

STUDY

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Steering economic recovery in Europe

Lessons for governing the Recovery and Resilience Facility



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Supporting EU economic governance scrutiny



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Abstract

The briefing assesses the interaction between the Recovery and Resilience Facility (RRF) and the European Semester by outlining coordination mechanisms between the two in the broader context of economic governance in the EU. Two main elements of this interaction are emphasised: coordination of investments and implementation capacities. The briefing argues that coordination of investment programmes remains fragmented in the EU, while the notion of policy capacities and experimentation should be given more strategic consideration in the Semester and RRF evaluation frameworks.

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LIST OF ABBREVIATIONS

CSR	Country-specific recommendations
DG ECFIN	Directorate General for Economic and Financial Affairs
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
EEFI	Energy Efficiency Financial Instrument
EFSI	European Fund for Strategic Investments
EIB	European Investment Bank
EIF	European Investment Fund
EP	European Parliament
EU	European Union
ES	European Semester
ESIF	European Structural and Investment Fund
GFC	Global Financial Crisis
JTF	Just Transition Fund
NGEU	Next Generation EU
NP	National Parliament
MA	Managing Authority
MS	Member State
MFF	Multiannual Financial Framework
NPI	National Promotional Institution
REACT-EU	Recovery Assistance for Cohesion and the Territories
RRF	Resilience and Recovery Facility
RRP	Recovery and Resilience Plan
RRF WG	ECON-BUDG Working Group on the Scrutiny of the
SDG	Sustainable Development Goal
SDR	Sustainable Development Report

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EXECUTIVE SUMMARY

Background

Despite the unprecedented response to the crisis at the European level, the challenges brought by the COVID-19 pandemic will require several additional years to overcome the economic and social consequences that hit all Member States (MS). In addition, the 2022 energy crisis caused by the war in Ukraine will further exacerbate existing problems. In this context, coordination among MS and availability of resources are crucial for the recovery. The newly designed Next Generation EU (NGEU) serves that purpose. With an endowment of €750 billion, mainly devoted to support Cohesion, Resilience and Values (96%), but also Natural Resources and Environment (2.5%), and Single Market, Innovation and Digital (1.5%), the NGEU is among the biggest institutional innovations at the European level. With a budget of €672.5 billion, the main instrument of the NGEU Fund, the Recovery and Resilience Facility (RRF), is used to fund public investments and reforms, addressing social and economic challenges emerging from the COVID-19 pandemic, in light of the green and sustainable recovery. RRF funds are conditioned upon the progress of structural reforms that each MS reports on as part of the European Semester (ES). The ES, established in 2011 as the main tool for economic policy coordination across the EU, was rapidly adapted to account for country-specific capacities and to support the implementation of the RRF.

Aim and key findings

This briefing assesses the interaction between the RRF and the European Semester by outlining coordination mechanisms between the two in the broader context of economic governance reform debate in the EU. The main elements of this interaction are emphasised: coordination of investments, implementation capacities and policy experimentation. The briefing argues that coordination of investment programmes remains fragmented in the EU, while the notion of policy capacities and public sector capabilities (at both national and supranational levels) should be given more strategic consideration, including in terms of policy experimentation capacities. Further, the mix of financial instruments should include more repayable loans and equity investments should be considered; and revised evaluation frameworks should be developed to account for the implementation of the RRF investment component more effectively. The briefing also introduces a mission-oriented framework for the coordination of investments and designing of green conditionalities. The briefing concludes with the following recommendations:

- Recommendation 1: For an RRF-like instrument to result in transformative investments, more explicit emphasis on investments coordination is needed in the EU.
- Recommendation 2: Strategic coordination of investments requires more targeted conditionalities, particularly in climate-related areas, that can be enforced across various investment programmes.
- Recommendation 3: Financial institutions with investment-related expertise (i.e. EIB, EIF, EBRD and National Promotional Institutions) may provide an additional financial and technical/advisory expertise during the implementation of an RRF-like instrument.
- Recommendation 4: Programming and implementation capacities at the MS level should be given a strategic consideration during RRF implementation and beyond.

1. INTRODUCTION: FROM AUSTERITY TO INVESTMENT WITH A GREEN DIRECTION

The European Union's challenges around climate change and the digital divide – to name just two – require investment- and innovation-led growth. That investment and innovation must be directed towards climate- and digital-related outcomes with purposeful policy coordination. The tools that the European Commission (EC) and European Parliament (EP) have at their disposal, including the Resilience and Recovery Facility (RRF), are critical, but they need effective alignment to ensure investment is being directed accordingly. This paper examines how European policy instruments can be better aligned and coordinated using a mission-oriented approach to investment.

The Resilience and Recovery Facility (RRF) was a landmark agreement between the 27 Member States (MS) and it represents a turning point for the European Union (EU): the €723.8 billion raised by issuing a common debt will be used for spending through €338 billion in grants and €385.8 billion in loans, with the purpose of making European economies more green, more inclusive and resilient.¹ RRF may be also a turning point in EU economic governance due to the rebalancing of powers between supranational and intergovernmental institutions: RRF is the main policy and investment anchor for the years to come.²

The RRF funds come with ambitious targets for green and digital investments, and it is more crucial than ever to use these investments with immense transformative potential wisely and to avoid doing 'business as usual'. The risks of failing to transform our economies are considerable: the austerity-driven response to the Global Financial Crisis (GFC) left European countries and national governments weaker and more fractured, and resulted in slower economic recovery combined with increased inequality.³

Post-GFC policies did not bring the expected results in terms of job creation, nor in terms of economic recovery.⁴ Instead, these policies left citizens just under €3000 worse off in terms of their household incomes and with €1000 less spent on their public and social services per a person.⁵ Historical data (covering the period of 1978-2019) reveals the direct link between austerity-led policy responses to economic crises and the rise of inequality, decrease in wage income and increase in prolonged unemployment.⁶ Further, the previous decade of fiscal consolidation seriously affected governments by reducing their policy space and by negatively impacting public sector capacities, notably regarding public investments, particularly at the national and local levels. This is important to consider when

¹ Figures in current prices, https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility_en

² Dias Pinheiro, B. and Dias, C. S. 2022. Parliaments' involvement in the Recovery and Resilience Facility, *The Journal of Legislative Studies*, 28 (3), 332-349, 334.

³ Mazzucato, M. 2020. The success of the EU recovery fund will depend on bold missions. *Financial Times*, 9 August.

⁴ See: <https://www.imf.org/external/pubs/ft/fandd/2016/06/ostry.htm>

⁵ Van Lerven, F., Caddick, C., Mang, S and Sutor-Sorel, L. 2022. *The New Fiscal Framework – the people's view? How austerity made us poorer and less able to cope with crises*, NEF and Finance Watch. Available at: https://neweconomics.org/uploads/files/NEF_Europes-Fiscal-Framework.pdf

⁶ See: <https://www.imf.org/external/pubs/ft/wp/2013/wp13151.pdf>

assessing the design of investment-led recovery policies due to the long-term nature of developing public sector capacities.

The so-called ‘Juncker Plan’ was a major policy response in the EU to help foster investment-led growth with multiple programmes aiming at recovery. Conceived as a ‘Keynesian mechanism’ to help stimulate demand through private investments and using public guarantees to mobilise additional finance, the European Fund for Strategic Investments (EFSI) indeed fulfilled this function.⁷ However, with few conditionalities attached and limited long-term vision, EFSI-led investments resulted in limited additionality,⁸ and scored low on sustainability and transparency of investment decisions.⁹

Now, with the post-COVID recovery, the Next Generation EU (NGEU) programme is driven by an investment-led agenda around climate change and digitalisation, and there is a real opportunity for ensuring strategic policy coordination and coherence across investment programmes to facilitate green structural change across Europe. This directed investment must be accompanied by a more holistic view of instruments and policies, and a renewed sense of the need to make our public administrations more capable. In other words, governments must not only invest in the real economy, but also in themselves to continuously develop their own dynamic capabilities (as discussed in Section 3 below).¹⁰

For RRF to become an effective mechanism for implementing transformative investments and for restructuring European economies, governments need to (pro)actively steer the direction of these investments.¹¹ ‘Directionality’ means that the type of finance and conditionality attached to the investments has a direct impact on the economic activities that occur. Therefore, policies aiming at structural transformation require strong and capable governments to steer financial investments in a strategic and deliberate way. The transition to greener and more resilient economies needs more ambitious and capable states that embrace their role as ‘market shapers’ – not mere ‘market fixers’ – and investors in public goods.¹²

Green growth means ‘economy-wide redirection’ and one way of coordinating such complexity is a mission-oriented approach with investments directed across the entire innovation chain, with a focus on both supply and demand.¹³ A mission-oriented approach to innovation-led economic growth and long-term finance emphasises alignment of policy priorities and instruments towards a shared vision and clear long-term policy goals. Policy instruments are designed, implemented and evaluated along clearly articulated and deliberately designed targets with a variety of policies aiming at achieving these policy goals.¹⁴ In terms of financing, missions imply coordination of investments towards these long-

⁷ Griffith-Jones, S. 2021. Promoting Investment in the European Union, Evaluating the Juncker Plan. In De Souza Guilherme, B., Ghymers, C., Griffith-Jones, S. and Ribeiro Hoffmann, A. (Eds.) *Financial Crisis Management and Democracy: Lessons from Europe and Latin America*, Springer, 323-336.

