

MAKING NEXT GENERATION EU A PERMANENT TOOL

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RECOVERY WATCH

WHAT IS THIS PROJECT ABOUT?

The National Recovery and Resilience Plans represent the new framework in which European member states identify their development strategies and allocate European and national resources – with the objective of relaunching socio-economic conditions following the coronavirus pandemic.

This process, initiated as part of the European response to the global health crisis, follows the construction of Next Generation EU. It combines national and European efforts to relaunch and reshape the economy, steering the digital and climate transitions.

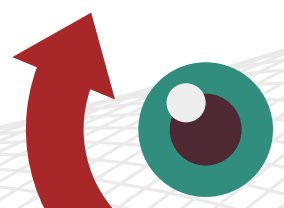
For European progressives, it is worth assessing the potential of these national plans for curbing inequalities and delivering wellbeing for all, as well as investigating how to create a European economic governance that supports social, regional, digital and climate justice.

The Foundation for European Progressive Studies (FEPS), the Friedrich Ebert Stiftung (FES) and the Institut Emile Vandervelde (IEV), in partnership with first-rate knowledge organisations, have built a structured network of experts to monitor the implementation of National Recovery and Resilience Plans and assess their impact on key social outcomes. Fact- and data-based evidence will sharpen the implementation of national plans and instruct progressive policymaking from the local to the European level.

The Recovery Watch will deliver over 15 policy studies dedicated to cross-country analysis of the National Recovery and Resilience Plans and Next Generation EU. Monitoring the distributive effects of EU spending via Next Generation EU, and the strategies and policies composing the national plans, the project will focus on four areas: climate action, digital investment, welfare measures and EU governance.



MAKING NEXT GENERATION EU A PERMANENT TOOL



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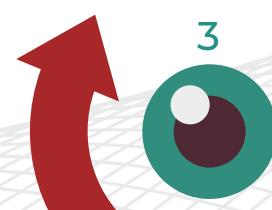


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EXECUTIVE SUMMARY

The policy study assesses the possible scope and the technical and legal difficulties in implementing a "permanent Next Generation EU (NGEU)", a central fiscal capacity for the EU, without ever losing sight of the democratic requirement.

The implementation of NGEU has raised coordination issues between the member states as to the allocation of funds across structural priorities (e.g. ecological transition vs digitalisation) and across countries. To these coordination difficulties, Section 2 adds the issue of the democratic legitimacy of EU policies when supranational priorities constrain the autonomy of national parliaments. The problem of accountability is not new when one thinks that supranational rules, such as the Stability and Growth Pact, impose limits on the power of parliaments to "tax and spend"; in fact, the intrinsic logic of coordination is to force (political) discretionary power to comply with (macroeconomic) functional imperatives; this inevitably produces a form of depoliticisation of fiscal policy. Throughout this policy study, we constantly keep in mind that transforming NGEU into a permanent programme offers an opportunity to fix this depoliticisation of EU policies and open a window for a breakthrough to a "political Europe".

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Section 3 recalls that the implementation of NGEU was not only of paramount importance to boost the post-pandemic recovery, with still uncertain economic outcomes, but, first and foremost, it also represented a shift in the

mindset of EU policymakers. For the first time, common borrowing and limited risk sharing became features of an EU package. It would be wrong to think of NGEU as a Hamiltonian moment, a founding act for a federal Europe: NGEU is limited in scope and in duration; does not involve member states' past debt; and it did not create a common expenditure (investment) capacity. Nevertheless, as the pandemic and successful response to it have clearly indicated that EU countries have a common purpose, the issue of whether a central fiscal capacity should be created and what its shape would be (or should be) are at the centre of the EU debate.

Section 4 asks the question of what the main task of a permanent NGEU would be. An obvious answer is the provision of the financing of European public goods (broadly defined to encompass welfare-enhancing concepts, such as "security" and "the environment") that member states may underprovide, due to lack of resources and/or because of externalities. For global public goods, preferences are quite homogeneous and, as the different Eurobarometers show over and over again, they are in high demand by EU citizens. This justifies central provision. On the other hand, the problem of the EU as a provider of public goods is that it lacks the fiscal capacity to finance the provision of public goods at the national level when preferences are heterogeneous. A central fiscal capacity would be a way to overcome this problem. The policy study highlights that the desirability of public goods needs do not stem exclusively from economic reasons but also from (geo)political ones. Section 4 concludes by highlighting that the debate on a central fiscal capacity should be led in parallel to the one on the reform of the Stability and Growth Pact to ensure that fiscal space is created in the EU.

Section 5 highlights that there are limited options for creating a central fiscal capacity within the current institutional setting. The treaties design a budgetary framework (centred around the multiannual financial framework) for the EU that links expenditure to the capacity to raise resources, thus strongly limiting, in ordinary times, the capacity to raise debt. The creation of special financial instruments and the decision to spend beyond their own resources (i.e. to raise debt) is explicitly linked to extraordinary circumstances and cannot be a solution for recurrent provision of public goods. The European financial stabilisation mechanism, the support to mitigate unemployment risks in an emergency (SURE) and other instruments have all been created under this umbrella. NGEU is not an exception to this general principle, and it was created under Article 122 of the Treaty on the Functioning of the EU as "exceptional

and temporary". EU legislation prohibits, as a matter of principle, that the EU uses funds borrowed on the capital markets for the financing of operational expenditure. The policy study reviews other provisions that might help finance public goods, but regardless of the legal basis chosen: (a) the EU does not have a general multipurpose financial instrument that it could activate, in addition to the general budget, to finance actions and projects over a long period; and (b) the EU cannot grant funding to finance actions outside its field of competence, that is, substitute itself for the member states in areas where they retain competence for their policies. Thus, either the revision of treaties or the establishment of new intergovernmental arrangements (on the blueprint of the European stability mechanism) seems unavoidable if the central fiscal capacity is to be created.

Section 5 also develops the proposal for a European Public Investment Agency, as a first step towards the creation of a properly defined central fiscal capacity. Such an agency would be capable of planning investment projects and implementing them, in cooperation with member states. Because of the EU legislation, the agency would not have complete control over strategic choices but would mostly act within the limits set by the EU institution roadmaps. Still, it would have the administrative capacity to design public investment projects that the Commission lacks today and could be given control of grant allocation, technical guidelines, monitoring of conditionality and so on.

Section 6 builds on the previous sections to argue that even substantial progress on a central fiscal capacity would not eliminate the need for national policies. As increasing powers are transferred to the European level concerning public goods, the issue of how to coordinate national government policies among them and with the policies implemented at the centre remains. The coordination of policies necessarily constrains the autonomy of national parliaments, raises the issue of the democratic legitimacy of EU policies and may cause a form of depoliticisation of fiscal policy. This would become even more problematic were the EU to transfer, at the supranational level, some of the decisions about what public goods to provide and who to make pay for them. Nothing short of European democracy, that is, a substantial leap forward in the creation of a democratic decisional process at the EU level (a federal Europe), would help to solve this crucial problem.



1. INTRODUCTION

The program Next Generation EU (NGEU) has crossed a few red lines (e.g. on European debt and country-specific allocation), but it remains a temporary tool within the current Treaty on the European Union (TEU) and Treaty on the Functioning of the EU (TFEU). While NGEU was developed as a tool to promote recovery from the pandemic and to make the EU resilient to new shocks in the future, these new shocks have already emerged: a war at the EU's borders, following the Russian invasion of Ukraine; an energy crisis; and – intertwined with the first two – a surge in inflation unseen for decades.

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Three economic aspects requiring some scrutiny before a permanent fiscal capacity could be enacted: NGEU's efficacy; public spending scope of the fiscal capacity; and its articulation with fiscal rules.

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This raises some important questions. Firstly, **considering the high frequency of shocks hitting the EU, should NGEU become a permanent tool? Should a permanent NGEU help EU countries confront pressing issues, not only the ecological transition and digitalisation that are at the core of the current program, but also security?** This is primarily a political question with an economic dimension that relates to the supply of public goods. All public goods are not alike, and a ranking of them in the European context may be helpful. Besides, providing new European public goods via a permanent program would certainly be made conditional on a prerequisite: that the current program has been successful at achieving its objectives. Still on the economic front, a permanent fiscal capacity has to be discussed in the wider European fiscal framework encompassing the Stability and Growth Pact (SGP). Indeed, a European fiscal capacity would complement the domestic fiscal

rules, the reform of which is currently being discussed after the recent reform proposals of the SGP by the European Commission in November 2022. Complementing domestic fiscal rules with a European fiscal capacity would also question the role of automatic stabilisers and their allocation between the European and national levels. There are, therefore, three economic aspects requiring some scrutiny before a permanent fiscal capacity could be enacted: NGEU's efficacy; public spending scope of the fiscal capacity; and its articulation with fiscal rules.

Secondly, if a permanent NGEU were the preferred option, **would it require a treaty change? Or would there be legal margins for manoeuvre within the treaties to develop a permanent tool?** This is primarily a legal question.

The last question relates to the strategic inter-relationship between two tiers of political governance: the national and European tiers. **How can a permanent European program reconcile with the heterogeneous preferences of European citizens?** There are two related issues here. On one hand, NGEU prioritises a few objectives, like the green transition and digitalisation. Going beyond these would enlarge the scope of targeted expenditures, including possibly the supply of new European public goods like defence. Following this direction would require a consensus across EU countries. Does such a consensus exist? On the other hand, a new and permanent European fiscal capacity would raise the issue of its financing, at a moment when the exact final funding of the current program has not yet been settled. An extension of NGEU would lead to acute issues of whether EU contributions would have to rise or new European taxes would have to emerge to pay for debt charges and, in the longer run, to repay debts. Beyond legal and economic perspectives, solving the trade-off between national contributions and European taxes is ultimately a political question.

In this policy study, we aim to shed light on these different questions in three steps.

The first step makes the case for having a permanent NGEU. Broadly speaking, there may be three purposes: to support growth and resilience-oriented reforms in the member states (as with the current version); to create a central fiscal capacity for macroeconomic stabilisation purposes; and to finance the provision of European public goods. We are inclined to favour the third option

because it answers some current and future concerns of the EU (e.g. green transition and defence, to which we add health); it provides good outcomes, in terms of well-being and, possibly, growth; and it may be the most feasible politically, given the emerging societal demand for public goods. A final reason is that the definition of a European public good may include the first two purposes, namely, economic resilience and macroeconomic stabilisation. Targeting the third option may thus embed the first two, whereas the opposite is not the case.

The second key step concerns the institutional form that a permanent NGEU should take, and the practical modalities of introducing it, including treaty changes. We argue that they may be necessary, unless new intergovernmental arrangements are found, like those established for the creation of the European stability mechanism (ESM).

The third step discusses the implications of a permanent European fiscal capacity for national and European democracy. It argues that genuine policy coordination on the provision of European public goods is necessary but not sufficient to tackle the democratic requirement. It has to be reinforced by the creation of an EU-level tax on economic gains from the single market and linked to a European parliamentary process, as a means of reconciling national and European democracy, while laying the groundwork for a breakthrough to a "political Europe".

But before undertaking these analytical steps, we briefly sketch the actual and expected achievements and shortcomings of NGEU as it currently exists. In doing so, we assess the benchmark of a possible permanent EU fiscal capacity.



2. NGEU AT THE CROSSROADS BETWEEN EXECUTIVE INTERSTATE FEDERALISM AND TRUE EUROPEAN DEMOCRACY

The European recovery plan brings the fiscal issue back to the forefront. The establishment of a budget goes to the heart of politics and parliamentary democracy. Within the EU, the fiscal issue has so far been governed by a logic of supranational coordination of national fiscal policy. However, the principle of supranational coordination, while it may be necessary on a functional level, runs counter to the principle of national democracy and self-legislation. Coordination of national fiscal policy affects the core of member states' democracies, in that it constrains national parliamentary budgetary power.

