



**Finance Watch**

Making finance serve society

# 10 Principles for a Sustainable Recovery

Overcoming the contradiction between recovery and resilience in Next Generation EU



**October 2020**





**Author:** Thierry Philipponnat

**Editor:** Duncan Lindo

**Contributor:** Ludovic Suttor-Sorel

**Cover photo:** Hamburger Gewässer - die Tarpenbek © Boysen/Adobe Stock

Typeset by Camila Dubois.

© Finance Watch 2020

The contents of this report may be freely used or reproduced without permission provided the original meaning and context are not altered in any way. Where third party copyright has been acknowledged, permission must be sought from the third party directly. For enquiries relating to this report, please email [contact@finance-watch.org](mailto:contact@finance-watch.org)

Finance Watch has received funding from the European Union to implement its work programme. There is no implied endorsement by the EU or the European Commission of Finance Watch's work, which remains the sole responsibility of Finance Watch.





# Content

<b>Introduction: the recovery vs. resilience paradox</b>	<b>4</b>
<b>Setting the context</b>	<b>6</b>
1. Resilience defined as avoiding the future disruption of the world	6
2. The RRF: more about recovery than resilience	8
<b>What direction of travel?</b>	<b>11</b>
3. Support sustainable activities	11
4. Do not support unsustainable activities (at all)	13
5. Support people whatever it takes	14
<b>Reconciling recovery and resilience</b>	<b>16</b>
6. Define 'green' and 'do no harm' precisely	16
7. Assess Member States' recovery and resilience plans for sustainability	19
8. Ensure the coherence between resources and the use of proceeds	21
9. Reform the EU economic governance	25
10. Money can grow on trees (for sovereign entities)	27

## INTRODUCTION:

### THE RECOVERY VS. RESILIENCE PARADOX

When the covid-19 epidemic became a pandemic in March 2020, governments all over the world took measures in an attempt to control the situation. Over four billion human beings went into lockdown and the impact of the situation on society, on people, on social structures, on human activity, on the economy and on the financial system was enormous.

From an economic standpoint, the consequences of the measures taken to try to control the pandemic can be summarised by two numbers:

1. World economic activity has entered a deep recession, as reflected in the forecast made by the World Bank of a global GDP contraction of 5.2% in 2020<sup>1</sup>. This aggregate hides a wide range of impacts with many countries facing a much deeper contraction.
2. CO2 emissions linked to economic activity reduced by 8% globally, for the first time putting the world on a path towards limiting human-induced global warming.

Numerous analysts have described the correlation between economic activity and CO2 emissions. But the real life confirmation offered by the unprecedented situation of 2020 has confronted political leaders with a dilemma they need to solve urgently: how can they stoke economic activity without reviving CO2 emissions, and more generally promote the sustainable economy they need to promote today if they do not want the world to be disrupted tomorrow?

The answer to this question is that they cannot. In a context of a global warming trend between + 3.7 °C and + 4.8°C by the end of the century (reported by the IPCC in 2014), the two objectives of reviving the economy as it was at the end of 2019 and building a sustainable future for the world are two mutually incompatible objectives.

Unfortunately for democracies with short political cycles there is a strong temptation to boost short-term economic growth and forget about the longer term and the more difficult task of building a sustainable future; while at the same time paying lip service to the need to 'build back better, greener and more just', in order to court more progressive voters.

This report looks at the way we can overcome the paradox embedded in the notion of a resilient recovery. If recovering the economic situation that was ours before the covid-19 pandemic struck has become the new objective, does it mean that we should forget, or postpone, the idea of building a sustainable future? Can we make the two objectives compatible? Is a compromise between the two objectives to be found? What do we mean by building a sustainable future? Are the environmental and the social objectives of recovery packages compatible? If yes, how? How can we support the job market without fostering a carbonised economy in a world where the vast majority of economic structures are highly carbonised?

---

1 [World Bank - Pandemic, Recession: The Global Economy in Crisis: June 2020](#)

Looking at the EU situation, how do we ensure that the €750 billion Next Generation EU (NGEU) instrument agreed on 21st July 2020 by the European Council overcomes the apparent paradox of trying to achieve the two mutually incompatible objectives contained in the name of its €672.5 billion Recovery and Resilience Facility? This question appears as particularly crucial when one reads the proposal for a *Regulation of the European Parliament and of the Council establishing a Recovery and Resilience Facility*<sup>2</sup> that was put on the table in May 2020: this proposal aims without ambiguity to orient capital flows towards reviving the economy of the EU as it was before the covid-19 crisis, as opposed to building a sustainable, and therefore resilient, EU economy. As an illustration, the first criterion given in Article 16.3(d) of the Regulation for the Commission to assess a Member State recovery and resilience plan is to consider whether the plan submitted “*is expected to effectively contribute to strengthen the growth potential...*”, knowing that none of the ensuing criteria refers to environmental sustainability.

Implementing a Recovery and Resilience Facility (RRF) with a clear focus on recovery and very little on resilience makes especially little sense in a context of low interest rates and currently relaxed Stability and Growth Pact (SGP) rules where all EU Member States have access to capital markets to support their economies as they decide to. In such an environment, the obvious focus of the RRF should be to build the resilience, and therefore the sustainability, of the EU economy, not to provide funding to Member States that they can obtain by themselves. Even if the grant portion of the RRF (less than half of the total) has an important solidarity dimension with far reaching consequences for the political momentum of the European Union, its size (about 2% of EU GDP) does not make it an economic game changer in a situation where national debts have often increased by as much as 20% or 30% of GDP following the support that Member States gave their economies following the covid-19 crisis. The RRF should be about setting the direction of travel, not about funding.

The RRF should be seen as a unique opportunity to build a sustainable and resilient economy. It should be the catalyst putting the economy of the European Union on a transition path. Unfortunately it is not the case at the moment.

