# NATIONAL RECOVERY AND RESILIENCE PLANS

SOCIAL EUROPE DOSSIER

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#### **PREFACE**

#### ANDREW WATT

When the pandemic hit in the spring of 2020, not only were individual European Union member states quick to react, but the EU as a whole swiftly changed gear. Fiscal and state-aid rules were suspended and substantial fiscal and monetary-policy measures deployed.

But it was clear that this was not enough to undergird recovery and that a medium-term support programme was needed. Helped by the perception of the coronavirus as a common shock, in July 2020 policy-makers launched NextGenerationEU. Its cornerstone, the Recovery and Resilience Facility (RRF), was agreed at the end of the year. To gain access to the more than €300 billion in grants and up to €360 billion in loans available, member states had to submit plans detailing how they would spend their allocation, recognising that at least 37 per cent of expenditure had to be climate-related with at least 20 per cent promoting digitalisation.

In the summer of 2021 Social Europe and the Macroeconomic Policy Institute (IMK) of the Hans-Böckler Foundation, with the support of finance from the latter, launched a series of articles to

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assess various aspects of this process. The ten articles in the series are brought together in this dossier.

While taking different angles, an overall picture emerges of the RRF at its current stage of development. The RRF marks an important step forward in European integration and a marked change, and improvement, from the response to the eurozone crisis. It anchors the principle of common borrowing and debt service in support of national economic-policy efforts under a loose policy co-ordination. It is highly redistributive. It creates common safe assets which will increase financial resilience.

Yet it is also limited. The facility is conceived as a one-off, not a permanent fiscal capacity, and it does not permit investment in genuinely European public goods.

There has been much talk of a 'Hamiltonian moment' for the EU —on the model of the debt-federalising initiative of the first United States Treasury secretary, Alexander Hamilton. This might yet come, if a fund on the same principles as the RRF were to be instituted as a permanent facility, enabling member states to finance public-investment projects approved by their peers and the EU to shoulder projects of strategic union-wide interest.

#### The ten contributions

Elizabeth Dirth and co-authors critically assess 13 national RRF plans. They measure performance against goals of 'just transition' and achieving decarbonisation and find substantial differences between countries, with considerable under-performance in some cases.

Michaela Holl and Claudio Baccianti focus on the key decarbonisation objective and the relationship between the RRF and the European Green Deal. Along with positive reform/investment projects they discuss ambiguities in initiatives in some national plans expanding hydrogen capacity will not help with dearbonisation unless renewable electricity generation is hugely expanded, for example. The main issue, though, is that long-term investment is needed and member states will be on their own after 2026 unless other facilities are created.

Hartmut Hirsch-Kreinsen focuses on digitalisation. Research shows that a purely technological approach to boosting digitalisation often results in failure and that conducive institutional and organisational environments are required, requiring reform in parallel. The RRF addresses this at least indirectly, via the funding of education and training to support digital skills.

Margit Schratzenstaller-Altzinger argues that a fiscal capacity that would enable Europe to address current and future challenges requires substantial changes to the EU budget. Not only must the next medium-term budget, from 2027, be reprioritised but it is vital that the EU gives itself new 'own resources'. She discusses some of the options for what are in effect European taxes, proposals for which are at different stages.

Rebecca Christie, Grégory Claeys and Pauline Weil find that the European Commission has been very successful in setting up the institutional infrastructure needed to become a major issuer of sovereign bonds. Early bond auctions met eager demand from investors and interest-rate spreads over German Bunds have been low, so that borrowing under the RRF has been attractive for high-interest member states. Only a permanent fund, though, will create a permanent stock of liquid European assets.

Bart Vanhercke and Amy Verdun examine the extent to which social actors have been incorporated into the drafting of the national RRF plans and thus able to exert influence over the reform and investment agendas. Thanks to the European Parliament, member states were obliged to report on stakeholder involvement. In practice, however, results have been patchy: under the severe time pressure to compile the reports consultations were rather formal exercises in most cases.

Katharina Weber, Maximilian Zangl and Mario Holzner take as a starting point the constraint that the RRF only provides finance for PREFACE ix

national projects. They show that pan-EU projects could make a major contribution to achieving the goal of decarbonisation, homing in on a high-speed rail project as part of a European Silk Road.

Two contributions look specifically at eastern Europe. Imre Szabo notes that previous cohesion programmes have been successful in improving the physical capital stock in countries of recent accession but have neglected human capital. Increasingly this is a constraint. Focusing on Hungary, he sees signs of a change in approach under the RRF towards improving wages and working conditions in key sectors such as health.

Péter Bucksky also scrutinises Hungary. Approval of the national plan is still at time of writing held up by rule-of-law concerns, and the author reviews evidence that EU money made available to Hungary under cohesion-fund programmes has not been spent efficiently and has encouraged rent-seeking by privileged companies.

In a concluding article I attempt an overall assessment of the RRF after one and a half years of operation. The facility marks an important step forward in European integration: it is a large-scale fund, financed out of common borrowing, distributing resources to member states according to need, to enable agreed investment projects to go ahead.

A genuinely Hamiltonian moment for the EU, though, requires a permanent facility constructed on RRF principles, generating a permanent stock of safe, liquid financial assets. A path towards this might come via reform of economic governance, where an RRF-style fund could solve the thorny problem of changing the eurozone fiscal rules so that they do not curtail public investment.

# ONE A FUTURE-FIT RECOVERY?

#### ELIZABETH DIRTH, JONATHAN BARTH, JAKOB HAFELE, CHRISTINY MILLER AND LYDIA CORINEK

More than a year into a global pandemic which has turned the *status quo* on its head, there is recognition around the world that the recovery process should focus on moving forward rather than a return to 'business as usual'. The twin public-health and economic crises stemming from the pandemic have highlighted and exacerbated inequalities in our societies and revealed the shortcomings in how our economies are run.

At the same time, climate change, biodiversity loss and political polarisation within the European Union pose additional challenges to our social and economic systems. As the EU attempts to address these new challenges, the scale of member states' collective response must be measured against the potential for rapid and large-scale transformation.

The €672.5 billion Recovery and Resilience Facility (RRF) is a once-in-a-generation opportunity for member states—not only to tackle the public-health crisis but also to pursue the transition to a low-carbon, resource-light economy, restore nature and biodiversity and create high social welfare and cohesion.

To make a real, enduring difference, for the planet and the people

who inhabit it, member states must look beyond solving the short-term problems of today to design policies and measures which create systemic change for sustainable and resilient societies, able to adapt to or mitigate future crises. And while these solutions need to benefit people and economies, they must also protect nature and biodiversity, as climate change and biodiversity loss are threatening the essential foundations of life.

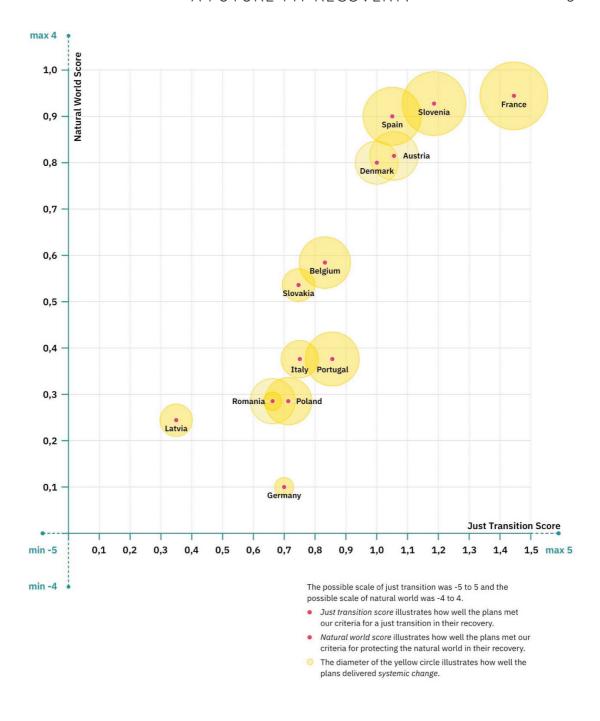
#### Unique analysis

To receive funding from the RRF, member states were required to submit their own National Recovery and Resilience Plans (NRRPs) to the European Commission. ZOE Institute, in cooperation with the New Economics Foundation, developed a Recovery Index for Transformative Change (RITC), to assess the adequacy of these plans to contribute to the necessary transformation of society.

Using the index, ZOE Institute assessed 13 NRRPs (see figure), evaluating the potential of—and risks associated with—the investments and reforms envisaged, against the criteria of a natural world, a just transition and systemic change. This analysis is unique as it not only explores where the money is going but also how it is to be invested. We examined specifically whether the investments would enable a fundamental shift towards a regenerative, distributive and resilient economy, rather than consolidating the status quo.

