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How to combine recovery with resilience in Europe

The funds of the EU's Recovery and Resilience Facility should be spent on two objectives – kickstart the European economy and make it more resilient to future crises. However, there can be a trade-off between rapid recovery from the current crisis and long-term, sustainable resilience of the economy. This policy brief suggests three policy measures to overcome this trade-off.

Introduction

Before the outbreak of the coronavirus crisis, climate protection and policies to facilitate a transformation towards a more climate-friendly economy were high up the European political agenda. The European Commission declared the Green New Deal to be one of the main priorities for the years 2019-2024 (European Commission, 2020a) and the growing number of climate protests, such as "Fridays for Future", demonstrate how the fight for a green transformation has gripped civil society. However, since the beginning of the pandemic, more immediate problems such as health, unemployment and untapped public and private finances overshadow the problem of high CO₂ emissions. But, while climate protection and

sustainable growth may seem to be secondary priorities given the current economic and social situation in Europe, this is not the time to lose sight of the climate emergency. Although short-term measures and rapid response aid from the EU and the member states are now required to meet the scale of the pandemic, they should also continue to pursue the long-term goal to decarbonize the European economy. The European Commission set a good example: In addition to its initial *Next Generation EU (NGEU)* proposal, it recently called for strengthening the climate-related projects of the member states within the *Recovery and Resilience Facility (RRF)* (European Commission, 2020b). The Commission also raised the target for reducing greenhouse gas emissions from 40% to 55% by 2030 (Von der Leyen, 2020).

However, there is a relevant trade-off between measures for short-term recovery from the crisis and long-term sustainable growth that has to be considered. As the RRF was designed to be a recovery instrument for the current crisis, its added impact in strengthening Europe over the longer run remains far from clear. The RRF funds should speedily flow into the real economy while implementing projects to make Europe more climate-resilient may well take too long to help the European recovery.

In our policy paper, we show, however, that there are also fields of action in which a rapid recovery from the coronavirus crisis and fostering long-term sustainability can go together. We identify three concrete policy recommendations that should be financed by the RRF. These include large-scale renovation of buildings, expanded and more efficient public infrastructure, and sustainable networks and renewable energies. As the European Commission and the European Council have set the stage, the European Parliament and the Council should now act and put the RRF into effect with concrete projects to meet its conditions and targets for a fast and sustainable recovery.

The RRF and its climate targets

To counter the pandemic's deleterious impact on the European economy and to push for a swift recovery, the RRF will be introduced as part of the new NGEU package. The RRF should also help to make the European economy more resilient to meet future crises. Overall RRF funds will be €672.5bn which will be partly distributed as loans (€360bn) and partly as grants (€312.5bn) to the member states. To receive these funds, member states will need to submit a national recovery and resilience plan where they lay out investments and reforms to be financed by the RRF for the years 2021-2023. 70% of grants will be committed in 2021 and 2022 with the remaining 30% being committed in 2023 as these last 30% will be distributed according to the actual GDP shortfall in 2020 and 2021. The Commission will review the member states' proposals in light of the criteria that will be specified in the regulation that Parliament and Council have to adopt now. This is why the context of the regulation is crucial. In

the Commission's proposal, the main factors to be considered are the following criteria: Environmental sustainability, productivity, fairness and macroeconomic stability. The plans should also enable the member states to support economic growth, job creation, economic and social resilience and to meet the green and digital transition (European Commission, 2020c). With regard to the green transformation, it remains unclear which projects should be funded by the RRF on achieving this objective, as there are so far no specific targets set. The only reliable number is that 30% of total expenditures from the new *Multiannual Financial Framework (MFF)* and NGEU should contribute to achieving the EU's 2030 climate targets, the Paris Agreement and the objective of climate neutrality by 2050 (European Council, 2020). Moreover, the European Commission recently proposed a 37% climate mainstreaming target for the RRF (European Commission, 2020b). This is consistent with the fact that the MFF achieves about 25%, which means that NGEU needs to do much of the heavy lifting to get to the overall 30% target. The 37% can be seen as a lower bound for the RRF as not all programmes of the NGEU are intended to increase the climate resilience of the European economy. Besides, it may be that not all lending from the RRF will be utilized by the member states. In this case, the remaining resources will have to meet an even higher environmental benchmark.