2.1 THE DEMOCRATIC LIMITS OF EUROPEAN COORDINATION BY SUPRANATIONAL RULES AND INSTITUTIONS

National fiscal policy, far from being an abstruse technical dimension reserved for technocrats, lies at the heart of parliamentary democracy. Democracy cannot be reduced to electoral procedures or the constitutional framework (checks and balances, rule of law, and protection of fundamental rights). Democracy is a *demos* and a *kratos*: a collective capacity to act on the common reality. In our modern political society, *kratos* refers to public power, which, in turn, corresponds to parliamentary budgetary power, that is, the fiscal capacity to produce public goods. Finance law condenses the essence of the nation's political life. It is twofold: on one hand, the vote on tax revenues corresponds to the share of common wealth and income that the political collective decides to take from private wealth and income (with the issue of the level and distribution of tax levies); on the other hand, the vote on public spending corresponds to the public goods that the political collective decides to produce for itself (with the issue of the nature and distribution of these public goods). Thus, according to a substantive understanding, democracy is the political regime that makes it possible to translate the preferences of the majority of citizens expressed through an election, voted for by the parliamentary majority and implemented by the government, into structuring public policies. The political value of the citizen's ballot is directly indexed to the reality of a parliament's budgetary power.

However, **any coordination of fiscal policies reduces parliamentary budgetary power at the national level, both quantitatively and qualitatively.** The macroeconomic gains of coordination should not hide their democratic limits.¹ The European fiscal rules bind national parliamentary budgetary power in a "quantitative" way, as the volume of the public budget cannot exceed certain thresholds – despite the adaptable implementation of these fiscal rules by the European Commission and the Council. The proposals for reforming the European fiscal framework aim precisely at restoring a certain fiscal margin for the member states, but there remain, in any case, limits to the discretionary budgetary power of national parliaments. Moreover, this European fiscal framework and the internal market's law (freedom of movement and European competition law) also "qualitatively" reduce national parliamentary budgetary power in its capacity to steer major socio-economic policies, since the "European economic constitution" constrains member states to adopt supply-side policies. Whether supranational coordination is based on rules or independent institutions (e.g. European fiscal board), or even political institutions at the level of the eurozone (Eurogroup) or the EU (ECOFIN or European Council), the intrinsic logic of coordination is to force (political) discretionary power to comply with (macroeconomic) functional imperatives, which inevitably produces a form of depoliticisation of fiscal policy that eventually feeds a negative politicisation of national democracies.²³

On the other hand, and paradoxically, **the improvement and easing of supranational coordination is in conflict with the national democratic principle of state sovereignty.**⁴

The poor macroeconomic relevance of rigid numerical criteria should not make us forget their strong political relevance in national democratic terms. They constitute an important guarantee that the majority preferences and demands of the European peoples of the north are respected within the framework of the pact they have agreed upon with the European peoples of the south. The reluctance of the northern states to any interstate fiscal transfer within the eurozone may seem negative from an economic point of view and selfish from a political one. However, it remains a fundamental political preference of the peoples of the north, as expressed in their parliamentary democracy. Hence, there is the political deadlock of a European debate structured around "solidarity versus responsibility". The debate on coronabonds perfectly illustrated this dilemma. Member states accused of being stingy,

such as the Netherlands or Austria, were simply following the preferences of their citizens. Imposing coronabonds on the Dutch, who did not want them, raises the question of democratic legitimacy. In the same way, forcing other member states into an austerity solution in the name of responsibility, when the citizens do not want it, raises the same problem of democratic legitimacy.

That being said, even the most deeply rooted peoples' preferences are never definitively fixed. They can evolve according to long-term changes occurring in the global context and/or abrupt internal and external shocks. Unthinkable a few months before the Covid-19 crisis, Germany has re-evaluated its position towards the principle of mutual indebtedness at the European level, while ensuring that its requirements are met (that the European recovery plan should not be an *ad hoc* instrument limited to the euro area, but be part of the EU budgetary framework). The new European fiscal instrument thus constitutes an unprecedented breach in the paradigm of supranational coordination. A genuine European fiscal dimension now seems possible. Its potentials and limits remain to be assessed.

2.2 EUROPE'S HAMILTONIAN MOMENT: THE RISK OF THE INTERSTATE TRAP

"It's a Hamiltonian moment", say the proponents of European federalism stunned by the tremendous surge of history – for once, in their direction, they believe – since the Franco-German proposal (18 May 2020) to mutualise debts in order to launch Europe's post-Covid-19 economic recovery.

The parallel between the history of the beginnings of American federalism and the current European situation was too tempting for some commentators and scholars not to draw on. However, they should remember that the first references to the "Hamiltonian moment" were made on the other side of the Atlantic by Ronald McKinnon⁵ and Paul Volcker,⁶ not to rejoice in the fact that a federal Europe was within sight, but to worry about the fact that "Europe is experiencing its Hamiltonian moment, but with no Alexander Hamilton in sight".

In the game of differences, let us note that American

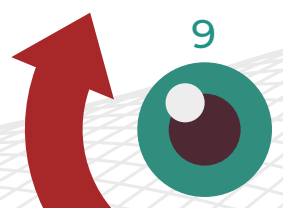
mutualisation was essentially about past debts, whereas European mutualisation is about future debts. The difference is significant: the pre-Covid-19 debt gap of member states endangered the integrity of the eurozone in 2011-2012 and will continue to do so once the economic crisis linked to the pandemic is resolved – if Europe succeeds in doing so. In 2016, alarmed by the unsustainability of such discrepancies, especially between French and German debt levels, Thierry Breton promoted an *ad hoc* plan to mutualise past defence spending (starting from the creation of the euro area) through a "European Security and Defence Fund".⁷ The argument was that the defence spending of one member state benefited the others and was, therefore, to be considered as a European public good (see Section 4.2).

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More problematic is the neo-functionalist potential logic that seems to underlie the European recovery plan. Neo-functionalism (also named the "small steps" method) seeks to achieve "an ever-closer union among the peoples of Europe" through incremental supranational transfers of regulatory and coordination powers for a growing number of policy areas from the national level, rather than the deployment of a genuine European public power producing European public goods. Far from merging the debts of all countries into a single European common pot, the mechanism is more a matter of supranational policy. This is explicit for the loans, for which the supranational guarantee – allowing advantageous rates – is conditioned



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to the respect of a series of requirements by the beneficiary member state (respect for the rule of law, ecological conditionality, earmarking of the amounts allocated for investment and not operating expenditure, presentation of a structural reform plan, all of which are validated by the European Commission and the member states by a qualified majority vote). But it is also implicitly the case for grants: the amounts stem from a European loan, the repayment of which will be based on an indeterminate mixture of national contributions – to be borne by future generations – and proper new European own resources that have not yet been decided.

In the case of interstate reimbursement, one can imagine the eagerness with which populist forces will speak out against such a transfer of burdens "weighing on our children's shoulders" to the benefit of neighbouring states. It risks reactivating the belief in a zero-sum game, where each member state does its own calculations and feels it has been aggrieved, further deepening the divide between northern and southern Europe. The "constitutional risk" of such a fiscal transfer must also be taken seriously, in the context of great nervousness on the part of the German Federal Constitutional Court – although the German court has so far rejected appeals against the European recovery plan.⁸ It may be argued, though, that the risk of interstate reimbursement may incentivise net contributors to the Recovery and Resilience Facility (RRF), like Germany and France, to develop new European own resources.

Another pitfall with the European recovery plan is its exceptional – and therefore, temporary – nature, like the original Hamiltonian plan. The latter ended in 1835 under President Jackson's administration and the counteroffensive of the federated states, which were determined to cut short the federal dynamic, and thus, sowed the seeds of the civil war. If the European recovery plan can hide the structurally divergent trajectories of the member states for a while, these will only reappear with greater force once the plan has been settled.

Finally, let us not forget that the success of Hamilton's plan was the result of an important concession: the definitive choice of the seat of the federal capital, transferred from New York to the banks of the Potomac. In the European recovery plan's narrative, the decision-making place of the "European state of emergency" no longer seems to be Brussels, or even Frankfurt, but European capitals, with Berlin at the top. National impetus to deliver on the European recovery plan has not been tied closely with parliaments.

Thus, Europe's Hamiltonian moment may lead to an interstate stalemate that would reinforce the executive federalism of the European Council, with heads of state and government deciding the future of the continent by themselves and above the peoples and parliaments, hence disconnecting even further the legitimacy loop binding the government and the governed.

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3. THE ACHIEVEMENTS OF NGEU SO FAR

The reaction of European policymakers to the Covid-19 crisis surprised many who had previously been critical of the timidity and mistakes in the management of the sovereign debt crisis. Both national governments and European institutions reacted promptly to the pandemic wave, although they could not avoid a crisis – the economic and social dimensions of which made the 2007-2008 global financial crisis pale by comparison – the policymakers' combined, titanic efforts managed to mitigate its impact on incomes and employment. But it is precisely the extraordinary dimension of the crisis that prompts **the question of whether the activism of economic policy and the swift and substantial fiscal and monetary expansion denoted a change in the mindset of European governments and institutions**, or simply was the only option available to policymakers to avoid the collapse of our economies.

3.1 A PERMANENT CHANGE IN THE MINDSET OF EUROPEAN POLICYMAKERS?

The reassessment of fiscal policy seems particularly relevant for the debate on European macroeconomic governance. Fiscal policy was previously relegated to a marginal role in demand management, but, in the past decade, turned out to be pivotal for macroeconomic stabilisation, among other things, because monetary policy has long been constrained by the zero (or effective) lower bound, limiting the central bank's capacity to stimulate economic growth.

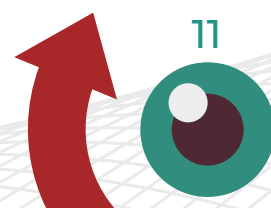
The rationale of economic policies seems to have returned to a broadly Keynesian perspective, albeit, for the time being, in a non-systematic way: an adaptive process in which, instead of delegating to supposedly efficient markets the task of converging to the best of all possible worlds, policymakers must attempt to guarantee the macroeconomic stability, which facilitates investment and accumulation of knowledge and human capital, and thus, stable long-term growth. The recent surge of inflation does not contradict this conception: investment in tangible and intangible assets remains a priority; and its impact on prices is not clear-cut, as it generates demand and supply effects.

This perspective contrasts strongly with the period right after 2010 and the sovereign debt crisis. The institutional reforms implemented between 2011 and 2014 (the Fiscal Compact, the Six-Pack and Two-Pack sets of regulations, the ESM, the banking union) reinforced EU control over national fiscal policies and perpetuated the idea that fiscal conservatism, structural reforms and market flexibility at the

country level ("risk reduction") were, in fact, the main drivers of economic convergence.

The spring of 2020 reshuffled the cards. Mistakes made in the management of previous crises prompted European policymakers to act and to act quickly. The first dam against the pandemic wave was erected by the governments of the member states, which was inevitable in the absence of a European federal government. Beyond increased health expenditures, member states injected resources into the economy to support businesses' liquidity, to limit the fall in labour income and to provide guarantees aimed at keeping credit flowing to the productive sector. In almost all European countries, the measures were extended and renewed as the economic effects of the pandemic unfolded. The effect of these measures on public finances was immediate: debt and deficits exploded. This colossal effort by European governments has borne fruit, however, and everywhere incomes and employment have fallen significantly less than GDP.

During the first-response phase, European institutions acted as guarantors of the member states' efforts, via prudential measures and new liquidity provisions by the European Central Bank (ECB) to protect the banking system, or via the activation of the general escape clause of the SGP by the Commission and the Ecofin Council that enabled member states to exceed the public deficit limit. The Commission also signalled its intention to support member states' efforts by easing state aid rules, so as not to hamper support for the sectors most affected by the pandemic. Moreover, the ECB opened a protective umbrella by launching a vast programme of government bond purchases (the *pandemic emergency purchase programme*, PEPP), which, in December 2020, was extended until the spring of 2022. This helped to reduce interest rates (already low due to the huge amount of savings available following the lockdowns and the drop of consumption and investment), making debt more sustainable. The European institutions also made loans available to member states for the most urgent expenses, on health-related policies and support to the labour market. Whether it was the adaptation of an existing mechanism, like the €240 billion ESM pandemic line, or a newly created instrument, like the €100 billion *European instrument for temporary support to mitigate unemployment risks in an emergency* (SURE), the principle was the same: **Europe borrows at favourable rates and transfers the funds to member states, which can therefore save on interest expenses.** If the ESM pandemic line did not take off, in the absence of any requests for conditional loans, SURE was highly in demand, and in autumn 2020 it started lending, reaching €90 billion to 19 countries by the summer of 2021.