It's clear from this analysis that member states are largely missing the opportunity to connect new reforms with investments to lead Europe towards a climate-neutral and socially-balanced future. Much more should be made of the recovery to build an economy that protects the climate and delivers social justice.

#### Scores of member states on the RITC



#### Do no harm

A cornerstone of our analysis has been an assessment of the application of the 'do no significant harm' (DNSH) principle, adopted by the commission to ensure member states evaluated the environmental impact of all measures included in the NRRPs. This represents a significant step forward in the decades-long work to integrate environmental impacts into economic and social policy in pursuit of

coherence on sustainable development. Utilised well, it is an essential tool for realising climate and biodiversity objectives.

In most cases, however, member states missed this opportunity and did not apply the DNSH principle in a rigorous way—often overlooking the risks to biodiversity in particular. For example, the Portuguese plan foresees an expansion of the road network, which entails direct emissions not only from combustion engines but also from tyres, brakes and the road surface, while the resulting damage to biodiversity is not sufficiently taken into account.

There are three important blind spots across the plans' DNSH assessments: the impact of infrastructure projects on biodiversity and nature, the increased energy consumption the digital transition will create and the need to embed measures related to material use into a circular economy. For example, within the widespread investments envisaged for the purchase of new digital equipment for education and public administration, reuse and appropriate procurement policies are lacking.

#### Social cohesion

Social cohesion needs also to be prioritised as part of an overarching vision for the future. The nature of the recovery will depend on whether the investments and reforms made today support the green and just transition Europe needs to realise. Despite far-reaching efforts, there remain gaps between the ambition and what is planned by member states.

Protecting biodiversity, while recognising its essential role in the economy, and building local resilience, by addressing economic disparities in a targeted way, are two key weak points of the plans. Particularly concerning is that most lack explicit consideration of the regions and people left behind by the combined impact of digitalisation and globalisation.

A recent report from Vivid Economics shows that nature-based solutions offer a unique avenue to deliver environmental, social and

economic objectives together. Yet, this is largely absent from the NRRPs, with only 1 per cent of funding going towards such measures.

#### Not enough

The funding from the RRF comes at a crucial time, but it is not enough to reach our critical aims: to deliver systemic transformation, to limit global heating to 1.5C, to realise a just transition or to achieve the United Nations Sustainable Development Goals. An estimated  $\in$ 349 billion to  $\in$ 883 billion in additional investments is needed annually just to realise the climate and environmental targets set by the commission.

The commission itself estimated a yearly investment need of €470 billion in the context of the old 2030 climate and environmental targets, which included a CO<sub>2</sub>-emissions reduction of 45 per cent (now 55). Other consultancies and researchers have come to similar conclusions.

With the NRRPs, however, only 37 per cent of the €672.5 billion over two and a half years is required to be invested in the green economy, amounting to roughly €100 billion yearly. Nor does this include measures essential for realising a just transition. It is clear this level of investment is insufficient for a systemic transformation of our societies and economies.

#### Building a future Europe

A crucial stepping-stone is to reframe the RRF investment as a foundation for building the future of Europe. The EU and member states can learn from the progress achieved, for example by applying the DNSH assessment to all future public investment. A multi-criteria analysis, using the DNSH principle, which connected social issues to environmental and social sustainability more deeply, could have a very strong and positive impact. Any

future investment mechanisms need to be scrutinised in such a rigorous way.

Operationalisation and implementation of the plans is also critical: the devil is in the details. Many measures can be carried out in ways that either increase negative side-effects or increase policy coherence and co-benefits—it is essential that member states achieve the latter. Their monitoring and evaluation frameworks and the scrutiny of the commission must adopt a systemic perspective, which takes into consideration the interconnections among policy areas. A transformation to sustainable prosperity cannot wait until after the recovery. It must start with it, run parallel to it, and go deeper to address the roots of the challenges we face.

ELIZABETH DIRTH IS senior policy consultant and project manager at ZOE, the Institute for Future-fit Economies, with a background in sustainable development and environmental governance and ten years of experience working to tackle climate change.

Jonathan Barth is a co-founder and managing director of ZOE, the Institute for Future-fit Economies, with expertise on EU policy networks and processes, co-creative methods for policy design and post-growth economics.

Christiny Miller is a junior policy consultant at ZOE, with a background in international and sustainable development.

Lydia Korinek is a junior policy consultant at ZOE, with a background in international political economy and EU systems and policies.

## TWO BUILDING BACK GREENER?

#### MICHAELA HOLL AND CLAUDIO BACCIANTI

Since 2019, the European Green Deal has been 'Europe's new growth strategy'. Last year, the European Climate Law set targets—a reduction in greenhouse-gases emissions across the European Union of at least 55 per cent on 1990 levels by 2030 and 'net zero' by 2050—which are more in line with the 2015 Paris Agreement. EU institutions and national governments are now legally bound by them.

Fully decarbonising the economy cannot be achieved in under three decades with minor policy adjustments and the Green Deal launches a process of reorienting how we produce and consume. Difficult negotiations on legislative proposals lie ahead—including on the phasing out of combustion-engine vehicles in Europe and the role of gas in the transition.

According to *Agora Energiewende*, reaching the 2030 goals implies that coal be almost eliminated from power generation and renewables deployed twice as rapidly as hitherto. Buildings must be renovated at at least twice the current 1 per cent annual rate, with two-thirds constituting deep renovations, to curtail energy demand and make electric heating more affordable. There should be 50

million heat pumps in buildings across the continent and 50 million electric vehicles on the road. There must be investment in the decarbonisation of industry and agriculture and large net carbon sinks—such as restored forests, peatlands and wetlands—established.

The NextGenerationEU programme provides member states with fresh money for 'building back better' after the pandemic. The Recovery and Resilience Facility (RRF), the EU instrument created to support recovery, is designed to prioritise 'green' investment, with a minimum 37 per cent share of spending in the National Recovery and Resilience Plans (NRRPs) allocated to climate-relevant projects. In most EU countries, especially in southern and eastern Europe, RRF funding represents a significant economic stimulus.

#### Question marks

In the 22 national plans thus far approved, the overall funding allocated for climate-related investment and programmes, according to the European Commission, stands at €177 billion—nearly 40 per cent of the total. There are however question marks over *how* green some of the components are, and this will need to be monitored carefully.

For example, will programmes supporting hydrogen as an energy source utilise fossil hydrogen—in countries with a carbon-intensive power mix this might even result in higher carbon-dioxide emissions—or genuinely green hydrogen, based on wind and solar? The latter requires significant additional renewables capacity, to power the electrolysis of water from which the hydrogen is derived.

We calculate that the new electrolysis capacity financed through the RRF will demand, in France, Germany, Italy and Spain alone, 3.3 to 3.9 gigawatts of extra renewable power. Ootherwise, it will just reduce the clean electricity available for e-vehicles or other applications and not truly advance the green transition.

The approved  $\in$  177 billion implies an average  $\in$  29.5 billion *per annum* of additional climate-related public expenditure over six

years, with the bulk (€18.8 billion) affecting power, buildings and industry. But the commission estimates the yearly climate investment gap for 2021-30 to be €390 billion (€245 billion if one excludes transport). True, the NRRP figures exclude Poland, Hungary, Bulgaria, Sweden and the Netherlands, whose plans have not yet been approved, as well as private finance thereby leveraged. But it is clear that RRF funding alone will not close the investment gap—particularly not in the medium term, beyond 2026, when the facility ends.

#### Positive features

The fund does however have several positive features. It will engender a co-ordinated investment wave across the EU, of notable size and concentrated in the countries most in need. And the combination of investment and structural reforms should not only make spending more effective but also deliver long-overdue change.

For example, Italy is taking the opportunity to tackle its critically slow processes for granting permission for renewable power plants. Slovakia is reforming its market regulation to facilitate renewables' access to the grid.

Denmark's green tax reform is transformative. Energy taxation will be reoriented towards  $CO_2$  intensity until a comprehensive  $CO_2$  tax covers industry, transport and agriculture. To ease companies' transition, there will be enhanced tax breaks for investments in clean energy. The RRF will initially finance the net tax deficit until 2025, when the national budget takes the strain, with net fiscal benefits expected from 2029.

There is also a significant impulse to green investment in buildings. Almost all member states have made this a priority: one quarter of the green funds support renovation and the programmes are in most cases heavily frontloaded.

In France, the *MaPrimeRénov'* programme received 700,000 applications in 2021—ten times as many as recorded five years earlier

under previous programmes. In Italy, the 'Superbonus 110%' initiative has raised the renovation rate of apartment buildings: 14,330 applications were accepted in 2021, compared with some 1,000 renovations financed between 2014 and 2019.