The ten principles described in this policy brief aim at making the RRF a true Recovery and Resilience Facility, as opposed to a RECOVERY and resilience Facility as is the case today.

---

2 [Regulation of the European Parliament and of the Council establishing a Recovery and Resilience Facility](#)

SETTING  
THE  
CONTEXT

---

# 01.

## **Resilience defined as avoiding the future disruption of the world**

---

The covid-19 crisis has shown the fragility of our economic system and its dependence on the sustainability of the world. It has demonstrated that the biggest risk borne by human societies and their economic systems is the risk of disruption, i.e. the risk that, confronted with the environmental consequences and geostrategic upheavals that an unsustainable world will bring, there is no plausible scenario under which human societies and the world economy can continue to function normally. The biggest threats to the sustainability of the world and to its resilience are, as widely discussed, climate change, the loss of biodiversity and an ever-higher level of pollution. Up until March 2020 the world was on a path to a global warming comprised between 3.7 °C and 4.8°C before the end of the century. Such a level of global warming is synonymous with droughts, wild fires, massive migrations of populations, loss of pollination, fighting for access to fresh water and food, rising sea levels, floods, hurricanes and pandemics. Any single one of those different events would suffice to disrupt the world, but in all likelihood many of them will take place concomitantly.

Bringing an undifferentiated support to the unsustainable economy we were running before the covid-19 crisis would mean supporting tomorrow's inevitable and disastrous disruption of human societies and their economies. This would be a fault of historical dimensions.

Policy-makers need to get their priorities right: in a context where economic and social resilience has become synonymous with sustainability, economic policies should focus exclusively on building a sustainable economy able to serve human societies, and stop considering GDP growth as an objective, contrary to what the RRF does when it gives growth potential as the first criterion to assess national recovery and resilience plans. The only objective that can make sense today is to take the measures necessary to build a sustainable world. The growth rate resulting from having taken the necessary measures should only be seen as a consequence.

Taking a growth rate as an objective, as opposed to an output, is inverting causes and consequences and can only lead to making the wrong decisions. In a world in transition, growth will by definition not be aligned throughout sectors: sustainable activities will grow at a very high rate, unsustainable activities will shrink, and the net result (GDP growth) should be seen as an ex-post measure of secondary interest. Most importantly, short term GDP growth achieved by supporting unsustainable activities would necessarily lead to the future disruption of the world and, therefore, to a global GDP collapse.

Importantly, in a European legal context, supporting unsustainable activities, which by construction feed the future disruption of our societies and of their economy, contravenes the precautionary principle established by article 191 of the Treaty on the Functioning of the European Union.

### **Theoretical contradiction between pursuing growth and building a sustainable world**

Abandoning growth as an objective should also include getting rid of the nebulous notion of potential growth and the corollary notion of output gap as economic policy tools.

The output gap is defined by economic theory as the difference between growth and potential growth, potential growth being itself defined as the level of growth theoretically achievable through a full utilisation of capital and labour as factors of production. These notions are fraught with many theoretical weaknesses, including the simplistic assumptions about substituting capital and labour, and are impossible to measure in practice.

Described by Benoît Coeuré, then a Member of the Board of the ECB, as “*a riddle, wrapped in a mystery, inside an enigma*”<sup>3</sup>, the output gap not only gives policy-makers an illusory sense of rigour when they make economic policy decisions, but it is most obviously incompatible with building the sustainable, and therefore resilient, economy we need to build. This is due to the fact that its logic is founded on a theory first developed in 1928 by Charles Cobb and Paul Douglas, which considers only financial capital and labour as production factors and ignores any form of natural capital, use of natural resources or negative externalities. Economic policies aiming at ‘closing the output gap’ or boosting growth potential, in other words economic policies taking GDP growth as an objective, therefore effectively ignore the sustainability of the world.

---

3 [Benoît Coeuré - Scars that never were? Potential output and slack after the crisis, 12 April 2018](#)

# 02.

## The RRF: more about recovery than resilience

---

The agreement reached by the Heads of States or Governments of the EU on 21st July 2020 saw the adoption by the European Council of a special covid-19 crisis related instrument called Next Generation EU (NGEU) for a total amount of €750 billion along with the EU Multiannual Financial Framework (MFF), which has an overall amount of €1,074.3 billion for the period from 2021 to 2027. NGEU will be funded through the issuance of debt instruments by the European Commission until the end of 2026, and the repayment of that debt will have to be completed by the end of 2058.

The bulk of NGEU (€672.5 billion out of €750 billion) is represented by the Recovery and Resilience Facility (RRF). Given its importance, we focus most of the analysis of this report on the RRF.

### Main features of the EU Recovery and Resilience Facility

- Size: €672.5 billion, of which:
  - Loans: 360 billion
  - Grants: 312.5 billion
- 70% of the grants shall be committed in 2021 and 2022, the remaining 30% being committed by the end of 2023.
- The RRF allocation shall be established according to the Commission proposal.
- Member States shall prepare national recovery and resilience plans setting out their reform and investment agenda for the years 2021-23 (A 18).
- Member States' recovery and resilience plans shall be assessed by the Commission within two months of their submission (A 19). The agreement poses the objective for the national recovery and resilience plans (in order of priority) to strengthen the growth potential, create jobs and foster economic and social resilience, knowing that green and digital transition shall also be a prerequisite for a positive assessment by the Commission.



**Finance Watch's comment:**

The RRF comes out, before anything else, as a recovery facility by setting short-term economic objectives (the first of which being the growth potential) as a priority.

The word “also” applied to ‘green’ (and digital) creates a logical incoherence given that a ‘non-green’ (understood as unsustainable) project cannot, by construction, be economically resilient.

