MEGA

'Super Mario' Raises Alarm over Sluggish EU Economy

MEGA: Make Europe Great Again.

Mario Draghi knows how to do that. Yesterday, the former president of the European Central Bank (ECB) unveiled his report on the Old World's many ailments and the cures he prescribes. Mr Draghi presented the study in Brussels to European Commission president Ursula von der Leyen. The commission manages the day-to-day affairs of the European Union and serves as its executive branch.

Mrs Von der Leyen had asked Mr Draghi to analyse the causes of Europe's lacklustre economic growth and suggest ways to address the issues. Whilst at the helm of the ECB, Mr Draghi successfully managed to navigate both the banking and debt crises, rescuing the euro in the process. When speculators and short sellers ganged up on the currency, he reminded them who's boss by bluntly stating that the bank would do 'whatever it takes' to defend the euro. No private investor or fund can possibly hope to financially outgun the ECB.

With the now legendary phrase, Mr Draghi scared all comers away, reaffirmed the primacy of his bank, and calmed the currency market. No-one has dared challenge the ECB since. The affable Italian - aka Super Mario - brought a similar resolve to his most recent assignment.

Mr Draghi dryly observes that the world in which Europe thrived no longer exists: the Russian war against in Ukraine requires the continent to urgently (and vastly) increase defence outlays whilst the war also abruptly ended the era of cheap energy.

European business pay up to five times more to meet their energy needs than competitors do in the US or China. This particularly affects the basic industries that form the backbone of any economy such as steel works, aluminium smelters, chemical plants, and cement mills.

Productivity Gap

However, the high cost of energy is a fairly recent phenomenon and, as such, does not help explain the widening productivity gap between the United States and Europe which has persisted for much longer. Mr Draghi points to market fragmentation as one of the main causes of low productivity growth in Europe. Rigid industrial structures that conspire against both consolidation and innovation are bear blame.

In an interesting and illustrative exercise in statistics, Mr Draghi stripped big tech out of the US economy and again compared several performance parameters. He found that Europe could hold its own against the US almost effortlessly as soon as big tech was left out of the equation. But, of course, it isn't and Europe must find ways to deal with the near-hegemony enjoyed by US tech behemoths.

Mr Draghi emphasises, rather superfluously, that Europe has 'definitely' lost out to the US on big tech, not for a lack of talent or creativity but because of a startup environment strewn with obstacles, including inflexible regulation and a dearth of venture capital.

Notwithstanding the advance of European integration, still unmatched anywhere in the world, the EU internal market remains compartmentalised construct divided along national borders. This impedes the economies of scale necessary to drive growth up and costs down - and encourage innovation.

Shopping for Guns

The most glaring example provided in the report concerns the sourcing of Europe's military hardware of which fully eighty percent is bought from US suppliers. Moreover, procurement is not coordinated within the union but is conducted haphazardly. Each of the EU's 27 member states shops for its own equipment with hardly a thought spared for compatibility or interoperability. The resulting mishmash of systems not only decreases effectiveness of national and collective defence, but also increases costs.

Mr Draghi notes that whilst European defence contractors produce some of the world's most advanced weapon systems, the sector's growth is hampered by both its reduced scale and the reluctance of financial institutions, including banks and pension funds, to invest for 'ethical reasons'. The Italian recommends speeding up the implementation of EU programs set up to streamline military purchases and give preference to Made in Europe kit.

Competition at Home and Abroad

The report also recommends a more proactive (read: protective) approach to clean energy. Mr Draghi notes that China dominates the field thanks to state subsidies whilst the US shields its domestic market from foreign competition. He sees no reason why Europe shouldn't take a similar attitude with its own Net Zero Industries Act and concludes that the EU would be wise to leverage local tech knowhow and institute clear rules regarding the participation of outside actors.

Mr Draghi's entire report reads like an appeal for the adoption of a more aggressive industrial policy such as those pursued by China and the US. In particular, he pleads for a relaxation of EU competition policy which threatens to become 'a barrier to Europe's goals'. The European Commission has blocked several large mergers such as Siemens' proposed acquisition Alstom, the French manufacturer of rolling stock and railway (and subway) signalling systems.

In 2019, Commissioner Margrethe Vestager, in charge of competition policy, blocked the merger which both companies considered of vital importance to ward off Chinese challengers. However, Mrs Vestager ruled that the combined company would have enjoyed monopoly powers in Europe, harming the interests of consumer.

Also in 2019, Mrs Vestager stopped the merger between Tata Steel and ThyssenKrupp alleging that the combined company would not face meaningful competition and arguing that its specialised products - including laminated, coated and galvanised steel - are not easily obtained from outside the union.

Such a strict interpretation of the EU's competition policy works against the consolidation of industry and the emergence of European 'champions'.

On the eve of the presentation of Mr Draghi's report, Volkswagen announced that it may have to shutter one or more assembly plants in Germany. That would be a first in the company's 87-year history. Volkswagen is the second-largest vehicle manufacturer in the world, after Toyota, shipping well over nine million cars in 2023.

Das Auto Troubled

Volkswagen CEO Thomas Schäfer explained that the company faces significant headwinds: "the roof is on fire and our survival is at stake." The company suffers from high energy and labour costs. In Germany its workers earn an average of €62 per hour whereas in neighbouring Czechia hourly pay at assembly plants comes in at a third of that. Volkswagen saw its profit margins shrink to barely two percent even after several rounds of spending cuts.

However, the powerful IG Metall labour union disagrees and points to repeated executive mishaps such as failing to spot the trend towards hybrid vehicles. Volkswagen also suffers a lag in automotive software development and was hurt by the marketing debacle surrounding the all-electric ID3 and ID4 models which were supposed to fill the shoes of the Volkswagen Golf. That was the company's best-selling model ever with more than thirty million units shipped worldwide - about nine million more than the iconic Beetle.

In common with other European industrial giants, Volkswagen faces stiff competition from Chinese manufacturers who have been inundating the market with under-priced, yet over-engineered, electric vehicles. Last month, the European Commission slapped a 36% import tariff on Chinese electric car imports. A reduced levy of 9% is available to manufacturers willing to grant access to their books so that the commission may assess the level of state support received.

Do-or-Agonise

Whilst denying that his report signals a do-or-die moment for the continent, Mr Draghi warns that a failure to meet the challenges he pinpointed will inevitably lead to an 'agonising' descend into irrelevance, if not oblivion, with the attendant reduction in living standards.

The report concludes with a bang of note: to implement its recommendations and Make Europe Great Again requires investments to the tune of some €800 billion annually. Though a significant contribution from industry may be expected, the EU will be on the hook for hundreds of billions. Such sums can only be financed through bonds issues which is a big no-no for Germany and The Netherlands.

Not only will the EU need vast sums of cash; it also needs more power. A further outsourcing of sovereign prerogatives to Brussels is called for to finish the job of creating a true single and deeply integrated internal market. Both exhortations are not only politically sensitive (mind the understatement) but also come at a most inconvenient moment when several EU member states battle rising nationalist demons in various guises.

Mrs Von der Leyen said that Mr Draghi's report will help her draft the policy guidelines for the new team of commissioners she is expected to present later this week.