⁸ European Court of Auditors. 2019. *European Fund for Strategic Investments: Action needed to make EFSI a full success*. Special Report 03/2019. Available at: https://www.eca.europa.eu/Lists/ECADocuments/SR19_03/SR_EFSI_EN.pdf

⁹ CEE Bankwatch Network and Counter Balance. 2019. Not Worth Celebrating Yet? The Investment Plan for Europe – a critical analysis of the pilot phase of the ‘Juncker Plan’. Available at: <https://bankwatch.org/wp-content/uploads/2019/09/EFSI-final.pdf>

¹⁰ Kattel, R. 2022. *Dynamic capabilities of the public sector: towards a new synthesis*. UCL IIPP Working Paper Series (WP 2022-07).

¹¹ Mazzucato, M. 2021. *Mission Economy: A moonshot guide to changing capitalism*. Penguin Allen Lane.

¹² Mazzucato, M. 2022. The entrepreneurial state must lead on climate change. Project Syndicate, 4 November.

¹³ Mazzucato, M. and Semieniuk, G. 2018. *Bridging the gap: The role of innovation policy and market creation*, Emissions Gap Report 2018, UNEP.

¹⁴ See: https://ec.europa.eu/info/sites/default/files/mazzucato_report_2018.pdf

term policy goals,¹⁵ in our case climate- and digitalisation-related, and their alignment with the broader goal of the green and just transition. That is, there are various mechanisms and policy tools for governing finance to achieve concrete socio-economic policy goals.¹⁶

In this briefing, we focus on two elements of the RRF. First, we look at the investment component introduced by the RRF mechanism within the wider context of the investment programmes ecosystem in the EU. Second, we look at synergies between the RRF and European Semester (ES) with the view of strategic coordination of investments and related capacities that need to be developed if RRF is to have truly transformative effects.

Previous studies of the interaction between the RRF and ES analysed the initial phase – drafting national investment plans – and the potential of the ES to provide an effective governance framework.¹⁷ A previous study prepared at the request of the European Parliament concluded that there are indeed important synergies between the two: 1) the EU Semester provides important informational and signalling advantages to Member States for the formulation of national recovery and resilience plans (RRPs); and 2) the RRF can potentially reinforce the EU Semester by enhancing domestic ownership and providing the financial incentives for reforms.¹⁸

In this briefing we keep focus on the importance of not just public spending *per se*, but on directionality of investments, i.e. the deliberate design of investment policy tools and its intended outcomes vis-a-vis the overall goal of green and innovation-led growth in Europe. We turn to the questions of policy coordination between investment-related programmes on the one hand and the RRF and European Semester on the other hand in the next section.

¹⁵ See: https://ec.europa.eu/info/sites/default/files/research_and_innovation/contact/documents/ec_rtd_mazzucato-report-issue2_072019.pdf

¹⁶ Mikheeva, O. and Ryan-Collins, J. 2022. Governing finance to support the net-zero transition: Lessons from successful industrialisation. UCL Institute for Innovation and Public Purpose, Working Paper Series (No. WP 2022/01).

¹⁷ See: <https://www.sipotra.it/wp-content/uploads/2020/11/What-role-for-the-European-Semester-in-the-recovery-plan.pdf>

¹⁸ *Ibid*, 8.

2. POLICY COORDINATION: ALIGNING INVESTMENT POLICIES FOR IMPACT

After the explosion of the COVID-19 pandemic, mission-oriented policy frameworks became even more imperative.¹⁹ Such frameworks, however, require public institutions with adequate and dynamic resources and skills, able to coordinate private sector activities, but also public sector activities, such as the health sector. Besides the alignment and coordination at the national level, it is also crucial that all EU countries and institutions align their missions and challenge-oriented policy tools harmoniously. Successful and less successful examples of coordination have been observed since the beginning of the COVID-19 pandemic, not only in relation to health systems, but also with regard to education systems or financial support, and measures for the industrial sectors. For the post-COVID recovery to be successful and transformative, political, economic and financial institutions at any administrative level should be actively involved in the European recovery mission.

2.1. The European Semester – history and recent changes due to the COVID-19 pandemic

There have been numerous efforts to achieve better coordination and alignment of EU Member States' (MS) activities. The European Semester (ES) was firstly introduced in 2011 as a tool to strengthen economic and policy coordination across the EU. Three pillars constitute the basis of the European Semester: *i)* synchronisation of timetables of different policy frameworks; *ii)* a new legal framework allowing for a more direct involvement of the European and National Parliaments (NP) together with other relevant stakeholders;²⁰ and *iii)* alignment of the goals of national fiscal, economic and employment policies.²¹ As part of the European Semester, during the first six-month cycle, starting in autumn, EU MS discuss the measures to be implemented during the second half of the year, following the country-specific recommendations (CSRs) of the European Commission based on the country reports submitted by the MS and adopted by the Council. However, doubts about the degree of effectiveness and regarding countries' responses to recommendations have been raised.^{22,23}

One of the main shortcomings of the ES was its strong focus on fiscal surveillance.²⁴ However, the role of policy coordination was further adapted in 2022 to support the implementation of the RRF and move from the initial response to the COVID-19 pandemic towards the support of a more inclusive, green and resilient recovery.

¹⁹ Mazzucato, M. 2018. Mission-oriented innovation policies: challenges and opportunities. *Industrial and Corporate Change*, 27 (5), 803–815.

²⁰ Obtained with the adoption of a new legislation which strengthened the Stability and Growth Pact.

²¹ See: https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/framework/european-semester-explained_en

²² Hagelstam, K., Dias, C., Angerer, J., and Zoppè, A. (2020). *The European Semester for economic policy coordination: A reflection paper*.

²³ Vanhercke, B. and Verdun, A. C. (2021). *From the European Semester to the Recovery and Resilience Facility: some social actors are (not) resurfacing*. ETUI Research Paper – Working Paper.

²⁴ Creel, J., Leron, N., Saraceno, F. and Ragot, X. 2021. *Embedding the recovery and resilience facility into the European Semester: macroeconomic coordination gains and democratic limits*. ETUI Research Paper – Policy Brief.

With the RRF-related conditionalities – the disbursement of RRF funds is conditional on the implementation of agreed milestones and targets of which a sub-set needs to address the CSRs – countries' attitudes towards EU policy recommendations have changed. That is, the synergy between the RRF and European Semester implies a strong enforcement mechanism: the direct link between structural reforms and financial incentives. Under previous ES, non-compliance meant that the Commission would start a long and complex process of Excessive Deficit or a Macroeconomic Imbalance Procedure. With the reformed ES under RRF, a failure of MS to meet milestones and targets from approved RRFs implies direct financial cost (loss),²⁵ although both Excessive Deficit and Macroeconomic Imbalance Procedures remain in place.

Further, since the beginning of the COVID-19 pandemic, standard procedures in place as part of the ES have been temporarily adapted to face the challenges brought by the pandemic and to account for the implementation of the measures in support of MS. In addition, countries' recommendations became generally fewer and more in line with the specific recipient's capacity for reform. Indeed, the binding nature of CSRs raises the question of reforms that are outside the RRF – therefore, it is meaningful to scale them down, and adjust towards realistic expectations of what is feasible and what are actual policy capacities at the national level.²⁶

In the context of the ongoing reform of the EU economic governance framework and recent Communication from the Commission,²⁷ ES becomes the focal point of implementation for country-specific reforms and investment plans. With the alignment of reporting timelines (between RRF and ES) and conditionalities mentioned above, there is essentially no demarcation line between investments and reforms. On the one hand, embedding investment plans into the wider economic governance coordination can result in long-needed strategic alignment of policy tools towards shared policy goals (e.g. greener and resilient economies). On the other hand, without differentiating between the types of investments (i.e. there is no explicit mention of the 'no significant harm' principle in the Commission's Communication) and little coordination with other investment programmes at the EU and national levels, the ES risks becoming a coordination tool that prioritises reform. Without balancing mid-term reform plans with mid-term and long-term green and investment plans – for which ES remains the prime coordination mechanism – there is a risk that European funds will not result in much needed additionality, as was the case with EFSI's support.²⁸

2.2. The Recovery and Resilience Facility – RRF

On 21 July 2020, the EU Council agreed on a €750 billion in 2018 prices (€723.8 billion in current prices²⁹) recovery plan for a long-term recovery of the EU economies hit by the COVID-19 pandemic, the Next

²⁵ Nguyen, T. and Redeker, N. 2022. How to make the marriage work: Wedding the Recovery and Resilience Facility and European Semester. Available at: <https://www.delorscentre.eu/en/publications/detail/publication/how-to-make-the-marriage-work>

²⁶ Ibid.

²⁷ See: https://economy-finance.ec.europa.eu/system/files/2022-11/com_2022_583_1_en.pdf

²⁸ Lower or no additionality was reported, particularly in the energy and transport sectors. See: <https://bankwatch.org/wp-content/uploads/2019/09/EFSI-final.pdf>

²⁹ Figures in current prices: https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility_en

Generation EU (NGEU) fund.³⁰ On 9 October 2020,³¹ EU Member States agreed on the main instrument of the NGEU, the Recovery and Resilience Facility (RRF), for which the regulation was adopted on 11 February 2021.³² The instrument, with an overall budget of €672.5 billion, will be mainly used to fund public investments and reforms, addressing social and economic challenges emerging from the COVID-19 pandemic, in light of a green and sustainable recovery. The RRF's financial resources will be distributed both as loans (€360 billion) and as grants (€312.5 billion), with 70% of the latter assigned using different country-level criteria, such as population, inverse GDP per capita and average unemployment rate over the period 2015-2019, while the remaining 30% assigned in light of the real GDP loss in 2020 and the cumulative observed real GDP loss over the 2020-2021 period.