3. THE ACHIEVEMENTS OF NGEU SO FAR

3.2 NGEU AS A RADICAL CHANGE

But these short-term responses were not enough, and this led to the NGEU programme, which supplements the €1 trillion 2021-2027 European budget with the RRF and other extraordinary mechanisms, for a total of €750 billion (Table 1).

There has been much discussion about the innovative aspects of the instrument:

- The political decision to create the programme was swift, despite heated debates. The European Commission made a proposal by the end of May 2020, and a first positive decision by the European Council was reached in July 2020.
- It is the first time that the Commission has issued debt on behalf of the EU for such significant amounts, to foster economic cooperation and finance a vast investment programme that should reconcile the exit from the Covid-19 crisis with the EU's long-term goals (green transition, digitalisation, social cohesion).
- In addition, resources are allocated to member states not according to the usual keys, but according to the needs linked to the costs of the pandemic and to the severity of the crisis; this creates substantial transfers among countries (risk sharing). It has been pointed out by many that Italy, usually a net contributor to the budget, will be a net beneficiary of the RRF.
- The member states retain some discretion on the allocation of funds, but they need to justify their investment projects within National Recovery and Resilience Plans (NRRPs). These plans need the Commission's approval during the European semester and must remain consistent with EU's goals of a double transition: 37% of the funds must be allocated towards the green transition; and 20% must be allocated towards the digital transition.
- Debt will be repaid starting in 2026 (until 2058), hopefully with European resources such as those raised via the carbon border adjustment mechanism (CBAM) that is currently under discussion in Brussels. If no progress is made on this side, each country's contribution to the EU budget will have to increase (by quite a modest amount).

3.3 THE ECONOMIC IMPACT OF NGEU

At this early stage, there are only a few *ex ante* economic assessments of NGEU on EU countries. Drawing on the NiGEM model, Watt and Watzka find a very limited expected impact in the first three years of the RRF, around +0.3% of GDP for the EU or the euro area.⁹ This is not surprising because the payments of grants from the RRF are progressive and culminate during the fourth year. Most other assessments are based upon dynamic-stochastic general equilibrium (DSGE) models developed and used by the Commission and by the ECB. Bankowski et al. conclude that grants from NGEU could increase the aggregate euro area GDP by one percentage point by 2025, while loans (under the assumption that they would be fully requested) would increase it by an additional 0.7 percentage points by 2025.¹⁰ Pfeiffer et al. find that the NGEU program is expected to increase aggregate euro area GDP by about 1.5 percentage points by 2024.¹¹ They show that one third of the effect can be explained by spillover effects from trade between EU member states (intra-EU trade). A simple aggregation of national effects would, therefore, underestimate the assessment of the effects of NGEU. Bozou and Creel,¹² with a (two-country) DSGE model, find strong fiscal multipliers from the use of grants from NGEU.¹³ An increase of public investment by one percentage point of GDP would increase GDP by eight percentage points after 20 years. While large multiplier effects like this one are not an unusual outcome in the academic literature¹⁴, a more interesting result is that funding via the NGEU programme would add 0.8 and one percentage points of GDP to the core and the periphery of the euro area, respectively, in comparison with a similar increase of public investment funded domestically (see Tables 2 and 3). Another striking result shown in Tables 2 and 3 relates to the spillover effects of NGEU grants in comparison with domestic funding of the increase of public investment. The lower debt and lower interest rate induced by a European-funded fiscal shock, in contrast with domestic funding, contributes to accelerating growth in the country implementing the fiscal impetus, which has, in return, a positive impact on the partner country. A fiscal shock on the core generates an additional rise in the GDP of the periphery of one percentage point, via trade effects. Furthermore, a fiscal shock on the periphery also generates an additional rise in the GDP of the core of 0.5 percentage points, which accounts for the larger size of the core versus the periphery in the euro area. To sum up, **NGEU grants provide additional fiscal multiplier effects and additional spillovers for both the core and the periphery of the euro area.**

Table 1: NGEU breakdown (in billions of constant 2018 euros, 2021-2027)

RRF	673
of which, loans	359
of which, grants	314
ReactEU	47
Horizon Europe	5
InvestEU	6
Rural development	8
Just transition funds (JTF)	10
RescEU	2
TOTAL	750

Source: European Commission.

Table 2: Impact on GDP of NGEU funding of a public investment expansion in the core of the euro area
(in percentage points and in comparison with a similar expansion funded domestically)

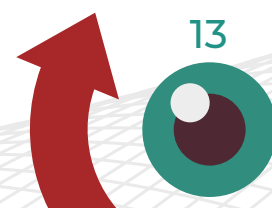
EFFECT ON	TIME AFTER EFFECT			
	1 QUARTER	3 YEARS	10 YEARS	20 YEARS
Core	2.1	0.3	0.6	0.8
Periphery	0.7	0.4	1.1	1.0

Source: Bozou and Creel (2023).

Table 3: : Impact on GDP of NGEU funding of a public investment expansion in the periphery of the euro area
(in percentage points and in comparison with a similar expansion funded domestically)

EFFECT ON	TIME AFTER EFFECT			
	1 QUARTER	3 YEARS	10 YEARS	20 YEARS
Core	-0.4	0.3	0.3	0.5
Periphery	2.2	0.4	0.8	1.0

Source: Bozou and Creel (2023).



3. THE ACHIEVEMENTS OF NGEU SO FAR

3.4 NGEU: A GLASS HALF EMPTY?

With NGEU, the EU is still very far from disposing of a *genuine* federal fiscal capacity. Germany's historic green light was conditioned by the one-off nature of NGEU, which does not take over existing debts.

Secondly, **all "federal" taxes that would make it possible to sustain this level of investment going forward, while avoiding an increase in the contributions of the member states to the European budget, are on hold, as a consensus between the member states is still far from being achieved.** Only the EU-wide plastic tax is now a reality, while the CBAM is planned to be gradually applied between 2023 and 2026.

“

We must tackle the challenges that the pandemic will inevitably leave behind. This means providing the "global public goods" that are essential for so-called inclusive growth, such as the green transition, the revival of public investment, digitalisation and the rethinking of our welfare systems.

”

Finally, **the RRF operates by transferring resources for investment programmes that will, nevertheless, remain national, as the EU does not currently have a spending capacity comparable to that of a federal state.** Therefore, a truly European investment program is currently very far from being a reality (see also Heimberger and Lichtenberg¹⁵). On the contrary, during negotiations for the NGEU, demand to reduce funding for genuinely European public goods, such as education, the Invest Europe programme and health emerged. For example, the proposal for an

embryonic health union has borne the brunt of struggles between member states concerned about paying as little as possible (the EU4Health programme was saved, albeit with a major downsizing, thanks to early intervention by the European Parliament).¹⁶ Beyond the quantitative aspects, the message that emerges is that of a downsizing of the EU's commitment to the provision of the few genuinely European public goods.

Lastly, **the question of conditionality is not yet resolved and requires some clarifications.** It was legitimate – indeed, necessary – for there to be constraints on the allocation of funds, precisely because of the principle that NGEU is a joint effort aimed at common goals and not at national political interests.¹⁷ However, and because agreement on funds allocation includes verifying the conformity of the NRRPs with the annual country-specific recommendations (CSRs) that the Commission addresses to the member states, there remains a risk that the interpretation of the so-called structural reforms that CSRs include shifts from one extreme, pro-social, to the other, anti-social. The current view that the Commission is pursuing the fulfilment of progressive reforms and social investment (see Bokhorst and Corti¹⁸) may not apply forever, and one cannot exclude the return of austerity-prone reforms.

However, highlighting the grey areas of NGEU should not lead to neglecting its innovative aspects, nor forgetting that Europe has been effective in the face of the pandemic, supporting member states in their emergency effort and launching a common programme to underpin recovery in the medium term.

If Europe's role in the short term could only be limited to supporting member states (as was done quite effectively), things change if we look beyond the emergency. As we are putting the pandemic crisis progressively behind us, we must tackle the challenges that the pandemic will inevitably leave behind. This means providing the "global public goods" that are essential for so-called inclusive growth, such as the green transition, the revival of public investment, digitalisation and the rethinking of our welfare systems. The Russian invasion of Ukraine has also revived the European defence project, mainly around the idea of better coordinating defence investments; the latter being viewed as another public good for Europeans. Not even the largest European countries can hope to meet these challenges alone:¹⁹ the greater effectiveness of coordinated investment; economies of scale; and "externalities" are all factors that favour policies conducted, or at least financed and coordinated, at a common level.

4. A PERMANENT NGEU TO DELIVER ON COMMON OBJECTIVES

Considering the current economic, social and geopolitical situation, asking whether the EU should deliver public goods to achieve better health, education and environment might seem a trivial question. But, in fact, it is far from trivial. Firstly, for legal and political reasons (as discussed in Sections 4 and 5). Secondly, and equally important, for economic reasons. On one hand, providing these "goods" (e.g. better health) may be a task left to markets. On the other hand, it may not need to be fulfilled at the EU level: the domestic level may be appropriate.

In the following we argue, firstly, that **public goods cannot be supplied optimally by the market without some public provisions and public regulations**. We also argue that, **in the European context, the provision of European public goods requires a common and centralised impetus that a European fiscal capacity would help deliver**. Indeed, we make the case that European integration brings forward a requirement to better share its benefits and to shield Europeans from its endogenous risks. Actually, European integration has produced industrial and service specialisation that, in turn, exacerbates the risk of asymmetric shocks. Without a common fiscal capacity, member states face uneven constraints on their public finances that may push them to sacrifice public goods, the value of which usually takes time to recognise. Delivering some public goods at the EU level, therefore, would alleviate the risk of their underprovision. Finally, we will also discuss the societal demand for public goods, which is relatively high and well specified in the EU.

4.1 FISCAL FEDERALISM: THE THEORETICAL ARGUMENT FOR A CENTRAL FISCAL CAPACITY

Finding the appropriate level of government for delivering public goods is complex because it involves consideration of the relative efficiency, the heterogeneity of preferences and the capacity of voters to hold accountable different levels of government. The foundations of fiscal federalism theory were laid in seminal work by Musgrave²⁰ and Oates.^{21,22} The main result of the early strands of the literature states that the central government should provide all the public goods for which there is no heterogeneity of preferences across jurisdictions, and those for which it is impossible for local governments to properly target the users (due, for example, to the mobility of the tax base and/or of the beneficiaries). On the other hand, decentralisation is optimal when heterogeneity of preferences (or production costs) over public goods exists across regions, together with the capacity of local governments

to provide them. In this latter case, provision by local governments can improve welfare. This is, in essence, the "decentralisation theorem",²³ the validity of which relies, nevertheless, on several conditions, the most important of which is the absence of externalities. If the effects of local public good provision spill over the boundaries of the jurisdiction, a trade-off emerges between the uniform provision of the public good by the central government, which internalises the externality but loses the capacity to equate marginal costs and revenues for citizens in different jurisdictions, and the provision by the local government, tailored to the needs of local citizens but unable to take into account the externality. The trade-off between heterogeneity and externalities remains central in more recent work on the subject, based on asymmetric information and incomplete contracts.²⁴

The second assumption of the decentralisation theorem is that the central government provides a uniform level of public good across jurisdictions, that is, it is unable to tailor the provision of the public good to local preferences. This assumption is usually justified on theoretical grounds by an informational advantage of local governments, which are closer to their constituencies, and consequently, have a knowledge of local preferences.

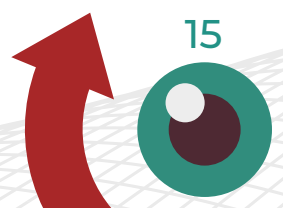
The creation of a permanent fiscal capacity requires policymakers to disentangle goods and services that should be provided at the European level from those delivered at the national level and to satisfy the decentralisation theorem.

4.2 THE DEFINITION OF PUBLIC GOODS IN ECONOMIC THEORY AND PRACTICE

As far as economic theory is concerned, a "public good" is defined by the following two characteristics²⁵:

- 1) non-excludability – if the good is available to one person, others cannot be excluded from the benefits it confers; and
- 2) non-rivalry – if the good is consumed by one person, it does not reduce the amount available to others.

Street lighting is perhaps the simplest and most intuitive example of what makes a public good: it is difficult to prevent someone from consuming it and its consumption does not reduce the consumption of others.