Clarification is needed on whether job creation includes all jobs, i.e. even jobs in unsustainable activities (which would implicitly mean that RRF money can support unsustainable activities as long as they represent employment potential).

Annex II of the proposal for an RRF Regulation<sup>4</sup> also states that, in its assessment of national plans, the Commission shall consider positively measures expected to “*contribute to establish climate- and environmental-friendly systems and to the greening of economic or social sectors*” or “*expected to significantly contribute to the digital transformation of economic or social sectors*”: the climate and environmental-friendly dimension is a possibility, not an obligation.

- At least 30% of the total amount of MFF and NGEU should contribute to climate objectives.

**Finance Watch's comment:**

Applying the 30% rule to the total amount of MFF and NGEU (i.e. €1,074.3 billion + €750 billion = €1824.3 billion) means that the amount of €547.29 billion (30% x = € 824.3 billion) dedicated to climate objectives could, in extreme cases, come exclusively from the MFF at the exclusion of the funds allocated through NGEU.

- EU expenditures (NGEU and MFF) “*should be consistent with Paris Agreement objectives and the ‘do no harm’ principle of the European Green Deal*” (point 18 of Agreement annex) and point A21 of the agreement (“*all EU expenditure should be consistent with Paris Agreement objectives*”).

**Finance Watch's comment:**

Consistency with Paris Agreement objectives and the ‘do no harm’ principle of the European Green Deal imply necessarily being on a transition path. An unsustainable activity, or enterprise, that is not able or willing to transition towards a sustainable model is, by definition, not consistent with Paris Agreement objectives and ‘does harm’. This point is particularly obvious

4 [Annex II of the proposal for an RRF Regulation](#)

in the case of high CO2 emitting activities, and is consistent with Article 17 (1.a) of Regulation (EU) 2020/852 (Taxonomy Regulation).

Embedding these principles in the criteria that will be used by the Commission to assess the recovery and resilience plans submitted by Member States is indispensable.

**Additional point of attention:**

As a matter of principle, Finance Watch regrets that a word as vague as ‘green’ should be used in a political agreement, let alone an agreement of that importance or in a legally binding document such as the *Regulation establishing a Recovery and Resilience Facility* (for instance in the current version of its Article 16 describing the assessment of Member States recovery and resilience plans by the Commission).

After the thorough work done by the High Level Group on sustainable finance (HLEG), and the Technical Expert Group on sustainable finance (TEG), and following the adoption in July 2020 of a Taxonomy Regulation<sup>5</sup> defining precisely the word ‘sustainable’, the EU should be using its own definition and classification of sustainable activities. This is essential to build policies on solid ground and to ensure the coherence of its different regulations dealing with public and private finance. This last point is more essential today than ever as the recovery and resilience agenda cannot be disconnected from the sustainable finance agenda. Rigorous definitions are indispensable and the word ‘green’, for all its power as a communications tool, is useless when it comes to defining a policy with any rigour.

For the Regulation establishing a *Recovery and Resilience Facility* to be effective, it is therefore indispensable that, among others, the word ‘green’ be replaced by the word ‘sustainable’, and that Article 16 of the RRF Regulation express clearly that the Commission should also assess the sustainability of the recovery and resilience plans submitted by Member States, sustainability being defined in the sense given to the word by the Taxonomy *Regulation* (EU 2020/852) adopted on 18 June 2020<sup>6</sup>. If this seems to be the direction taken by the European Commission Staff working document dated 17th September 2021 and by the Council of the European Union’s fourth draft compromise released on 21st September 2021, this will need to be confirmed in the final text of the Regulation to be adopted.

5 [Regulation 2020/852 on the establishment of a framework to facilitate sustainable investment](#)

6 Ibid.

## WHAT DIRECTION OF TRAVEL?

---

# 03.

## Support sustainable activities

---

Building a resilient recovery implies that the entire RRF should be dedicated to supporting sustainable activities. This requires, in turn, defining sustainable activities.

The statement<sup>7</sup> issued on 15th July 2020 by the EU Technical Expert Group on sustainable finance gives an important insight into that dimension:

*To ensure the recovery enables resilience building, we need to encourage investments in:*

- **Social resilience:** *activities that enable social cohesion and co-operation and ensure that the most vulnerable are able to access social and health systems without putting themselves at risk. This crisis has taught us that building resilience to climate change and other shocks has to include health system resilience. Health systems need to be able to scale up quickly for future pandemics and other health crises including those created directly by climate change such as extreme heat events; and access has to be available to all.*
- **Economic resilience:** *Jobs need to be created in sectors that contribute the most to a more sustainable and resilient economy - sectors that need to grow in the future and are prepared for climate change impacts. Enormous opportunity exists for job creation in sectors such as energy efficiency, distributed solar, afforestation and environmental remediation.*
- **Ecosystem resilience:** *a focus on healthy ecosystems is needed to reduce the risk of future pandemics. That will mean protecting and rebuilding natural capital and biodiversity in Europe while mitigating climate change to minimize climatic impacts on ecosystems.*

This insight, based on economic logic, must be sustained by the definition given to sustainable activities by the Taxonomy Regulation.

