Reinventing European Social-Democracy in a New World Disorder
Reinventing European Social-Democracy in a New World Disorder – A Plea for a New Governance of EU Investments

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In the post-pandemic Interregnum, unprecedented investment needs

As Belgium takes on the Presidency of the EU, our socio-economic environment is already affected by the war in Ukraine and its multiple consequences, not to mention increasingly tense relationships with China and a decisive US election later into the year with a likely return of “America-first” type of policy on industry, trade and defense. In such a challenging context, it is of the essence to act with firmness and clearness to safeguard the unique European model of combined solidarity and prosperity while being mindful of the urge to carry out the infrastructure investments required by digital and green “twin transitions”. Various estimates converge on the need for an additional annual investment effort of approximately 2% of GDP by 2030 (EUR 356bn in total) to maintain the trajectory towards climate neutrality. Adding the amounts for the digital transition and the reinforcement of our European defense systems, we easily reach an additional EUR 500bn per year, a figure that Mario Draghi also mentioned in his presentation to governments in late February 2024. If this amount might look overwhelming, it is certainly not when confronted to the magnitude of the challenges ahead of us or to the efforts currently deployed by other world powers - China and the US to name a few.

As Secretary of State in charge of strategic investments within the Belgian Federal government, I will develop hereafter my views on the “Resilience and Recovery Facility” (RRF), anew ground-breaking financial instrument launched as stimulus in response to the COVID-19 pandemic in 2020. First I will highlight the many virtues of sound public investment, then I will take stock of what has been accomplished so far, on the back of the “Mid-Term Review” of RRF that has been published in February 2024. Secondly, I will share my thoughts on how the EU should get its act together on supporting key infrastructure investments beyond the term of RRF in 2026.

In defense of a Strategic State

As science, in the form of substantial GIEC reports, has established beyond any doubt, there never was a challenge of this importance in mankind’s history than climate change. We need to act fast and decisively to get to carbon neutrality by 2050, which requires massive investments to be carried out now. As UN Secretary General António Guterres recently warned on the opening of COP27, ‘we are on a highway to climate hell’. In the same way as the steam engine was
powered by coal in the 19th century, and as oil and gas replaced coal in the next century, we will increasingly rely on a massive inflow of electricity from renewable sources and green gas molecules to reinvent our energy systems. This requires advanced engineering and innovation, which in turn will be incentivized by policy-driven economic mechanisms such as carbon pricing and taxation, including a carbon border adjustment mechanism that would reconcile public opinions with a properly regulated globalization. Improved technology and modified individual behaviours are two essential ingredients for the transition and the third one, no less important but often underestimated in mainstream media and political debate, is the massive investment in infrastructure.

Historically, the previous energy transition from coal to oil and gas required wide-ranging adaptations of energy networks, long-distance and urban transport, from waterways to pipelines, roads, factories, industrial capabilities, and so on. This was reflected in a high proportion of investment-to-GDP, as high as 5-6% from the 1950s to the 70s, which ended brutally with the neo-liberal turn of the 80s. In Belgium, it never exceeded 3% of GDP since then (I hope to see this figure increase to 3.5% this year, and the trend to continue to 4% in 2030). There lies a paradox of our time: while a vast majority of our citizens is well aware of the climate catastrophe ahead, there is no commensurate push on the side of climate-related infrastructure investments. From sustainable transport, to renewable energy (including nuclear, until other renewables are deployed at scale and intermittency is addressed) energy efficiency investments across all segments (industry, housing, public buildings), carbon capture network and sourcing of critical raw materials, the list of investment needs is long.

As Oxford professor Dieter Helm puts it, a new view of the economic borders of the state must emerge that is not obsessed with GDP, an asset-based approach of our common wealth with the public goods of climate, biodiversity, social and physical infrastructure at its core, much in the same way as Keynes created the concept of “war economy” where usual economic signals are no more sufficient to drive a systemic change. We are now witnessing a return to the State in economic affairs—a “Strategic State”.

