Synopsis

Getting the Green Deal Done – Progressive Economics Network Meeting in Brussels, September 2023

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At the heart of the 4th Progressive Economics Network meeting in September 2023 was the question of how to equip Europe with similar policy tools, funding and governance to enable a far-reaching industrial and investment strategy that can deliver a just transition to net-zero emissions, whilst securing competitiveness and energy security.

Capacity building. While the NextGen EU funding has provided an unprecedented opportunity for green initiatives and industrial development, there seems to be insufficient capacity in member states to effectively use these resources for investment. There's a need to continuously improve monitoring the investment frameworks to ensure high-quality investment whilst unlocking additional resources for decarbonising physcial infrastructure (buildings, roads, railways, etc.) and deploying renewable energy. If such investment needs remain unaddressed, the returns from existing funding and the returns in terms of European competitiveness and quality of life would be compromised.

Fiscal space. Moreover, EU-led investment is necessary as state capacity varies across member states and the clean energy transition cannot generate a risk of increasing inequality and divergence.

Several elements of the European Green Industrial Plan have already been outlined, including the Net Zero Act, the Critical Raw Materials Act, and more recently the Strategic Technologies for Europe Platform (STEP) and the note on the Economic Security Strategy. Nonetheless, a comprehensive approach for implementation is still missing, including its interaction with the EU's economic governance framework, NextGenEU funding and a strategy for joint borrowing.

Six themes stood out from the discussion:

Theme 1: There is a need for increased institutional capacity

A core theme was the need for enhancing the institutional capacity in industrial strategy formulation and implementation.

Participants highlighted that for instance the selection of sectors and technologies are based on critical policy decisions that require significant analytical capacities that must strike a balance between economic viability and long-term sustainability. For instance, the prioritisation of the solar industry might be driven by its alignment with net zero, but given the US expansion into the sector and huge upfront costs for stabilsing the EU's industry, it might not pass the cost benefit test. The rationale behind selecting any sector must be transparent and well-founded, encompassing a range of factors from economic impacts to future growth potential.

The devil lies in the detail when devising politca strategies, participants stressed. For instance, the Inflation Reduction Act (IRA) outlines specific allocations such as funding for Electric Vehicles (EVs). But, the detailed mechanisms for implementation, including fine print and regulatory requirements, are yet to be fully developed. Leaving this to individual member states on EU level might lead to delays and inconsistencies.

More widely, as we highlighted in Jung (2023) New Industrial Strategy policies require new types of analyses:

> "(1) To understand production systems and supply chains, careful analysis is nee- ded that explores the complementarities between sectors and technologies.
> (2) Data driven analysis of how systems work will have to replace high level economic principles.
> (3) Consistent definitions will have to be developed in order to ensure comparability and analytical rigour.
> (4) All of these then have to feed into scenarios that explore under what policy constellations the objectives set through industrial strategy are achieved."

EU member states are often not equipped, at the moment, to conduct this type of analysis. Participants highlighted that, say, German industrial policy making currently consists of "ten people in a ministry".

Moreover, if there is conditionality to funding for industrial policy this requires in-depth analyses, harmonisation and coordination among EU members when increasing institutional capacity. Participants highlighted that the struggle of many countries, including Germany, to effectively disburse NextGen EU funding underscores the need for increasing institutional capacity in an efficient manner.

Theme 2: There is divergence risk from industrial strategy on member state level of EU

A key concern in the EU's industrial strategy is the potential for subsidy races between member states. These races can lead to significant divergence in industrial capabilities and outcomes due to varying fiscal capacities. Member states with greater fiscal space may offer more substantial subsidies, potentially creating imbalances and inefficiencies within the EU market. In effect, especially smaller member states are concerened of losing out and falling behind in the race for the industries of tomorrow. This divergence can also result in coordination failures, leading to overcapacity in certain sectors and underutilization in others.

The European Union’s funds that could be allocated to this, constitute only about 36% of its collective GDP, posing a limitation to the execution of a unified industrial strategy. Of this budget, only a fraction is available for strategic investments and initiatives. This constraint underscores the need for strategic allocation of resources and enhanced coordination among member states to maximise the impact of available funding.

Participants highlighted that even though more centralised funding is needed, the role of local knowledge and expertise in shaping and implementing industrial policies is indispensable. Each member state possesses unique insights into its industrial sectors, market dynamics, and regional economic conditions. Leveraging this local knowledge is crucial for tailoring policies that are effective at the national level while also aligning with broader EU objectives, such as strategic autonomy and the decarbonising the EU’s economy.