As explained by the Technical Expert Group on sustainable finance in its 15th July statement, the EU taxonomy has a three-pronged approach of sustainable activities:

---

<sup>7</sup> [5 high-level principles for Recovery & Resilience, TEG](#)



*When considering climate change mitigation, the Taxonomy differentiates between three types of activities: low carbon, transition and enabling. These concepts could be used in further specifying and targeting the types of reforms and investments included in the plans for climate change mitigation:*

- *Low carbon activities are those already operating at a level close to net-zero performance. Targeted policy reform and investment to expand and develop these sectors is necessary.*
- *Transition activities are those which are a substantial source of carbon emissions and where substantial investment and policy reform is required to improve environmental performance.*
- *Enabling activities are those which support other sectors of the economy to make a substantial contribution, on a lifecycle basis. As with low carbon activities, these sectors need to be expanded and developed.*

The inclusion of transition and enabling activities in the taxonomy of sustainable activities has been seen as essential for the TEG and is now part of EU regulation. Its importance comes from the fact that developing a sustainable economic system will be as much about the evolution of currently unsustainable modes of production towards sustainable ones as it will be about developing new sustainable technologies, activities and businesses. This has obvious consequences on the usability of the *Taxonomy Regulation* in the context of the RRF, as it means that traditional (and currently unsustainable) businesses can be supported as long as they invest to transform their way of operating or producing to become sustainable or enable other activities to be sustainable. If low carbon activities are obviously essential, they represent today only a small fraction of the European economy. If the RRF follows our recommendation to support only sustainable activities in the sense given to the word by the Taxonomy Regulation, it can be expected that the bulk of its support will go to enterprises conducting transition or enabling activities.

There are three main reasons why it is essential for the RRF to support transition and enabling activities, along with low carbon activities: 1) it will constitute a major support to the EU job market; 2) enterprises operating in transition and enabling activities must be operating in the long run and therefore be supported in the short run if we want them to be able to transform themselves; 3) RRF support will act as an incentive for enterprises that were not previously inclined to transform themselves towards sustainable models to do so.

This incentive dimension is, in our view, particularly important and relates to the point we are making in the following paragraphs: do not support unsustainable activities, as doing so would disincentivise the development of sustainable activities.

# 04.

## **Do not support unsustainable activities (at all)**

---

The indispensable corollary to providing support to sustainable activities is to provide no support to unsustainable activities. If the recovery supported by the RRF is to be resilient, only sustainable activities must be supported.

On top of feeding the future disruption of the world, money invested in unsustainable activities will be wasted for similar reasons that fossil fuel assets will become stranded because of climate change (e.g. as researched by the Carbon Tracker Initiative<sup>8</sup>). Either unsustainable activities will have to cease in the not too distant future in an attempt to stop the race towards the collapse of an unsustainable world or, if they are not stopped, their value will be swept away in the general disruption of the world. All unsustainable activities and investments are doomed to be stranded. All RRF money directed towards supporting unsustainable activities will be wasted.

As importantly, supporting enterprises involved in unsustainable activities would remove the incentive that will come with applying the transition activity logic of the EU Taxonomy to provide RRF support. If enterprises involved in unsustainable activities, including enterprises not willing to invest into a sustainable future, receive public support, most of them will not make the effort of transforming themselves. This would be a most counterproductive result.

Transition is, by construction, a forward-looking exercise, and an enterprise refusing to invest into the transition of its activity toward sustainability should be denied support under RRF. The RRF is a unique occasion to incentivise the conversion to sustainability of the most sceptical and to trigger a most significant shift of the economy towards sustainability, which is obviously the objective.

In summary, investing in sustainable activities, or supporting them, creates a triple dividend: it boosts economic activity, it creates long-term jobs and, by definition, it contributes to building a sustainable world. Conversely, investing in unsustainable activities, or supporting them, creates a triple loss: money will soon be lost, related jobs will subsequently also soon be lost, and if the future disruption of society will grow.

# 05.

## Support people whatever it takes

---

Public money will need to be spent on the necessary scale to support people currently working in, or dependent on, unsustainable businesses. The money not spent on supporting unsustainable businesses should be spent on supporting the people whose life depends on those businesses, making sure that they receive the support to train to work in new sustainable activities and, more generally, that they benefit from sufficient revenues to live a decent life.

There is no doubt that building a sustainable society will be synonymous with a high level of economic activity, will lead to massive job creation and that there are strong incentives for enterprises to embark on a sustainability path. However, supporting only enterprises conducting sustainable activities, i.e. including transition and enabling activities, will mean enterprises operating on unsustainable models will not receive public support and inevitably a proportion of them will fail - some in the near term some in the longer term as the economy changes. This, in turn, will have negative consequences for the people employed by those enterprises. In the ensuing debate, the arguments in favour of supporting unsustainable activities in order to protect jobs should be put in perspective with the fact that jobs in unsustainable activities will be by construction short-lived as unsustainable activities are doomed to be stranded (see principle 4 above).

Agreeing on the fact that the best way to ensure a just transition towards a sustainable economy is to provide people with good jobs in sustainable activities that give them sufficient revenues to live a decent life is not controversial. The more difficult question is to determine how we reconcile the necessity to support only sustainable activities with the necessity of not leaving people behind, including those who work for enterprises involved in unsustainable activities. Supporting those people should be an absolute priority for policy-makers and public budgets.

Fiscal authorities should embrace the 'whatever it takes' logic rolled out by the European Central Bank in 2012 to save the euro. Given what is at stake, there should, literally, be no limit to the amount of public money spent on supporting people, and no self-declared budgetary orthodoxy should get in the way of achieving this objective. This does not preclude, naturally, the fact that spending large amounts of public money requires a high degree of planning and control to ensure that the money is well spent, let alone not diverted or misappropriated.



Support to people will need to be rolled-out in two steps:

1. The first step will be to train people to work in sustainable activities, which will have at least three positive consequences: 1) it will open the possibility for the people made redundant to start new careers; 2) it will be an essential element, and to a significant extent a prerequisite, for the entire economy to move towards a sustainable model; 3) it will create a large number of training jobs.
2. The second step will be to support the people who do not have the capacity to retrain and start new careers in sustainable activities. It is a question of fairness, of human dignity, of social coherence, but also of cold economic interest of the entire society. This support should take the form of a guaranteed income, fixed at a level sufficient to ensure the preservation of human dignity.