The economic case for sound public investment

Public investments contribute in various ways to economic activity and job creation. As they are part of the GDP, which measures the value of all final goods and services produced during a quarter or year, an increase in public investments directly leads to an increase in the GDP. Beyond this accounting dimension, the fundamental role of public investment in promoting economic growth has been studied extensively in the economic literature. It is now generally accepted that investment has a positive multiplier effect on the economy and acts as a driver of long-term growth as it modernises infrastructure, it catalyses private sector investment, it enhances productivity and it stimulates innovation. An increase in public investment can affect economic growth in two ways. First, an increase in public investment has positive effects on aggregate demand. Second, efficient public investment can contribute to the economy’s productive capacity by increasing the stock of public capital. Meta-analyses
of the relationship between infrastructure investment and economic growth have found that in the right conditions (strong institutional management, well-planned infrastructure, with climate-related projects bringing the highest added value) the “multiplier effect” can reach 1.4 (meaning that a 1% increase will bring 1.4% GDP growth), which is significantly more than non-investment public expenditure with a multiplier of 0.9.

The impact of public investments on the GDP is also indirect and typically exceeds the initial shock due to a multiplier effect. Economic research shows that the longer-term effect of investment, captured by the elasticity factor, is also positive, depending also on the type of infrastructure investment considered. So public investments tend to stimulate private investments by boosting general demand and instilling renewed confidence and by so doing they contribute to the initiation of a virtuous cycle of demand and supply growth within the economy. This stimulation of private investments is particularly desirable in a context marked by increased risk aversion and rising savings rates, a combination that affects interest rates and thus compresses financing costs. The short-term effect of public investments on economic activity is even more significant when the economic activity is depressed, or the economy is in recession and when monetary policy has reached its limits in terms of easing financing conditions.

In the EU, government investment as a percentage of GDP has remained resilient since the start of the COVID-19 crisis and has grown each year since 2020 thanks to the EU’s decision to put budget rules on hold during the pandemic, combined with the injection of RRF finance, which has resulted in a supportive environment for public investment. But the EU’s deficit in terms of public investment compared to China (annually investing between 6% and 9% of its GDP) and the USA (recently boosted by the IRA) is a cause for concern. In the medium, it threatens the competitive position of the European Union and reduces our abilities to be technological front-runners in the race against climate change.

**RRF, the EU's Hamiltonian moment in 2020**

As a reminder, in 2020, an historical EU initiative (prompted by a Franco-German push) branded “Next Generation EU” (or NextGenEU) was launched to restore confidence and counter the effects of the Covid-19 pandemy. Its major component, which came into force in February 2021, was the “Recovery and Resilience Fund” (so called, RRF). Essentially, the RRF brought two fundamental novelties: (i) for the first time ever (the “Hamiltonian moment”, as it was then called to draw a parallel with USA’s historical federalist step) the EU raised under its own signature a massive amount - EUR 800bn - in “AAA” bonds on the capital markets, to be distributed to the Member States as a roughly 50/50 mix of (non-repayable) grants and loans and (ii) the EU attached two types of strings to these substantial handovers in the form of mandatory implementation of structural reforms (as conditions precedent for disbursements) and strict eligibility criteria for the use of the proceeds, which had to be mainly deployed towards infrastructure investments in relation to climate change.

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1 — Economic data in this section is drawn from the recent report by Belgium’s Committee on the Study of Public Investment (January 2024).
and digitalisation. The ultimate goal of the RRF was, according to EC President Ursula von der Leyen, «to invest in a collective recovery and a common future.» Another condition of the RRF was that all funds had to be invested by the end of 2026 to maximize short term impact on members states economies.

To complement the RRF, the ECB intensified its sovereign eurozone bonds purchasing program and the “Maastricht rules” regarding public finances were relaxed during the Covid19 pandemy and until 1 January 2024 to allow Member States to carry out emergency support to their economies and public services. On behalf of the Belgian Federal and Regional governments, I sub
mitted our National Recovery and Resilience Plan to the European Commission in April 2021. Such plans, taken collectively, provide for the first time ever a comprehensive mapping of the strategic infrastructure investments across the EU. It also creates for economic actors (construction companies, technology firms, advisors, and so on) an invaluable “roadmap” of the direction of travel at EU level when it comes to investing in renewable energy and hydrogen, digitalisation and fiber, sustainable transport etc. In Belgium, for example, we received about EUR 5bn from RRF (including a top-up under RePowerEU, an adjacent initiative that followed the Ukraine war) of which 51% was allocated to green projects and 27% to digital investments, which considerably helped in transforming the North Sea into a major power generation hub, turning our country into the future continental hub for green hydrogen or expanding fiber optic infrastructure and 5G capabilities in industrial parks, to name but a few examples.