Theme 3: distributional concerns should be part of the industrial policy debate

Participants said that redistribution must go beyond job creation. They discussed the significance of taxation in achieving redistribution goals. This includes the exploration of excess profits taxes, where companies benefiting disproportionately from the market or public policies may be taxed more heavily.

Another crucial aspect brought forward by participants is the need to link industrial policy with the creation of "good jobs" — positions that offer fair wages, stability, and growth opportunities. This focus shifts the narrative from mere job creation to the enhancement of job quality, ensuring that industrial growth translates into tangible improvements in workers' lives. Policies that encourage or mandate better employment standards within supported industries can play a significant role in this aspect.

An innovative solution highlighted by participants was the idea of equity shares in exchange for industrial policy support. This approach proposes that when public resources or incentives are provided to private entities, the state or public should receive an equity stake in those entities. This model aligns private sector growth with public welfare and ensures a more equitable distribution of the benefits derived from industrial policies. It represents a shift towards a more participatory and inclusive economic growth model, where public investment leads to shared gains.

Theme 4: Various countries are already trialling this on a small scale

Several countries within the European Union are experimenting with innovative approaches to industrial policy on a small scale. These trials represent attempts to link industrial policy support with broader socio-economic objectives, such as wage improvement. However, existing EU policies pose challenges to the broader implementation of these initiatives.

A notable example is Portugal, where industrial policy support has been directly linked to wage improvements. The country entered into an agreement with employer associations to increase wages by 20%, aiming to align them with the EU average. In return, businesses received a 50% tax deduction. This approach demonstrates an innovative method of using industrial policy as a lever to address wage disparities and improve living standards.

Despite these positive developments at the national level, broader EU policies present significant obstacles. The current EU framework emphasises privatisation and minimal state intervention in the market. This stance restricts member states from implementing conditions that aim to maximize public gain from state aid. The EU's approach often clashes with national policies that seek to impose conditions on industrial support for achieving specific social or economic goals.

Theme 5: fiscal rules will limited space for national level borrowing to invest in climate policy

According to one recent estimate, the EU has a public investment gap of about 1 per cent of GDP (Agora Energiewende, 2023). This applies broadly across member states, with EU funds only making a dent in the smaller countries.

To the extend that these are investments with future returns, it would make economic sense to increase the public debt level as investments will yield returns over time. But fiscal rules in the EU now basically prevent investments that have a longer pay off horizon.

But the new EU fiscal rules agreed in December won't provide such headroom. Key elements of the European Commission's initial proposal were maintained, meaning the revised rules are more tailored to individual countries, emphasising gradual debt reduction based on comprehensive debt sustainability analyses rather than adhering to rigid, simplistic rules. A key aspect of this new framework is the focus on net expenditure as the primary indicator, especially once multi-year spending plans are established.

However, there are notable flaws in this approach, particularly for countries in Europe with high levels of debt. One such concern is the limitation placed on these countries regarding investment. While they are allowed a three-year extension to spread out debt reduction, this may not be sufficient for significant investments. This is especially problematic as there are no exemptions from the safeguards for investments, which could have allowed for more flexibility in managing debt while pursuing crucial infrastructural or developmental projects.

In the long term, the absence of specific incentives for prioritising investments in critical areas such as climate change is thus the key challenge. The current framework does not distinctly favour investment in these crucial sectors over other types of spending. Consequently, there is a risk that investments in vital areas like climate change mitigation and adaptation may not receive the necessary emphasis or funding, potentially hindering progress in these essential fields.

Theme 6: Expanding Common Fiscal Capacity in the EU

Participants highlighted that given the above-discussed limitations of fiscal rules, the focus will needs to shift to common finance instruments. But at the moment joint EU funds only have a capacity of 0.35 per cent of GDP per year.

From 2025 there could be a renewed version of NextGenerationEU to achieve this. There is potential for a significant shift with the introduction of a renewed version of the NextGenerationEU initiative. This could emerge as a major financing strategy for the EU, following a model of communal EU debt acquisition. Such an approach would legally be feasible as a financing mechanism similar to the NextGenerationEU, provided it is regarded as an exceptional and temporary measure. Implementing this, however, would require a reform of the EU's Own Resources Decision, necessitating unanimous agreement in the Council and ratification in the member states.

In the interim, until the new Multiannual Financial Framework (MFF) is introduced in 2025, the Recovery and Resilience Facility (RRF) is expected to be the primary instrument for fiscal support within the EU. The RRF, however, faces its own set of implementation challenges and there is a consensus on the need for more time, at least until 2027, to fully realise its potential. The commission has expressed concerns about the administrative capacity required to manage the RRF effectively, acknowledging it as a significant challenge for member states. To address regional disparities, there's a growing recognition of the need to consider regional capacities more thoughtfully within the RRF framework.