## RECONCILING RECOVERY AND RESILIENCE

---

# 06.

### Define 'green' and 'do no harm' precisely

---

NGEU and the RRF have been given the objective of being at least 30% 'green', with the entirety of the package respecting the 'do no harm' principle. Without defining unambiguously the notions of 'green' and 'do no harm' at the heart of the NGEU and the EU MFF, and therefore of the RRF, overcoming the paradox of combining recovery and resilience will not be possible.

The work to define sustainable activities has already been done in the EU with the development of a Taxonomy of sustainable activities described in detail in the final report of the Technical Expert Group on sustainable finance released in March 2020<sup>9</sup> and adopted as a Regulation in July 2020<sup>10</sup>. The EU can pride itself on having developed this Taxonomy of sustainable activities at the price of an enormous collective effort of many parties and experts, and it provides a rigorous and concrete approach of sustainability. As such, it is a key asset when it comes to orienting capital flows towards sustainable activities or designing economic policies aiming at promoting sustainability, and it is essential that NGEU and the Recovery & Resilience Facility be based on it.

The principle should be 1) to replace in RRF the notion of 'green' by 'sustainable' as defined in the Taxonomy Regulation, and 2) apply the 'do no significant harm' logic developed in that regulation. The European Commission should also apply this principle in its assessment of Member States' recovery and resilience plans.

Article 10 of the Taxonomy Regulation (EU 2020/852) deals with climate change mitigation and defines sustainable activities as those being already low carbon, those on a transition path and those enabling low carbon activities. Article 11 adopts a similar logic for climate change adaptation, Article 12 for the sustainable use of and protection of water and marine resources, Article 13 for the transition to a circular economy, Article 14 to pollution prevention and control, and Article 15 to the protection and restoration of biodiversity and ecosystems. Article 16 defines what enabling activities are, and Article 17 what is meant by 'significant harm' when it comes to climate, water and marine resources, the circular economy, pollution prevention and control, and the protection and preservation of biodiversity and ecosystems.

In the case of climate, arguably the most urgent problem humanity has to address given the limited number of years before the planet's carbon

---

9 [Taxonomy: final report of the Technical Expert Group on sustainable finance](#)

10 [Regulation 2020/852 on the establishment of a framework to facilitate sustainable investment](#)

budget is exhausted, Article 17 of Regulation EU 2020/852 considers as doing significant harm an “*activity that leads to significant greenhouse gas emissions*”. Article 17 applies a similar logic to water and marine resources, the circular economy, pollution prevention and control, and the protection and preservation of biodiversity and ecosystems: activities considered as harmful are the ones not transitioning or not enabling other activities to become sustainable.

This conception of ‘doing significant harm’ is both ambitious and pragmatic. Its ambition comes from the implicit affirmation that economic activities that do not either contribute to mitigate environmental challenges or enter into a transition are to be considered as harmful. This is coherent with the fact that such activities will inevitably lead to a disruption of the world, and it is extremely significant that EU regulation should recognise this fundamental principle. But it is also pragmatic if one relates this provision to Article 10 of the same Regulation that defines an activity bringing a substantial contribution to climate change mitigation as either an activity bringing solutions to mitigate the climate change problem (§ 1), or an activity on a transition path (§ 2), as long as, in the latter case, the said activity “*has greenhouse gas emission levels that correspond to the best performance in the sector or industry*”. Clearly, Article 10(2) allows for a wide inclusion of the vast majority of economic activities, as long as they transform to become sustainable and can demonstrate it through the proportion of their turnover, capital expenditure and operational expenditure being ‘Taxonomy compliant’ (Article 8 of Regulation EU 2020/852).

This combination of ambition and pragmatism, together with the absolute necessity of ensuring the coherence of the EU regulatory framework, explains our conviction that the word ‘green’ employed by NGEU should effectively mean ‘sustainable’ in the sense given to the word by the EU Taxonomy Regulation, and the expression ‘do no harm’ have the meaning given implicitly by its Article 17.



### **Ensuring the coherence of the EU framework in the Regulation**

To ensure the consistency of the EU regulatory framework, the methodology used by the Commission to screen the sustainability of national plans should be based on the EU taxonomy of sustainable activities (Regulation EU 2020/852).

### **Clarify ‘do no harm’ and its consequence**

Given the ambition of the RRF to respect in its entirety the ‘do no harm’ principle, there is a need to define this principle and to make it unambiguous. The precision that the RRF should only finance projects respecting the ‘do no harm’ principle should therefore be present in the core of the RRF Regulation.

Article 17 of Regulation EU 2020/852 (‘Taxonomy Regulation’) defines what is meant by “*significant harm to environmental objectives*”. The RRF should consequently be explicit that activities that ‘do no harm’ are those not falling under the provisions of Article 17 of the Taxonomy Regulation. When applied to climate mitigation, the consequence of Article 17 of Regulation EU 2020/852 is that an activity that is ‘not doing significant harm’ is one that does not lead to significant GHG emissions.

In summary, in order to ensure regulatory coherence and overcome the paradox between resilience and recovery, the following principles should be clarified:

- At least 30% of the RRF should support low-carbon activity fully aligned with Paris agreement – in the sense of the Art 10(1) of Regulation EU 2020/852 – and other environmentally sustainable activities – as defined by Art 11, 12, 13, 14 and 15 of Regulation EU 2020/852 – and
- The remaining 70% has to at least support EU companies that ‘do no significant harm’ in the sense of the Art 17 of Regulation EU 2020/852, by ensuring that they either enable other activities to become sustainable in the sense of Art 10(1) of the same Regulation, or they transition to the highest environmental performance possible for their sector – in the sense of Art 10(2) of the Regulation.