RRF represents an ambitious 'institutional innovation' whereby Member States design Recovery and Resilience Plans (RRPs), which are then evaluated by the Commission and adopted by the Council. RRF is also unique in that it is directly managed by the Commission, which is different from the typical EU 'budget' (MFF) where a small part of funding is managed by the Commission with 70% of funds being in shared management with national authorities in MS.³³ Another distinct characteristic of the RRF is the emphasis on grants (and loans) as opposed to financial instruments, which the Commission prioritised previously for the 2021-2027 budgeting period.

RRPs highlighting the areas of reform and public investments to be carried forward with the financial resources are meant to be aligned with and guided by the priorities set by the European Semester. This alignment has four dimensions, presented in the 2021 Annual Sustainable Growth strategy: *i*) Environmental sustainability; *ii*) productivity; *iii*) fairness; and *iv*) macroeconomic stability. National plans are also expected to have a minimum of 37% of the expenditure related to climate and 20% related to the digital transition. Resources will be distributed as follows: 70% of the overall grants will be disbursed over the period 2021-2022 and the remaining 30% will be disbursed in 2023, while loans will be distributed until the end of 2023. Six pillars are at the basis of the RRF: *i*) green transition; *ii*) digital transformation; *iii*) smart, sustainable and inclusive growth; *iv*) social and territorial cohesion; *v*) health, and economic, social and institutional resilience; and *vi*) policies for next generation.

Finally, a public scoreboard provides information on the progress of each MS in the implementation of the projects.³⁴ The scoreboard serves the purpose of transparency and was included in the RRF Regulation based on the request of the European Parliament (EP) as part of its overall mandate to scrutinise implementation of the RRF.

The European Commission remains the key actor for the implementation of the RRF, its evaluation and its coordination via the ES. In addition to continuous communication with the European Council, the activities of the Commission's various DGs are constantly reported to the European Parliament, although the Parliament does not have any voting power in this regard. Member States are also directly assisted by Commission's country-teams (for example, DG ECFIN has permanent teams in all EU countries) with the aim of supporting them through their investment decisions.

³⁰ For a detailed discussion on the NGEU Fund, please refer to Section A1 in the Annexe.

³¹ See: <https://www.consilium.europa.eu/en/policies/eu-recovery-plan/>

³² Ibid.

³³ See: https://ec.europa.eu/info/funding-tenders/find-funding/funding-management-mode_en

³⁴ See: https://ec.europa.eu/economy_finance/recovery-and-resilience-scoreboard/

The RRF Regulation, co-legislated by the European Parliament (EP) and the Council, assigns a specific role to the EP, mostly of a scrutinising or monitoring nature. The EP is responsible for the overall monitoring of the RRF and for scrutinising the Commission. The scrutiny mandate is quite broad as there are very few limitations as to what the EP can ask for from the Commission. The RRF Regulation grants the EP access to information on equal terms with the Council, as well as access to the information from the Council's preparatory bodies' proceedings (Article 25(2) of the Regulation) – in this context, the RRF-related access to information has a wider scope than within the economic governance framework for EP.³⁵

Whereas the EP has a strong role towards the Commission, its mandate over national implementation is, in contrast, rather limited. There are avenues being suggested for making interparliamentary coordination of RRF implementation stronger: namely, through deepening cooperation between the EP and NPs.³⁶

NPs responsible for national budgets are equally responsible for spending RRF funds, and therefore coordination between NPs and national governments is equally crucial for safeguarding the intergenerational and procedural justice of climate-related investments. Notably, however, the RRF Regulation requires RRFs to include details of the progress of stakeholder consultation, while no explicit mention of the role of NPs is made, thereby assigning to national legislatures a broader notion of a 'stakeholder'.³⁷

Overall, in terms of the core target of the programme – increasing the level of investments at European level – the RRF does not represent a novelty *per se*. Similar programmes have been launched in the past and, among the most recent after the 2008 Global Financial Crisis, the European Union launched the European Fund for Strategic Investments (EFSI) as the main pillar of the European Commission's Investment Plan for Europe (EC IPE) (also known as the EU Infrastructure Investment Plan for Europe or 'Juncker plan'). The EFSI was the central pillar of the Investment Plan for Europe launched in 2015, providing EU first loss guarantees to the EIB for private and riskier investments, with an initial investment target of €392.6 billion by 2018, then €500 billion by 2020, a target that has already been met in early December 2020.³⁸ Although RRF was not meant to be designed as the next EFSI – a role reserved for the InvestEU programme since 2021 – both programmes have in common the fact that they have been created after a crisis to increase the level of investments, so best practices can be learnt and adapted to the new challenges. Among these best practices and results achieved by the EFSI, two key points deserve major attention. First, additionality played a great role as it enabled the triggering of private investments at a national level – although heterogeneously across sectors, as previously discussed – for an amount of resources up to 15 times of that received by countries as part of the programme.³⁹ Second, the role of the EIB Group has been crucial for the successful crowding-in of additional financial resources and implementation of the plan.

³⁵ Dias Pinheiro, B. and Dias, C. S. 2022. Parliaments' involvement in the Recovery and Resilience Facility, *The Journal of Legislative Studies*, 28 (3), 332-349, 335-336.

³⁶ Ibid.

³⁷ Ibid, 337.

³⁸ [EFSI shows how a big government programme can work closely with markets \(eib.org\)](#).

³⁹ See: https://commission.europa.eu/content/investment-plan-results_en

2.3. The coordination across different institutional actors

Considering various investment programmes, instruments and various levels of their deployment (EU, regional, national), the question of overall capacities and internal capabilities that should be developed at various levels of economic governance becomes apparent. Namely, the abilities of the public sector to 'steer' the direction of investments and to allow for a certain degree of policy experimentation (adjustments to initial investment trajectories when needed, learning from doing), including the coordination between various types of investments.

In this context, it is interesting to observe the different levels of involvement of EU institutions in the European recovery plan. While the Commission plays the most important role, evaluating national plans and disbursing financial resources, the Parliament was crucial in the initial phase when political alignment was needed among Member States to reach an approval. This was eventually granted on the 9 October 2020. It will again become crucial over the next few years, towards the end of the RRF in 2026, when new political agreements will be necessary to define new investment programmes.

At the same time, European financial institutions are only playing a marginal role. The European Investment Bank (EIB), the European Investment Fund (EIF), the European Bank for Reconstruction and Development (EBRD) – all represent financial institutions with great expertise on investments and financial instruments.^{40 41} At the national level, there are National Promotional Institutions (NPIs) that often represent this expertise. Such financial and technical/advisory expertise is crucial for implementing investments with transformative impact⁴² and to ensure the success of the European recovery. Particularly, the specialised technical expertise of these financial institutions is crucial for understanding the wider trajectory of investments (new technological trajectories, market intelligence, value chain perspectives) and therefore can directly feed into not only investment decisions and their coordination, but also evaluation and monitoring. Hence, their limited role in the RRF implementation requires further consideration in light of a possible extension of the RRF or design of new programmes following the experience with the RRF.

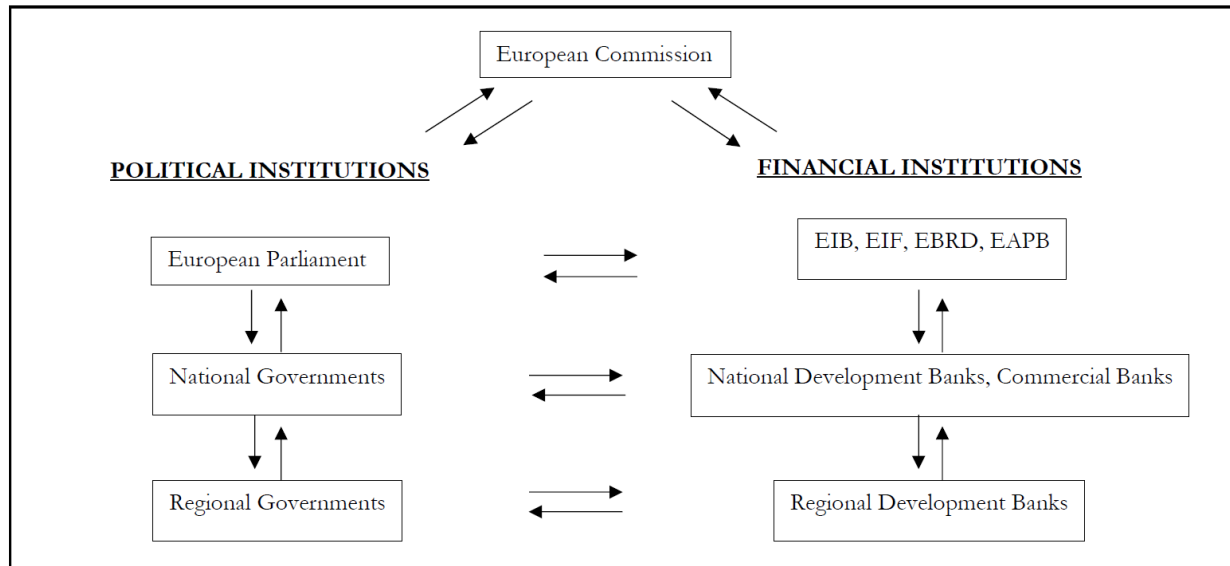
The necessity of continuous feedbacks among institutions across different administrative levels, as shown in Figure 1, nevertheless brings higher levels of complexity in the process and this complexity has to be taken under serious consideration in order to be minimised or dealt with.

⁴⁰ Griffith-Jones, S. and Naqvi, N. 2021. Leveraging Policy Steer? Industrial Policy, Risk-Sharing, and the European investment Bank in Mertens, D., Thiemann, M. and Volberding, P., (Eds.) *The Reinvention of Development Banking in the European Union*, OUP.