To what extent renovations benefit those most exposed to high energy prices and deep renovations are encouraged will have to be monitored. And again the renovation wave cannot ebb in 2026: member states need to support homeowners and commercial landlords to plan renovations better, while regulation tightens the grip on the most energy-consuming buildings.

#### Short term

The RRF has set the right green priorities, with a focus on renovations, charging infrastructure and renewables for which it provides fresh funds. But the effect is limited to the short term. Member states will have to rely largely on their national budgets to close the investment gap after 2026. Yet reintroduction from 2023 of the suspended EU fiscal rules—unless these are promptly reformed—may not provide the most fiscally fragile countries sufficient flexibility to pursue the climate agenda.

Moreover, the recovery plans still allow fossil-fuel investments in certain cases and it cannot yet be determined whether spending tagged as 100 per cent climate relevant will indeed be so. Members of the European Parliament last month stressed the need for transparent monitoring of expenditure and the methodology will need to be carefully checked—to make sure that investments presented as green truly are.

MICHAELA HOLL IS a senior associate at *Agora Energiewende* on the European Green Deal. She worked for 16 years in the European

Commission, in the last year setting up renewable-investment aspects of the Recovery and Resilience facility.

Claudio Baccianti is project manager for EU sustainable finance at *Agora Energiewende*. He works primarily on green fiscal policy, sustainable finance and the European Green Deal.

# THREE DIGITALISATION AND RECOVERY—IT'S NOT JUST ABOUT THE TECHNOLOGY

#### HARTMUT HIRSCH-KREINSEN

The digital transformation is progressing slowly in many European Union countries. Available digital technologies are not being implemented and utilised to improve processes in government administration, in healthcare or in many companies.

This deficit became particularly evident with the Covid-19 crisis. For example, in the supposedly high-tech country of Germany the federal administration and the health-care system were often unable adequately to track infection chains, due to outdated equipment, hence failing to ensure prompt quarantine.

The EU's National Recovery and Resilience Plans (NRRPs) aim significantly to improve this situation, through massive financial stimulus in the member states. A minimum of 20 per cent of the total of just under €724 billion available from the Recovery and Resilience Facility is intended to promote digital transformation. The financing of digital technology comprises three pillars: the modernisation of public administration, expansion of the digital infrastructure, and education and training to support digital skills.

Without question, this plan will accelerate digitalisation in the EU. It will particularly benefit countries hardest hit by the pandemic with only limited investment resources. But the NRRPs can also enhance digitalisation in some of the western- and northern-European countries more advanced in technological development.

#### 'General-purpose technologies'

The question is, however, to what extent the previous deficits can actually be overcome with this financial injection. There is a risk that while investments will be made in new technologies the goal of increasing social resilience will only be suboptimally realised. The mere introduction of digital technologies alone does not automatically lead to the desired structural change in institutions, organisations or companies.

This is because digital technologies are 'general-purpose technologies'. They can be flexibly integrated into existing institutional and organisational structures and do not in themselves create any greater pressure for change. Research in the corporate sector, for example, has shown that the introduction of digital technologies is characterised by a high degree of hesitation in many companies and fundamental structural changes are seldom made. Similar situations can be found—even more pronounced—in the bureaucratised, established areas of the state administration.

The motives for this hesitancy are obvious and at first glance very rational: with such an approach, decision-makers avoid the costs and the risks of far-reaching digital innovation. Above all, they avoid conflicts of interest with the employees likely to be affected by the change process.

On closer inspection, however, this means there is only a limited increase in efficiency and suboptimal structures are stabilised. In a nutshell, existing organisational deficits, well-established routines and excessively bureaucratic regulations cannot be eliminated through the introduction of digital systems alone.

#### Far from sufficient

Crisis-free, 'normal' situations can usually be managed with such well-worn, only partially digitally-supported routines. Against the background of the pandemic, however—and aiming for a recovery which establishes a new 'normal'—it becomes clear that incremental and cautious innovation steps are far from sufficient.

This is clearly shown by analyses of the often not only inadequate but even hapless and inefficient government measures to cope with the Covid-19 crisis in Germany. The mere digitalisation of established processes may not only fail to enhance resilience but sustain inertia.

That may go fine for a while. But in view of the future challenges to the ability of companies and states to act, digitalised 'business as usual' is extremely risky. This is particularly true of the oncoming climate crisis but also forecast further pandemics.

A situation threatens to arise which, following the British sociologist Anthony Giddens, can be termed 'Giddens' paradox': the willingness to take effective measures to increase resilience will only arise when the pressure to act has become unavoidably high as a result of a crisis. Impending crises are not really reckoned with for a long time and well-trodden paths and routines continue to be followed. When measures are introduced, they are too late—as the crisis can no longer be mastered, still less averted.

#### Social conditions

How can this risk be avoided and the funding from the NRRPs used to create structures of high resilience and social ability to act, effective over the long term? Research and practical experience indicate that a successful digitalisation push must by no means only be technology-centered but must also systematically take into account the social conditions of innovation. There is a close connection between the effectiveness potential of the new technologies on the one hand

and their institutional, organisational and personnel embedding on the other.

Yet it is very often overlooked that efficient use of digital technologies always requires innovation in their institutional and organisational environments. As early as 2014, Erik Brynjolfsson and Andrew McAfee—leading global figures on digitalisation and artificial intelligence—strongly emphasised the indispensability of 'complementary innovations' in *The Second Machine Age*, a bestseller.

The Recovery and Resilience Facility does address this aspect at least indirectly, via the funding of education and training to support digital skills. This would deal with the personnel side of digitalisation but a broader perspective on the social prerequisites of successful implementation and utilisation of digital technologies is absent. In terms of a convincing political programme, it would have been appropriate to identify 'social innovation' as an essential focus to complement the introduction of digital technologies.

In other words, this cannot just be about the introduction of new technologies. Digitalisation, regardless of its purposes, affects the interdependences between technology, humans and the organisation as a whole. So the overall 'socio-technical system' must be explored. Key to this approach is the formula of joint optimisation: the desired goals can only be achieved if the social and technological elements of the overall socio-technical system are co-ordinated with one another.

#### Particular consideration

A systematic, socio-technical perspective for a genuinely crisisresilient digitalisation can only be a matter for the individual member states: they each have specific social conditions. These peculiarities require particular consideration in each case through adapted national implementation strategies.

For example, an aim of the German recovery plan is to strengthen social participation in the process of digitalisation. Without question this refers to the tradition of the German system of corporate codetermination, which can be seen as a positive example for other areas of society.

The specific challenges of individual member states are also shown clearly by the continuing hiatus affecting the NRRPs submitted by Hungary and Poland. This demonstrates *in extremis* that the introduction of digital technologies without the simultaneous tackling of social challenges makes little sense.

HARTMUT HIRSCH-KREINSEN IS a former professor of economic and industrial sociology at the TU Dortmund and currently a senior research professor working on the digitisation of work and industry 4.0, in close co-operation with the Social Research Centre Dortmund.

# FOUR RAISING THE RESOURCES TO OPEN THE EUROPEAN SLUICE-GATES

#### MARGIT SCHRATZENSTALLER-ALTZINGER

The European recovery plan, agreed by the German presidency of the Council of the EU and the European Parliament in November 2020 and accepted by the council the following month, comprises the Next Generation EU (NGEU) package of €750 billion and the EU budget, or Multiannual Financial Framework (MFF), for 2021-27 of €1,074 billion.

The total volume of €1.8 trillion is limited compared with crisisrelated fiscal-policy measures by member states. Nevertheless, the plan is a remarkable EU project—and not only due to the joint borrowing member states have for the first time incurred to finance NGEU.

For one thing, the poorer member states particularly benefit from NGEU funds. And its core instrument, the Recovery and Resilience Facility (RRF), worth  $\leqslant 672.5$  billion ( $\leqslant 360$  billion in loans,  $\leqslant 312.5$  billion in grants), is based explicitly on a future-oriented design aiming at a 'twin transition': 37 per cent of the funds must go to climate protection and another 20 per cent to the digital transformation. Not least, there is a legally-binding, inter-institutional agree-

ment (IIA) to repay the debt incurred for the grants from NGEU, through new EU budgetary 'own resources'.

Besides the current pandemic, the EU is however confronted with numerous long-term challenges: digitalisation, persistent regional divergences and demographic change, as well as the climate crisis and energy transition. And many observers consider the level and structure of the budget to be inadequate to address these challenges effectively. The impressive overall recovery plan and the forward-looking NGEU mask the inadequate adaptation of the MFF for this task.