4. A PERMANENT NGEU TO DELIVER ON COMMON OBJECTIVES

Given their characteristics, public goods cannot be secured through markets. This is because, on the demand side, non-excludability and non-rivalry in consumption imply that users have no incentive to pay for public goods and will seek to "free ride". On the supply side, nobody has an incentive to provide public goods, since they will not be paid to do so. Together, these two factors explain the undersupply of public goods, and therefore, the need, in most cases, for public intervention to achieve a desirable level of provision in line with societal demand. That said, public intervention is not always needed to secure the supply of public goods. Some amounts of public goods can be provided incidentally, as a side effect of economically viable activities, or as a result of altruism or self-interest.

In reality, *pure* public goods are quite rare.²⁶²⁷²⁸ Peace and security constitute an example of goods with a high degree of "publicness": to the extent that one person in a geographic area is defended from foreign attack or invasion; other people in that same area are likely defended as well. This makes it hard to charge people for defence, which means that defence faces the classic free-rider problem. Indeed, in most cases, the only way to provide a sufficient level of defence is to have government provide it, and finance it with taxes.²⁹ However, in a regional context, such as the EU, the absence of a supranational entity may make it difficult to tax citizens to provide these goods – a fundamental problem for achieving collective action for regional public goods.³⁰ Therefore, a third characteristic of public goods in a regional context is the so-called:

- 3) aggregator technology – how individual contributions add up to make the public good socially available at the regional level; the exact form of such a technology depends on the public good at stake and on the institutional setting.

Let us consider the main forms of aggregator technology and the benefits of an EU institutional setting that would perpetuate NGEU.

With respect to the forms taken, the simplest technology is the "summation aggregator", which refers to the case where the socially available amount of the good is the *sum* of the separate amounts produced by the members of the community. Measures to reduce greenhouse gas (GHG) emissions are typically related to this kind of technology, with the overall reduction being equal to the sum of each country's emission reduction.^{31 32} The drawback of the "summation aggregator" is, however, that it makes each

contributor's provision effort of the public good a perfect substitute for that of other contributors, thus encouraging free riding and underprovision. In the example of reducing GHG emissions, even a non-contributing country to the effort can easily capture the benefits of climate change mitigation resulting from the effort of others. In this case, institutionalising the reduction effort, as in the EU's Green Deal, contributes strongly to reducing the free-rider problem, with the EU acting as an entity with ultimate enforcement power. Importantly, by allocating at least 30% of expenditures to climate purposes, the NGEU gives funds to each member state to reach its GHG emissions reduction targets. It is worth noting that, to date, except for the EU, no other international arrangement has been successful in giving incentives and financial resources to meet the international agreements of climate change mitigation signed in 2015.

In terms of aggregation technology, there are, however, many other possibilities of practical importance than the "summation aggregator".^{33 34} Among them are the "weakest-link aggregator", where the socially available amount is the *minimum* of the quantities individually provided. Curbing the spread of infectious disease is an example where the smallest contribution determines the aggregate, as only large-scale vaccination programs can help to eradicate the disease: omitting some countries from this large-scale effort would jeopardise success.³⁵³⁶ Other examples include security measures at airports to protect against terrorist attacks or protection of the integrity of computer networks through firewalls and antivirus programs. Caparrós and Finus provide another example:³⁷ the success of EU measures to address illegal migration depends on the "weakest" member at the periphery of the EU area; irrespective of the measures taken by "stronger" members. In the case of the "weakest-link aggregator", the free-rider problem no longer exists when the contributors are homogeneous in terms of endowment and preferences.³⁸ On one hand, this means that any income transfers (e.g. grants through the NGEU) that compensate for differences in initial endowments help to overcome the free-rider problem. On the other hand, it means that the unanimity vote in European institutions is counterproductive in weakest-link environments, since the "weakest" country *de facto* imposes its veto power in the absence of any strong financial incentive.

Another form of aggregation technology with practical importance is the "best-shot aggregator", where the socially available amount is the *maximum* of the quantities

individually provided. Missile protection³⁹ or vaccine development⁴⁰ are often viewed as types of best-shot technology, where the best chance of success occurs if the most technologically advanced countries take the lead. More generally, the "best-shot aggregator" applies when different teams engage in a contest in which "victory" benefits the entire team as a public good, while the scoring rule depends solely on the best individual performance.⁴¹⁴² In that environment, loans through the NGEU mechanism are appropriate to assist the best-shooter EU contributors (either countries or private enterprises). Moreover, EU institutions have a huge role to play, in terms of coordination, when there are several potential best-shooter contributors, because only one of them needs to provide a given best-shot European public good.

As evidenced from the previous discussion, "one size does not fit all" for achieving an adequate level of European public goods: **each particular public good relies on a specific aggregator technology; and requires a tailored institutional setting to create the right incentives.** In this context, NGEU offers just enough flexibility to provide a tailored response to each European public good that needs to be financed. It is, however, important to stress that the "goods" we speak about here are not necessarily merchandise or services (although these may be called upon within the framework that provides the goods). Rather "goods" refer to the benefits to society from the provision of certain utilities and from satisfying particular wants and needs.

Alongside peace and security, five other broad sectors of public goods are rather consensual among economists:

- 1) environment (e.g. climate change mitigation, clean air, drinking water);
- 2) health (e.g. eradication of disease);
- 3) infrastructure (e.g. roads, internet network);
- 4) knowledge (e.g. education, R&D); and
- 5) governance (e.g. law enforcement, financial stability).

Within each of these sectors, goods can be identified that bring advantages to society as a whole and to which every individual has an equal entitlement. To quote a few, this includes financial stability,^{43 44 45} adequate digital infrastructures,^{46 47 48} energy security⁴⁹ and environment protection.⁵⁰

Sometimes, public goods are viewed as "common challenges" or "challenges on which there is a relatively broad level of agreement".⁵¹ Thus, the list can become quite long and includes social cohesion, dealing with ageing populations, remaining competitive in the global economy, tackling exclusion from the labour market, etc.

4.3 THE QUESTION OF GEOGRAPHICAL SCOPE FOR PUBLIC GOODS

Due to higher interconnectedness (both economic, social and political), more and more public goods range beyond national borders, with some of them truly global in their reach and others regional and/or international.⁵²⁵³ Reduction in GHG emissions, for instance, has clear attributes of a global public good, but others have a more ambiguous scope. Moreover, for a given public good, the optimal scope can change over time, depending on the context and societal needs. On the supply side of public goods, alongside spillovers and externalities arising from interconnectedness, returns to scale are another key factor to consider in defining the optimal scope. Dealing with higher uncertainty (due to greater climate-related and geopolitical risks) also calls for a scope beyond national borders.^{54 55 56}

Table 4 summarises the three economic criteria, as proposed in the literature, that defines a (European) public good and cross-checks them with different areas in which the attributes of public goods have been recognised. At this stage, three points should be emphasised.

Firstly, the demand for (European) public goods, such as those exemplified in Table 4, is that emanating from academic and political circles and is not necessarily coincidental with the demand emanating from citizens (we return to this point later).

Secondly, criteria in Table 4 are solely economic in nature, whereas other criteria (e.g. political or institutional) should also be addressed. Besides the fact that European public goods have to meet European citizens' demand, they have to be decided and evaluated through a European political democratic process (i.e. European elections) and effective European parliamentary control. They also have to touch a significant number of European citizens. For instance, the Erasmus programme, which is commonly presented as a typical European achievement, only concerns less than 1% of a European age cohort, which is too low to



4. A PERMANENT NGEU TO DELIVER ON COMMON OBJECTIVES

consider it as a genuine European public good. This quantitative criterion implies a larger amount of the EU budget to get the means to generalise these kinds of European projects. Moreover, and more fundamentally, there remains a "qualitative criterion": European public goods – in order to be truly European public goods and not interstate public goods – have to be funded by European fiscal resources through the taxation of the single market (see Section 6).

Thirdly, we do not propose here any kind of rule – based on scientific analysis – to discriminate between the different criteria. Probably a weighted-based rule would be useful to help in choosing which European public goods should be funded.⁵⁷ In any case, this question needs to be explored and informed by concrete *ex ante* case studies, such as those undertaken by Berger et al.⁵⁸ or Creel et al.⁵⁹ The examples listed in Table 4 are those found in the literature on the topic of European public goods or, at least, deserving consideration.

In the specific case of the EU, the process of economic integration itself has generated a thick layer of European public goods, which cannot be provided efficiently by markets, but need to be managed by public authorities at the European level.^{60 61 62} In that sense, European public goods are a by-product of European integration. Within the EU's four fundamental freedoms, national borders no longer automatically delimit the extent to which public infrastructures and other services exert their effect and spread their benefits.⁶³ The economic integration fostered by the single market (and the single currency) brings gains for all. On the less-positive side, though, economic integration, by favouring specialisation of economies (industrial concentration) increases asymmetric shocks, and thus, calls for risk sharing. The SURE mechanism, by providing a European unemployment insurance, is a first step in the right direction.^{64 65} In fact, from the EU's beginning, there has been a need to provide public goods on a European scale to achieve the full benefits of integration. For example, at the end of the Bretton Woods regime in 1971, exchange rate volatility was a concern for the very open and heavily trading European countries, thus calling for their stabilisation and, ultimately, for the adoption of the single currency, which has obvious attributes of a European public good. Then, in the 2010s, the euro crisis proved the need to strengthen European financial stability, hence the creation of several mechanisms at the European level, including financial assistance and capacity building for troubled economies, financial regulation and supervision, all with clear attributes of European public goods as well.

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In the specific case of the EU, the process of economic integration itself has generated a thick layer of European public goods, which cannot be provided efficiently by markets, but need to be managed by public authorities at the European level.

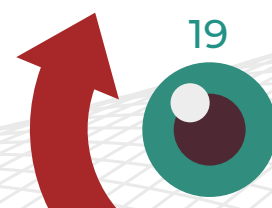
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Table 4: Demand and supply of (European) public goods

			SUPPLY OF (EUROPEAN) PUBLIC GOODS		
			ECONOMIC CRITERIA		
DEMAND FOR (EUROPEAN) PUBLIC GOODS	SECTORS	EXAMPLES	Externalities ¹	Increasing returns to scale ²	Uncertainty ³
	Environment	Mitigation of climate change	X	X	X
		Natural resource protection	X		
	Peace & security	Defence	X	X	X
		External border protection	X	X	X
		Fight against terrorism	X	X	X
		Cyberattacks	X	X	X
		Energy security	X	X	X
		Food self-sufficiency	X		X
	Infrastructure	Digitalisation	X	X	
	Health	Epidemic preparedness and response	X	X	X
	Governance	Single currency	X	X	
		Unemployment insurance	X	X	X
	Knowledge	R&D	X	X	X
		Targeted programs for groups (e.g. youth, unemployed)	X		

- 1 Externalities: The provision of goods through the market creates either positive or negative consequences for uninvolved third parties. From the point of view of society as a whole, in the case of positive externalities, a purely market-based supply provides too little of the good concerned (because nobody is internalising such positive consequences on third parties). In contrast, in the case of negative externalities, the free interplay of market leads to a provision of the good concerned that is too high, in comparison to the overall social optimum (because nobody is internalising such negative consequences on third parties). Thus, in the presence of market failures, the adequate provision of the good concerned requires public intervention. The most striking example of negative externalities is GHG emissions. "Schooling for all" is a good example of positive externalities.
- 2 Increasing returns to scale: Production on a higher scale leads to lower unitary costs of production (decreasing marginal cost) because fixed costs are allocated over more units. When the production of a good entails high fixed costs: the higher the scale of production, the lower the price to be charged for the consumer. Fixed costs can be material or immaterial, direct or indirect. Network industries are generally operating with high fixed costs due to their infrastructure.
- 3 Uncertainty: risk is inherent to human activities but varying with periods and people (more or fewer "good" times). Some risks will not be insured by private operators (due to moral hazard) and some activities will not be developed by private agents (due to a low probability of risk occurrence), again signalling some problem of market failure. The actual period is perceived as times with growing uncertainty in various areas (risks due to extreme weather events, pandemics, geopolitics, job polarisation, etc.).

Source: authors.