Put another way, a large part of the RRF's funds needs to flow into green projects to fulfil the 30% target of the European Commission. However, it is still not clear what these green projects may be. Although there are some proposals such as a European high-speed rail network (Creel et al., 2020), they often do not fit into the RRF's framework or intended time horizon. Most proposals will be costly and/or require lengthy implementation and may therefore fail to support a swift recovery even if their environmental value is substantial. This can be thought of as a trade-off. On the one hand, any measures taken need to kick-start the economy very quickly. On the other hand, the measures need to have a positive benefit on long-term sustainability and resilience by helping to achieve the EU's climate targets. The next section explains this trade-off in more detail.

Box: Next Generation EU and its political process

In light of the coronavirus crisis, the European Commission proposed the emission of newly issued debt, namely *Next Generation EU (NGEU)*, to counter the negative impact of the crisis. This first proposal by the Commission was revised by the European Council in late July. While the overall size of NGEU remained the same as before, the share of grants was cutted (and the share of loans was increased, respectively). In summary, the European Union will be permitted to newly emit €750bn worth of debt under the NGEU proposal. The largest part of the NGEU funds will be channelled to the member states through the new *Recovery and Resilience Facility (RRF)*, while a small part will be used to scale-up existing programmes under the EU's *Multiannual Financial Framework (MFF)*. The following presents an overview of the current NGEU plan:

Next Generation EU (€750bn)

Member States funds:

- Recovery and Resilience Facility (RRF) (€672.5bn) of which €360bn will be distributed as loans and €312.5bn as grants to the member states

Scaled-up programmes within the MFF:

- ReactEU (€47.5bn)
- Horizon Europe (€5bn)
- InvestEU (€5.6bn)
- Rural Development (€7.5bn)
- Just Transition Fund (JTF) (€10bn)
- RescEU (€1.9bn)

Currently, the European Parliament and the Council - which need to agree on the Council's NGEU proposal - have yet to pass this legislation. They are in discussion about some specific aspects of the proposal like the conditions for the member states to receive the funds from the RRF and the governance of it.

The trade-off between a fast recovery and long-term resilience

» *The rationale for a green recovery is clear: the disruption caused by COVID-19 offers an opportunity to build a new eco-friendly system, for the benefit of current and future generations. But pursuing a green recovery might not be as straightforward as one might think. Trade-offs must be weighed between the need to provide a short-term stimulus to the economy and the need to address the long-term challenge posed by global warming. [...]* « (Bruegel annual meetings 2020, session description from "Greening the recovery")

This citation puts the problem in a nutshell: There can be a trade-off between rapid recovery from the current crisis and long-term, sustainable resilience. In the wake of the crisis, many workers across Europe have lost their jobs or are on active labour market programmes and economic output has fallen at a record pace. The coronavirus crisis is forecast to be the worst economic downturn since the Great Depression in the 1920s and 1930s (Vlieghe, 2020). Therefore, a rescue package should be designed to rapidly create new jobs and raise economic output.

At the same time, the European economy should also become more resilient to future shocks and climate change. Thus, the RRF should pursue both short-term and long-term objectives. These two objectives are not necessarily

complementary. An example is the recent financial aid for the aviation industry in Germany, where a non-ecological industry was rescued to secure jobs in the short term (nevertheless, not all jobs were saved). The long-term negative consequences of extensive flying were not addressed in the conditions attached to these payments. However, it often takes a long time to bring green investments to fruition. For example, the development of European rail networks should lead to a better climate balance in the future, but planning and implementation alone will take years, with little or no positive immediate employment or output effects. Many policymakers have already drawn attention to this trade-off, stressing the need for short-term measures and for putting long-term goals to one side if one is to get out of the crisis first (Elkerbout et al., 2020).