#### Stagnating volume

The new MFF amounts to 1.05 per cent of the EU's gross national income (GNI). It thus follows the long-term trend of stagnating, or even declining, volume relative to output. In addition, it has been modernised only slightly.

Agriculture remains the largest expenditure item, although its share in total spending will decline from just under 36 per cent to just over 31 per cent, compared with the preceding MFF. And the structure of that spending does not adequately reflect the necessary sustainability-oriented turnaround in agricultural policy: the first pillar (direct payments), whose European added value is limited, is even gaining in weight slightly (from 75 to 77 per cent) compared with the second pillar (rural development), more strongly oriented toward social and climate goals.

It is true that conditionality is envisaged for direct payments that directly address environmental objectives ('eco schemes'). But experts consider the planned reforms of the Common Agricultural Policy to be insufficient to achieve the goals of the European Green Deal.

As the share of cohesion spending—the second-largest item—is also reduced only moderately (from around 34 to just under 31 per cent), the scope for expanding areas of spending with a larger European added value is limited. Funding for the Horizon Europe

research-framework programme will increase, but only from 6 to 7.1 per cent of the total. Support for the Connecting Europe Facility, which could create considerable European added value via cross-border infrastructure in transport, digitisation and energy supply, barely moves from 1.6 to 1.7 per cent.

#### Fundamental reform

The need to repay NGEU debt has provided new momentum to the debate about a fundamental reform of the EU system of own resources. 'True' own resources (the traditional custom duties and agricultural levies) have been declining for decades, which is why national contributions (based on GNI and value-added tax) have become the dominant source of revenue for the EU.

The system of own resources has various drawbacks. Financing the EU budget mainly through direct contributions by member states leads them to focus on their net positions, rather than on maximising the added value for the union as a whole. Moreover, the revenue system does not contribute to central EU objectives.

Replacing a part of current sources by innovative, sustainability-oriented own resources would allow a reduction of national contributions and thus create budgetary space for member states themselves to cut less sustainability-oriented taxes (such as on labour), resulting in a supranational strengthening of the sustainability focus of taxation in the EU. New own resources could also generate additional revenues to expand EU expenditures on European public goods. Well-suited candidates are those taxes and levies which are genuinely European in nature, being directly linked to European policies, or those which cannot be implemented and enforced effectively by member states, due to tax competition, avoidance and/or cross-border externalities, and which contribute to European strategies and policies.

#### Stepwise introduction

The IIA on the European recovery plan includes a roadmap for the stepwise introduction of innovative own resources during the new MFF period. Besides a plastic-based own resource from this year, the agreement foresees the stepwise implementation of others which would support important EU goals.

As of 2023, an expanded EU Emissions Trading System (ETS) and a carbon border-adjustment mechanism—a levy on imports from third countries having no or only low carbon prices, to protect international competitiveness and avoid carbon leakage—are envisaged. As these would be linked to a central European climate-policy measure, they can be seen as good candidates. Also a digital levy, comprising a share of the sales of large digital firms, is planned by the commission; this would contribute to fair taxation in the EU. In a second step, new own resources based on the taxation of corporations and financial transactions are to be implemented as of 2026, which should also contribute to that end.

The legislative proposals for the first batch of new own resources, as well as for a corresponding new own-resources package, should have been put forward by the commission in June this year. While it did issue legislative proposals for the carbon border-adjustment mechanism and a revised ETS in July, the roadmap is otherwise delayed. As the envisaged new own resources would form a basket of innovative funds to support important EU objectives—besides the green transition and fair taxation, European competitiveness and financial-market stability—they should be implemented as soon as possible.

Overall, the current MFF period should be used to prepare a more future-oriented, post-2027 model. And additional own-resource options, creating European added value, should be explored. Given the urgency of effective measures to fight the climate crisis and fulfil the ambitious targets of the European Green Deal, 'green' own

resources particularly—such as taxes on aviation or surcharges on national fuel taxes—should be considered.

MARGIT SCHRATZENSTALLER IS senior economist at WIFO, the Austrian Institute of Economic Research, and has been working in the research group 'Macroeconomics and European Economic Policy' since 2003. Her areas of expertise include (European) tax and budget policy, the EU budget, tax competition and harmonisation, family policy and gender budgeting.

#### FIVE

## EU BORROWING—TIME TO THINK OF THE GENERATION AFTER NEXT

## REBECCA CHRISTIE, GRÉGORY CLAEYS AND PAULINE WEIL

The issuance of European Union bonds to finance NextGenerationEU (NGEU)—the common recovery programme agreed by member states during the summer of 2020—has begun. This represents a small revolution in the supranational bond market.

Before the Covid-19 crisis, the EU had been issuing bonds for decades but it was a relatively minor player in the bond market, only borrowing for small, back-to-back lending programmes. But with the debt issued for NGEU, the EU will become one of the major borrowers in Europe in the coming years—up to around €800 billion, depending on the amount of loans member states take out. It will already issue €80 billion this year and could issue up to €150 billion per year in the next five years, putting it on a par with major European sovereign issuers, such as Germany, France and Italy.

As documented in our recent paper, the first issuances since June have evinced strong interest from investors all over the world. This was to be expected, given the current high demand for safe, well-rated assets, as well as for 'green' bonds.

#### Significant change

The European Commission has quickly assembled a qualified debtmanagement team and adopted a diversified borrowing strategy, similar to that of other major issuers, to raise money reliably and costeffectively. This represents a significant change in the way the EU interacts with financial markets.

Before, given its relatively low borrowing needs, the EU could tap the markets opportunistically, as and when required or when financing conditions were advantageous. With this much larger issuance, it needed to put in place a strategy. To capture the lowest interest rate at a given time but also to ensure funding needs would be easily met in future, this would be defined by regular and predictable issuances, so that debt securities were attractive to a diverse investor base.

The EU has decided to establish its presence in the bond market over the whole yield curve, issuing debt securities with maturities ranging from three months to 30 years. It has established a a 'primary dealer network' of investors, which will participate in the syndicated transactions and auctions through which the bonds will be primarily issued. The primary dealers will also play an important role in secondary markets, to ensure that EU bonds are liquid, as investors want to be sure they can quickly and easily resell the bonds at a good price.

#### Positive side-effects

Not only will this allow the EU to finance its recovery programme very cheaply—even at negative rates at the moment. There could also be positive side-effects: if successful, this could lay the groundwork for a European safe asset and common-benchmark yield curve, help develop EU capital markets, improve the euro-area financial and macro-architecture and bolster the international role of the euro.

First, the eurozone has a longstanding shortage of safe assets:

those rated 'AAA' or 'AA' represent only 37 percent of gross domestic product in the EU, compared with 89 per cent in the United States. NGEU could represent about 5 per cent of euro-area GDP. As EU debt is rated better than most member states' debt, issuing at the supranational level mechanically increases the volume of euro-denominated safe assets.

Secondly, if the EU were to become a permanent large-scale issuer, the yield curve of EU bonds could become a European benchmark for interest rates. Such a cross-border reference point could reduce differences in financing conditions for companies across the EU and favour economic convergence.

#### Mitigating the 'doom loop'

Finally, large-scale EU-level debt could bolster the resilience of European financial markets, by reducing the potential magnitude of capital flights in times of market distress: the issuance of common debt sends a strong signal that European countries want to stick together in the long run. It could also help reduce the sovereign-bank 'doom loop', in which national banks are overexposed to their sovereign's debt, as EU bonds would provide banks with a truly common safe asset to fulfil their regulatory requirements.

Mitigation of the doom loop will however be limited. NGEU debt will be overshadowed by national debt held by banks, which represents 19 per cent of GDP in the eurozone. Resolving this long-standing issue would require permanent issuance at higher volumes.

Moreover, EU bonds remain less attractive to banks than sovereign bonds. In the current collateral framework for refinancing operations, the European Central Bank applies a bigger 'haircut' to institutional and agency debt than to central-government debt at the same credit rating and maturity. This should be addressed by the ECB, as such haircuts shape market perceptions of the safety of a debt security, determining whether financial institutions will be able

to exchange them easily and almost at par against the ultimate safe asset—central-bank reserves.

#### Potential risks

The commission has done a good job and won praise from all stakeholders for its quick and efficient establishment of the borrowing programme. There are however potential risks, which the commission will need to monitor carefully to ensure that it maximises the benefits of the programme.

First, given the importance of the primary dealers in ensuring performance of EU bonds in secondary markets, the relationship with these investors needs to be managed carefully. The commission has to ensure, mindful of national sensitivities, that it is transparent and fair in its choice of mandated banks for issuances.

