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Promoting European Public Goods

The EU has a number of common economic priorities. These include a fair green and digital transition, including the objective of climate neutrality by 2050; social and economic resilience; energy security; and, where necessary, build-up of defense capabilities. These priorities not only require action at the national level, but warrant substantial provision at the level of the EU, because the collective benefit of fulfilling them is larger than the sum of the benefits of pursuing them at the national level, i. e., they take the form of European public goods (EPGs). This contribution discusses the case for a successor fund to Next Generation EU (NextGenEU) specifically aimed at the provision of EPGs. It also makes the case for streamlining the available instruments for the provision of EPGs, and it argues that in many instances better coordination among national policymakers can effectively mimic the central provision of EPGs. Thereby, we also touch upon the question of which goods may be provided at the level of the EU and which may be provided at the national level through better coordination.

KEY MESSAGES

- **EU economic policies need to be fundamentally reoriented to deliver European public good (EPGs) in economic and non-economic areas. To attain that, an approach that overcomes the sterile debate between risk reduction and risk sharing is needed**
- **“Genuine” EPGs in the area of the green and digital transitions would be financed by a new Fund of some EUR 750bn to be established as a follow up of Next Generation EU, access to which would be conditional on adhering to the revised fiscal rulebook**
- **A systematic review of the various existing instruments at the EU level to stimulate investments should be carried out. Where feasible, collecting the EU financing instruments into a single facility would substantially improve the market perception of EU debt**
- **In many areas, progress is held back not so much by a lack of available financial resources at the EU level as by a lack of coordination among national governments. In areas such as defense, stepping up the supply of EPGs requires the coordination of national policies rather than additional EU funds**
- **Achieving such goals would also help enhance the role of the EU in global governance. The agenda we put forward will require political leadership and a long-term time horizon**

A TAXONOMY OF EPGS

Buti (2023) and Buti et al. (2023) identify six priority areas for EPGs: the “green” transition and energy, the digital transition, the social transition, raw materials, security and defense, and health. The first two of these, the energy and digital transitions, require large investments, in particular in infrastructure. The European Commission estimates a necessary additional annual investment in energy and transport systems of about 2 percent of GDP (compared to 2011–2020 levels), or about EUR 360 billion. This corresponds roughly to the extra investment requirements estimated by Pisani-Ferry et al. (2023) for France. Out of the total, public investment would need to deliver a share of 0.5–1.0 percent of GDP. Typical examples of such investments would be investments in high-speed trains, electricity grids, and hydrogen infrastructure. Of course, the additional spending needs on EPGs exceed those just mentioned, and include, for example, investments in a common defense capacity.

Four configurations are possible for EPGs (see Table 1). “Loose” EPGs are delivered and financed at the national level; “NGEU-type” EPGs are delivered at the national level and financed at the EU level; projects financed by externally assigned revenue are financed at the national level and delivered at the EU level; and, finally, “genuine” EPGs are both delivered and financed at the EU level.

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Table 1

Classification of EPGs

		Delivery	
		EU	National
Financing	EU	"Genuine" EPGs	"NGEU-type" EPGs
	National	Projects financed by externally assigned revenue	Coordination of national activities

Source: Authors' elaboration.

The first three cases produce EPG "by aggregation." The composition and amount of EPGs are unlikely to be optimal. For example, while in the initial design of NextGenEU there was a substantial EPG component, member states managed to reduce it in favor of more transfers to the national level. While the European Commission tried to give bottom-up incentives for joint plans, in the end national priorities prevailed and countries came up with their own plans for reforms and investments, resulting in an uncoordinated configuration of measures with limited benefit for the EU as a whole (Beetsma et al. 2020).

In what follows, we essentially articulate the delivery of the various types of EPGs sketched out in Table 1.

"GENUINE" EPGS

Buti et al. (2023) provide examples of "genuine EPGs" provided and financed at the level of the EU. A substantial fraction of EU funding needs to be focused on infrastructures for the energy and digital transition. The benefit increases more than proportionally with the number of countries across which these infrastructures are expanded (known as "network benefits"). Typical examples are the transportation of hydrogen, electricity, high-speed internet, and high-speed railways. Regarding the first, an obvious question is whether it will become a main source of future energy. This will to a large extent be in the EU's own hands: a larger coverage of the infrastructure will stimulate the production of hydrogen. The role of the EU is to finance the central infrastructure with the help of national governments and private parties. Industry connecting to the infrastructure would pay user fees that help cover the original investment.

How to promote and finance "genuine" EPGs? Elsewhere we have made the case for a new fund ("the Fund") to succeed NextGenEU (see Bakker and Beetsma 2023; Bakker et al. 2024a and 2024b). The Fund is specifically aimed at financing public investments with positive cross-border spillovers, in other words, investments the full benefits of which are insufficiently internalized at the national level. The fund would be on the order of EUR 750 billion, so roughly the size of NextGenEU. Each country would have its own compartment in the Fund, with a share related to the relative size of its economy. Access would be conditional on adhering to the revised fiscal rulebook, that is, being outside the Excessive Deficit Procedure (EDP) or being on track with the corrections required in the context of an EDP, including the delivery of the agreed structural reforms. In fact, the European Commission is developing plans to link cash disbursements from the EU's cohesion funding to reforms undertaken by countries (Politico 2024), in other words, by deploying a "performance-based" approach somewhat similar to that under NextGenEU.