# 07.

## Assess Member States' recovery and resilience plans for sustainability

The European Commission will assess Member States' recovery and resilience plans, and in particular their consistency with the objectives of the RRF (Article 16 of RRF Regulation). Strikingly, the conclusions reached by the European Council on 21st July 2020 state that "*all EU expenditure should be consistent with Paris Agreement objectives*" ("Climate targets", point A 21), but no such mention is made in Article 16 of the proposal for an RRF Regulation among the criteria for the Commission to assess Member States' recovery and resilience plans.

A number of points will need to be considered in the assessment of the recovery and resilience plans submitted by Member States if they are to make a difference to transform the EU economy and make it sustainable.

### Looking at the big picture:

Money is fungible and the entirety of aid to public budgets effectively finances the public budget it is destined for. This has the implication that the effectiveness of RRF in financing the resilient recovery of a particular Member State should be assessed by considering the entire budget it is destined to, not the marginal projects deemed to be financed by the funds allocated thanks to the RRF. For all its significance, the total amount of RRF represents less than 5% of the GDP of the European Union and only around 2% if we consider only grants ("non-repayable support"). Behind this average percentage there is, of course, a dispersion of the level of support to the benefit of Member States whose economies have been most affected by the crisis, and it is a major achievement of the European Union to have reached an agreement putting in practice the principle of solidarity between its Member States. However, these numbers show that even in a very positive, and unlikely, scenario where the RRF would be entirely allocated to sustainable activities, its impact on the sustainability of the EU would be negligible if the rest of the EU economy develops unsustainable activities.

The only way for the RRF to make a substantial difference on the sustainability of the EU economy is to be used as a catalyst, and a bargaining chip, by the European Commission. RRF funds should therefore be allocated to Member States only after three tests have been conducted:

1. **Assessment of the projects presented:** Member State recovery and resilience plans should respect in their entirety the sustainability and 'do no harm' criteria defined by the EU Taxonomy Regulation (principle 6 above);

2. **Overall compliance of recipient Member States budgets to the ‘do no harm’ principle:** the budgets of the Member States receiving the money should not subsidise the consumption of fossil fuels, as is so often the case today. Fossil fuels subsidies contribute to increasing the global warming problem as they encourage harmful activities as defined by Article 17 (1.a) of the Taxonomy Regulation (“*activities leading to significant greenhouse gas emissions*”). Providing RRF money to a Member State subsidising fossil fuel consumption would come down to financing activities that ‘do harm’, and should be banned as such;
  
3. **Internal coherence:** there should be no contradiction between the support provided to businesses by Member States’ national budgets (not only by the recovery and resilience plans presented by Member States to the Commission to receive their share of the RRF) and the overall objectives or tools of NGEU. For instance, a particular Member State’s plan to support without conditions its national airline or maritime companies should disqualify that Member State from receiving RRF funding given that it contradicts the EU objective of extending the emissions trading system (ETS) to the aviation and maritime sectors (note: the situation would be different if a precise plan to transition towards sustainable / low carbon models were adopted by those companies). More generally, any support by a national budget to unsustainable activities in the sense of the Taxonomy Regulation should disqualify a Member State from receiving RRF funding.



# 08.

## Ensure the coherence between resources and the use of proceeds

---

The resource side of the RRF must be in coherence with its use of proceeds. This is true for the funding structure of the RRF as well as for the own resources of the EU, which have the double characteristic of making possible the future reimbursement of its debt by the EU and of being policy instruments in their own right.

### Funding structure: bringing transparency to NGEU

Point A5 of the conclusions of the European Council meeting agreed on 21st July 2020 states that the European Commission shall be empowered to borrow up to €750 billion until the end of 2026. Point A7 states, in turn, that the sums raised will be reimbursed at the latest at the end of 2058.

There are two dimensions to a financing instrument: its financial dimension and its governance dimension. From a financial standpoint, issuing €750 billion will not be a problem for the European Commission. As a AAA rated sovereign issuer, and one of the very best credits in the world, the Commission will be able to raise that amount of money easily and at favourable rates, particularly in the current low to negative interest rate environment. The real question is therefore only for the Commission to choose the financing instrument(s) that will best serve the logic of NGEU and be in coherence with its use of proceeds. As already stated, NGEU is about impetus, not about funding of Member States, and its financing structure should reflect this. Consequently, the Commission should be willing to issue debt instruments bringing transparency to debt holders regarding the use of proceeds.

The European Commission has three options to raise the €750 billion of debt it has been given the mandate to raise on capital markets.

#### 1. Green bonds

The first option is to issue green bonds. Even if green bonds standards have not been adopted as an EU Regulation yet, the Commission could decide to follow the recommendations made by the TEG in March 2020 in its proposal for an EU Green Bonds Standard<sup>11</sup>. This is the best option, and it has five main advantages:

1. Bringing transparency to the allocation of money made under NGEU (the main added value of green bonds comes from the fact that they enable bond holders to track the use of proceeds);

---

11 [TEG Usability guide, proposal for an EU green bond standard](#), March 2020

2. Linking NGEU's commitment towards sustainability to the EU Taxonomy of sustainable activities;
3. Giving the EU the necessary flexibility<sup>12</sup> given its link to the definition of 'do no harm' provided in Article 17 of the Taxonomy Regulation (see principle 6 above);
4. Providing a major boost to the EU green bond market;
5. Promoting the coherence of EU regulation by implicitly carving in stone the fact that 'green' in the context of NGEU has the same meaning as 'sustainable' in the context of the Taxonomy Regulation.

