EU Member States have opted for an economic model that is detrimental to the supply-side of the economy. This economic policy stance has contributed to a loss of economic dynamism in Europe, which now finds itself well behind the United States in terms of growth, productivity, and investment. Indeed, productivity gains have faded in Europe since the 2008 Global Financial Crisis, as most Member States have systematically focused on stimulating private demand through public spending. Indeed, fiscal policies have most often sought to preserve household consumption at the expense of productive investment. The ECB's permanent accommodative monetary policy until 2022 – in the form of negative interest rates and asset purchase programs that have pushed its balance sheet up to 70% of EA GDP – has facilitated the financing of these public deficits, discouraged structural reforms, and massively favoured the expansion of debt not to finance productive investment as a priority, but speculative and real estate purchases (without creating new value).

As long as it is not sufficiently understood, especially in the highly indebted countries, that excessive debt is a source of under-competitiveness, the economic situation in these countries will continue to deteriorate and it will be all the more difficult to make progress in the construction of an economic and financial Europe. Indeed, the intensity of fiscal and economic divergences between EU countries makes it more difficult to define a common interest in Europe, encourages a policy of "every man for himself" and creates a climate of mistrust between Member States that hinders any progress in terms of public and private risk sharing and weakens the Euro area.

A monetary union can only work if a minimum of fiscal discipline is guaranteed by all states, which has not been the case for 25 years. Ultimately, the fate of the euro will depend on the political will to achieve genuine cooperation within the zone. If the fiscal and economic drift in the Eurozone continues, the 'virtuous' countries will end up paying the price. That would be the definition of an uncooperative game, in which most players try to evade their obligations by passing on the costs to those who respect them. We must therefore take control of the Union's destiny and not let it drift. If we do, the logical consequence could well be another inevitable crisis in the Eurozone.

It is economic growth that ultimately solves debt problems. The only way to promote robust and sustainable growth in the EU is to implement fiscal discipline and ambitious supply-side structural reforms in all member states. "This means fostering competition, increasing labour and product market flexibility and promoting innovation. It also means a judicious use of scarce public resources to support the economy's adjustment to the new realities"<sup>70</sup> Any demand-driven stimulus financed by increasing deficits and taxes in highly indebted countries can only harm business competitiveness.

If Europe and the Eurozone are to correct their growth disadvantage relative to the United States and China, a considerable investment effort in research and development, in industrial equipment, in decarbonization, in digital technology, in improving equity financing, the education system and the skills of the population, in promoting selective immigration of "people" who can occupy sufficiently skilled jobs, will therefore be necessary. Furthermore, scale matters more than ever and the completion of the single market must be a permanent objective progressively based on an EU industrial policy.

We must understand that our future – non-inflationary – depends on the elasticity of supply and therefore on sufficient investment and a well-trained workforce. Anything that encourages savings to be channeled into liquid assets at the expense of long-term capital investment must be opposed.

As explained by Jacques de Larosière<sup>71</sup>, "One day we will have to understand that the narrowing of the output gap between potential and observed growth cannot be reduced to the mere fight against the restoration of production

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70. BIS, Annual Economic Report, June 2024.

71. J. de Larosière, "Putting an end to the reign of financial illusion", Odile Jacob, September 2022.

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chains, but requires the activation of all the sources that ultimately constitute our eco system: productive investment – penalized for 20 years by lasting very low interest rates –, the development of training, the recovery of the share of wages in income, the revitalization of competition... To revive productive investment, refrain from administratively setting ("or guiding" the market) long term interest rates and accept to let the market remunerate savings in the medium and long term according to supply and demand without which there can be neither productive investment nor productivity gains."

Monetary policy can erase spread differentials but cannot address structural issues, notably the lack of confidence and the persistence of structural discrepancies, which explains the limited capital flows from North to South<sup>72</sup> Europe benefits from a large pool of savings which could contribute to financing long-term investments, especially those related to the green and digital transition, provided that such savings are not taxed but remunerated.

However, these savings leave the EU and finance the rest of the world (in particular the United States). Indeed, since the EU sovereign debt crisis (2011-2012), Member States with excess savings (Germany and the Netherlands in particular) no longer finance investment projects in countries with lower GDP per capita (Spain, Italy, Portugal, Greece). This is due in particular to the interest rate differential between the US and Europe, the higher returns on US equity markets, and, more generally, to the capital invested compared with the EU (risk-taking is more rewarded in the US than in Europe).

These limited cross-border capital flows in the Euro area highlight the lack of a genuine Banking Union and integrated financial markets as well as persistent doubts of some investors in Northern Europe about the solvency of states and companies in other countries.

Consequently, the Eurozone must embark on the right course: more fiscal responsibility and more supply reforms geared to increase productivity<sup>73</sup>. It must fight persistent inflation, as well as take the necessary steps to complete the Banking Union and implement the Capital Market Union. But these steps are only conceivable if sufficient discipline is applied to reverse the trend of ever-growing economic heterogeneity among member states.