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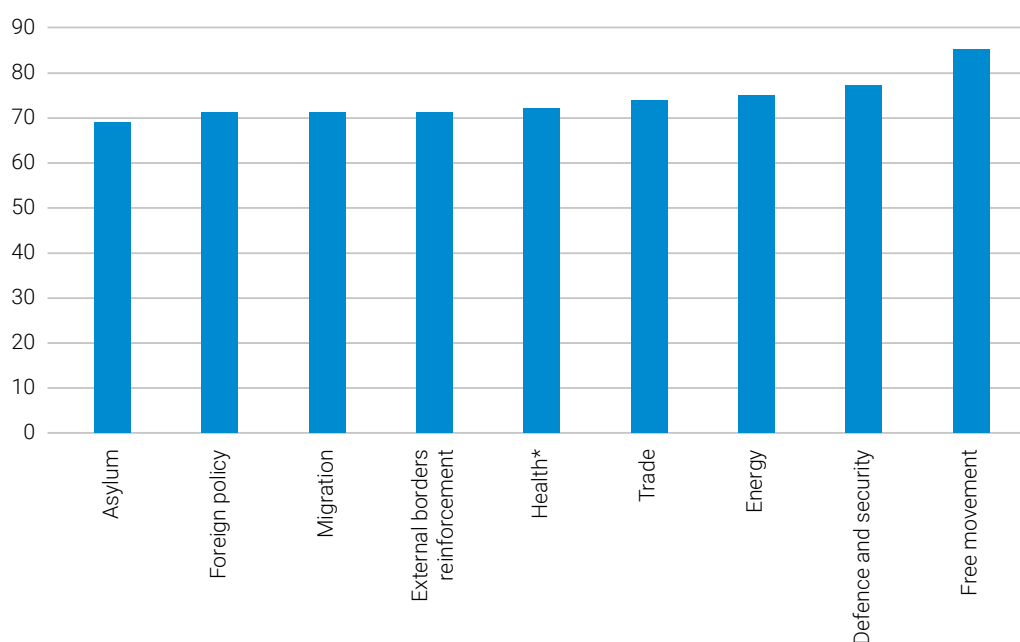
4.4 IS THERE A SOCIETAL DEMAND FOR EUROPEAN PUBLIC GOODS?

As there is no direct evidence on the demand for European public goods, we rely on Eurobarometers, following Buti and Papaconstantinou,⁶⁶ and a report from "the Conference on the Future of Europe".⁶⁷

The latest standard Eurobarometer, realised between 18 January 2022 and 14 February 2022, shows that European citizens are in favour of a common policy in diverse

domains, from free movement within the EU to defence, energy, trade, health and foreign policy; a point already made clear by Buti and Papaconstantinou.⁶⁸ Even the *a priori* less consensual policy actions, namely, a common European asylum system and migration policy, record 70% in favour (Figure 1). Yet, it is important to bear in mind that the Eurobarometer does not say whether citizens are in favour of common policy while keeping responsibility at national level, or whether citizens want the EU to take full responsibility, through a common budget and without any role for national policy.

Figure 1: Share of Europeans in favour of an EU common policy, by type (in %)



Source: Standard Eurobarometer Winter 2021-2022 (2022), no. 96, published April. Survey realised between 18 January and 14 February 2022.

Interestingly, two Flash Eurobarometers screening the EU's response to the situation in Ukraine (no. 506, published in May 2022) and to the energy challenges (no. 514, published in December 2022) show an even stronger demand for the delivery of public goods at the European level. In particular, common policy actions to ensure EU independence from Russian gas and oil are favoured by 85% of European citizens, with a high desirability for the

green transition to clean energy and energy efficiency measures (again 85% in favour of). Moreover, EU gas storage, joint gas purchasing (the latter following the joint action during the coronavirus pandemic to obtain vaccines) and measures to limit energy price increases are valuable goods, according to these flash Eurobarometers: all items related to any of these topics are supported by 83-90% of European citizens.

It is worth noting that the demand for "more Europe" is also present for the international scene, with 80% of Europeans in favour of trade agreements with non-EU countries respecting the highest standards of climate, environmental and labour protection (standard Eurobarometer, no. 96, published in April 2022). So far, the establishment of a digital single market is not gaining much support, however, with "only" 63% of opinion in favour.

A report from "the Conference on the Future of Europe",⁶⁹ which is based on 17,000 ideas posted on a dedicated platform between April 2021 and May 2022, and discussed in panels, confirms the previous findings. There is great demand for a cleaner, more inclusive and less dependent Europe in various areas (food, energy, sensitive productions). From the 49 proposals that emerged from the conference, proposals 16 and 40 are of particular interest for our purposes. Proposal 16 is directly linked to the EU's fiscal capacity and exemplified by both the NGEU initiative and the SURE instrument to promote forward-looking investments focused on green and digital transitions, with a strong social and gender dimension. Proposal 40 is entitled "subsidiarity" and calls, among other things, for the use of a subsidiarity definition commonly agreed by all EU institutions to clarify whether decisions have to be taken at European, national or regional level. More generally, **citizens want a Europe in which decisions are made transparently and quickly, where the unanimity principle is reconsidered and in which citizens are regularly and seriously involved** (Closing plenary, p. 39 of the report, third cross-cutting topics).⁷⁰

We must bear in mind that, until now, citizens have not always been aware of the EU's achievements (in terms of funding and regulation) or of the meaningfulness of some EU policy actions in practice (in their everyday life), especially in terms of benefits they derive from these policy actions. For instance, what proportion of EU citizens are conscious of the EU's actions in mitigating overpricing in international mobile roaming (IMR)?⁷¹ Through an EU-wide approach, the wholesale interoperator tariff payment for roaming voice calls decreased from an impressive €1 (before the regulation took place in 2007) to €0.024 per minute in 2017.⁷² The invisibility of European actions is equally obvious concerning, for instance, the integration of the electricity market, which has allowed supply security to be ensured through EU-harmonised market rules (the "software") and cross-border infrastructure investments (the "hardware").

These examples (and we could find many more) highlight that, due to an informational deficit, some citizens can miss the point of the benefits of the EU's actions.

Yet, it also calls for a democratic debate to discuss in an informed manner and ultimately decide what public goods the EU may fund.

4.5 HOW CAN WE ENSURE THAT EUROPEAN PUBLIC GOODS ARE PROVIDED EFFICIENTLY?

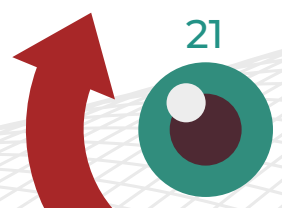
Once we have defined the public goods the EU may finance, **we need to make sure that these European public goods are adequately provided in both quantitative and qualitative terms**. In this respect, useful lessons can be learned from the cohesion policy, which accounts for about one third of the EU budget. As Fratesi and Wishlade point out,⁷³ over the past decade, academic research has focused on the *conditioning factors* that explain where, when and how EU policy funding is effective.

From this empirical literature, three main factors emerge:

- 1) the quality of government;
- 2) the absorptive capacity of regions; and
- 3) the presence of territorial capital in the regions.

We now examine these three factors in more detail. For instance, Rodriguez-Pose and Garcilazo find that the quality of government (e.g. low corruption, high quality of bureaucracy, no pervasive rent seeking) makes a difference for regional economic growth,⁷⁴ but that above a threshold of cohesion expenditure – calculated at more than €120 of cohesion expenditure per capita per year – government quality improvements are a far more important option for regional development than additional public investment. Put differently, further improvements in economic growth would require massive amounts of additional investment, unless the quality of government is significantly enhanced.

Analysing the impact of EU transfers to regions below a certain income level, Becker et al. find that only about 30% – those with sufficient human capital and good-enough institutions – are able to turn transfers into faster per capita income growth.⁷⁵ The absorptive capacity of a country (or region) is then crucial to realise the full benefits of EU transfers. Incaltarau et al. provide a refined understanding of conditions conducive to the absorption of EU funds:⁷⁶ in particular, tackling corruption and improving government effectiveness could act as core drivers for the absorption



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of EU funds and would explain, to a large extent, the differences in the absorptive capacity of new *versus* old EU countries.

Starting from the observation that the capital regions have very different socio-economic settings (in terms of infrastructure and private, human and social capital), Fratesi and Perucca find that the presence of territorially specific assets, jointly with increasing returns, allows most capital regions to gain more from EU policy investment than non-capital regions in related fields.⁷⁷ Cohesion policy, therefore, works well as an economic growth activator when EU funds complement the regional endowment. For example, entrepreneurship, innovation, information and telecommunication policies are only effective when the region is endowed with human capital, while their impact in regions not endowed is not positive.

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Cohesion policy, therefore, works well as an economic growth activator when EU funds complement the regional endowment.

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Keeping in mind the *conditioning factors* is particularly important in the context of the perpetuation of NGEU in order (1) not to waste financial resources and (2) to reap the full benefits from the provision of European public goods. In this respect, tackling corruption and reducing administrative inefficiencies are necessary, if not sufficient, conditions.

4.6 ARTICULATING A PERMANENT NGEU WITH THE SGP

The debate on rethinking macroeconomics is far from settled,^{78 79} but a consensus is emerging that fiscal policy needs to be part of the toolbox of policymakers, both to shield the economy from shocks and to help put it on a

sustainable long-term growth path. European institutions, as they were designed in the 1990s with the Maastricht Treaty and with the SGP, do not provide room for it, thus being clearly at odds with the zeitgeist.

To equip the EU and member states with a permanent fiscal capacity to react to shocks and foster well-being, growth and convergence, different paths can be taken. It can be decided to **create such a fiscal capacity at the central level, providing European institutions with a spend-and-tax capacity to be put at the service of countercyclical expenditure, investment and convergence;** if that choice were made, individual member states would be unburdened of part of the tasks and fiscal rules might not need to be much looser than they are today. Such a choice would follow the model of the USA (and in general of federal states), where individual states have strict balanced budget constraints, but the federal government uses the fiscal lever actively and without constraints, other than market pressure.

The alternative would be to remain in a setting quite like the existing one, with **limited spending capacity and revenue collection at the central level; in that case, nevertheless, a radical overhaul of the SGP would be needed, to provide member states with the fiscal capacity needed for macroeconomic regulation and investment.** Which way the EU will go will eventually depend on political equilibria.

What is clear is that fiscal policy needs to remain in the toolbox of European policymakers. The latest reform proposal by the European Commission in November 2022 gives weight to this argument. The proposal explicitly tackles the issue of fiscal space and argues that, due to different domestic conditions, the application of fiscal rules should become (more) country specific. While the proposal goes beyond allowing some country-specific fiscal rooms for manoeuvre, it is not articulated with a European fiscal capacity or a permanent NGEU. The only reference to NGEU relates to its governance and, more specifically, to its controls on the use of funding. This is a missed opportunity to foster a more active coordination of fiscal policies at the federal and domestic levels. Such coordination would involve debating common objectives (European public goods) and national objectives, and the best tools to achieve both. Tensions between the European and domestic political layers on the best allocation of spending are discussed in Section 6. Before that, an important question arises: is it legally possible to deliver a permanent NGEU under the current legislation, or are changes to the treaties required?

5. HOW TO DELIVER A PERMANENT NGEU: TOWARDS A EUROPEAN PUBLIC INVESTMENT AGENCY

The EU is not an international organisation like any other. The objectives it has to achieve, the competences and the real powers conferred on its institutions are those of a pre-federal state.⁸⁰ This is also reflected in its fiscal capacity.

The MFF for the period 2021-2027 sets the amount of commitment appropriations over the period at €1,074 billion (2018 prices), corresponding to an average amount of €153 billion per financial year. For 2022, the expenditure appropriations authorised by the budget totals €169 billion (current prices) in commitments and €170 billion in payments. To these amounts must be added the appropriations provided under the NGEU instrument, that is, €143.5 billion in commitments and €78 billion in payments.⁸¹ This is 30 times more than the UN budget, including peace-keeping operations. The 2022 EU general budget, including NGEU appropriations, corresponds to the annual budget in non-crisis periods of "large" member states, such as Germany (€360 billion in 2019) or France (€333 billion in 2019). However, it is not comparable to the US federal budget (\$4,700 billion in 2019).

5.1 WITHIN THE TREATIES: LITTLE MARGIN FOR MANOEUVRE

From a legal point of view, the constitutional provisions governing the EU's public finances are characterised by a very restricted and limited budgetary power. **This limit on its fiscal capacity is partially overridden by the NGEU instrument.** However, this instrument features a number of particularities that make it difficult to duplicate or to make permanent.