In her State of the Union speech on 16th September 2020, Commission President Ursula von der Leyen announced that she was "*setting a target of 30% of Next Generation EU's €750 billion to be raised through green bonds*". If this is, everything else being equal, a step in the right direction, three comments can be made on the announced policy:

- It is indispensable that these green bonds be issued following the yet to be adopted green bonds standards and, until this is the case, they should follow the recommendations made by the TEG in its Usability guide of March 2020;
- Given the implicit reference to the EU sustainable finance regulation coming with the issuance of green bonds, and given the definition of sustainability including transition and enabling activities adopted by the Taxonomy Regulation, it is surprising, and disappointing, that only 30% of the funding should be made through green bonds: does this indicate that the EU is contemplating to devote 70% of NGEU funds to support economic activities that will not even be enabling activities in the sense of Article 10(1) of Regulation EU 2020/852, or on a transition path towards sustainability in the sense of Article 10(2) of the same Regulation? In other words, does this mean that the EU is contemplating to use 70% of the proceeds of its bonds sales to support unsustainable activities that will lead inevitably to the disruption of its economy?
- The EU should be supporting nothing but sustainable activities, as advocated in this policy brief, and should therefore have no problem funding 100% of the RRF through the issuance of green bonds.

## **2. Taxonomy-transparent bonds**

As the Commission is setting as a target to fund NGEU regrettably with only 30% of green bonds, it should at least provide transparency on the level of compliance with the EU Taxonomy of sustainable activities of the remaining 70% of the bonds issued.

---

12 See TEG's [5 high-level recommendations for Recovery & Resilience](#); 15 July 2020

Green bonds, as suggested by the TEG, should be 100% compliant with the Taxonomy of sustainable activities. The logic of Taxonomy-transparent bonds would be to shed light on their degree of sustainability by providing the proportion of compliance of their use of proceeds with the EU Taxonomy Regulation on sustainable activities.

This would be consistent with Article 8 of Regulation EU 2020/852 and its provision that non-financial undertakings disclose the proportion of compliance with the Taxonomy of their capital expenditure, their operational expenditure and their turnover.

With Article 8 in force, the European Commission and Member States will have at hand the information necessary to provide transparency on the proportion of Taxonomy compliance of the bonds issued, and it would be most inconsistent for the EU to require, as Article 4 of Regulation EU 2020/852 does, that “*financial market participants or issuers in respect of financial products or corporate bonds that are made available as environmentally sustainable*” disclose their proportion of compliance with the Taxonomy of sustainable activities without applying the same rule to itself.

Issuing Taxonomy-transparent bonds would be the second best option after issuing green bonds, as it would provide transparency to the whole NGEU process and create an incentive for Member States and for the Commission to make sure that the proportion of Taxonomy compliance achieved by NGEU and the RRF is as high as possible. This, in turn, would make a huge difference for the future sustainability, and therefore the resilience, of the EU economy.

### **3. Plain vanilla bonds**

The third option, potentially applied to 70% of the bonds to be issued by the European Commission, would be for the Commission to issue plain vanilla bonds. This option would be a purely financial solution and it would constitute a refusal by the EU to use its Taxonomy of sustainable activities to orient capital flows towards building a sustainable economy. Technically, it would be incomprehensible given the fact that Article 8 of the Taxonomy Regulation will make the necessary information available. Politically, it would be an implicit recognition that the RRF, and more generally NGEU, do not have the ambition to build a sustainable economy and a refusal to bring transparency on this crucial issue. Finally, it would send a most unwelcome message that the European Union does not want to apply to itself the rules of the Taxonomy Regulation it intends to apply to private actors.

### **Ensuring the coherence between EU own resources and NGEU's allocation of financial support:**

Point A29 of the Agreement reached by the European Council on 21st July 2020 allows for a number of new ‘own resources’ sources of funds for the European Union, such as a tax on non-recycled plastic waste, a carbon border adjustment mechanism, a digital levy, a revised and extended emissions trading system (ETS) and possibly the introduction of a financial transaction tax.

These own resources constitute both the means by which the EU will be able to reimburse the €750 billion of debt raised to finance NGEU, and economic policy tools aiming, at least for the most significant of them, to put the EU economy on a path towards sustainability. This will require heightened attention from the European Commission when it manages the implementation of NGEU and assess national recovery and resilience plans to ensure the global coherence of RRF. For instance, in the case of the ETS, it would be most counterproductive to see public money raised through NGEU support enterprises that will use the money received to purchase ETS rights. This would come down to the EU to providing money to enterprises, only to see the same enterprises return the money received from the EU to the EU. It would be financially sterile and, most importantly, make the ETS useless as an economic policy tool.

This point is of particular importance given that the extended ETS represents by far the biggest source of potential revenues for the EU among the different own resources contemplated. According to a policy contribution released in September 2020 by Bruegel<sup>13</sup>, the ETS will be, in all likelihood, sufficient by itself to reimburse the €750 billion of debt issued by the European Commission.

---

13 Bruegel estimates that the ETS could generate between €300 billion and €1.5 trillion, and €800 billion in the most likely scenario, of revenues for the EU over the next 30 years – [Financing the European Union: New context, new responses](#) - September 2020

## 09.

**Reform the EU economic governance**

In February 2020, only a few weeks before the covid-19 crisis brought the EU and a large part of the world under lockdown, the European Commission launched a public debate on the review of the EU economic governance. The crisis led to the subsequent delay of the review, but it is anticipated that the subject will return to prominence in 2021.

The world and the economic landscape have changed radically since February 2020, hence the adoption of NGEU. This makes for an even more crucial necessity to reflect on the review of the EU economic governance, with a particular focus on the necessary review of the Stability and Growth Pact (SGP) and of the six-pack and the two-pack Regulations.

**Getting rid of the 3% and 60% thresholds:**

At the time of writing this report, the rules limiting the deficit allowed for Member States' budgets to 3% of GDP and the stock of sovereign debt of a Member State to 60% of GDP, have been suspended until 2022<sup>14</sup>. This suspension was most welcome as those rules, that never had any economic rationale (the 3% and 60% numbers are meaningless from an economic standpoint) and have inflicted since the financial crisis of 2007 – 2009 a high level of unnecessary duress on the EU economy, had become untenable in the face of the necessity to bail out economic actors and people impacted by the economic consequences of the covid-19 crisis.