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Ultimately, the paradox of the Euro is that a single currency and national economic policies coexist without a strong cement of coordination. Ultra-accommodative and asymmetric monetary policies have been used to overcome the contradictions of this paradox, but the price of this permanent rescue is costly. To make the euro sustainable, it is essential to ensure the convergence of fiscal and structural policies. To be viable, the Eurozone needs:

- **National budgets under control in all parts of the Union.** No responsible state can be expected to finance durably current public deficits generated by other Eurozone members of the Union that do not follow the rules of the Union. The future – and notably the solution to market fragmentation – depends on a consolidation of present weak fiscal positions (primary surpluses) and a shift towards quality of expenditure and investment. We do not need more redistributive expenses. We must rein them in and allow adequate space for public investment.

We have to recognise that the shift towards more investment will require a substantial political effort; at present, public investment accounts for only about 4% of GDP, while current – unproductive – expenditure accounts for almost all public spending. As much as we need to tackle unproductive spending, we can encourage the financing of infrastructure spending (including research). The implementation of the revised Stability and Growth Pact is of paramount importance in this respect. Unfortunately, the agreement reached by the Ecofin Council in December states that countries subject to the excessive deficit procedure (total public deficit above 3% of GDP) will be exempted from the rule requiring them to reduce their public debt by an average of 1% per year until their deficit falls below 3%, which is not the best way to encourage the worst performers to reduce their debt to GDP ratio!

The case of Portugal shows that a healthy economy goes hand in hand with sound public finances. After receiving financial assistance following the sovereign debt crisis, Portugal undertook ambitious reforms. These measures have allowed the Portuguese economy to recover and become one of the best performers in the Euro area in terms of growth, productivity, competitiveness and fiscal consolidation.

Despite persistent structural weaknesses (rigidities in the labour market, complexity and lack of transparency in the tax system, lack of human capital), the Portuguese case demonstrates to all indebted countries that a healthy economy depends on sound public finances.

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72. P. Herzog, "Un nouveau récit pour l'Europe", Les Entretiens européens, 2024.

73. R. Aron, "L'Unité économique de l'Europe", La Revue Libre, n°2, October 1952.

- **Domestic structural measures aimed at enhancing business dynamism and increasing growth potential should be encouraged and monitored.** We have seen that the economic and financial model based on monetary abundance, the under-remuneration (taxation) of savings, the financialization in response to structural insufficiencies, the systematic short-termism, and the increase in the – essentially speculative – valuation of financial assets, does not meet the needs of our society. These needs require long-term investment, a response to climate and digital challenges, and an adequate return on savings and wages. Without such a reorientation of our policies, it seems difficult to achieve the “common good” and to correct the major current imbalances. Raising potential growth requires increasing in the productivity of the system, which requires more competition and long-term investment.
- **To curb persistent inflation.** The most pressing monetary policy task is to restore low and stable inflation and to sustainably rebuild monetary buffers. According to the BIS Annual Report of June 2024, key interest rates should remain high for as long as necessary to restore price stability. “A premature easing could reignite inflation pressures and force a costly policy reversal – all the costlier because credibility would be undermined.” The reappearance of spreads should not dominate the decision-making process. The history of high inflation episodes tells us that if central banks loosen too quickly before the problem is really addressed, then we get another inflation wave, and then another wave of interest rate hikes, which would be a worse scenario. Last but not least, it is necessary to refrain from fixing administratively (“or directing” the market) long-term interest rates and to accept that the market should reward medium – and long-term savings – according to supply and demand – without which there can be no productive investment or productivity gains.
- **An active banking and integrated capital market in Europe.**

Finally, it's high time to return to a more pragmatic conception of Europe, by thinking about strengthening it, giving it strong groups worldwide, not neglecting the community preference advocated by Maurice Allais in his day, and working for “projects in Europe” and not for “a greater Europe”.

Most of the necessary remedies are within the power of the Member States and the European Union to implement: fiscal discipline, expansion of SMEs, CMU, BU, design of selective Community preference. But this requires political will, leadership, impeccable intellectual support, with a sensible supporting EU programme. In sum, members of the Monetary Union must act together to make it work, and not behave as passive individual bystanders hoping that things will turn out fine. Ultimately, the fate of the euro will depend on the political will to achieve genuine cooperation within the Euro area.

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We need to be very careful about our economic choices in the circumstances that Europe is going through today: French budgetary and political crisis, Germany's economic weakening, demographic decline, growing inequalities, increasing nationalism, weakening democracies, disrupted transatlantic relations, etc. The economic performance of the various countries is very heterogeneous, the strength of the states is very uneven and there is little cooperation.

One temptation to solve the economic problems of the EU countries is to complete Europe by giving it the power of a state. According to this line of thinking, a fundamental change would have to be made: the transition to a single state in all matters of economic, financial and even military sovereignty.