**How the RRF prevented a major crisis**

As we are reaching the mid-term of RRF, it is clear that a major economic (and social) crisis was avoided. The EU did not repeat the 2008 mistake, when a sudden budgetary contraction triggered a protracted recession in European whereas the Obama administration opted for a boost through the Reinvestment Act that led to a US rebound as early as 2009.

The EU has pretty much returned to its pre-pandemic levels of growth (in 2022, it even grew faster than the US and China). The independent Mid-Term Evaluation Report of RRF, a requirement under the RRF Regulation, has been published on 21 February 2024. It deals with the achievements and teething problems of the instrument and, more importantly, it paves the way to the future beyond the term of RRF as the question being asked to EU Member States is: what should come next, after the RRF funds have been invested by the end of 2026? I will address these two aspects. First, the RRF assessment has produced a number of relevant findings, including - as one would expect - a series of teething problems. These need to be recognized. The delays in submitting or processing payment requests due to

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administrative reasons such as (i) the difficulties in fulfilling certain conditions (the adequacy of Belgium’s pension reform is still being challenged by the EC), (ii) the complexity of adjusting recovery plans for recalculations of final RRF grants (Belgium lost hundreds of millions compared to the initial estimate, due to its higher-than-expected growth, which necessitated complex renegotiations at national level and led to scaling-down or cancelation of several projects) or (iii) the downsizing or cancelation of planned investments due to inflation or project-specific issues (simplifying permitting and other legal impediments will help, this is slowly happening).

But around this evaluation report, a critical narrative is building up among the most frugal or conservative Member States, centering on more substantive criticisms. They boil down to two main points: (i) RRF would have disappointed in terms of macroeconomic effect measured in terms of GDP growth; and (ii) the investments financed under RRF would have a weak additionality (i.e. they would have taken place in any case) and would, for a significant part, be marred by delays, modifications or cancelations. I would like to address them successively.

**The RRF effect: for the first time, a safeguarded public investment**

As regards the lackluster macro-economic impact, it is true that the EC initially estimated that RRF would increase EU GDP by 1.9% in 2022, whereas the actual increase has been 0.4%. But as explained above the positive longer-term effect of infrastructure investments on growth and competitiveness is confirmed by a corpus of economic literature. Of course, investments also need to be economically and technically relevant, well-planned and implemented. On this point, it is worth noting that one of the main merits of RRF resides in the ex-ante screening of the quality and relevance of the various schemes submitted by member states, contrary to the less stringent conditionality for the structural funds handed over by the EC to the less affluent EU regions.

It is also an unfair criticism of RRF to focus solely on the short-term impact on GDP, whereas RRF has contributed significantly to the stabilization of the post-crisis level of government investment contrary to previous crises, as evidenced by research from EIB. 4

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As is clear from the above data, public sector investment in Europe has indeed held up surprisingly well despite the various economic shocks. In the past, after major downturns such as the recent financial crisis, EU governments tended to sharply cut investments, perceived as the easiest option when in need of reducing public spending quickly. This time around, however, government investment was largely spared, and the RRF instrument has certainly played an important role in this.

The reinstatement of EU fiscal rules in 2024 is likely to result in fiscal consolidation, which tends to affect public investment disproportionately. Indeed, historical data for 16 OECD countries show that fiscal retrenchment has a disproportionate and long-lasting negative effect on public investment. I therefore strongly believe that government investment must be ‘sanctuaried’ and insulated from temporary shocks, despite the return of the EU fiscal rules this year. To prevent another prolonged period of low government investment, the EU needs a protective framework for government investment spending.

Of course, aside of these fiscal rules, structural challenges remain, such as the governance and absorption capacity or the shortage of skilled workers mainly in the construction industry. Yet maintaining the current high level of government investment will be crucial to meet our objectives for the climate and digital transitions. Furthermore, public investment is known to have a catalytic effect on private investment, meaning that a slowdown in government investment could depress private investment in general.