⁴¹ Griffith-Jones, S. and Carreras, M. 2021. *The Role of the EIB in the Green Transformation*. The Foundation for European Progressive Studies (FEPS) and the Initiative for Policy Dialogue (IPD), Columbia University.

⁴² Mazzucato, M. and Mikheeva, O. 2020. *The EIB and the new EU missions framework: Opportunities and lessons from the EIB's advisory support to the circular economy*. UCL Institute for Innovation and Public Purpose (IIPP), Policy Report (IIPP WP 2020-17).

Figure 1: Coordination among political and financial institutions as part of the European recovery plan



Source: Authors' own elaboration

Notes: EIB = European Investment Bank; EIF = European Investment Fund; EBRD = European Bank for Reconstruction and Development; EAPB = European Association of Public Banks.

Hence, it is necessary to guarantee that the existing political and financial expertise, present at any administrative level, is fully employed for the European recovery mission. In this context, alignment and strong coordination are crucial. While political institutions guarantee the democratic control over the entire process, financial institutions bring the extensive knowledge of markets and technologies, strong existing networks of stakeholders, ability to leverage private investments and great expertise in terms of financial instruments and riskevaluation.

As outlined above, the RRF-related instruments to help fight the economic consequences of the COVID pandemic were designed in the 'emergency' mode and within limited timelines: the RRF Regulation was adopted in February 2021 while RRFs had to be submitted to the Commission by the end of April 2021. In many cases active parliamentary scrutiny at the national level – which requires time and access to information – was very limited. Similarly, empirical studies suggest National Parliaments (NPs) demonstrated uneven participation in influencing parliamentary scrutiny of ES prior to the RRF.⁴³ However, both, formal powers and monitoring capabilities are crucial for effective parliamentary involvement in the ES.⁴⁴ As the capacity of NPs – or any other institution – to adapt to new challenges

⁴³ Skazlic, I. 2021. Routine or rare activity? A quantitative assessment of parliamentary scrutiny in the European Semester. *Politics and Governance*, 9 (3), 112–123.

⁴⁴ Rasmussen, M. B. 2018. Accountability challenges in EU economic governance? Parliamentary scrutiny of the European Semester. *Journal of European Integration*, 40(3), 341–357.

is incremental and conditioned by previous experience, the more NPs were previously involved in the ES, the more capacity they may have for scrutinising implementation of the RRF.⁴⁵

In terms of governance, most NPs reported on utilising existing standing committees for monitoring and reporting on implementation of the RRF (in most cases committees on EU affairs and/or budget and finance), except one country – Portugal – which established a specific body to oversee implementation of the NGEU/RRF.⁴⁶ This trend demonstrates that NPs will perform scrutiny within the regular budgetary framework, which might overlook the multi-dimensional nature of the RRF and priorities in different policy areas that are outside budgetary rationale.⁴⁷

⁴⁵ Dias Pinheiro, B. and Dias, C. S. 2022. Parliaments' involvement in the Recovery and Resilience Facility. *The Journal of Legislative Studies*, 28 (3), 332-349, 333-334.

⁴⁶ See: [https://www.europarl.europa.eu/RegData/etudes/IDAN/2022/699524/IPOL_IDA\(2022\)699524_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2022/699524/IPOL_IDA(2022)699524_EN.pdf)

⁴⁷ Dias Pinheiro, B. and Dias, C. S. 2022. Parliaments' involvement in the Recovery and Resilience Facility. *The Journal of Legislative Studies*, 28 (3), 332-349, 341.

3. GOVERNMENTS AS STRATEGIC INVESTORS: RRF IMPLEMENTATION AND CAPABILITIES

3.1. Implementation capacities

The design of policies to help mitigate the consequences of the COVID pandemic have acutely demonstrated that implementation capacities are as important as public policies themselves.⁴⁸ The existing programming and implementation capacities of the public sector, both at the EU and MS levels, are linked with the experience of implementing previous EU programmes. If the previous crisis response (to the GFC) was conditioned by governments' abilities to cut public expenditures and implement policies of 'internal devaluations', this policy experience resulted in developing related capacities within public administrations. In other words, path-dependency on previously enforced conditionalities will be part of the implementation of the new programmes – such as RRF – and are worth considering when looking at the transformative effects of RRF-related conditionalities.⁴⁹

Developing new implementation capacities that are linked to NGEU transformative investments requires governments to explicitly commit towards this goal. Developing projects for continuous investments in line with clear policy targets (as in RRFs) should go hand in hand with investing into their own capacities to do so. In other words, designing and implementing transformative investments implies equally transformative competences developed by the public sector organisations/agencies that are in charge of these investment policies. Otherwise, there is a risk that RRF investments will be 'stuck' in limited planning and implementation, including little participation by sub-national administrations⁵⁰ – which are key for the transition to greener and more equally distributed economies.

Implementing investments that target the green transition requires enhanced coordination across multiple policy domains: for example, how to structure debt finance (repayable financial instruments) alongside fiscal spending in a way that the logic of repayable loans does not contradict but re-enforces the logic of fiscally financed public goods. Investments in climate-related justice and, say, reforestation will yield high impact, but these returns cannot be used to repay a loan.⁵¹ Governments' abilities to navigate this complexity and coordinate across environmental, industrial, fiscal, monetary and investment policies require an equally strategic prioritisation of their own capacities to 'govern finance'.⁵²

The implementation capacities of MS were considered by the Commission when streamlining CSRs that lie outside RRF national plans. Hence, there should be a possibility to make implementation capacities as one of the RRF conditionalities or at least an explicit policy priority. Monitoring capacities are also needed to navigate the multi-layered policy framework: for example, not all Sustainable Development Reports' (SDRs – linked to the UN Sustainable Development Goals) success metrics are included in CSRs

⁴⁸ Mazzucato, M. and Kattel, R. 2020. COVID-19 and public-sector capacity. *Oxford Review of Economic Policy*, 36 (Supplement1), 256-269.

⁴⁹ Domorenok, E. and Guardiancich, I. 2022. The Italian National Recovery and Resilience Plan: coordination and conditionality, *Contemporary Italian Politics*, 14 (2), 191-206.

⁵⁰ Ibid.

⁵¹ Mazzucato, M. 2022. The entrepreneurial state must lead on climate change. Project Syndicate, 4 November.

⁵² Mikheeva, O. and Ryan-Collins, J. 2022. *Governing finance to support the net-zero transition: lessons from successful industrialisation*. UCL Institute for Innovation and Public Purpose, Working Paper Series (No. WP 2022/01).

under the ES. This means that the CSR process within the ES does not capture all sustainability-related developments in Member States.⁵³

3.2. Dynamic capabilities and strategic investments

Related to the wider notion of implementation capacities that span a longer period of time, public sector organisations retain and continuously develop internal capabilities and competences.⁵⁴ This also means that they purposefully invest in internal competence-building and avoid relying on external expert advice – a common feature of public administrations today.⁵⁵

Capabilities to design, implement and coordinate investments require strong internal technical competences that feed into financing decisions: for example, the EIB's Advisory Team has been instrumental to adjusting lending criteria so circular economy-focused projects can qualify.⁵⁶ Having in mind the amount of the overall RRF disbursement and the necessity of involving many stakeholders, it is essential to take a serious consideration of governments' internal capabilities.

The dynamic notion of public sector capabilities – that is, the internal competences of public sector organisations are not static but evolve over time in line with internal priorities – is particularly useful when considering policy experimentation. Learning by doing and the 'flexibility to act', including in the absence of formal (or *ex-ante*) procedures,⁵⁷ echoes the current needs of governments to implement transformative investment plans with a view of long-term economic, social and climate effects. Given the complexity of coordination and uncertainty of the actual effects of these investments, the public sector at both MS and EU levels will need to embrace experimenting capacities, including in evaluation and monitoring practices that will define future, post-RRF investment programmes.

At the MS level, National Promotional Institutions (NPIs) deserve special attention as these agencies are often in charge of state-supported investments and are key for governing investments in the EU.⁵⁸ In the context of previous investment programmes and an over-reliance on grants, with NPIs having limited financial discretion over investment decisions, some NPIs developed strong capabilities in prudent financial management and reporting. Without neglecting its importance, developing capabilities to invest in new sectors and projects requires an additional set of skills (such as more complex project appraisal, technological and market forecasts, and evaluation techniques).⁵⁹ Therefore,

⁵³ Koundouri, P., Devves, S. and Plataniotis, A. 2021. Alignment of the European Green Deal, the Sustainable Development Goals and the European Semester Process: Method and Application. *Theoretical Economics Letters*, 11, 743-770.

⁵⁴ Kattel, R. 2022. *Dynamic capabilities of the public sector: towards a new synthesis*. UCL Institute for Innovation and Public Purpose, Working Paper Series (WP 2022-07).

⁵⁵ Collington, R. and Mazzucato, M. 2022. *Beyond outsourcing: Re-embedding the state in public value production*, UCL Institute for Innovation and Public Purpose, Working Paper Series (IIPP WP 2022-14).

⁵⁶ Mazzucato, M. and Mikheeva, O. 2020. *The EIB and the new EU missions framework: Opportunities and lessons from the EIB's advisory support to the circular economy*. UCL Institute for Innovation and Public Purpose, Policy Report (IIPP WP 2020-17).

⁵⁷ Meijer, A. (2019). Public innovation capacity: Developing and testing a self-assessment survey instrument. *International Journal of Public Administration*, 42(8), 617-627.

⁵⁸ Mertens, D., Thiemann, M. and Volberding, P. (Eds.) 2021. *The Reinvention of Development Banking in the European Union: Industrial Policy in the Single Market and the Emergence of a Field*, Oxford University Press.