If a country fails to come up with suitable projects or fails to adhere to the new Stability and Growth Pact rules, it would forgo part or all of its allocated envelope. These resources would then be allocated over the other envelopes. In an "ideal world," the Fund would provide an incentive both to follow disciplined fiscal policies and to make those investments that benefit groups of countries or the EU as a whole. Which projects fulfill the condition of producing cross-border spillovers and of generating positive net present values would be assessed by an independent institution with hands-on investment expertise. Ideally, this party would also have skin in the game, thereby aligning its own interests with those who benefit from its advice. A good candidate might be the European Investment Bank.

Unfortunately, however, we do not live in an ideal world and there are several obstacles to reaching the goal of providing the full range of desirable EPGs. The political appetite for a successor to NextGenEU is rather low, although a "good" design would potentially help.[1] Total investment needs are way higher than what could reasonably be provided through financing at the level of the EU. Hence, there is an essential role for national public investment spending and private investment support, as mentioned above.

Delivering "genuine" EPGs requires more than central financing. Investments in the digital and energy transitions require long-term political commitment. They have a scale way beyond that of an ordinary industrial plant. Moreover, they have very long lead times starting with planning, arranging permits (often the most time-consuming part), the building activity itself, followed by the period in which the investment yields a return. Besides EU-level financing, national public co-financing is likely needed. However, public funds alone will generally not be enough. Typically, most of the investment needs to come from the private sector. For the latter to be willing to step in, very long-term commitment on the side of policymakers is necessary. This includes stable policies (such as on the taxation of projects), concessions, and the financial contribution from the government's side. Sometimes the latter can be replaced or partially replaced by some risk-sharing arrangement whereby the government takes part of the losses if the project goes awry.

[1] As Buti (2023) points out, political resistance to genuine EPGs should be limited by the fact that the juste retour argument is less relevant than for other programs and that they do not lead to cross-border transfers.

As an example, recently the five largest Dutch pension funds indicated their willingness to invest in the energy transition, especially in electricity and heat grids. The conditions would include a long-term partnership with the government to avoid a situation where the government withdraws from the investment projects at a later stage, the possibility of joint loan provision in which the government provides certain guarantees against losses, and a fully-fledged national investment institution as a linking pin between the government and the pension funds. The linking pin would have the role of coordinating all initiatives and ensuring consistent policies. Because pension funds have long-term liabilities, which they try to match with long-term assets, they are ideal parties to invest in the digital and energy transitions (e.g., Beetsma et al. 2024).

In this regard, there may be a role for the EU itself. EU legislation supersedes national legislation. Therefore, EU-level agreements among member state governments and private sector parties on the modalities of large infrastructure investments could support government commitments at the national level toward such investments. The European Commission could come up with a proposal for a framework for such collaboration between governments and private parties that also enshrines the long-term commitment on the side of the former.

"NGEU-TYPE" EPGS

Demertzis et al. (2024) provide a comprehensive overview of the various existing instruments at the EU level to stimulate investments. A large number of such instruments exist covering different areas, periods over which they are active, and funding sources. Funding comes mostly from the EU budget or NextGenEU. In some instances, merely an EU budget guarantee suffices. Many of these investment initiatives are strategic, i.e., consistent with the EU's long-term priorities, such as investment in the green and digital transitions.

However, among the existing instruments there is no instrument explicitly aimed at investments with positive cross-border spillovers of the type discussed here. There exists the Important Projects of Common European Interest (IPCEI) (see European Commission 2024), through which state aid rules allow member states and industry to jointly invest in breakthrough innovation and infrastructure. Conditions are that the market alone cannot deliver these investments, because the risks are too large for an individual player; they have to benefit the EU economy at large; at least four member states are involved; they result in concrete positive spillover effects for the EU as a whole; and they involve co-financing by companies that receive state aid. However, the IPCEIs do not receive funding from central resources.

Not all investments a priori justify (co-)financing through EU instruments. However, investments that do have positive externalities beyond national border are likely underprovided because these externalities are not internalized at the national level. Hence, subsidiarity considerations are an argument to finance them at the level of the EU. However, for some of the funds listed in Demertzis et al. (2024), the question is whether they can be justified from a subsidiarity perspective, while other funds do indeed fall into the areas on which our Fund focuses. Examples are the Connecting Europe Facility and the Digital Europe Program.

Overall, a streamlining of the available resources for EPGs seems desirable, collecting into a single facility – like the Fund we propose – all available financing for initiatives that benefit multiple countries or the EU as a whole. The IPCEI criteria could form a basis for the investment projects to be financed by the EPGs Fund. Above all, a single facility would provide an instrument for an integral trade-off among initiatives based on EU priorities.

COORDINATION OF NATIONAL ACTIVITIES

In many areas progress is held back not so much by a lack of available financial resources at the EU level as by a lack of coordination among national governments. In these areas, stepping up the supply of EPGs requires the coordination of national policies (see Table 1 above).