5.1.1 A legally limited fiscal capacity

The principles relating to the EU's fiscal capacity are set out in Articles 310-326 TFEU (Title II Financial Provisions of Part Six of the TFEU). A specific legal regime applies to expenditure relating to the common foreign and security policy, and to expenditure resulting from the implementation of enhanced cooperation. A regulation of the European Parliament and of the Council – the financial regulation⁸² – lays down the substantive rules applicable to budgetary matters, with regards the establishment of the annual

budget, its presentation and verification. An interinstitutional agreement between the Commission, the European Parliament and the Council specifies the procedural rules applicable to the adoption of **the EU's two budgetary instruments: the MFF and the annual budget.**

These two budgetary instruments deal with the expenditure of the EU. The MFF aims to ensure that the EU "expenditure develops in an orderly manner and within the limits of its own resources".⁸³ Budgetary programming consists of fixing the amounts of the annual ceilings of appropriations by heading, and distinguishing between commitments and payments. The expenditure headings correspond to the EU's main policy areas. The MFF is established for a minimum of five years (in practice, seven). The MFF is adopted by the Council acting unanimously, after approval by the European Parliament.⁸⁴ Similarly, the annual budget is limited to the vote on expenditure (commitment and payment appropriations). It is adopted by the European Parliament and the Council in accordance with a special legislative procedure.⁸⁵ The Council acts by qualified majority. The EU must exercise its budgetary power in accordance with the principle of fiscal discipline: (1) its annual budget must have revenue and expenditure in balance,⁸⁶ which excludes any budget deficit; (2) it must respect the ceilings on commitment and payment appropriations laid down in the MFF; and, consequently, 3) it must respect the EU's own resources ceiling.

According to Article 311 TFEU, the EU shall provide itself with the means necessary to attain its objectives and carry through its policies. This means that, in theory, the size of the budget depends on the EU's exercise of its competences. However, the development of any European policy does not automatically lead to an increase in the budget. The EU has other means at its disposal, such as normative or communicative means, to implement a policy. Consequently, appropriation is only entered in the budget if it corresponds to expenditure deemed necessary, that is, if the European institutions consider that the objectives pursued by the EU's policy cannot be achieved effectively or efficiently by means of other instruments. A European public good on which EU member states would have agreed politically may fall into this category. The principle of economy also prescribes that the resources used by the EU in the pursuit of its activities shall be made available in due time, in appropriate quantity and quality, and at the best price.⁸⁷

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Beyond that, the increase in expenditure cannot accompany the development of policies in an *unlimited* way: the total amount of expenditure is capped by the ceiling on payment and commitment appropriations set out in the MFF regulation and, above all, by the EU's own resources ceiling. A Council decision defines the resources that wholly finance the budget. In practice, this decision is adopted by the Council, in parallel with the adoption of the MFF regulation. The Council acts unanimously, after consulting the European Parliament. By virtue of the principle of budgetary balance, appropriations are legally limited to the maximum amount of own resources that the Council (the member states) allocates to the EU. For the period 2021-2027, the total amount of own resources to cover annual payment appropriations shall not exceed 1.40% of the sum of the gross national income (GNI) of all member states, and 1.46% for commitment appropriations.⁸⁸

In addition to this first budgetary limitation, the treaties also limit the European fiscal power: member states keep tight control over the resources that can be allocated to the EU. There are two categories of resources: the so-called "traditional" own resources (TOR) and the contributions from member states. TOR correspond to revenue, which is directly generated by the implementation of the EU's policies and the enforcement of common rules at the EU level (mainly customs duties). These indirect duties and taxes are enacted in legal acts separated from the own resources decision, which alone can allocate all or part of the revenue generated to the EU. In most cases, the introduction of these indirect duties and taxes requires a unanimous vote by the Council. By contrast, the principle and modalities for calculating member states' contributions to the EU budget are directly defined in the own resources decision. As far as the member states' contributions are concerned, they correspond, on one hand, to the transfer of a fraction of VAT revenue and, on the other hand, to the application of uniform call rates calculated on the volume of non-recycled plastic waste and on GNI. The GNI contribution is used to balance the budget.

The development of the EU's policies is hampered by the "glass ceiling" of its own resources and its lack of fiscal power.

5.1.2 Only a few possibilities for additional financial capacity

Faced with new challenges and the need to step up European action, the EU's budgetary framework offers only a limited number of options:

- 1) transfer budgetary appropriations from one heading of expenditure to another;
- 4) carry over unused appropriations at the end of the budget year;
- 5) eliminate the de-commitment of unused budgetary appropriations;
- 6) exploit margins under the MFF ceiling (i.e. the difference between authorised budgetary appropriations and MFF ceilings);
- 7) exploit the margins under the own resources ceiling (i.e. the difference between the MFF ceilings and the ceilings defined in the own resources decision), through the creation/mobilisation of special financial instruments;
- 8) allocate externally assigned revenue to the EU, in the form of voluntary contributions from member states;
- 9) raise the ceiling of own resources; and
- 10) create *ad hoc* financial instruments outside the EU's framework.

Options 1 to 4 are the easiest for the European budgetary institutions to implement, when voting or amending the annual budget. However, their use is strictly regulated to avoid destabilising the overall structure of the EU's budget and/or the political and technical balance between its headings. The combined use of these different options makes it possible to release budgetary resources of around €10 billion per year to cover expenditure linked to unforeseen circumstances, for all policy areas combined. It should be noted that dropping the principle of decommitment of appropriations would make it possible to recover between €21 and 28 billion over the period 2021-2027.⁸⁹ While these amounts are non-negligible, they remain quite limited with regards to some of major challenges, like the ecological transition or security, that match the definition of a European public good. Recent estimates point to needs of €350 billion of public and private investment until 2030.

The margins under the own resources ceiling (option 5) guarantee the EU's budgetary capacity to deal with crisis situations in specific policy areas. These margins are not intended to be used to finance European policies, namely, recurrent annual expenditures. The margins vary from one budget year to another: they are estimated at between €27 and 45 billion. Several so-called "special" instruments tap into this EU budgetary "reserve" concurrently: the European Globalisation Adjustment Fund for Displaced Workers (EGF); the EU Solidarity Fund; the Brexit Adjustment Reserve; the European Financial Stabilisation Mechanism (EFSM); the facility providing medium-term financial assistance for member states' balances of payments; and the SURE instrument.

There are two approaches to defining the amount available for funding each instrument. The instrument is funded by the EU's own resources: in this case, an annual ceiling set in the MFF limits the amount of expenditure that the instrument can take on (see table 5). The ceilings are generally low: €1.2 billion (at 2018 prices) for the Solidarity Fund; €186 million for the EGF, for example. The interventions of such financial instruments take the form of grants. The overshooting of the MFF ceilings is balanced by increasing the GNI contributions of the member states.

Under the second approach, **the instrument is funded by a loan contracted by the Commission on behalf of the EU.** In some cases, the maximum outstanding amount of the loan is capped (€50 billion for the balance of payments support, €100 billion for the SURE instrument). In other (rarer) cases, the amount outstanding is only limited by the own resources ceiling (see the EFSM). Revenues from borrowing are used to finance loans or credit lines to member states that request them. The repayment of loans by the member states constitutes revenue allocated to the payment of borrowings that the EU has contracted. These borrowing-lending operations (back-to-back) are assumed to be neutral for the EU budget, subject to appropriate conditionality applied to the borrowing states. Moreover, the financing of special instruments by borrowing limits *a priori* the pressure on the EU's budgetary reserve, since it allows for a smoothing-over time of the repayment of the principal loan and interest. In addition, for the purposes of sound management, debt servicing may also be limited. The regulation establishing the SURE instrument thus provides that debt service shall not exceed €10 billion per year.⁹⁰

Table 5: Margins between the MFF and own resources ceilings for payment appropriations (in % of GNI EU27)

	2021	2022	2023	2024	2025	2026	2027	2021-2027
MFF ceiling for payment appropriations	1.20	1.15	1.10	1.09	1.07	1.06	1.06	1.10
Margin beneath the own resources ceiling in application of Council Decision 2014/335/EU, Euratom	0.00	0.05	0.10	0.11	0.13	0.14	0.14	0.10
Margin beneath the own resources ceiling in application of Council Decision 2020/2053/EU, Euratom	0.20	0.25	0.30	0.31	0.33	0.34	0.34	0.30

Source: Commission (2020), Communication on the technical adjustment of the financial framework for 2021 in accordance with Article 4 of Council Regulation (EU, Euratom) 2020/2093 laying down the multiannual financial framework for the years 2021 to 2027, COM(2020) 848 final, 18 December.

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Options 6 and 7 aim to maximise the amount of resources available to the EU. Some research and technological development programmes, or actions in the field of external action, are financed by complementary and voluntary contributions from member states. Under the Cotonou Agreement, the European Development Fund (EDF) was funded by contributions from member states – €30 billion over the period 2014-2020. The European Peace Facility, created in March 2021, is also funded by national contributions, up to a financial ceiling of €5.7 billion over the period 2021-2027 (supplemented by annual ceilings).⁹¹ The creation of a budgetary capacity for the euro area discussed before the Covid-19 crisis was based on the provision of additional contributions by the participating member states. As for the amendment of the own resources ceilings, this takes place at the time of the adoption of each new MFF. In 2020, the ceilings increased more than in previous years, mainly due to the integration of the EDF into the EU's budget and the need to have greater budgetary flexibility to deal with contingencies.

Finally, the lack of budgetary capacity in the EU may lead member states to create financial facilities outside the framework of EU law but linked to the achievement of the EU's objectives (option 8). This has happened twice so far, with the creation of (1) a special vehicle purpose, the European Financial Stability Facility (a limited company registered in Luxembourg, the shareholders of which are the Euro area member states); and (2) an international organisation, the ESM, endowed with a capital of €700 billion by the euro area member states. This may be the main route towards financing recurrent spending via a permanent budgetary tool because the size of the budget, though limited, could be quite substantial.

5.1.3 Innovations and limitations of the NGEU instrument

The NGEU instrument is innovative and, at the same time, does not depart from the EU budgetary framework in terms of its funding arrangements. The innovation is threefold:

- 1) The NGEU instrument is based on the combination of options 5 and 7: it uses the margins under the own resources ceiling, provided that the own resources ceilings are raised by 0.6% on an "exceptional and temporary basis" (see above).

- 2) The EU's financial support is of a hybrid nature (see Table 1) with loans following the model of back-to-back operations, and, by way of derogation, with grants whose reimbursement should be covered by new own resources.
- 3) The NGEU instrument is financed by borrowing. Unlike the other instruments, the own resources ceilings, including the 0.6% increase, are lower than the total amount of the EU's maximum outstanding borrowings. The obligation of Article 323 TFEU is reinterpreted from a financial perspective: the EU need only have the financial means to service the debt that is not covered under back-to-back operations. In that sense, the amounts due in a given year for the repayment of the principal of the funds borrowed by the EU shall not exceed 7.5% of the maximum amount of €390 billion (grants) to be used for expenditure.⁹²

The NGEU instrument is thus designed as an "exceptional and temporary" measure. Commitment appropriations must be allocated by 31 December 2023 at the latest, with no automatic carryover possible, and payments must be made by 31 December 2026 at the latest (with some exceptions). The same applies to decisions to grant loans to member states.⁹³ Incidentally, no new net borrowing may take place after 2026 and all commitments entered into by the Commission on behalf of the EU must be repaid in full by 31 December 2058. Until that date, the exceptional increase in the own resources ceilings will have to be renewed.

From a constitutional point of view, there is nothing to prevent the NGEU instrument, established in response to an exceptional crisis, from being made permanent.

This only requires removing the time limits on credit authorisations, on the granting of loans and on the deadline for the repayment of loans. The 0.6% increase in the own resources ceiling should also be extended accordingly and remain mentioned as "exceptional" in the own resource decision, that is, separate from the "normal" own resources ceiling, to guarantee the financial equilibrium of the NGEU instrument alone. If, on the other hand, this increase were to result in an upward adjustment of the "normal" own resources ceiling from 1.40% to 2.0% for payment appropriations, the various special instruments (those mentioned under option 5) could benefit from this change, and/or new special instruments could be adopted. Such an approach would potentially reduce the budgetary capacity available for the NGEU instrument.