However, preserving existing structures in the short-term may cost more in the medium-term than modernising them in the first place. Investing in something today already knowing you will have to modernise yet again in a few years' time is inefficient and uncondusive to a sustainable recovery (Mukanjari & Sterner, 2020).

The task of the European Parliament and the Council is therefore to solve this trade-off by defining clear targets and projects for the recovery plans of the member states to be funded by the RRF. The aim of any measures should be to combine short-term recovery and stabilisation with long-term crisis and climate resilience. In the following, we will outline possible measures to achieve this.

European measures to ensure a green recovery

Since our measures are only examples and equally feasible measures can probably be found, they should serve as reference points. Nevertheless, the following measures are among the most important to reach the European climate targets and ensure a rapid economic recovery. Besides bringing a positive short- and long-term effect, they can be swiftly implemented since no lengthy planning periods are involved.

1. Large-scale building renovations

The first and most important measure to be financed by the RRF is large-scale national packages to enhance the energy performance of older buildings. Its urgency results from the fact that the energy use of buildings in Europe accounts for 40% of total European energy consumption (Von der Leyen, 2020). A study by the European Commission also shows that the current energy renovation rate of 1% is too low to achieve average climate neutrality of buildings by 2050, as proposed by the Commission. Here, a rate three times higher would be required (European Commission, 2019). This is mainly caused by older buildings that have not yet been renovated. By contrast, new buildings are generally more energy efficient (Umweltbundesamt, 2019). Therefore, a rapid renovation of all buildings yet to be refurbished would significantly reduce overall energy consumption in Europe and thus also reduce greenhouse gas emissions. This measure would make a major contribution to achieving the EU's climate objectives. The European Commission also names the renovation target as one of seven flagship initiatives that should be included in the member states' recovery plans (European Commission, 2020b).

For this measure to completely unwind the trade-off, the long-term impact on the climate must be positive but that must also hold true for the short-term effects on employment and economic growth. In the short-term, employment, in particular in the construction sector, would rise sharply in order to manage all the renovations (Mukanjari & Sterner, 2020). A study from the Buildings Performance Institute Europe (BPIE) estimates that each investment of around €1m in the energy-efficient renovation of a building would create up to 18 short- and long-term jobs (Rapf, 2020). This would also increase the profits of construction companies, which could in turn have a positive effect on wages in the industry. Furthermore, studies show that the construction sector is an important driver of economic output (UNECE, 2020). Moreover, large-scale renovations would not only have a rapid impact on macroeconomic variables but could also be carried out in the short and middle run as many cities already have renovation plans which could

be scaled up. It can therefore be assumed that this measure will contribute to a swift economic recovery.

2. Expansion and improvement of public infrastructure

Already Munnell and Cook showed that a scaled-up and efficient public infrastructure in Europe is important for growth, investment and employment (Munnell & Cook, 1990). The development of public transport locally, but also of long-distance transport within and between the member states, could go ahead without a complete institutional overhaul while creating new jobs and increasing labour mobility in the short term. In addition, more extensive and more frequent bus and train services would also reduce air and noise pollution as there would be fewer cars on the road. Sustainable drive systems should be promoted specifically. Economic stimulus packages already put in place, such as in France, show that the sustainable renovation and expansion of public infrastructure can play a significant role in the current crisis (Schubert, 2020). As much as 11% of the French economic stimulus package is to be used for the eco-conversion of the transport sector alone. Furthermore, bicycle lanes could be expanded and made safer quickly as well, as many cities already push for such initiatives. All these measures should be taken above all in more rural regions, where the modernisation of public infrastructure is lagging behind urban centres.

Next to improving public transport, private transport needs to become more eco-friendly as well in order to enable a green transformation. First of all, there is still a great need in Europe for charging stations for electric cars or hydrogen fuel stations (Transport & Environment, 2020). Electric mobility in Europe must increase to complete a green transformation (European Commission, 2020b). The German economic stimulus package, which provides €2.5bn for building new charging stations, shows that this can be achieved mainly in the short term. The purchase of an electric car is also being subsidised. This should boost short-term demand, leading to extra output. The impact of these investments could also quickly materialize in the real economy as the funds could

easily be used to scale up pre-existing national plans. Moreover, the construction of new charging stations will have positive short-term employment effects and boost demand for electric cars in the longer term.