It's an old tendency to take refuge in this doctrine of European unification! Ah, if there were only one state, only one financial system, only one market, only one army, how much happier we would be!

But this idea of turning the Union into a state has never been realized. Why not?

Because the states (and their citizens) do not want it. At their request, Europe was not built on the federal principle after the Second World War. The construction of Europe was based on the sovereignty of the nation states, and the progress made in Europe, even if it had a federal dimension and logic, was based on compromises between the divergent interests of the member states.

As P. Herzog points out: “Today our nations want a Union that protects them, but very few support the idea of a political community.” The European Union has been a great political innovation in creating understanding between states, but it has done so without sharing sovereignty and by making competition a veritable sacrament to the detriment of public goods, for which responsibility is being returned to the nation states.”

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Promoting a single European state means forgetting that we now have two economic and financial Europes:

On the one hand, there is the relative equilibrium of the northern states, which respect the minimum discipline required by a monetary union. On the other hand, there is the massive imbalance of a number of over-indebted states, whose budgets have no room for manoeuvre and which are contributing to the weakening of Europe.

It's like water and oil: they don't mix.

The debt-ridden countries of the South may be tempted to take refuge in the illusion that Europe will take care of everything. But realism does not favour such a solution. We must be aware that a number of European countries have now overstepped all the boundaries and yellow lines of the economic discipline they have chosen and ratified.

Those who advocate taking refuge in a rescuing European state do not take into account the need for the over-indebted states to return to the normal level that has been jointly decided. This blindness does not bode well. The failure to highlight the importance of the problem of the massive heterogeneity of fiscal situations is worrying. This blindness deprives the idea of a unified budget, which by some miracle would have eradicated untenable and unsustainable national situations, of a great deal of credibility.

It is time to correct this error and look at things as they are: what is sustainable is sustainable; what is unsustainable is unsustainable. To this end, the European Commission should encourage over-indebted countries to put their public finances in order. Unfortunately, the particular interests of individual states prevail.

We will never eliminate the excesses of debt by calling for fiscal and financial unity. The only way to move towards financial union is to repair what is unsustainable, because, as they said in the 18th century, "you should never put money into a bad fund."

The weakness of the argument criticised above is that no one asks the central question: who will pay? The huge European loans envisaged by the proponents of the single finance thesis require a guarantee. The market will ask what procedures will reassure lenders. What will happen if certain states are unable to contribute to the repayment of a common debt? Will their obligations be shifted onto the stronger shoulders of states that have performed better from a budgetary point of view?

The problem of the guarantee is never mentioned in the reports calling for fiscal union, which is quite inconceivable.

Moreover, the claim that the fiscal rules have become "obsolete" and that breaking or changing the thermometer (to the extent that military expenditure would be excluded from the calculation of the public deficit in relation to GDP) would solve the problems would only aggravate the situation of the public finances of the most indebted countries and weaken the euro.

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One of the clearest thinkers of our time, Raymond Aron, has shown us the way: "Internal consolidation is a prerequisite for international integration."

Consequently, all the Member States must work together to improve the economic level of Europe as a whole, in other words, they must start by respecting the budgetary and economic commitments they have made in a spirit of solidarity.

Can we indefinitely consider as acceptable and credible a whole whose founding rule (a minimum of budgetary discipline must be respected) is violated by a number of Member States? We must stop believing that the permanent violation of budgetary commitments ratified by national parliaments is a solution. The law prosecutes individuals who break the law, but when it comes to the state, the same principles should apply.

The truth is simple. If we want to revive the European economy, there are not several methods, but only one: work more and invest more. It is these two weaknesses that explain Europe's economic decline.

Instead of calling for illusory European funding and continuing with easy monetary and budgetary policies, we need to start rolling up our sleeves: get our public finances in order and get back on the road to economic convergence in Europe. And move from an economy based on the permanent stimulation of domestic demand to one in which productive investment stimulates supply.

What is certain is that we must ensure that the return on savings in the Euro area is at least equal to that in the United States and that a climate of confidence is created to encourage individual initiative. In this respect, the current interest rate differential between Europe and the United States is glaring and needs to be corrected.

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The problem is not playing with numbers. It's about tackling the underlying problem. It's not easy money that will solve everything, but productive investment, which is the basis of future growth. That's what we need to encourage. And not discouraged by the burden of taxation (due to accumulated budget deficits and public debt) and abusive regulation.

Advocates of easy European money admit that "Europeans are poorer than Americans but save twice as much" But we need to draw the right conclusion from this observation: keeping interest rates in the Eurozone much lower than in the United States will certainly not encourage long-term saving in Europe. On the contrary. Experience shows that artificially and permanently low interest rates discourage productive investment and prevent governments from undertaking structural reforms.

Every effort must therefore be made to improve the profitability of companies and their equity financing so that the return on capital in our continent is at least equal to that in the United States.

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Notes

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