⁵⁹ Mikheeva, O. and Juuse, E. 2021. Development Finance in the Baltic States and the Process of Europeanization. In Mertens, D., Thiemann, M. and Volberding, P. (Eds.) *The Reinvention of Development Banking in the European Union: Industrial Policy in the Single Market and the Emergence of a Field*, Oxford University Press, 253-282.

the important questions of the transformative impact of RRF investments are directly linked to the internal capabilities that exist and those that are required to achieve the NGEU's ambitious policy goals.⁶⁰

Various capacity-building tools exist at the EU level – such as the Commission's Technical Support Instrument⁶¹ or the EIB's InvestEU Advisory Hub⁶² – in order to help develop technical capacities at the MS or organisational level, be it for designing reforms or helping make projects more suitable for financing. Without dismissing the importance of these facilities, dynamic capabilities needed for transformative investments need to be developed in-house and internally. This is essential for institutionalising new knowledge and sets of skills that can be retained by public sector organisations beyond the RRF timeline.

3.3. Mission-oriented investments

A mission-based approach to investments transcends a focus on 'investment gaps' and emphasises the need for capable and proactive governments that can act as 'entrepreneurial states'⁶³ that foster and support private businesses with strategic public investments distributed across the entire industrial and innovation chain.⁶⁴ Mission-oriented policies can be effective in achieving the needed cross-sectoral dynamics, as illustrated in Figure 2. Namely, multi-directionality of climate change implies investments and policy coordination at various levels and of various scales.

This also implies new relations between businesses and governments centred around shared goals of value creation rather than rent-seeking and value extraction. The strategic use of conditionalities can help redefine public-private partnerships towards more dynamic and mutualistic relations.⁶⁵ Virtuous examples of this strategic use of conditionalities are represented by the recent bailouts used by MS during the COVID-19 crisis, with France supporting Renault and Air France conditional on carbon-reduction commitments⁶⁶ or Netherlands using the same conditionalities for KLM.⁶⁷ Another best practice is represented by the German state-owned development bank, KfW, which offers financial resources to the steel industry with conditionalities in terms of reduction of carbon content and emissions.⁶⁸ These best practices represent a viable strategy that can be replicated in order to achieve a new social contract necessary under the Green New Deal.

⁶⁰ Kattel, R. and Mazzucato, M. 2018. Mission-oriented innovation policy and dynamic capabilities in the public sector. *Industrial and Corporate Change*, 27 (5), 787–801.

⁶¹ See: https://commission.europa.eu/funding-tenders/find-funding/eu-funding-programmes/technical-support-instrument/technical-support-instrument-tsi_en

⁶² See: <https://advisory.eib.org/about/the-hub>

⁶³ See: https://ec.europa.eu/info/sites/default/files/research_and_innovation/contact/documents/ec_rtd_mazzucato-report-issue2_072019.pdf

⁶⁴ Mazzucato, M. 2018. Mission-oriented innovation policies: challenges and opportunities. *Industrial and Corporate Change*, 27 (5), 803–815.

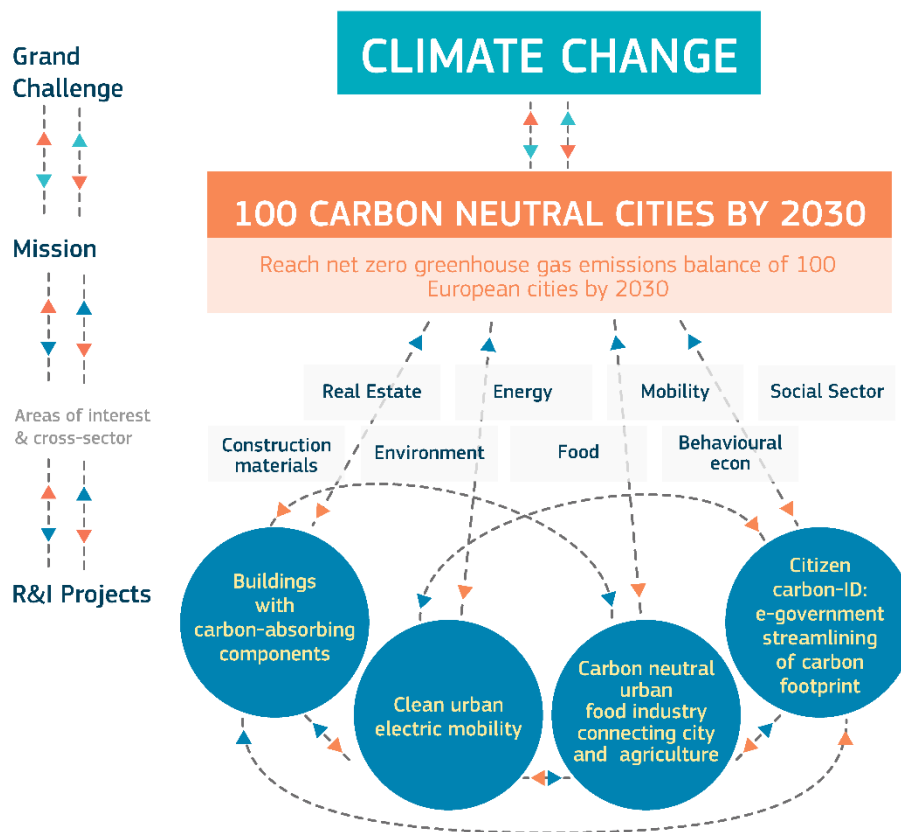
⁶⁵ Mazzucato, M. 2022. *Transformational change in Latin America and the Caribbean: a mission-oriented approach* (LC/TS.2022/150), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC).

⁶⁶ See: <https://www.bartlettannualreview.com/features/covid-19-and-the-green-new-deal>

⁶⁷ See: <https://www.nature.com/articles/s41893-021-00828-x>

⁶⁸ Ibid.

Figure 2: An example of a mission-oriented approach and cross-sectoral dynamics



Source: Mazzucato (2018)

A mission-oriented framework also implies the use of multiple policy tools and the strategic coordination of these tools: from outcome-oriented public procurement to grants and prizes, to the mix of financial instruments and advisory support provided by state investment agencies and banks – in order to achieve complementarity of funding mechanisms and tools.⁶⁹

With governments acting as ‘investors of first resort’, not only risks should be socialised (or often shifted from private investors to the public sector), but also rewards, for example, by taking equity stakes in newly established green energy companies or re-orienting state-owned companies towards ambitious decarbonisation targets,⁷⁰ or through using publicly owned intellectual property rights (IPRs) allocated to governments for the IPR profits to be re-invested in new green projects.⁷¹

⁶⁹ Ibid.

⁷⁰ Gasperin, S., Dosi, G., Mazzucato, M. and Roventini, A. 2021. *Strategic missions and policy opportunities for state-owned enterprises*. UCL Institute for Innovation and Public Purpose, Policy Brief series (IIPP PB 15).

⁷¹ Mazzucato, M. 2022. The entrepreneurial state must lead on climate change. Project Syndicate, 4 November.

4. GOVERNING GREEN AND SUSTAINABLE RECOVERY

Europe's Green Deal requires a new green social contract.⁷² A green social contract means redefining partnerships between public and private sector through sharing not only the risks (i.e. governments de-risking investments for the private sector), but also sharing the rewards, with green conditionalities systematically enforced as part of public support programmes, as mentioned above, as well as public procurement contracts as a way of directing limited financial resources in a targeted and strategic way towards decarbonisation.⁷³ In other words, a green social contract requires a renewed take on both conditionality and additionality of investments by making it similarly targeted rather than over-leveraging public funding as much as possible *per se*.

4.1. Additionality of investments

A major constraint on the EU measures in support to MS is related to the amount of available resources, as highlighted in the recent study.⁷⁴ The overall amount of financial resources over the period 2021-2027, summing up the NGEU Fund and the Multiannual Financial Framework (MFF),⁷⁵ is equal to €1824 billion. Although this amount represents a record in terms of financial resources disbursed by European institutions, and it is also the first time in which a debt-sharing/pooling approach was introduced in the EU, the overall budget for the period 2021-2027 accounts for only 13.2% of the total annual GDP of EU countries in 2019.⁷⁶ Assuming, for simplicity, a constant amount of disbursement per a year over the eight-year programme, the yearly disbursement would then be equal to €230 billion, roughly the same as the yearly GDP of the 13th largest economy in the EU in 2019 (Czech Republic). Hence, there is an urgent need to crowd-in additional financial resources to those that will be made available by the European institutions.

Additionality to build up new economic activities, and not only to bail out firms and sectors in trouble, is crucial in this context. When assessing which financial resources to use for a long-term strategy to crowd-in additional investors, it is also important to distinguish between the two main instruments that will be used at the European level, grants and loans. While grants, by definition, do not give any possibility of being even partially repaid, loan instruments are usually repaid, hence giving the possibility of re-channelling financial resources to new projects. For the programmes to be successful and to catalyse the highest amount of additional financial resources, it is crucial to adequately assess the risks and to match them with the appropriate instrument.^{77,78} Consequently, one of the main tasks

⁷² See: <https://www.nature.com/articles/s41893-021-00828-x>

⁷³ Mazzucato, M. 2022. Rethinking the social contract between the state and business: A new approach to industrial strategy with conditionalities. UCL Institute for Innovation and Public Purpose Policy Note 2022-02.

⁷⁴ Vitrey, A. and Lumet, S. 2020. Multiannual financial framework and Next Generation EU, Review of an unprecedented, tumultuous European budgetary chapter. Fondation Robert Schuman.

⁷⁵ For a detailed discussion on the Multiannual Financial Framework (MFF), please refer to Section A2 in the Annexe.

⁷⁶ Which EU countries had the highest GDP in 2019? Eurostat (europa.eu).

