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Next Generation EU: Europe needs pan-European investment

Rein Berentsen, Lorenzo Castiglioni, Paul van den Noord 29 November 2020

Projects need to fulfil certain conditions and should be reform- and investment-related, based on guidelines provided by the Commission. As such, projects should come as a complement to structural reform plans.

This approach has a strong macroeconomic rationale. Yet, it is subject to a number of concerns, common to most EU policy initiatives that rely on countries submitting their own plans (even when subject to coordination such as the European Semester), of which some are acknowledged to have long plagued the effectiveness of EU projects:

1. The additivity of the plans may turn out limited as countries use EU funds to finance existing projects or projects that would have been undertaken anyway. In that case, support funding can at most limit the default increase of countries with already tight fiscal space.
2. European funds may have a small impact on the public investment instrument relative to existing national instruments, such as public debt. The funds may also come attached with strings, affecting national autonomy.
3. Spillover is often not channelled, which could lead to resources being misallocated. With the widespread increase in debt-to-GDP ratios across European countries impinging on national decision making and budgets, or not undertaken at all.
4. Countries could shun the take-up of conditional loans (Spain and Portugal have already hinted at that), preferring grants and market loans without strings attached. The latter are cheap even for the worst affected countries owing to risk sharing via the ECB's quantitative easing and the common bond issuance of the EU package itself.

The bulk of the funds are channelled through the Recovery and Resilience Facility. Each country has a right to claim a fraction of the total pot for grants and loans, based on a prior agreed formula relying on a set of objective indicators. Figure 1 depicts the allocation of Next Generation EU funding over the Member States, broken down into grants and loans. Figure 2 shows the estimated Next Generation EU cash flows over time, together with an assessment of the European Commission’s Support to National Investment Plans (SNIAP) programme and the support from the European Stability Mechanism (ESM).

Conclusions

1. Next Generation EU should not turn out to be a missed opportunity to initiate and fund genuine pan-European infrastructure projects with a high impact on potential growth. Roel Beetsma, Lorenzo Codogno and Paul van den Noord argue that the subsidiarity principle calls for such a pan-EU initiative.

2. Next Generation EU's unprecedented fiscal package adopted by the European Council this summer is a commendable endeavor. Its aim is to boost public investment with a long overdue strategy to lock in a shared vision of post-coronavirus growth and ensure the economic growth potential of the Union (Verwey et al. 2020, European Commission 2020a, 2020b, European Council 2020c, European Fiscal Board 2020).

3. Next Generation EU should go beyond an immediate fiscal stimulus to a genuine R&D strategy to lay the foundations for post-coronavirus recovery. It should focus on projects with a high impact on sustainable growth (renewable energy, human capital, green mobility) that have broader spill-overs and a strong 'common good' characteristic and for which national governments are ill-equipped.

4. Moreover, the scale of such investments is too large for national administrations to handle on their own. Not only do individual countries fail to internalise positive spill-overs, but they also find it inherently complicated to work together on projects that transcend national interests. The emphasis should be on projects with a high impact on sustainable growth (renewable energy, human capital, green mobility) that have broader spill-overs and a strong 'common good' characteristic.

5. This approach has a strong macroeconomic rationale. Yet, it is subject to a number of concerns, common to most EU policy initiatives that rely on countries submitting their own plans (even when subject to coordination such as the European Semester), of which some are acknowledged to have long plagued the effectiveness of EU projects.

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