It should also monitor carefully how dealers play their role, to ensure EU bonds remain attractive, readjusting duties and incentives if need be. For instance, it could add market-making obligations in secondary markets if the liquidity of EU bonds is much lower than that for major issuers such as France and Germany (as measured, for instance, by bid-ask spreads) or it could increase its fees, lower than those of major EU issuers, should the incentives not be sufficient for dealers.

Secondly, there were initial fears that a large volume of EU debt issuances could have a 'crowding out' effect on demand for euro-area sovereign debts. So far, the risk appears low, because of market conditions, high investor demand and co-ordination among European issuers. Indeed, anecdotal evidence points to the opposite: the NGEU bonds seem to have caused crowding in, notably because of demand from non-EU investors encouraged by the positive signal of long-run European cohesion.

This should however be carefully monitored, as market conditions could change in the coming years—if, for example, the ECB were to reduce significantly its role in eurozone bond markets. Thus,

it is crucial that sovereign and EU issuances remain well co-ordinated within the Economic and Financial Committee's Sub-Committee on EU Sovereign Debt Markets. This includes member states' debt-management offices, the European Stability Mechanism, the European Investment Bank, the commission and the ECB.

#### Important limitation

Overall, EU bonds could offer significant benefits to member states. Yet the temporary nature of NGEU represents an important limitation.

While market participants appear in their investment strategies to perceive the 2058 time-horizon as distant enough to consider EU bonds as if somehow permanent, there is evident appetite from investors for large EU debt issuances to become so. If the benefits envisaged manifest themselves and the risks feared do not, the EU would have good reason to prolong and reuse EU debt—or make it permanent.

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#### SIX

# WILL EUROPEAN RECOVERY EVER BE CO-DETERMINED BY SOCIAL ACTORS?

#### BART VANHERCKE AND AMY VERDUN

In response to the pandemic, the European Union pledged major financial support to member states. Via the multiannual financial framework and 'NextGenerationEU' (NGEU), with its temporary 'Recovery and Resilience Facility' (RRF), the EU earmarked €800 billion, for which member states were required to submit national recovery and resilience plans (RRPs). While some reporting templates were invented, others drew on the established procedures of the European Semester, which served as a 'Goldilocks' governance option.

To what extent has the new set-up changed the power balance among EU actors in the monitoring of economic and social policies? When the semester was launched in 2011, for instance, there was a bias in favour of financial and economic players. But over time social-institutional actors managed to become involved in its day-to-day operation, 'socialising' the semester.

The answers we give to that question are based on EU documents, semi-structured elite interviews and discussions with representatives of the European social partners and civil-society organisations (CSOs), as well as of member states.

#### Stakeholder consultation

The RRF regulation stipulated that national reforms and investments had to relate to the country-specific recommendations (CSRs) of the semester, the strengthening of growth potential, job creation and economic, social and institutional resilience, and implementation of the European Pillar of Social Rights. Effective contribution to the green and digital transitions was also required: expenditure related to climate had to comprise at least 37 per cent of each RRP, digital initiatives 20 per cent. No explicit 'social' targets were however included—although the European Commission would be mandated to develop (through delegated regulation) a methodology for reporting social expenditure, including on measures focused on children and young people as well as gender equality.

The final version of the regulation was a big step forward, at least on paper, regarding stakeholder consultation—so far stipulated only in general terms under the semester as formally set out. As a result of the European Parliament's first reading, the adopted regulation requires member states not only to provide 'a summary of the consultation process' but also to report on 'how the input of the stakeholders is reflected in the recovery and resilience plan'. In addition to the social partners, the regulation widens stakeholders to include local and regional authorities and CSOs including youth organisations.

In practice, however, the involvement of social actors in the RRF has proved highly problematic: the motto was to act first and consult later.

#### Crisis mode

The pandemic erupted in March 2020. The EU responded in steps but rapidly, breaking some old taboos. By the summer the European Council had agreed to a massive package. During the autumn policy-makers were still in crisis mode. Many established procedures associ-

ated with the semester, such as the country reports and CSRs, were altered or put on hold.

Within the commission, decision-making was centralised in a Recovery and Resilience Task Force (RECOVER) of the Secretariat-General, in close co-operation with the Directorate General for Economic and Financial Affairs (DG ECFIN). The role of DG Employment, Social Affairs and Inclusion (EMPL), previously in the semester's 'core group', was significantly pruned.

As for the Council of the EU, the Employment, Social Policy, Health and Consumer Affairs (EPSCO) formation had no say in the recovery being rolled out. Nor did its advisory bodies: the employment (EMCO) and social-protection (SPC) committees.

# Drastically reduced

What is more, the usual consultation of a variety of social players was drastically reduced. The social actors, in turn, were very concerned they might be sidelined for a longer period. While the social partners and CSOs were typically included at the outset of the drafting of the RRPs, this engagement was not sustained. Meetings discussed draft plans, sometimes shared in advance, but stakeholders usually did not receive feedback on how their contributions factored into the final plan.

Recent analysis of the involvement of stakeholders in the drafting process by the European Parliament confirms that at least 17 member states engaged in extensive, formal, public consultation when preparing their RRPs, even if this varied greatly. Fewer, however, point to specific proposals from stakeholders reflected in the RRPs. Some countries also reported in their RRP that they had given the public the opportunity to engage in the debate, without revealing anything about the quality of the consultation.

Research forthcoming from Eurofound has assessed the quality of involvement of social partners in these consultations. Fewer than ten member states were given a positive assessment: the Nordic countries, Belgium, Czechia and Spain and (to a lesser extent) Bulgaria, Cyprus and France. All other countries recorded only low-quality social-partner involvement, with deficiencies in the timeliness of, and feedback from, the consultation.

# Different set-up

At national level, ministers—premiers and ministers responsible for finance and cohesion—have mainly steered RRP decision-making. This stands in stark contrast with previous reform programmes driven largely by officialdom. Because the set-up was different, social partners and CSOs had to develop new national and EU networks—which takes more time than was available.

The lack of detailed requirements for quality consultation on the RRP—its extent and the time allotted, the transparency of the contributions by social actors—combined with the change of national 'drivers' severely to limit effective engagement, even in countries with established avenues for consultation under the semester. It remains to be seen whether the 'social recalibration' of the RRF objectives obtained by the European Parliament during the negotiations on the regulation has ultimately affected the social quality of the plans. In the absence of quantitative social targets—it seems these were more difficult to agree than green or digital ones—member states appear largely free to choose how much to stake on social reform and investment in their RRP.

When the RRF was launched, due to the desire for quick action, there was a serious risk of the EU's institutional social actors losing the prominence they had acquired over the years in the context of the semester. DG EMPL, EPSCO and its advisory bodies however gradually reclaimed their position, as the immediacy of the crisis subsided. A longer-term focus emerged, the EU returned to previous semester practices and these players managed to get a foot in the door.

Officials also engaged with the social partners on both sides of

industry, but it remains an open question whether this consultation was really meaningful. European CSOs, by contrast, have been sidelined in the RRF process. And in most member states consultation with domestic stakeholders—both social partners and CSOs—has remained insufficient.

# Democratising the polity

The European Parliament was reasonably successful in its substantive impact on the RRF regulation. It has since failed, however, to insert itself in the approval and assessment procedures of the recovery programme.

Time will tell whether the EU is ready to seize this opportunity to democratise the polity further and to enhance the inclusion of social actors in these processes. Making 'soft' modes of governance harder, including strengthening the role of the European Parliament in oversight of the semester and the RRF, could reinforce democracy and enhance EU legitimacy.

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# SEVEN HIGH-SPEED RAIL ALONG A 'EUROPEAN SILK ROAD'

# KATHARINA WEBER, MAXIMILIAN ZANGL AND MARIO HOLZNER

The European Union is clear on its goal to be climate-neutral by 2050. Transport accounts for a quarter of the EU's greenhouse-gas emissions. The European Green Deal seeks a 90 per cent reduction in these emissions by 2050. But the road is still long and some drastic changes will be required.

The EU's Recovery and Resilience Facility aims to support the green (and digital) transition by financing large-scale investment in infrastructure. Overall funds of more than €720 billion are available in loans and grants. It is however the EU member states which will deliver national plans, with primarily national projects. There are hardly any projects with European value added, crossing borders, although network infrastructure typically yields the highest social returns. The European Fiscal Board recently suggested promoting green public investment as an EU common good.

# Ineffective patchwork

A high-speed rail (HSR) network connecting the European continent could facilitate a drastic cut in emissions. Yet no such network exists, with only a few national lines, especially in France and Spain, constituting an ineffective patchwork.