Nevertheless, **two major reservations limit the feasibility of the transformation of the NGEU instrument into a permanent facility. The first is of a financial nature.**

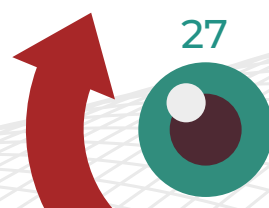
By the end of June 2022, the Commission had issued €121 billion of long-term debt (maturity of 5-30 years) and €57.9 billion of short-term debt (maturity of 3-6 months), of which €22.9 billion is outstanding.⁹⁴ Once the borrowing capacity is exhausted, the instrument will not be able to fund any new action or programme. Like a revolving credit facility, any new financial support from the NGEU instrument will first require the repayment of all or part of the previous borrowings. As of June 2022, there is still room for manoeuvre, due to the fact that only seven member states (Cyprus, Greece, Italy, Poland, Portugal, Romania and Slovenia) have requested loans amounting to a total of €166 billion out of the €385.8 billion available for loans.⁹⁵ The rise in ECB policy rates since July 2022 may accelerate the appropriation of NGEU loans.

The second constraint is of a legal nature. It relates to the specific objectives of the NGEU instrument and the conditions for its activation. The NGEU instrument is based on Article 122 TFEU. Inserted in the part of the treaty dealing with the Economic and Monetary Union, and more specifically economic policy, this provision gives the EU the right to take emergency measures in favour of a member state in accordance with the solidarity principle. Article 122(1) TFEU gives the Council, acting on a proposal from the Commission, the power to decide on any measures appropriate to the economic situation. This was the basis for the establishment in 2016 of emergency support within the EU to help member states facing the migrant and refugee crisis.⁹⁶ This facility was extended in April 2020 to cover the health crisis. On this basis, the EU may directly assume a range of costs (or pay grants to national authorities or partner organisations) related to the implementation of emergency actions: temporary reinforcement of medical staff; setting up of temporary healthcare structures; management and large-scale implementation of medical tests; etc..⁹⁷ Article 122(2) TFEU refers to the more specific case of financial difficulties or a serious threat of serious financial difficulties following an exceptional event beyond the control of the state concerned. It is no longer a question of expressing solidarity by funding certain expenditure linked to a disaster and its management, but of providing assistance to the member state unable to meet its financial obligations. The form of financial assistance is not defined and is left to the discretion of the Council, acting on a proposal from the Commission. It may consist of a loan, a credit line or any

other instrument deemed appropriate to ensure effective support.⁹⁸ The granting of assistance is subject to the fulfilment of certain conditions by the beneficiary member state.

On the basis of Article 122 TFEU, the NGEU instrument, be it temporary or permanent, can only provide emergency, exceptional and one-off financial support.⁹⁹

It does not allow for the continuous and regular financing of operational expenditure, such as European public goods, nor does it provide substantial one-off funding outside of any emergency situation. These types of expenditures are funded by the general budget of the EU, adopted in accordance with the procedure of Article 314 TFEU and the MFF. The European Court of Justice rules in its *Pringle* case that Article 122 TFEU cannot be used as an appropriate legal basis for any permanent financial assistance.¹⁰⁰ In the same vein, the Council, the European Parliament and the Commission acknowledge, in a joint declaration adopted in parallel with the NGEU instrument in December 2020, that "Article 122 TFEU constitutes a legal basis for adopting measures to address *specific crisis situations* that may entail potential budgetary implications".¹⁰¹ To put it another way, operational expenditures can be funded through a mechanism based on Article 122 TFEU, as long as their purpose is to respond to a crisis situation, and therefore, remain exceptional. Any contrary solution is interpreted as a misuse of legal procedure. As a reminder, the implementation of Article 122 TFEU is based on a Council decision, while the vote of the budget constitutes a legislative act of the European Parliament and the Council. In this sense, the financial regulation prohibits, as a matter of principle, the EU from using funds borrowed on the capital markets for the financing of operational expenditure – a prohibition repeated in the own resources decision. From this perspective, the derogation that the NGEU instrument introduces to this principle is legally valid because of the limited nature in time and amount of fundings available under the NGEU.¹⁰² The amount of €390 billion constitutes externally assigned revenues: they can only be used to finance specific expenditure,^{103 104} namely, those defined in the RRF (€312.5 billion) and in other sectoral action programmes of the EU.



5. HOW TO DELIVER A PERMANENT NGEU: TOWARDS A EUROPEAN PUBLIC INVESTMENT AGENCY

5.1.4 The establishment of financial instruments on other legal bases

The treaties contain other legal bases than Article 122 TFEU for setting up, implicitly or explicitly, financial instruments to exploit the margins under the own resources ceiling. Article 175 TFEU allows the European Parliament and the Council to adopt specific actions in the field of economic, social and territorial cohesion, outside the cohesion funds. This basis has been used, among other things, for the creation of the EU Solidarity Fund, the European Adjustment Fund and the RRF, and was also envisaged for the establishment of a European Investment Stabilisation Function,¹⁰⁵ and the programme funded by the budgetary capacity of the euro area.¹⁰⁶ The medium-term financial assistance mechanism, created in 1971 and repealed in 1988, was based on Article 108 of the Treaty Establishing the European Economic Community (now Article 143 TFEU). Some policy areas may allow financial support, without defining the powers of the legislator to do so. In such cases, it remains possible to use the "flexibility clause" of Article 352 TFEU, either alone or in conjunction with the legal basis of the sectoral policy concerned. This provision is the basis for the balance of payments support mechanism.¹⁰⁷ It was also used to create a mechanism for financing investment projects in the infrastructure and energy sectors in the 1980s (the "New Community Instrument", also called the "Ortoli Facility"). The Commission also considered using Article 352 TFEU to borrow the funds needed to cover the budget deficits recorded for the years 1984 and 1985 from the member states.¹⁰⁸

Whatever the legal basis chosen, each instrument has a field of action limited to the EU policy to which it relates. The EU's budgetary resources must serve its objectives and enable it to carry out its policies.¹⁰⁹ To put it another way, **the EU does not have a general financial instrument that it could activate, in addition to the general budget, to finance actions and projects over a long period.** This being said, two non-thematic special instruments constitute a form of budgetary reserve that can be used for any policy area of the EU: the single margin instrument (SMI) and the flexibility instrument. However, the budgetary capacity of the SMI is limited to the margins (past, present, future) left available under the MFF ceilings in one or more budget headings for the benefit of another budget heading. In any case, its capacity may not exceed 0.04% of the EU's GNI in commitment appropriations and 0.03% in payment appropriations.¹¹⁰ As for the flexibility instrument, the ceiling for the annual amount available shall be €915 million (in 2018 prices).¹¹¹

A second legal aspect has to be fully considered. **The EU cannot grant funding to finance actions outside its field of competence, that is, substitute itself for the member states in areas where they retain competence for their policies.**¹¹² For example, operational expenditure with military or defence implications, resulting from decisions taken under the Common Foreign and Security Policy, is not covered by the EU budget but remains the responsibility of the member states.¹¹³ The European Defence Agency is funded mainly by contributions from participating member states.¹¹⁴ In the field of health, the EU can take accompanying measures that complement national policies. Typically, it can contract for the procurement of national stocks of essential health products in the event of a crisis, but only up to a maximum of 12.5% of the amounts allocated to its EU4Health programme,¹¹⁵ namely, €668 million over the period 2021-2027. The primary competence and financial responsibility for building up strategic stocks lies with the member states, in accordance with EU law. In fact, most public goods are the responsibility of the member states and only marginally of the EU, with the notable exception of the environment. In the fields of security (external and internal), R&D and innovation, industrial policy, education, and public health, the EU has either shared competences, with a very limited material scope (police and criminal law cooperation, energy), or supporting competences that complement those of the member states.

Any permanent financing of public goods by the EU would require a prior extension of its competences, and thus, a revision of the treaties in accordance with the procedure of Article 48(2)-(5) TEU. Yet, as discussed below, the EU may also contemplate new intergovernmental arrangements.

The impossibility of guaranteeing adequate funding within the framework of the European treaties can be solved by revising the treaties or by adopting new legal arrangements outside EU law.

5.2 REVISION OF THE EUROPEAN TREATIES

In light of the above considerations, the revision of the treaties could focus on two issues:

- 1) The competences of the EU, so that it can take on at least the core aspects of providing European public goods.

In its conclusions delivered in spring 2022, the Conference on the Future of Europe made a series of recommendations in favour of increased EU actions in the fields of health, energy, environment and defence.¹¹⁶ Subsequently, the European Parliament recommended to the Council the opening of a convention for the revision of the treaties. In particular, it proposes that the treaty amendments aim to adapt the competences conferred on the EU in the treaties, especially in the areas of health and cross-border health threats, in the completion of the energy union based on energy efficiency and renewable energies designed in line with international agreements to mitigate climate change, in defence, and in social and economic policies.¹¹⁷

- 2) The budgetary capacity of the EU. The NGEU instrument makes use of the flexibility of the European budgetary framework. Its establishment is based on the current treaties. This being said, two revisions could be appropriate to allow the duplication of this type of instrument for the financing of European public goods.

The first would be to **replace unanimity by qualified majority in the Council for adopting the decision on own resources and legislative measures** that introduce indirect taxes or duties or harmonise member states' legislation on taxation.¹¹⁸ This would facilitate the allocation of new resources to the EU and the setting of their ceiling. In addition, if these resources finance European public goods, the European Parliament should co-decide with the Council. The special procedures that apply for the adoption of the decision on own resources or measures of a fiscal nature should be replaced by the ordinary legislative procedure.

A second amendment to the treaties would be necessary **to strengthen the EU's power to introduce new financial instruments**. It would relate to the principle of the balance of revenue and expenditure. This rule, as we have pointed out, prohibits borrowing to finance operational expenditure – or only on an exceptional and temporary basis. Nevertheless, EU law has not always prohibited borrowing as a financial resource for the general budget. For example, the European Coal and Steel Community Treaty empowered the "High Authority" (i.e. the Commission) to borrow the funds necessary for the carrying out of its tasks. To this end, the treaty allowed for two sources of funding: a direct levy on coal and steel undertakings and borrowing. Borrowing was a secondary resource, the use of which was limited: to collect financial resources for lending to undertakings in the context

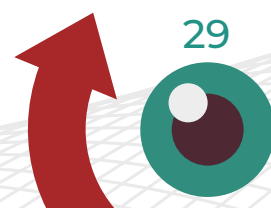
of investment programmes; or for programmes to carry out construction work or facilities. In a similar way, the Euratom Treaty authorises borrowing to finance research or investment.¹¹⁹ Therefore, Article 311 TFEU could be revised to allow borrowing exclusively for the purpose of financing investments necessary for the purpose of protecting/promoting European public goods. To ensure that the EU is able to meet its budgetary commitments, the debt service owed by the EU could be capped at 0.5% of the GNI of all member states (around €70 billion, at 2018 prices).¹²⁰ The own resources ceiling would be raised by the same amount. Own resources should be allocated to debt servicing.

To strengthen synergies between the EU and the member states, an equivalent "golden rule" could be introduced into Article 126 TFEU on the excessive deficit procedure.¹²¹

These reforms are, in our view, both necessary and worthy of consideration. They were first called for long ago and regularly repeated.¹²²¹²³¹²⁴ However, they are unlikely to succeed. These revisions, although limited, have considerable political significance. They question the very nature of the EU: they are invitations to move the EU from a pre-federal state to a quasi-federal state.

5.3 THE ESTABLISHMENT OF NEW INTERGOVERNMENTAL ARRANGEMENTS

As an alternative to amending the EU treaties, a final option is to establish financial mechanisms outside the EU but linked to the EU's objectives and policies. One example is the ESM, established by a treaty between the euro area member states. In areas where the EU does not have exclusive competence, member states retain the right to enter into arrangements between themselves, including financial arrangements, to organise their relations or the matter in question.¹²⁵¹²⁶ On the model of the EDF, member states that so wish could contribute annually to a European Strategic Investment Fund. The purpose of this fund would be to finance investments related to European public goods, in addition to EU funding. Another option would be to establish a European Investment Mechanism modelled on the ESM, or to have the ESM host an investment support fund.¹²⁷ While these options may raise free-riding behaviours, there is no legal means to force a member state to step in, as these arrangements are established in areas where member states retain competences.