Beyond that, however, the question arises whether electromobility really is an immediate alternative to conventional combustion engines. This mainly arises because of the short range of many electric cars and energy-intensive battery production. The focus should therefore not only be on electromobility, but also on research into alternative drive systems. One example is the possible production of biofuel from straw (Bierl, 2019). Research into alternative drive systems could also lead to economies of scale in the longer term since the use of electric motors in aircraft or shipping is simply not feasible for the foreseeable future. Biofuel could offer a medium-term alternative and funds should already be invested today in increased research into it. Additional research funding will also lead to more jobs in the short term. In this context, R&D into sustainable drive systems and modes of transport should also be supported.

3. Future-proof energy networks and renewable energies

Another measure is the expansion of renewable energies and sustainable energy grids. In 2018 only 32% of European electricity generation was renewable (Eurostat, 2020). To achieve EU climate neutrality by 2050, Europe's energy supply must also change, as at least 80% of electricity generation will then have to be renewable (Simon, 2019). However, the expansion of green power plants is not the only solution, as this also creates fresh challenges. Due to differences in wind strength or hours of sunshine per day, there are always fluctuations in energy availability. Therefore, alternatives to coal and other fossil fuels which can compensate for these fluctuations must be found. Such alternatives could include increased storage of electricity, a stronger interconnection of European electricity grids and more intelligent electricity grid management.

Energy storage technologies are essential for the transition to a decarbonised economy (European Parliament, 2020). As the construction of new or the expansion of existing pumped-storage plants are already in planning or progress across Europe, additional support through the RRF could speed up the completion. Greater interconnection of the electricity grids of European countries can also be swiftly implemented. Already, European countries with the highest share of renewable energies have the best electricity grid interconnection with their European neighbours. This means that electricity can be exported to another country on sunny and windy days. Conversely, electricity can be imported if domestic production is insufficient. Finally, Europe needs intelligent (smart) electricity grid management (European Commission, 2011). In the future, there will be more and more individual electricity feed-ins, such as private households with wind turbines or solar panels on the roof. Thus, these individual producers need to be able to sell their own electricity to the energy market which requires a special electricity meter that measures the net electricity generated. Such meters already exist but are not a standard in every building and national roll out plans are slow to implement. Thus, the RRF's funds could be used to speed-up these national roll-out plans.

These measures are not only indispensable for a sustainable future in Europe but would also have a significant effect on the immediate economic recovery. The construction of new wind, solar and other environmentally friendly power plants should boost the economy and support, in particular, the construction industry. Jobs could also be created in many areas, such as the supply and control of these plants. This also applies to the further development of grid interconnections and transforming it into an intelligent grid. Here the EU could play a central planning role.

Conclusion

The coronavirus crisis has hit the European economy hard until now. The RRF, as the largest building block of the NGEU alongside the MFF 2021-2027, should ensure a rapid and sustainable recovery. There is a trade-off between short-term

measures for a swift recovery and longer-term measures to create a sustainable Europe that is resilient to both economic and climate crises. But there are also effective measures that can overcome this trade-off and combine both objectives. These include large-scale building renovation, expanded and more efficient public transport infrastructure, sustainable energy networks and renewable energies. It is now up to the European Parliament and the Council to make sure that member states must submit proposals which include such projects within their recovery plans.

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About the project

Repair and Prepare: Strengthening Europe is a joint Project by the Bertelsmann Stiftung and the Jacques Delors Centre that delivers ideas and analyses for a stronger European economy. It covers three areas: We outline a reform agenda for the Eurozone that addresses key economic, political, and legal aspects; we propose improvements to make the European Single Market fit for the future; and we address the prospects for and determinants of sustained growth and prosperity in a Social Europe.

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