In 2018 the Vienna Institute for International Economic Studies (wiiw) suggested construction of a a 'European silk road'. The proposal recently accrued attention as the Macroeconomic Policy Institute in Düsseldorf, the *Observatoire français des conjonctures économiques* in Paris and the wiiw advocated dedicating part of the EU's €2 trillion recovery fund (including the multiannual budget) to a pan-European HSR network.

The network would be around 11,000 kilometres long, with a northern route from Lisbon to Uralsk on the Russian-Kazakh border and a southern line from Milan to Constanta, onward via a maritime extension to Volgograd and Baku (see map). The plans include a high-speed section from Lyon to Moscow, with an estimated cost of €200 billion.



#### Substantial cuts

Rail is the mode of transport responsible for the least carbon-dioxide emissions. Air travel emits 4.5 times as much  $Co_2$  per passenger kilo-

metre. Thus shifting from air and road to rail can result in substantial emissions cuts.

The main factors determining choice of travel are price, travel time, time reliability and frequency of connections, as well as convenience, comfort and safety. Studies have shown that passengers are more likely to use the train as a means of transport for a travel time of up to four hours. An average velocity of 250km per hour for HSR means the train would be a good substitute for routes of up to 1,000km. On the proposed line, this would encompass corridors such as Paris to Berlin, Lyon to Brussels or Warsaw to Minsk.

Even more distant routes could be covered conveniently if night trains were introduced in addition. Imagine leaving Lyon at 6pm and arriving in Moscow at around 8am. Currently, a mix of trains and buses would take about two full days.

#### Wide-open window

The window of opportunity is wide open. Estimates of the potential modal shift from plane to train range up to 90 per cent if the line is cheaper and faster. High substitution rates can especially be expected due to the growing environmental consciousness among Europeans.

Life-cycle assessments (LCA) are used to determine the environmental burden of infrastructure construction and use. The analysis covers the entire life cycle, from construction and operation to maintenance and waste disposal—typically around 60 years.

In a recent book chapter and background study, we used an LCA to examine the potential environmental burden of the line from Lyon to Moscow. Optimistic, medium and conservative models accounting for emissions from construction and savings due to the modal shift all indicated that the latter would be greater than the former, implying net negative CO<sub>2</sub>-equivalent emissions. The time taken for the construction emissions to be fully offset ranged from 3-4 to 37 years of operation in the respective models.

The most optimistic model projected savings of 273 million tonnes of  $\mathrm{CO}_2$ -equivalent, which corresponds to one third of greenhouse-gas emissions from transport in Europe in 2019. Breaking down the results over 60 years shows that an HSR network will not be the magic solution to reducing emissions from the sector but it could play a significant part.

# Paradigm shift

Putting the results into perspective, only passenger travel was included in the study. Recently the European Environment Agency disclosed that transport of freight via air emits 43 times as much  $CO_2$  as via rail. More sustainable freight transport is thus key to lowering the environmental burden.

Moreover, the study did not consider the construction, maintenance and disposal of road and air infrastructure, while all aspects for rail were included. Of course growing demand for rail will decrease the need for new road and air infrastructure, which will save further emissions.

Constructing a pan-European HSR network also goes hand in hand with economic benefits, favouring convergence between the east and west of the continent. And the examined passage is only part of a potentially much bigger network which could save further emissions—the wiiw proposal discusses, for instance, a route from Milan to the Black Sea.

# Solution-finding

We are asked many questions about this project. Who should finance it? Who should run it? How would one deal with the absence of uniform standards for gauge, axle load and operating voltage? How would the required political co-operation be obtained?

While these are all legitimate questions, they should not hinder realisation of the vision. Reducing emissions in transport by 90 per cent will require radical and revolutionary ideas. The focus should shift from problem- to solution-finding.

On financing, wiiw has specified an extra-budgetary model. It proposes a European Silk Road Trust, owned by the eurozone members, other EU member states and third countries wishing to join in the construction. The trust could rely on a public guarantee when it came to issuing long-term bonds (at currently zero or even negative real interest rates). Formally it would be part of the private sector, especially as it would have sufficient income of its own from private customers.

#### **Bold** actions

Decision-makers are in dire need of climate action. As we witness another COP summit with weak targets and non-binding goals, bold actions are necessary to deliver results. A pan-European HSR network would be one step towards a more sustainable, innovative and advanced future.

The European Silk Road initiative fits well with the European Commission's recently announced €300 billion Global Gateway programme, running until 2027. This aims to support sustainable infrastructure beyond the EU.

The initiative would have the potential to set common infrastructure standards with potentially global relevance. It could help strengthen political and cultural co-operation in a larger Europe. It would provide the continent with a new narrative—much needed to oppose the centrifugal forces tearing at its fabric.

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# FIGHT 'RECOVERY AND RESILIENCE'—HOW THAT LOOKS FROM THE EAST

# IMRE SZABÓ

Preparations are in full swing to spend the €724 billion available from the European Union's Recovery and Resilience Facility (RRF), as most member states have secured the European Commission's endorsement for their national recovery and resilience plans (NRRPs). The commission however keeps postponing approval of the NRRPs of Hungary and Poland , as a further step in the slow-burning conflict between EU institutions and the illiberal governments of those two countries.

Member states in central and eastern Europe (CEE) have been the main net beneficiaries of EU budgets since their accessions. Amid the tug-of-war between the commission and certain of their governments, it is worth exploring the impact of previous EU budgets on the region and whether the RRF might represent a departure from earlier spending patterns.

# East-west gap

One of the main purposes of the EU budget is to strengthen territorial cohesion, by reducing inequalities across EU regions and member

states. At accession in 2004 and 2007, the relative underdevelopment of eastern member states qualified them for a large share of the cohesion and regional funds. The significance of EU funds even increased for them over time, in parallel with the shrinkage of their domestic fiscal space (itself partly due to enhanced budgetary surveillance by the EU's 'new economic governance' regime).

The influx of EU money has led to a visible improvement of physical infrastructure in eastern Europe. New highways, refurbished train stations and manicured town centres are tangible evidence of the benefits of EU membership for citizens.

Yet the east-west gap has not disappeared—it has just changed its character. It is no longer about the contrast between a crumbling eastern infrastructure and the west's well-kept public buildings, roads and railways.

The main difference now lies in the crisis of human resources increasingly consuming the east. There is a general shortage of skilled labour in these ageing societies. But the deficit of personnel reaches crisis proportions in labour-intensive public services: education, child- and eldercare and, most importantly, healthcare.

Due to low public-sector wages and often humiliating working conditions, fewer and fewer people are left in the essential public-service professions of medicine, nursing and teaching. This has been aggravated by emigration in search of better wages and working conditions to 'old' member states, taking advantage of the right to free movement within the single market.

#### Unable to offset

EU investment funds have not been able to offset these processes—they were not even intended to, as they were not designed to finance wages apart from in fixed-term, project-based employment. EU funding overall is heavily tilted towards investment in physical infrastructure and in eastern Europe at best supports a revival of strategic industrial policy.

The pandemic exposed these contradictions in a tragic way, the Hungarian case being the most instructive. In a country where many hospitals have been renovated with EU funds and equipped with cutting-edge equipment, the biggest obstacle to effective treatment of patients was the shortage of staff.

The government prevented the collapse of the system by introducing *de facto* military rule for healthcare workers. For the duration of the emergency, legislation prohibited nurses and doctors from quitting their jobs and allowed managers to redeploy staff across distant locations.

The links to the single market are nuanced but clear: the ban on resignations served as a roundabout way to limit freedom of movement for healthcare workers. While not acknowledging this, the government relied on these drastic measures during the pandemic because previously it had not taken sufficient steps to address the exodus of healthcare workers to the west. It was also content with pouring EU funds into bricks and mortar—thereby nourishing a political-cum-business elite with very close ties to the governing party.

# Innovative proposal

Can the new EU long-term budget and the RRF be a turning point? The priorities of the traditional financial framework remain largely unchanged and the new priorities, of climate investment and digital transition, are also infrastructure-heavy. At the same time, governments have some leeway in setting their own priorities. And, looking at the plans, there is at least one innovative proposal coming from an unlikely place.

Hungary's NRRP includes a large expenditure item, of close to €1 billion, partially to cover salary increases for medical doctors, thereby moving the human-resources issue into the domain of EU politics. The appearance of public-service wages in the NRRP signals a turnaround in the government's preferences as to how it spends EU money. Its acceptance by the commission would be close

to a sea change in EU budgeting (though the RRF was announced only as a temporary instrument).

But why should the EU provide support for a current spending item in an area within member states' core competences—the financing of government employees' wages? The Hungarian government argues that wage increases are part of structural reforms and anti-corruption measures in healthcare. In particular, they are linked to the fight against the longstanding practice of informal payments by patients to medical professionals in Hungary. The country-specific recommendations (CSRs) issued in the European Semester framework in 2020 also call on the government to address labour shortages in healthcare.