5. HOW TO DELIVER A PERMANENT NGEU: TOWARDS A EUROPEAN PUBLIC INVESTMENT AGENCY

5.4 HEADING TOWARDS A EUROPEAN PUBLIC INVESTMENT AGENCY?

Should the EU be given sufficient competences, it is hard to see how a permanent NGEU could be implemented without creating an administrative capacity at the European level, capable of planning investment projects and implementing them. Despite its expertise, the Commission does not have sufficient human resources to plan investments. In addition, the structure of decision-making inside the Commission renders it prone to "politicisation".¹²⁸ Lacking a federal structure, such a capacity should be endowed to a newly created European public investment agency that would naturally be associated with the Commission, the budgetary authority in charge of the implementation of the EU's budget.

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The major legal drawback with this approach lies in the limited nature and scope of the powers that can be attributed to the EU's agencies. The Court of Justice drew attention early on to the fact that these agencies cannot have more powers than the institutions that set them up;¹²⁹ the possibility of adopting acts of general application is also strongly limited.^{130 131} With regard to these limitations, the financial regulation allows the Commission to delegate budget-implementing tasks to executive agencies.¹³² This delegation may cover all or part of the implementation, on behalf of the Commission and under its responsibility, of an EU programme or project.

Therefore, it could be envisaged that a European Public Investment Agency could adopt the following measures:

- detailed programming of investments in line with the action plan/roadmap/investment strategy adopted by the Commission, the Council and/or the European Parliament;
- the implementation of the appropriations allocated to each of the EU programmes financed by the permanent budgetary capacity;
- the adoption of individual grant decisions;
- monitoring the effective and satisfactory implementation of the commitments made by the beneficiaries of the funds; and
- the adoption of technical guidelines to promote good practice among beneficiaries or to invite beneficiaries to respect the investment action plan.

While it is a first best in terms of efficacy, a central fiscal capacity implemented through an EU agency would be quite difficult to put in place, even removing the scepticism of some member states worried about free riding and moral hazard. In fact, fiscal policy is, together with defence and monetary issuance, the natural seat of sovereignty; and with sovereignty comes accountability ("no taxation without representation"). Therefore, **in creating an agency with the power to decide how to spend taxpayers' money, the problem of the coexistence of "federal" instances with local ones, the division of tasks and the determination of accountability among the various levels of decision will be of paramount importance.** A technocratic investment agency would risk reinforcing the Eurosceptic argument of an intrinsic democratic deficit of the EU institutions. To avoid this risk, policymakers should be ready to accept several checks and balances in designing the operation of the agency, involving the Council and the European Parliament. A cumbersome decision process is a lesser evil with respect to a lean and technocratic body unaccountable to governments and, ultimately, to citizens.

In the absence of a political union, the creation of a central tax-and-spend capacity will need to be thoroughly weighted and framed in the appropriate legal framework.

6. THE "DOUBLE EUROPEAN DEMOCRACY" HYPOTHESIS

For the first time in European integration history, the European recovery plan, if made it permanent, could allow the EU to break out of the principle of supranational coordination paradigm and jump into the paradigm of European democracy: the fact that European citizens have the real means to decide *as Europeans* on proper European public goods through a EU-level democratic process. This major political leap, as important as the single currency was, implies the creation of Europe's own fiscal resources. **Shifting toward a European democracy to provide European public goods requires more than a common debt capacity; it requires permanent consent by European citizens to take a leap towards political integration.** Consent to Europe's extended own resources would constitute a historic turning point for political Europe.

6.1 THE NGEU'S MAIN ISSUE: REIMBURSEMENT, OR THE OPENING OF A NEW "EUROPEAN ACCOUNT" FOR A TRUE EUROPEAN DEMOCRACY

The European Gordian knot does not lie in the coordination of member states indebtedness, but in the creation of a genuine European public power, backed by a fiscal capacity, itself funded by its own European fiscal resources – and no longer derived from national contributions. Taxing the internal market *at a European level* is the European revolution that needs to be driven and that European recovery plan's reimbursement issue seems to trigger.

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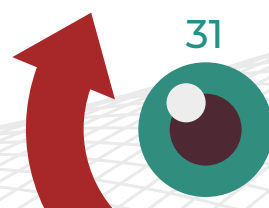
Taxing the internal market at a European level is the European revolution that needs to be driven and that European recovery plan's reimbursement issue seems to trigger.

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Common European bonds would be the natural continuation of a European fiscal capacity. Moreover, it would no longer be a question, strictly speaking, of mutualisation or solidarity between member states, but of a common capacity to produce European public goods that are incommensurable with the accounting of any interstate transfers. In other words, the making of a European society. The meanderings of the European recovery plan can aggravate the negative interdependence of member states, mired in a false interstate debt solidarity, or lead to the possibility of a European tax system, and thus, to the opening of a European (fiscal) account belonging to Europeans *as Europeans* – the emergence of a genuine European political substance.

Let us be clear: this is not a matter of a fiscal transfer between member states, which would amount to falling back into the trap of "solidarity versus responsibility". It is about establishing a transfer of wealth between, on one hand, European citizens benefiting from European public goods incorporating a European added value and, on the other hand, the private profits generated by the very existence of the internal market – which is already a transfer union. Here, we find the foundations of modern democracy: the figure of the European citizen – and therefore, political Europe – can only take shape on the condition that the internal market is taxed at a European level (and not only at an interstate level), and therefore, that public incomes and spending generated at the European level are partly incommensurable to any interstate accounting. That the European citizen cannot be inferred from the sum of national citizens. In a word, **European integration must "break the fourth wall" to address the European public directly.**

The advent of a genuine European democracy based on a public power on a continental scale is not only a question of the fiscal amount available (*condition of volume*), but also a question of the source of fiscal incomes (*condition of nature*). On a theoretical level, one could indeed think of the possibility of an interstate European public power (a fiscal capacity of political size, but essentially backed by interstate financing), but this would not reach an authentic European democracy. In that case, European public power would ultimately be linked to national citizens. Only a European parliamentary budgetary power based on proper European fiscal resources would make it possible to link it to the political figure of the European citizen, and thus, to reach the threshold of a genuine European democracy.



6. THE "DOUBLE EUROPEAN DEMOCRACY" HYPOTHESIS

Taxing the internal market, levying the legitimate share of private wealth made possible by the very existence of the internal market and its institutions simply stem from a consistent thinking of democracy. If the creation of the euro currency was possible, then so is the establishment of a European tax system. And just as the single currency and the European System of Central Banks gave rise to a radically new political configuration in Europe, the creation of a European political budget, triggered by the permanent institutionalisation of NGEU, will open up a new area of incommensurability: a political European dimension.

6.2 ELABORATING ON THE "DOUBLE EUROPEAN DEMOCRACY" HYPOTHESIS

If, as we have seen above, the national democracy principle limits any large-scale interstate cooperation (political and constitutional resistance of national democracies), an authentic European democracy would open up a new space for collective action – and produce a European added value for Europeans *as Europeans* (and not as an aggregation of national citizens) through genuine European public goods – *without* undermining national democracy. Democracy is not exclusive: **a European democracy does not overwhelm national democracies – as long as the source of sovereignty remains clearly established at the nation state level.** But European democracy must be given its own political substance, its own *kratos*. As with all democracies, this is to be found in the levying of taxes on a political budget in the hands of an elected parliament. No European democracy can be born of a technical budget that is essentially funded by member state contributions, nor of a mutualisation of debt where each party counts its marbles. The European fiscal leap, which we identify as the real political leap, is twofold: in volume and in the nature of fiscal resources.

The proposal of a "double" European democracy envisages a European democracy articulated to national democracies, as a third way between the federalist headlong rush and the sovereignist withdrawal.^{133 134} Contrary to the multilevel governance approach, which amalgamates (without any substantial distinction) local, regional, national and European levels and reasons in terms of functional coordination,¹³⁵ the European double democracy approach focuses on the national level – as the seat of sovereignty and primary public power – and the European level – the place of a non-sovereign public power combined with supranational coordination by rules and institutions – and focuses on the production of a true European political

substance understood both as public power (collective capacity to act on the common reality) and as the making of society (collective capacity to project itself into the inter-generational time, which itself depends on the capacity to produce long-term public goods).

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Political Europe will be born of the victorious fight for the institution of a truly European political budget, that is, one that crosses the threshold of political significance (estimated at around 3-4% of GDP, as opposed to 1% of GDP today)¹³⁶ and funded by its own fiscal incomes directly extracted from the private profits made from the internal market. The operation certainly requires a significant political leap, but it does not meet any categorical objection – unlike the proposals for European sovereignty or a European super-state.

7. CONCLUSION

The issue of making NGEU a permanent tool, and consequently, how to reimburse European loans and grants, opens up the possibility of a fundamental political leap towards a political Europe. Given the scale of the amounts to be repaid and the very risky prospect of an interstate reimbursement, the question of a genuine European tax system becomes intellectually conceivable and politically a necessity.

In this policy study, we have constantly argued that **only the production of European public goods financed by a truly European tax system, not by national contributions, would enable the creation of a genuine democratic basis for the EU**, a further step in the European integration process that would permit the EU to face urgent challenges. The scope for funding genuine European public goods matching these challenges is large, including, beyond the green transition and the digitalisation, equal access to health and education, redistributive justice and defence issues. These should be the cornerstone of the EU agenda for the next decade.

With a permanent NGEU, Europeans could decide to allocate for themselves a share of the common wealth drawn from the immense private profits made from the internal market. That would be the true Hamiltonian moment for Europe: the advent of a European fiscal capacity to provide public goods and, meanwhile, to tax the internal market and give birth to a European democracy, since "no representation (can work) without taxation".

It is true that there are only limited legal options for creating a central fiscal capacity within the current institutional setting and either the revision of treaties or the establishment of new intergovernmental arrangements (on the blueprint of the ESM) seems unavoidable if the central fiscal capacity is to be created. This shall not be an excuse for passive behaviour. Not only are there economic needs for the production of European public goods, there is also a demand emanating from European citizens: they deserve an answer worthy of the challenges that climate, geopolitical, social and economic uncertainty pose for them.

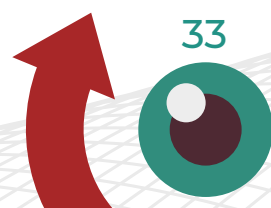
It is certainly worth remembering that a permanent central fiscal capacity or permanent NGEU may happen, but only provided the existing NGEU programme has definitely shown its value. Crossing some red lines like risk sharing will not be enough if NGEU does not deliver on the objectives it is meant to achieve. **The success of NGEU is a prerequisite to its transformation into a permanent programme.**

While the success of NGEU highly depends on the appropriate and, to some extent, discrete use of EU funds by national governments, a change in governance might be contemplated. **The creation of a European Public Investment Agency could be viewed as a first step towards the creation of a central fiscal capacity properly defined.** Such an agency would be capable of planning investment projects and implementing them, in close cooperation with member states, hence favouring a regime of permanent checks and balances and a democratic balance between the supra- and national tiers of governments. United in diversity to fix Europeans' present and future challenges: greening; socialising; democratising; and fostering the EU.

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Not only are there economic needs for the production of European public goods, there is also a demand emanating from European citizens: they deserve an answer worthy of the challenges that climate, geopolitical, social and economic uncertainty pose for them.

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RECOVERY WATCH

RECOVERY WATCH

The issue of making NGEU a permanent tool, and consequently, how to reimburse European loans and grants, opens up the possibility of a fundamental political leap: it offers an opportunity to fix the depoliticisation of EU policies and open a window for a breakthrough to a "political Europe". With a permanent NGEU, Europeans could decide to allocate for themselves a share of the common wealth drawn from the immense private profits made from the internal market.

A permanent tool may fulfil three separate purposes: supporting growth and resilience-oriented reforms in the member states; creating a central fiscal capacity, either for macroeconomic stabilisation purposes or to finance the provision of European public goods. In this policy study, we argue that only the production of European public goods financed by a truly European tax system, not by national contributions, would enable the creation of a genuine democratic basis for the EU, a further step in the European integration process that would permit the EU to face urgent challenges.

Either the revision of treaties or the establishment of new intergovernmental arrangements (on the blueprint of the European stability mechanism) could establish a permanent tool. In this latter respect, we propose the creation of a European Public Investment Agency capable of planning investment projects and implementing them, in cooperation with member states.

The debate on a central fiscal capacity should be led in parallel to the reform of the Stability and Growth Pact to ensure that fiscal space is created in the EU.

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