It is essential that those rules be never reinstated and that they disappear altogether from the EU economic governance rulebook. Regardless of the economic policy direction taken, tomorrow's public deficits and levels of debt will be above the 3% and 60% thresholds, either because public authorities will have invested, as they should, to build a sustainable and just society, or because the economy will have collapsed if they have not.

The choice today is no longer between balanced budgets following the 3% and 60% SGP rules and unbalanced budgets coming from supposedly reckless spending. Unbalanced public budgets and high levels of public debt are a given for the foreseeable future, and the only choice is between a renewed economic governance enabling a transition towards sustainability, and keeping the existing economic governance that will lead to a disruption of the world and the ensuing explosion of public deficits and debt. This new state of the world does not preclude, of course, the necessity to control strictly budget procedures and the allocation of public money.

14 FT: [National budget rules to remain suspended next year, Brussels says](#) – 9 August 2020



### Enhancing sustainability and social inclusion indicators in European Semester rules:

Another essential dimension of the necessary reform of the EU economic governance will be to enhance sustainability and social inclusion indicators in the renewed European Semester as part of a reform of the Macroeconomic Imbalance Procedure (MIP) of the six-pack Regulation. Absent such a reform, the very notion of a green and just transition will become an empty concept.

Analysing in depth the reform of the EU economic governance is beyond the scope of this paper, but it is nonetheless interesting to see such ideas emerging more and more regularly, for instance in a recent paper<sup>15</sup> published by Bruegel calling for the inclusion of indicators of the fragility of European households in European Semester rules. Importantly, the Commission recently included a monitoring of the Sustainable Development Goals (SDG) as part of the EU Semester, but in order to have an impact this process has to gain the same weight as indicators of macroeconomic imbalances and become a key component of country-specific recommendations.

The enhancement of sustainability and social inclusion indicators in the European Semester rules will be all the more important to take the EU on the path of a 'green and just' transition that the proposal for a *Regulation establishing a Recovery and Resilience Facility* mentions in several instances country-specific recommendations and the European Semester as being at the centre of the assessment by the Commission of the recovery and resilience plans submitted by Member States.

---

15 [The financial fragility of European households in the time of COVID-19](#) – July 2020

# 10.

## Money can grow on trees (for sovereign entities)

---

This paper argues that public budget deficits should be managed according to prevailing economic and financial circumstances and not by applying inflexible rules that have been carved in stone. Given the number of parameters involved to determine in a rational manner whether a public budget deficit is desirable or not, fixing its limit once and for all is tantamount to deciding to always go out wearing a heavy coat without consideration for prevailing weather conditions. By the same token, refusing to raise debt to invest in essential sustainable infrastructures when interest rates are in negative territory defies the most basic economic logic, as negative interest rates effectively mean that investors are paying sovereign issuers to realise those investments. Deciding on public deficit and debt levels requires fine-tuning, as opposed to applying preconceived ideas.

We are well aware of the traditional argument for limiting public budget deficits with strict rules. This argument can be summarised as the ‘money does not grow on trees’ argument. However, it ignores the fact that money is a human created social convention and an expression of sovereignty, and that, as such, it can be made available at will, provided monetary and political authorities decide to do so.

The supporters of the ‘money does not grow on trees’ argument will usually respond at this stage of the debate that printing money creates inflation. If historically true in different circumstances, this response has lost all validity in today’s world. Despite the enormous amount of money created by central banks over the past twelve years, the global economic environment remains deflationary. The traditional monetary theory linking money creation to inflation has run out of steam, witness the fact that the European economy slid into deflation in August 2020, with prices decreasing by 0.2%, after an exercise of unprecedented money creation by central banks over the preceding months in response to the covid-19 crisis.

We have been experiencing a deflationary, or very low inflationary, economic environment for several years now, and the decrease of aggregate demand linked to the covid-19 crisis is yet another factor that will push the global economic system towards deflation in the future. Without doubt, this trend will be reinforced by the coming disruptions of our unsustainable world

We have argued in a paper released in July 2020<sup>16</sup> that the direct financing of budget deficits by central banks was, in the current environment, a perfectly sound solution with no inflationary effect under plausible economic scenarios.

---

16 Finance Watch: [Debt sustainability and a sustainable COVID recovery](#) – July 2020

Adding to this argument, we could point out the fact that central banks have created over the past 25 years enormous amounts of money to support the financial system, and that this creation of central bank money has not been inflationary. With that experience in mind, it would sound incoherent to argue that money creation could be inflationary if it goes towards supporting public budgets, people, the real economy and investment in a sustainable future when it was not when it went to supporting the financial system.



## About Finance Watch

Finance Watch is an independently funded public interest association dedicated to making finance work for the good of society. Its mission is to strengthen the voice of society in the reform of financial regulation by conducting advocacy and presenting public interest arguments to lawmakers and the public. Finance Watch's members include consumer groups, housing associations, trade unions, NGOs, financial experts, academics and other civil society groups that collectively represent a large number of European citizens. Finance Watch's founding principles state that finance is essential for society in bringing capital to productive use in a transparent and sustainable manner, but that the legitimate pursuit of private interests by the financial industry should not be conducted to the detriment of society. For further information, see [www.finance-watch.org](http://www.finance-watch.org)



# Finance Watch

Making finance serve society

Rue Ducale 67 b3

1000 Bruxelles

T: + 32 (0)2 880 0430

[contact@finance-watch.org](mailto:contact@finance-watch.org)

[www.finance-watch.org](http://www.finance-watch.org)