#### Rife with contradictions

The current proposal is rife with contradictions, most importantly because it does not extend to nurses and other healthcare staff. Wage increases these groups have received in recent years have been more modest than those offered to doctors—not to mention continuing wage suppression in education and other public services.

Moreover, the wage settlement is part of a broader healthcare reform plan to reduce hospital capacity while strengthening outpatient and primary care—a goal shared by the EU CSRs and the Hungarian government. While in theory and in the long run 'shifting care out of hospitals' is a good idea, in the wake of a pandemic any responsible policy-maker should plan for some slack in the system in case of another emergency.

Despite these contradictions, and despite coming from an otherwise extremely right-wing government, the idea of supporting health-care wages from EU funds could open the way for more progressive EU budget policies. It could even be read as an acknowledgement that the EU is on the way to doing more to preserve the free movement of labour in times when this principle is increasingly contested, in host and sending countries alike.

This salvage operation should resolve the underlying tensions that make free movement of labour a contentious issue—such as the east-west gap in wages and working conditions, particularly wide in public services. An acknowledgement of joint responsibility by the EU and CEE member states to address the human-resources crisis in public services could be part of this process.

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# NINE HUNGARIAN BUSINESSES AS EU RENTIERS

# PÉTER BUCSKY

As with its Polish counterpart, the Hungarian national recovery and resilience plan has been held up by the European Commission due to sustained rule-of-law concerns. Meanwhile, a series of articles on the effectiveness of past European Union funding in the country has been published in three parts by the Hungarian news portal g7.hu.

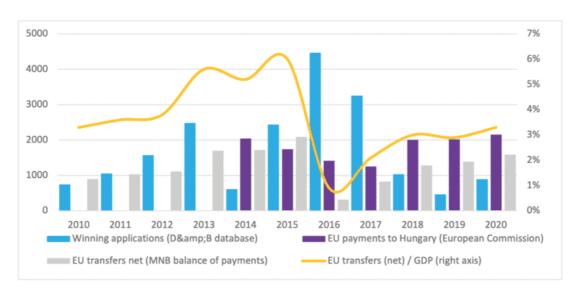
Since joining the EU in 2004, the Hungarian economy has received immense amounts of cohesion funding (Figure 1). From 2014 to 2020 alone, according to the Hungarian National Bank's balance-of-payments data, Budapest received HUF9,200 billion (€24.6 billion) more in subsidies from Brussels than it paid into the EU budget. In these 11 years the equivalent of 3.3 per cent of Hungary's gross domestic product flowed into the economy each year.

This support has provided a very significant boost, with nominal GDP growing by an average of 5.7 per cent annually over the same period. EU support therefore accounts for some 58 per cent of growth. In fact, with inflation taken into account, average annual growth was only 2.3 per cent. This means that without EU support,

economic output could easily have declined, although this would require further analysis.

Actual EU subsidies flowing into the economy have however been much larger than the net position: projects approved between 2010 and 2020 amounted to HUF13,160 billion. This is a staggeringly high figure. It means the equivalent of 4.7 per cent of GDP was spent on EU-financed projects during the period.

Figure 1: total volume of EU subsidies (billion HUF) and their share of GDP (%)



Source: Dun & Bradstreet, KSH, European Commission, Hungarian National Bank (MNB)

The data for EU financing are however not transparent. They can be accessed via a Hungarian government website, but only if one searches for specific projects—export of bulk data is rendered impossible.

# Corporate subsidies

Most of the EU funding has gone to government agencies and companies. Excluding those state firms which have received funds above HUF10 billion in the analysed period, we are left with the funds

awarded to the corporate sector. Direct subsidies to corporations were HUF3,400 billion out of a total of HUF10,000 billion.

Based on data from the Hungarian Central Statistical Office (KSH), over the 11 years these subsidies to companies amounted to 1.1 per cent of their turnover, including state-owned companies. It means they received twice as much EU support as the corporation tax they paid in the same decade.

This amounts to a massive redistribution: the state is transferring vast sums to market actors. Even if we exclude subsidies above HUF20 billion—which presumably all went to state-owned companies—in 2010-20 firms subsidised by EU funds received HUF3,390 billion in subsidies, while paying only HUF2,086 billion in corporate taxes if we consider only private companies. But most of the massive HUF6,212 billion EU funding for state-owned companies was passed on to the corporate sector as funding or as public procurement.

# Efficiency concerns

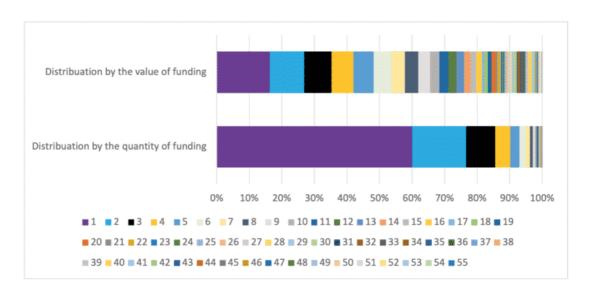
There are two important concerns about the efficiency of public funding for corporations: deadweight and substitution effects. In the former case, some or all of the investment would have been carried out anyway, so EU money replaces bank financing or equity. In the latter, due to demand constraints the enterprise supported only grows at the expense of non-supported businesses, even though these may be more efficient.

Concerns about the effectiveness of these subsidies are exacerbated by the fact that over the period analysed in 1,085 cases they were paid to firms which did not have any employees. Of these, 320 companies (receiving a total of HUF26.6 billion) had no turnover either!

Sixty per cent of firms received only one grant, yet these comprised only 16 per cent of the total amount of aid (Figure 2).

More than half was awarded to those which were beneficiaries at least five times—more than a third went to those with ten or more funded projects. While single grantees received an average of HUF<sub>4</sub>o million, those for which five to nine projects were supported received an average of HUF<sub>7</sub>6 million.

Figure 2: distribution of EU funding by sum and number of grants won



# Subsidy hunting

Overall, the growth rate of assisted firms was on average 20 per cent *lower*: all firms grew by 7.1 per cent on average during the period, while assisted firms grew by only 5.7 per cent. Far too many Hungarian companies base their business model on subsidy hunting, rather than real, commercially-sound activity.

It might still be argued that the companies supported would otherwise have lost workers or even have gone out of business. This is possible, of course, but sustaining poorly-performing firms is hardly a strategy for economic renewal.

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# TEN RECOVERY AND RESILIENCE: STOPGAP OR SEA-CHANGE?

#### ANDREW WATT

When the pandemic hit in the spring of 2020, not only were individual European Union member states quick to react but the EU as a whole swiftly changed gear. Fiscal and state-aid rules were suspended, the European Central Bank launched an emergency bond-buying scheme, the SURE programme was initiated to refinance national short-time-working schemes and the European Stability Mechanism was expanded.

But it was clear that this was not enough to undergird recovery and that a medium-term support programme was needed. National capitals were anxious not to repeat the 'blame game' of the eurozone crisis of the early 2010s and to reduce over-reliance on the ECB, which had taken most of the policy strain after 2012 (with the openended, 'whatever it takes' commitment by its then president, Mario Draghi).

Helped by some favourable political changes—not least a change at the German finance ministry—and the perception of the coronavirus as a common shock, in July 2020 policy-makers launched NextGenerationEU. It was a blueprint for a recovery, rather than an austerity programme. Its cornerstone, the Recovery and Resilience

Facility (RRF), was subsequently agreed—after difficult negotiations and hold-ups, not least because of rule-of-law issues in Poland and Hungary—by the end of 2020.

The articles in this series have looked at different aspects of the RRF, including its funding, the substantive contribution of national recovery plans and the political processes behind their formulation. This concluding contribution steps back to consider the historical significance of the facility. Is it a hastily concocted stop-gap or does it mark a sea-change in European integration? This requires exploration of its impact so far and its future potential.

#### Path-breaking features

Suggestions that the RRF will take its place in the history of European integration typically start with its sheer size, with a headline figure of more than €670 billion. This is spread across all countries and five years, however, and less than half comes as grants. Thanks to the efforts of the four 'frugal' member states (Germany having defected from that group), loans predominate, their take-up limited so far. Rather than sheer quantity, it is the structural features of the RRF which can lay claim to be path-breaking.

The European Commission is authorised to raise loans on international capital markets on behalf of the EU and make resources available to member states. While this is not entirely unprecedented, it is the first time it has been done for all member states and on anything like such a scale: unlike national government budgets, that for the EU has always been fully funded. Servicing of RRF-borrowing is fully Europeanised, folded into the overall EU budget.