**Boost investment in EU strategic infrastructure**

Critics of RRF have argued that the projects often lack additionality and disappoint in their implementation. As is known to all infrastructure specialists, such projects can’t be expected to be “shovel-ready” when new money is offered and typically require a long period for their planning, development and implementation, which explains why the new RRF instrument could not realistically be expected to generate 100% of brand-new greenfield projects proposed from scratch under the national recovery plans. In other words, by design RRF created a contradictory injunction for projects to be additional ex ante on the one hand, and fully delivered by 2026 on the other hand. With only two years to go, several Member-States (such as Poland, Spain or Italy) appear to be struggling to complete on time a large part of their pledged RRF investments.

Since the RRF legislation provides for a hard stop in 2026, I considered that under the EU Presidency it was my duty to start thinking about the options available post-RRF. For this, I spearheaded a report on “Accelerating strategic investment in the European Union beyond 2026 - A potential long-term EU approach to the financing of strategic objectives”. This important research argues for the need for a continuity and consistency in EU’s pro-investment

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5 — As indicated in the EIB Investment Report 2023-24, p.17.
6 — Maria Demertzis David Pinkus, Accelerating strategic investment in the European Union beyond 2026, Bruegel, January 2024.
schemes (no more « stop-and-go »), for a better utilization of the EU budget and for an increased role for the European Investment Bank, the EU’s financial arm, the closest thing we have at the moment to an EU sovereign fund.

Conclusion

Until recently, monetary policy (low interest rates) has been at the centre of European economic stimulus policies. RRF brought a new lever in the form of a budgetary boost for investments fed by fresh EU money raised on the capital markets. As Jean Monnet famously said, Europe makes progress through crises. Covid19 was no exception. With RRF, the EU has made a significant step towards sovereignty. Whereas in 2011 the « Eurobonds » never made it beyond political speeches, they have resurrected with a new face during the pandemic. And the repayment of these bonds will sooner or later require a fiscal consolidation at EU level, which will be another leap in the same direction. These developments are significant, but certainly not sufficient. At a time when unprecedented investment requirements are facing renewed compression of public finances fueled by strict budgetary rules, future will tell whether Europe has been able to raise to the hopes and expectations of the younger generations.

Recovery will also require a more policy-driven internal market, factoring in new objectives such as climate and sustainability, strategic autonomy, democratic values and so on. In other words, we need a “New Industrial Strategy”. The EC is looking for fresh ideas and has requested two important reports on respectively the EU’s competitiveness (by Mario Draghi) and the deepening of the internal market (by Enrico Letta). They are expected very shortly. It will be a fine line to draw between an efficient private sector left to the competitive forces and a central strategic planning of investments and financial support. As the late Jacques Delors, a long-time inspiration for me, once insisted: “on doit pouvoir concilier planification et liberté” (“One should be able to reconcile planning and freedom”). While we should not take it for granted that the authorities systematically “know better” (there is plenty of evidence of poor judgment by governments when involved in the business sphere),7 public authorities will have to act at the same time assertively and smartly in the economy when it is duly justified (in Belgium, for example, this already happened to keep the nuclear industry alive, to design new hydrogen networks in the absence of an existing market).

It is time for “smart dirigism”, time for Europe to connect all the dots (including the policy objectives such as carbon targets and the available financing resources, or the intertwined requirements of infrastructure and industry) and develop a broad policy and action masterplan covering carbon-reduction and digitalisation projects, de-risking of priority technologies and resources and possibly an upscale in defense capabilities. Alas, too often EU’s initiatives fall victims of silo effects, the institutional set-up being intrinsically conducive of fragmentation and short-sightedness when a comprehensive approach and

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structural remedies would be required. To implement it, political leaders will have to articulate smartly EU and national resources (public and private) and use in a discerning way derogatory schemes in the areas of State Aid or trade protection, this while avoiding undue intra-EU competition or market distortion. In a world of new perils and imbalances, time has come for a European action plan across all these fronts, which will be the most effective way of consolidating our unique socio-economic European model and protecting the well-being and peaceful future of our citizens.