⁷⁷ Fernandez-Arias, E., and Xu, J. 2020. Effective development banking: loans or guarantees? International Research Initiative on PDBs and DFIs Working Groups Working Paper N° 8.

⁷⁸ Griffith-Jones, S., Spiegel, S., Jiajun, X. U., Carreras, M. and Naqvi, N. 2020. Matching risks with instruments in development banks. International Research Initiative on PDBs and DFIs Working Groups Working Paper N° 9.

is measuring different types of risk around the investment (credit, market, climate, etc) and, eventually, how to measure the achievements of the disbursed financial products.

There are different frameworks for evaluating grants as compared to repayable funds: the impact of one-off grants is often measured in terms of number of jobs generated or fixed assets acquired and other immediate indicators during the short life cycle of a grant; whereas repayable instruments typically have a longer time horizon with less immediate impact-related indicators. This means that high-impact grants might look more favourable (in terms of impact indicators) as an investment tool as compared to loans or other financial instruments with longer maturities.

In the context of RRF, the 'performance-based' principle is followed, whereby the funds are disbursed once milestones and targets identified in the RRFs are fulfilled. In other words, while evaluating RRFs, the Commission is giving preference to indicators measuring outputs rather than impact since impact indicators have a longer time horizon that goes beyond RRF.⁷⁹ While useful for RRF-related reporting and compliance, a lack of consideration to capturing the dynamics of change may result in not capturing unintended impacts or over-focusing on short-term effects. At the same time, transformative investments, by definition, have a long-term orientation and impact.

Rethinking additionality also means the need for a new and diverse set of financial instruments, and more interaction between public and private finance, which is already part of the debate at the European level.⁸⁰ In this context, the current lack of equity investments may represent a considerable constraint in sharing not only risks, but also rewards, between public and private financial interests.⁸¹ With the help of the RRF funds, national governments may consider the use of equity instruments through existing agencies – such as NPIs – as well as in synergy with the EIB-led financing mechanisms. Further, the overreliance on grants and the general lack of interest of all EU Member States in debt instruments, such as loans, poses serious questions about the long-term sustainability of big programmes like the RRF.

The important measures put in place at European level to contrast the negative economic and social consequences of the COVID-19 pandemic represent a milestone in the history of the EU. Nevertheless, the overall amount of available financial resources, although representing a record, is still quite limited compared to the size of the European economy and requires additional resources to be crowded-in to reach the appropriate scale necessary for the long-term recovery phase. In addition, the limited time frames of NGEU and MFF, both lasting for six years, raises additional concerns around the possibility of promoting the ground-breaking and radical investments necessary for the long-term recovery phase, but requiring a much longer time horizon for implementation.

⁷⁹ See: https://www.eca.europa.eu/Lists/ECADocuments/SR22_21/SR_NRRPs_EN.pdf

⁸⁰ Mazzucato, M. 2018. *Mission-oriented research and innovation in the European Union*. Report for the European Commission.

⁸¹ See: <https://www.nature.com/articles/s41893-021-00828-x>; also Mazzucato, M. 2022. Rethinking the social contract between the state and business: A new approach to industrial strategy with conditionalities. UCL Institute for Innovation and Public Purpose Policy Note 2022-02.

4.2. Conditionalities in the RRF

Conditionalities in the RRF are predominantly related to the reforms mentioned in national RRFs and in CSRs issued by the Commission. In other words, the ES represents a consolidation of structural conditionalities over time that the EU identifies as enabling conditions for effective and efficient budgetary spending.⁸² Echoing the recent Communication of the Commission on reforming economic governance, fiscal adjustments and national debt reduction plans are central to these reforms, and assume a medium-term horizon (four years with potential extension to seven years).⁸³ At the same time, many RRF investments with transformative potential will not have immediate or medium-term effects on debt-reduction trajectories, but will materialise in the long-term.

Approved RRFs represent an *ex-ante* conditionality – the conditionality logic that was strengthened in the European Structural and Investment Fund (ESIF) during 2014-2020. That is, under ESIF, MS were submitting plans for six-year Operational Programmes with commitments to structural and macroeconomic reforms. At the same time, the NGEU was conceived as an ‘expansionary-oriented’ conditionality framework⁸⁴ with the Commission intending to enable policy transformations across the EU, but there is emerging evidence to suggest that there will be continuity with their past performance during previous programmes, such as ESIF, in how governments will respond to NGEU policy guidance.⁸⁵

Thematic or sector-specific conditionalities are defined through very broad spending targets (37% for green investments and 20% for digital), whereas investments are required to be ‘growth-enhancing’. In terms of a more clear-cut conditionality, RePowerEU is the most ‘focused’ mechanism, whereby countries receive funding conditioned upon adjusting their energy mix and reducing their dependence on Russia’s fossil fuels.

Climate-related conditionalities remain at a very broad level (37% of all spending) and the fundamental principle of ‘do no significant harm’ does not feature in the recent Communication of the Commission on the economic governance reform.⁸⁶ This is unfortunate and it remains unclear how such broader framing of climate-related priorities will help mobilise the required investments on the scale needed for the European Green Deal and more broadly for the just transition.⁸⁷

Overall, existing thematic conditionalities (green, digital) of a rather general nature on one hand and strengthened structural conditionalities on the other hand may not incentivise policy experimentation and ‘flexibility to act’, which is essential for implementing truly transformative investments. At the same time, the renewed emphasis on fiscal consolidation may further limit the development of dynamic

⁸² Domorenok, E. and Guardiancich, I. 2022. The Italian National Recovery and Resilience Plan: coordination and conditionality. *Contemporary Italian Politics*, 14 (2), 191-206.

⁸³ See: https://economy-finance.ec.europa.eu/system/files/2022-11/com_2022_583_1_en.pdf

⁸⁴ Armingeon, K., de la Porte, C., Heins, E. and Sacchi, S. 2022. *Voices from the Past: Economic and Political Vulnerabilities in the Making of Next Generation EU. Comparative European Politics*. Doi:10.1057/s41295-022-00277-6

⁸⁵ Domorenok, E. and Guardiancich, I. (2022). The Italian National Recovery and Resilience Plan: coordination and conditionality. *Contemporary Italian Politics*, 14 (2), 191-206, 193.

⁸⁶ See: https://economy-finance.ec.europa.eu/system/files/2022-11/com_2022_583_1_en.pdf

⁸⁷ The EC orientation paper refers to ‘green’ investments, but this appears to be a rather general notion of climate-friendly principles.

capabilities within public sector organisations to design and implement investment programmes aiming at long-term structural effects.

5. TRANSFORMATIVE INVESTMENTS NEED DYNAMIC EVALUATION

One of the current core issues in the evaluation of policy effectiveness and public expenditure is strictly related to the use of the static multiplier, often leading to very different positions compared to what is determined from a dynamic analysis.⁸⁸ Being able to distinguish the type of public expenditure and its effect at different stages of project implementation is paramount to evaluating the different dynamics within programmes, particularly with a medium to long-term horizon.

It is then necessary to disaggregate public spending into its different components and evaluate at different points in what are the dynamics, allowing for greater additionality and ‘crowding-in’ effects. Previous evidence has shown a greater multiplier for investments – when initial investment leads to additional spending and investments – guided by mission-oriented policies, able to respond to the grand socio-economic and environmental challenge involving different sectors in the economy.⁸⁹ More specifically, permanent changes in the rate of growth of mission-oriented public expenditure generate the largest effect in terms of labour productivity, investments and output growth, additionally ‘crowding-in’ resources from private companies.⁹⁰ This is due to the embedded ‘ripple effect’ of these policies, generated by fostering inter-sectoral investment and bottom-up innovation.

Consequently, it is important to select those missions – and focus on those targets – requiring the participation of multiple sectors and actors, to be able to face the great challenges EU Member States will face over the next years. In addition, there is also the necessity to select the correct tools to evaluate the strengths and weaknesses of the policies in place, accounting for the multiple and different dynamics of long-term and mission-oriented policies.

We need to move towards an understanding that public sector organisations are dynamic in terms of developing their own capacities and competences. The following key aspects have been identified in the ability of public organisations to: *i)* adapt and learn; *ii)* align public services and citizen needs; *iii)* govern resilient production systems; and *iv)* govern data and digital platforms.⁹¹ Only through these new acquired skills can the public sector proactively participate in markets, actively ‘shaping’ them and not just ‘fixing’ them when they fail.

This also implies that evaluation metrics should focus on dynamics of change, using approaches that go beyond the concept of general equilibrium to help understand the over-time evolution of systems under general conditions.⁹² As noted in most recent studies, evaluation practices often lag behind

⁸⁸ De Soto, JH. 2009. *The Theory of Dynamic Efficiency*. Routledge.

⁸⁹ Deleidi, M., and Mazzucato, M. 2021. Directed innovation policies and the supermultiplier: An empirical assessment of mission-oriented policies in the US economy. *Research Policy*, 50(2), 104-151.

⁹⁰ Deleidi, M., and Mazzucato, M. 2019. Putting austerity to bed: Technical progress, aggregate demand and the supermultiplier. *Review of Political Economy*, 31(3), 315-335.

⁹¹ Mazzucato, M., and Kattel, R. 2020. COVID-19 and public-sector capacity. *Oxford Review of Economic Policy*, 36 (Supplement 1), 256-269.

⁹² BEIS. 2020. *Alternative policy evaluation frameworks and tools. Exploratory study*. BEIS Research Paper 2020/044.

theoretical advances in policy evaluation and the advent of transformative innovation policies make this gap apparent while calling for the integration of existing evaluation approaches, including sustainability transitions.⁹³

Currently, both reform and investment components are evaluated under the same framework in RRF. Although the evaluation follows distinct paths and milestones depending on the nature of the component, the lack of a dedicated framework for investments nevertheless raises concerns about the possibility of clearly including several aspects in the evaluation of the component, such as multiplier, complementarity, additionality, etc.