In contrast to the eurozone crisis, the RRF is heavily redistributive, making a substantial macroeconomic impact in lower-income countries and those worst hit by the pandemic, while representing merely an add-on for those with less pressing needs. In Greece, Romania, Croatia and Italy the RRF allowance (grant plus loans

requested) amounts to more than 10 per cent of annual gross domestic product.

The bonds issued create a lasting safe asset for the EU—final repayment will not occur until 2058—which can be bought and held by the ECB and domestic and foreign financial actors. They are 'euro bonds' by any other name. This will go some way to stabilise the financial structure, easing the 'doom loop' between national banking systems and government budgets: these bonds will not be subject to rising 'spreads'—their excess over benchmark rates—in times of financial tension, shielding government finances (from interest-rate spikes) and bank balance sheets (from severe capital losses).

Lastly, the requirement to submit, and obtain approval for, national recovery plans, as well as the linking of disbursement to the achievement of agreed milestones, gives the European institutions a lever with which to exert influence over important national economic policies. In all these respects the RRF undoubtedly marks a seachange.

#### Overblown claims

Overblown claims of a 'Hamiltonian moment' for Europe, comparable with the assumption of state debt at the federal level in the United States after the war of independence, should however be treated with caution. Most fundamentally, *existing* public debt has not been 'federalised' and the RRF is explicitly conceived as a one-off response to the Covid-19 crisis.

A fiscal Europe this is clearly not—at least not yet. Nor, importantly, does it provide for investment in EU-wide public goods, such as cross-border rail or electricity links. It is a federal support programme for national initiatives, albeit lightly co-ordinated around common goals, such as decarbonisation and digitalisation.

This risks diseconomies of scale and duplication, while the reliance on national actors raises concern about misuse of funds, which in turn entails reputational risks. The medium-term EU

budget (2021-27) was also scarcely expanded or reprioritised. Whether this can change for the next Multiannual Financial Framework starting in 2028, with the incorporation of new 'own resources' on the revenue side, is a key open question.

# **Encouraging picture**

At least as important as the big issues of principle is how the RRF has been rolled out over the last year and a half. So far, on the surface, the picture is encouraging but these are early days.

Most of the national plans were submitted by the deadline of May 2021. In Hungary, Poland, Bulgaria and the Netherlands, submission was however delayed and hold-ups continue with Hungary and Poland (though agreement with Poland, facing huge challenges because of the influx of Ukrainian refugees, may be imminent.) Thirteen per cent of the financial allotment in national plans has been made available as 'pre-financing' and the biannual payments available on passing reform and investment milestones have started to be approved and transferred (Italy received €21 billion in mid-April, for instance).

On the financing side, the commission has encountered a healthy appetite from investors for RRF-related bonds. Bonds have been issued across the yield curve (from three months to 30 years). Almost one third have been green bonds, in high demand among investors seeking assets addressing 'ESG' (ecological, social and governance) concerns.

Interest rates on the bonds have only slightly exceeded those for benchmark German Bunds and are roughly in line with French rates. An initial spread on Bunds of around 0.2 percentage points has widened to around half a point as interest rates have been swept up, yet it has remained much smaller than spreads on some national bonds. Last autumn Italian (ten-year) Bund spreads were scarcely higher than for EU bonds but they have widened sharply to more than two percentage points. Italy's use of EU funding, rather than

issuing more national bonds—as it would otherwise have had to do to finance public investment—has therefore considerably sheltered it from the risk of interest-rate hikes.

# Still untapped

If the RRF were fully tapped by the member states—they all took advantage of their potential allotment of loans—commission borrowing on financial markets would need to be on a par with that of the largest sovereign borrowers (Italy, France and Germany) over the next few years. Member states have until August 2023 to decide on their demand but, apart from substantial loans taken up by Greece and Italy, they have been reticent. As of the end of February, €224 billion remained untapped.

Of course, those whose national borrowing costs are lower than for RRF loans have no financial incentive. Countries such as Spain could benefit from lower borrowing costs yet have taken a wait-and-see position. Unused, the availability of the loans sends a signal to markets, acting as a kind of insurance against shifts in sentiment. With interest rates now rising and spreads widening once more, it is likely more governments will avail themselves of RRF loans.

It is not possible at this stage to analyse the effectiveness of the projects coming into being on the ground by virtue of RRF funding. Questions have been raised as to whether some member states, particularly where RRF finance is very substantial as a share of GDP or investment, will be able to absorb the funds in productivity-enhancing ways. In other countries RRF-labelled projects have—not least due to the time pressure to deliver national plans—partially substituted for endeavours national governments would in any case have taken and financed from national means. Time—and further research—will tell.

One thing is though clear: possible extensions to the RRF are contingent on the emerging evidence showing that, overwhelmingly, European money has been well spent by national actors. Signs of wasteful spending, not to mention corruption, would be inimical to efforts to extend the programme.

#### Potential role

If the assessment of the RRF so far is broadly positive, what about the facility's potential role in the future?

The medium-term EU budget and the question of 'own resources' will be crucial. Discussions are at various stages on possible sources of genuinely European financial means: the carbon-border-adjustment mechanism (a legislative proposal is due this year), a tax on digital services/companies and ecological taxes such as on plastics or aviation fuel. If agreement cannot be reached, member states will have to increase their national contributions to the EU budget from 2028—this ought to focus minds. Strategically, a greater role for own resources would be significant in weakening the *juste retour* mentality—the obsessive national bookkeeping of (supposed) direct financial benefits and costs of EU membership—in favour of the much more important question of what Europeans can best (or even only) do together.

The implications of the RRF for policy co-ordination will be a further area of debate. Apart from the agreed thematic foci, such as decarbonisation, member states are to invest and reform in line with their country-specific recommendations (CSRs) under the European Semester. To date, this appears to have been a low bar: the commission does not appear to have threatened to withhold approval for any national plan on this criterion.

Some see this as an opportunity finally to give some teeth to the CSR process—and to the Macroeconomic Imbalance Procedure to which it is related. Others are concerned about the potential for heavy-handed interference from Brussels in national policy-making. The sensible solution is, on the one hand, to limit recommendations to issues which are clearly of common interest (where there are cross-border spillovers) while, on the other, bringing more pressure to bear

to ensure that national policies avoid freeriding and duly consider broader European requirements. Additionally, access to RRF funding can be used to ensure commitment by member states to universal norms, such as the rule of law.

# Thorny problem

Following this logic, the principles underpinning the RRF could be used to unblock one of the thorniest problems in economic-governance reform. There is widespread agreement that the eurozone fiscal rules need to change to ensure that they do not unduly curtail public investment.

Numerous economically sensible proposals for some version of a 'golden rule'—the principle that public investment, unlike current spending, ought to be deficit-financed—have been proffered. But these have foundered politically on a lack of trust between member states, reflected in argument over the appropriate definition of public investment to be exempted from spending constraints under the fiscal rules.

Providing European funding for national public investment along the lines of the RRF (but likely with a lower degree of redistribution between countries) elegantly solves this problem: member states have to receive *ex ante* approval of spending projects from the commission and ultimately their peers on the Council of the EU. And the idea goes beyond the golden rule in that all countries could benefit from low interest rates to finance their investment. I expect this avenue to be explored in commission proposals in the near future.

# Permanent facility?

This brings us, finally, to the issue of whether the RRF should remain a one-off crisis response or whether Europe needs additional, dedicated 'facilities'—up to and including a permanent one. There is certainly no shortage of challenges broadly on a par with that of emerging stronger from the pandemic.

The fall-out from the war in Ukraine—with the need to shift away from Russian fossil energy (RePowerEU) while sticking to the decarbonisation agenda, together with the huge reconstruction needs in what is set to become a (large) EU member state—is an obvious example. But greater foreign-policy and defence co-operation more generally requires that policy-makers' good intentions be backed by financial means. At a minimum, some of the unused borrowing potential of the existing RRF should be repurposed, although with caution given its insurance function for potentially vulnerable countries.

More promising would be to seize the opportunity of the 'polycrises' facing Europe to set up additional RRF-type schemes (again, without necessarily implying such a high degree of redistribution between countries). They would offer an institutionally well-founded way forward to address these crucial challenges, in a way that promotes cohesion and gives Europe a shared purpose and the means to achieve common goals.

There is an urgent need to invest in genuinely European public goods, such as transport and (renewable) energy interconnection between countries. A permanent borrowing capacity for the EU to finance such projects and a substantial stock of liquid safe assets, like US Treasuries, serviced by European revenue sources—now that really would be a Hamiltonian moment for the European project!

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