In the area of defense, outlays are primarily at the national level per the NATO requirement to spend at least 2 percent of GDP on defense. Hence, relatively little EU financing appears to be needed. The role of the EU level could mostly consist of the coordination of defense expenditures (to avoid duplication and to avoid omissions) and the joint procurement of equipment, although when it comes to what is being purchased the question is what the role of the EU is versus that of NATO. Purchases need to fit into the composition of collective needs of NATO. Collective expenditures in the area of health would mainly concern the joint procurement of medicines and medical equipment. Initiatives for the joint procurement of medical countermeasures have been underway for some time and got a boost with the joint procurement of Covid vaccines. However, the more distant goal of a European Health Union will only materialize in piecemeal steps of new initiatives with a limited scope (McKee and De Ruijter 2024), although the support for new steps seems to be quite strong (Beetsma and Nicoli 2024). In view of the large and increasing labor shortages, the social transition could take place with an eye on the need to reskill the labor force toward professions where demand is highest. Obviously, technical skills and information technology fall under these, but also healthcare. Securing critical raw materials would require the extraction of those materials found within the EU and joint procurement of materials needed from outside.

There are other important examples of the need for national coordination. One concerns the lack of capacity on electricity grids. Expanding the capacity is essential in view of the electrification of the economy. However, now a lot of capacity is effectively being lost, because national grids are not or are insufficiently connected, preventing electricity from flowing to those places where it is needed most (Het Financieele Dagblad 2024). At an EU scale, under- and overcapacity coexist. Also, the supply of electricity is unbalanced. Diversification of green sources of electricity will keep its supply more stable over time. This requires EU level planning of where these sources are best located. For example, windmills have a higher output in the north of the EU, while solar panels are more productive in the southern parts of the EU. Unfortunately, current investment patterns do not always follow this logic.

Related to this is the question of where to locate energy-intensive industry. An example concerns the greenification of Tata Steel Netherlands. A large government subsidy would be needed to transform the plant into one that runs on electricity. In addition, cheap green energy would need to be provided to the plant. Looking at it from a European perspective, it would be better to locate highly energy-intensive activities at locations close to where green energy is produced, because electricity networks are not fully integrated and because transportation of electricity over long distances leads to substantial losses.

CAPITAL MARKETS UNION TO SUPPORT FUNDING OF EPGS

An EU fund roughly the size of the current NextGenEU would have the capacity to finance roughly only one-fifth of the full investment needs for the energy and digital transitions. Hence, most of the financial resources would need to come from the private sector. Here, the lack of an integrated Capital Markets Union (CMU) stands in the way. The CMU would channel savings to those places where their risk-adjusted expected return is highest. Moreover, a better risk-return trade-off would likely elicit an increase in the volume of savings. Hence, the CMU and the large transitions need to go hand in hand.

A recent contribution by ELEC (2024) makes the case for CMU. Interestingly, Letta (2024) advocates "the formation of a Savings and Investments Union, built upon the incomplete Capital Markets Union. By achieving full integration of financial services within the Single Market, the Savings and Investments Union is envisioned to not only retain European private savings but also to attract additional resources from abroad."

Completion of the CMU comprises a large set of measures that includes, for example, simplifying prospectus rules and reducing compliance costs for listed companies, harmonizing insolvency regimes (including shorter recovery time and higher recovery rates), a common EU-wide system for withholding taxes on dividends and interest, a retail investment strategy to better inform consumers about financial products, improvements to the regulatory framework for securitizations, and harmonizing the definition of shareholders and rules regarding the exercise of voting rights. Completion of the CMU requires progress on each of these files separately, which makes it a long-winded process. This makes it important to speed up with these harmonizations.

POLICY CONCLUSIONS

In this contribution we have explored the promotion of EPGs. The priorities are in the areas of the "green" transition and energy, the digital transition, the social transition, raw materials, security and defense, and health. Investment needs are huge and need to be fulfilled with EU-central resources, national public spending, and private investments. We have argued that EU policies should be revamped in a consistent manner to meet these challenges. Central financing of "genuine" EPGs can take the form of a similarly sized successor to NextGenEU, with access conditional on investment projects having beneficial cross-border spillovers and countries adhering to the fiscal rulebook, including the reform commitments in the national fiscal-structural plans. However, not only central funding is needed to promote EPGs. Also, better coordination of national investment plans, such as with the upgrading of electricity grids, and a streamlining of the different EU financing instruments will be conducive to the promotion of EPGs.

An important benefit of such streamlining are the possibilities to issue debt to finance a common large-scale instrument. Investors typically prefer new instruments to be issued in substantial volumes so they attain sufficient market liquidity. Hence, a wide range of different investment projects should be financed with common debt instruments. Most important for such a "unified funding approach" is the backing by a sufficiently large base of own resources (Buti 2023).

Achieving such goals would also help enhance the role of the EU in global governance. The approach we put forward – which attempts to bring together the different political sensitivities in the EU – will require political leadership and a long-term time horizon.

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