In addition, the absence of quantified social targets poses additional questions about the ability to correctly evaluate the different activities.⁹⁴ Attempts to keep track of the fulfilment of milestones and existing targets on RRF disbursements have been made through the Recovery and Resilience Scoreboard and the inclusion of common indicators in late 2021. Nevertheless several key topics are still missing.

In this regard, best practices can be learned from the previous experience of the Commission in the evaluation of structural reforms, for example with reference to the CESAR database containing assessments made by the different DGs on the level of implementation of CSRs across all Member States.⁹⁵ Best practices in the evaluation of investment can also be learnt from institutions with greater history and experience of providing project-based financing and support, such as the European Investment Bank (EIB), which currently does not play any direct role in the RRF, but has, however, contributed to support activities in response to the COVID-19 pandemic. Finally, capacity in terms of political expertise needs to be further developed to guarantee a greater homogeneity across Member States and for a greater alignment of the promoted activities with the current needs of the European Union.

⁹³ Haddad, C. R. and Bergek, A. 2023. Towards an integrated framework for evaluating transformative innovation policy. *Research Policy* 52(2), <https://doi.org/10.1016/j.respol.2022.104676>

⁹⁴ Vanhercke, B. and Verdun, A. C. 2021. *From the European Semester to the Recovery and Resilience Facility: Some social actors are (not) resurfacing*. ETUI Research Paper-Working Paper.

⁹⁵ See: https://ec.europa.eu/eurostat/cros/category/acronyms/cesar_en

6. CONCLUSIONS AND RECOMMENDATIONS

The synergies between the RRF and the ES should be assessed with the long-term view in mind: any debates about future ES will be conditioned by the RRF experience, whereas future conversations about a fiscal capacity in the EU will involve a reform, similar to the ES format. There was a shift towards more binding economic coordination with the Commission's enhanced role to enforce reform, due to RRF. This will result in the development of Commission's own internal capacities that will have a direct effect on economic governance post-2026, when the RRF is meant to end.⁹⁶

Further, the experience with the RRF will have a long-lasting impact on the discussion of European economic (and green) governance post-RRF, since the combination of reform and financing sets the precedent. This makes an RRF-like mechanism likely to be replicated during the next crisis.⁹⁷ Therefore, it is crucial to strike the right balance between flexibility and enforcement, and between reform and investments.

Below we list a set of recommendations for more effective coordination of the RRF and in light of the ongoing debate on reforming economic governance in the EU.

Recommendation 1: For an RRF-like instrument to result in transformative investments, more explicit emphasis on investments coordination is needed in the EU.

The RRF Regulation calls for complementarity, coherence and coordination among different EU instruments and funding sources but does not provide comprehensive guidance on how this can be achieved. More explicit emphasis on coordination of investments across the levels of governance and between EU investment programmes, as well as in time (beyond the RRF timeline), is needed for the RRF to achieve transformative effects.

Related to this, a clear framework for evaluating investments (in terms of intended transformation of economic activities over different time horizons) is needed in addition to existing links between investments and fiscal adjustment plans. This may become an important learning experience that can pave the way for designing post-RRF investment programmes in synergy with the EU economic governance framework.

Recommendation 2: Strategic coordination of investments requires more targeted conditionalities, particularly in climate-related areas, that can be enforced across various investment programmes.

There is a need to strike a balance between evaluating investments in terms of the medium-term effects on public debt reduction on the one hand and the longer-term climate-related effects of these investments on the other. At the moment, there is less clarity on how RRF-related targets will feed into longer-term green strategies at both MS and EU levels.

Putting in place mutually reinforcing conditionalities can help in such coordination, crucial for the new social contract conducive to the green and just transition. For example, firms and sectors that benefit

⁹⁶ Nguyen, T. and Redeker, N. 2022. *How to make the marriage work: Wedding the Recovery and Resilience Facility and European Semester*. Hertie School Jacques Delors Centre, Policy Brief.

⁹⁷ Ibid.

from public financial support at the national level can be asked to align their operations and business strategies to green policy objectives,⁹⁸ but in a more targeted way, and procedures should be in place to continuously monitor compliance, including beyond the RRF timeline.

Recommendation 3: Financial institutions with investment-related expertise (i.e. EIB, EIF and EBRD) may provide additional financial and technical/advisory expertise during the implementation of an RRF-like instrument.

Not all investments will be effective and produce the intended results, while some milestones at the technical and economic level will not be met. At the same time, national RRFs can be amended under certain circumstances but the broader notion of policy experimentation should be considered.

Implementing and coordinating investments that aim at structural transformation and green transition means that a large amount of sectoral, technological, market-related and business strategy knowledge is needed. In other words, investing in new activities and sectors requires financial expertise just as much as technical expertise. This expertise is typically accumulated in public investment banks and institutions, such as the European Investment Bank or national development banks. Co-opting this existing expertise in the form of external expert advice or through other, more direct, modalities can be considered at the national level (by National Promotional Institutions) and at the EU level (e.g. through Recovery and Resilience Dialogues between the EP and the Commission).

Recommendation 4: Programming and implementation capacities at the MS level should be given a strategic consideration during RRF implementation and beyond.

Particular attention should be given to the capacities of national governments, and particularly of National Parliaments (NPs) and their dedicated teams for RRF- and investment-related capabilities, to enhance policy coherence and coordination. This also applies to interparliamentary coordination between NPs and the EP.^{99 100}

Typically, parliamentary oversight is associated with democratic control and accountability. Without reducing its importance, parliamentary scrutiny can also play the role of an additional lever for policy alignment at the strategy level. Namely, scrutinising implementation of industrial and green strategies alongside budgetary spending and investment strategies can help develop the needed capacities for working with multi-dimensional policy areas, such as climate change.

⁹⁸ Mazzucato, M. 2022. Rethinking the social contract between the state and business: A new approach to industrial strategy with conditionalities. UCL Institute for Innovation and Public Purpose Policy Note 2022-02.

⁹⁹ Dias, C. 2022. *European Parliament involvement in scrutinising the Recovery and Resilience Facility*. European Parliament Briefing.

¹⁰⁰ Fromage, D. and Markakis, M. 2022. The European Parliament in the Economic and Monetary Union after COVID: towards a slow empowerment? *The Journal of Legislative Studies*, 28 (3), 385-401.

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ANNEXE

A1. THE NEXT GENERATION EU FUND

The NGEU Fund represents one of the most important recent EU milestones, not only for its record high endowment of €750 billion in 2018 prices (€723.8 billion in current prices). In addition, and for the first time in EU history, the EU Commission has been authorised to borrow in the capital markets directly and the funds are to be used for spending by MS, not lending. Consequently, for the first time, the EU will share a common debt that will be characterised by a common risk shared among all state members. The NGEU Fund, adopted by the Council of the European Union on 17 December 2020, is divided into loans (€360 billion) and grants (€390 billion),¹⁰¹ and aims at: *i*) supporting state members in their efforts to recover; *ii*) boosting private investments; and *iii*) reinforcing EU programmes. Financial resources, borrowed on the markets by the EU, will be distributed to three main areas of interest, as reported in Table 1.

Table 1: Next Generation EU – Areas of interest and disbursement

<u>Areas of interest</u>	<u>€ billion</u>
Cohesion, Resilience and Values	721.9
Natural Resources and Environment	17.5
Single Market, Innovation and Digital	10.6
Total	750

Source: European Commission 2020

Note: All amounts in 2018 prices

Most of the resources of the NGEU Fund will be spent on the area of ‘Cohesion, Resilience and Values’, leaving the remaining 4% of the available resources for ‘Natural Resources and Environment’ (€17.5 billion) and for ‘Single Market, Innovation and Digital’ (€10.6 billion).

To complement the resources of the RRF, the NGEU Fund includes six additional programmes with an overall endowment of €77.5 billion, as reported in Table 2.

¹⁰¹ In current prices, €338 billion in grants and €385.8 billion in loans.

Table 2: Next Generation EU – Other programmes and disbursement¹⁰²

Programme	€ billion
REACT-EU	47.5
Just Transition Fund	10
Rural Development	7.5
InvestEU	5.6
Horizon Europe	5
RescEU	1.9
Total	77.5

Source: European Commission, 2020

Note: All amounts in 2018 prices

Except for the Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU) Fund, all other instruments/programmes were pre-existing and financial resources have been redirected towards grants in light of the COVID-19 pandemic. The REACT-EU programme provides €47.5 billion additional investment grants under the investment for growth and jobs goal. The financial resources under the REACT-EU programme are primarily aimed at maintaining jobs (short-term work schemes and support to the self-employed), creating new jobs, measures for youth unemployment, education and training, and skills development, in light of the green and digital transitions, and measures to increase access to social and health care services.

The Just Transition Fund (JTF), designed to support the challenges of reaching carbon neutrality by 2050, is one of the pillars of the Just Transition Mechanism (JTM), part of the European Green Deal.¹⁰³ Initially designed with an overall budget of €40 billion, the fund has subsequently been allocated €17.5 billion, €10 billion from the NGEU and €7.5 billion from the 2021-2027 Multiannual Financial Framework (MFF), specifically as part of the disbursement for ‘Natural Resources and Environment’.¹⁰⁴ The NGEU will also contribute to the European Agricultural Fund for Rural Development, with €7.5 billion over the period 2021-2022 to address the challenges of the COVID-19 pandemic in rural areas.¹⁰⁵

The InvestEU programme, designed to group all EU financial instruments for internal policies into one instrument, will receive financial resources from both the NGEU (€5.6 billion) and from the 2021-2027 MFF (€43.8 billion).¹⁰⁶

¹⁰² See: <https://www.consilium.europa.eu/en/infographics/ngeu-covid-19-recovery-package/>

¹⁰³ Political agreement on the Just Transition Fund (europa.eu).

¹⁰⁴ Just Transition Fund: Council endorses the political deal with the Parliament. Consilium (europa.eu).

¹⁰⁵ Common Agricultural Policy (CAP) (europa.eu).

¹⁰⁶ InvestEU | Legislative train schedule | European Parliament (europa.eu).

Resources of the NGEU will also fund Horizon Europe, the transnational programme for research and innovation, with an overall budget of €95 billion for the period 2021-2027, of which €5 billion comes from the NGEU. Among the discussed measures, Horizon Europe represents a key example of a mission-oriented programme,¹⁰⁷ with five big challenges identified for the period 2021-2027: conquering cancer; accelerating the transition to a climate-prepared and resilient Europe; regenerating oceans and waters; 100 climate-neutral cities by 2030; and soil health and food.¹⁰⁸

Finally, the EU's Civil Protection Mechanism (RescEU) will receive €1.9 billion to strengthen civil protection and the response to disasters, and to increase resources for its health cluster and for medical and protective equipment.

As a response to the energy crisis, following the war in Ukraine on 18 May 2022 the European Commission presented the RePowerEU plan for the period 2022-2027, with the aim of ending the EU's dependency on Russian fossil fuels and in support of measures to fight climate change.¹⁰⁹ The plan is supported with financial resources coming from different sources, mainly the RRF – with €225 billion available as loans – but also with an additional €20 billion disbursed as grants, with resources raised through the EU Emission Trading System allowances. In addition, up to €100 billion from the 2021-2027 MFF are already supporting investments in renewable energy, hydrogen and infrastructure; €26.9 billion from the Cohesion Fund and €7.5 billion from the Common Agricultural Policy can be voluntarily transferred to the RRF; and €3 billion will finally come from the 2022 Large Scale Call of the Innovation Fund, with resources that will be doubled by the Commission in Autumn 2022.

Three main pillars are at the core of the RePowerEU plan: *i*) energy savings, with an increase in the proposed target of energy savings from 9% to 13% in 2030 (compared to 2020); *ii*) diversification of energy supplies, increasing gas storage at national level; and *iii*) accelerated roll-out of renewable energy, incentivising the use of domestic renewable energy with a target of 67% of wind and solar in domestic power production by 2030.

What makes RePowerEU different from the rest of the RRF is the use of repayable financial instruments, in addition to grants which dominate the structure of the RRF. The EC, together with the EIB, has developed a model of extending loans on more favourable terms to projects that receive EU grants. Combining grants and loans into a single financial instrument allows Managing Authorities (MA) and financial intermediaries in Member States further support investments in energy efficiency.¹¹⁰ The energy efficiency financial instrument (EEFI) takes the form of a combined loan or a guarantee (depending on a project assessment) and grant financial instrument to be managed by a financial intermediary on behalf of a MA, acting either directly or through a holding fund (HF).¹¹¹

¹⁰⁷ See: <https://www.ft.com/content/b26f6785-e08a-450b-8c62-bdafbeb5ff2c>

¹⁰⁸ See: https://ec.europa.eu/info/news/top-experts-propose-potential-eu-missions-further-consultation-europeans-2020-jun-25_en

¹⁰⁹ See: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_3131

¹¹⁰ See: https://www.fi-compass.eu/sites/default/files/publications/energy-efficiency-model_0.pdf

¹¹¹ Ibid, 9.

A2. The additional resources from the Multiannual Financial Framework (MFF)

In addition to the resources of the NGEU Fund, MS can also rely on financial resources made available with the 2021-2027 MFF. The MFF is the EU long-term budget, for which consultations at a European level for the new 2021-2027 version, replacing the previous 2014-2020 version, began prior to the COVID-19 pandemic. In May 2018, the European Commission presented the first proposal for the 2021-2027 budget, for which discussions lasted more than a year. With the beginning of the COVID-19 crisis in early 2020, the need to structure adequate financial resources for the states became the primary mandate at the European level. After several rounds of proposals and discussions, in May 2020 the European Commission presented a new version of the 2021-2027 MFF, agreed by MS in July 2020 and adopted by the EU Council on 17 December 2020, with a final endowment of €1074.3 billion, for which it will be necessary to borrow on the financial markets from 2024.¹¹² The available financial resources will be distributed through several programmes, as in Table 3.

Table 3: 2021-2027 Multiannual Financial Framework – Areas of interest and disbursement

Areas of interest	€ billion
Cohesion, Resilience and Values	377.8
Natural Resources and Environment	356.4
Single Market, Innovation and Digital	132.8
Neighbourhood and the World	98.4
European Public Administration	73.1
Migration and Border Management	22.7
Security and Defence	13.2
Total	1074.3

Source: European Commission, 2020¹¹³

Note: All amounts in 2018 prices

All the financial resources, distributed over eight years, will be directed towards research and innovation, strategic investments, regional development, agriculture and environment, security and migration. The first two largest recipient areas, 'Cohesion, Resilience and Values' and 'Natural Resources and Environment', will receive almost 70% of the available resources over the period 2021-2027, with

¹¹² Negotiation process of the 2021-2027 long-term EU budget and NextGenerationEU | European Commission (europa.eu).

¹¹³ See: mff_factsheet_agreement_en_web_20.11.pdf (europa.eu)

'Single Market, Innovation and Digital' as the third largest recipient, receiving €132 billion over the same period. A detailed list of the programmes by area of interest can be found in Table 4.

Table 4: 2021-2027 Multiannual Financial Framework – Programmes by area¹¹⁴

<u>Area of interest</u>	<u>€ billion</u>	<u>Programme</u>	<u>%</u>	<u>€ billion</u>
<u>Cohesion, Resilience and Values</u>	377.8	European Regional Development Fund (ERDF)	51.2	193.4
		European Social Fund+	22.9	86.5
		Cohesion Fund (CF)	10.5	39.7
		Erasmus+	6.7	25.3
		Reform Support	5.7	21.5
		Decentralised agencies	0.7	2.6
		Creative Europe	0.4	1.5
		Other (of which, 1% margin)	1.9	7.2
<u>Natural Resources and Environment</u>	356.4	European Agricultural Guarantee Fund (EAGF)	75.5	269.1
		European Agricultural Fund for Rural Development	20.8	74.1
		European Maritime and Fisheries Fund	1.6	5.7
		LIFE	1.4	5.0
		Decentralised agencies	0.2	0.7
		Other (of which, 0.2% margin)	0.5	1.8
<u>Single Market, Innovation and Digital</u>	132.8	Horizon Europe	50.2	66.7
		Connecting Europe Facility	13.1	17.4
		European Space	8.5	11.3
		InvestEU fund	7.8	10.4
		Digital Europe	4.9	6.5
		I TER	3.2	4.2
		Single Market	2.2	2.9
		Euratom	1.3	1.7
		Agencies	1.2	1.6
		Customs	0.5	0.7
		Other (of which, 6.4% margin)	7.1	9.4

¹¹⁴ European Parliament: Facts and Figures (euagenda.eu).

<u>Neighbourhood and the World</u>	98.4	Neighbourhood, Development and International Cooperation Instrument (NDICI)	72.7	71.5
		Pre-accession assistance	11.8	11.6
		Humanitarian aid	9	8.9
		CFSP	2.4	2.4
		Overseas Countries and Territories	0.4	0.4
		Decentralised agencies	0.1	0.1
		Other (of which, 2.7% margin)	3.6	3.5
<u>European Public Administration</u>	73.1	Administrative expenditure of the institutions	77.4	56.6
		European Schools and Pensions	22.6	16.5
<u>Migration and Border Management</u>	22.7	Decentralised agencies – Borders	34.3	7.8
		Asylum and Migration Fund (AMF)	29.9	6.8
		Integrated Border Management Fund (IBMF)	26.7	6.1
		Decentralised agencies – Migration	2.5	0.6
		Margin	6.6	1.5
<u>Security and Defence</u>	13.2	European Defence Fund	47.1	6.2
		Military Mobility	23.7	3.1
		Internal Security Fund	9.1	1.2
		rescEU	5.1	0.7
		Decentralised agencies	4.1	0.5
		Nuclear safety and decommissioning (BG, SK)	2.3	0.3
		Nuclear decommissioning (LT)	2.0	0.3
		Margin	6.6	0.9

Source: European Commission, 2020

Note: All amounts in 2018 prices

While the 2014-2020 MFF was mainly aimed at addressing the long-lasting downsides of the 2008 subprime mortgage crisis, the 2021-2027 MFF comes with a combination of both previous unresolved challenges together with the most recent ones brought by the COVID-19 pandemic. The current context will inevitably make it more difficult to combine the necessity of short-term responses, as provision of liquidity, and long-term planning and investments. The success of European, national and regional institutions will then directly depend on their ability to have a common and ambitious vision for the (not-so-distant) future in 2027, and their ability to combine the necessity of a prompt and short-term emergency response with a more long-term challenge-oriented strategy.

This paper assesses the interaction between the Recovery and Resilience Facility (RRF) and the European Semester by outlining coordination mechanisms between the two in the broader context of economic governance in the EU. Two main elements of this interaction are emphasised: coordination of investments and implementation capacities. The study argues that coordination of investment programmes remains fragmented in the EU, while the notion of policy capacities should be given more strategic consideration in the Semester and RRF evaluation frameworks.

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