ИНСТИТУТ ЗА ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ НА БЪЛГАРСКАТА АКАДЕМИЯ НА НАУКИТЕ
ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
ECONOMIC STUDIES

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Volume 33(3), 2024

NEXT GENERATION EU AND FISCAL INTEGRATION IN EUROPE[2]

The creation of Next Generation EU in response to the COVID-19 pandemic was a significant milestone in the European integration project. NGEU is an innovative financial instrument with the ambitious tasks to boost economic recovery and to finance long-term investments, thus raising the question if it can be viewed as a common fiscal capacity. The aim of the present article is to analyse in detail the structure of NGEU expenditure from the perspective of the public sector's three main functions (allocation, redistribution and stabilisation) and to draw conclusions about whether this instrument increases the EU's capacity to perform them. After a concise literature review of the main arguments in favour of a supranational fiscal capacity, the article examines in detail the expenditure side of NGEU's main component, the Recovery and Resilience Facility. It is concluded in the article that NGEU increases the EU's capacity to perform the redistribution function and to some extent the allocation function. However, it cannot be viewed as a macroeconomic stabilisation mechanism. The article discusses several challenges arising from the establishment of the fund.
Keywords: European Union; Next Generation EU; fiscal integration; public sector functions; fiscal federalism
JEL: F15; H7; H87

1. Introduction

The European Union is without doubt the most ambitious and far-reaching integration project in the world. Since the establishment of the Common agricultural policy in 1962 and especially after the creation of the Single Market and the euro area, Member States' economies have become increasingly interconnected. Although the integration process is based on close coordination of Member States' public finances, the necessity of a common fiscal capacity has become an important issue in the debate on the future of integration, especially after the introduction of the euro and the sovereign debt crisis of the 2010s.

The severe crisis induced by the COVID-19 pandemic has reinforced the academic interest towards the possibilities for closer fiscal integration in terms of macroeconomic stabilisation

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[2] This work was financially supported by the UNWE Research Programme.
This paper should be cited as: *Popova, N. (2024). Next Generation EU and Fiscal Integration in Europe. – Economic Studies (Ikonomicheski Izsledvania), 33(3), pp. 46-64.*

and the supply of public goods at the EU level. In response to the pandemic, the Member States created Next Generation EU, a financial instrument with the ambitions not only to boost a post-crisis recovery but also to cover long-term investments in strategic policy areas such as the transition to the green economy and digitalisation. In other words, it was intended to serve both as a mechanism for adjustment to asymmetrical economic shocks and as an additional common budget to finance activities with the characteristics of European public goods. When combined with the long-term budget for 2021-2027, NGEU implies a strong increase in the total amount of EU expenditure. However, unlike the common budget, this instrument is entirely financed with debt and its repayment in the next decades will require the introduction of new own resources. Moreover, NGEU is managed directly by the European Commission but at the same time, the Member States have the responsibility to implement reforms and investments in the specified areas.

The abovementioned characteristics raise the question if NGEU can be viewed as a fiscal capacity that would increase the impact of the EU in fiscal policy. The aim of the present article is to analyse in detail the structure of NGEU expenditure from the perspective of the public sector's three main functions (allocation, redistribution and stabilisation) and to draw conclusions about whether this instrument increases the EU’s capacity to perform them.

The methodology used in the article is analysis and interpretation of the expenditure side of the Recovery and Resilience facility as NGEU’s main component based on statistical data from the Recovery and Resilience Scoreboard.

A limitation in the present article arises from its focus entirely on the expenditure side of NGEU. The financing of this financial instrument is also an important issue, especially considering the issuance of common debt, and future research can study the advantages and risks related to financing the supply of European public goods with common borrowing. Furthermore, the research focus is placed entirely on the Recovery and Resilience Facility (RRF) which allocates by far the largest share of total NGEU funds.

The article is structured as follows: section two presents a concise literature review of the main arguments for fiscal integration; section three contains a detailed analysis of the structure of NGEU expenditure from the perspective of public sector main functions; section four discusses the main risks and challenges arising from the creation of NGEU; section five concludes.

2. The case for closer coordination of the Member States’ public finances – a review of the literature

Considering the advanced level of integration in the EU, including the introduction of the common currency, in the past decades there has been a growing academic interest towards the possibilities for closer integration in the area of public finances, including through a common fiscal capacity. An important aspect of the theoretical debate is related to the possible objectives that fiscal integration can pursue. In their groundbreaking work, Musgrave and Musgrave (1989, p. 6) defined allocation (supply of public goods), income

redistribution and macroeconomic stabilisation as the three main functions of the public sector in the individual country.

In a multilevel governance context, fiscal federalism literature asks at which level of government – local, regional or central – revenue and spending functions and instruments should be allocated to achieve an efficient provision of public goods, income redistribution and macroeconomic stabilisation but also to maintain sound public finances (ECB, 2020, p. 10). As Nenkova (2021, p. 19) pointed out, in Europe, there is a situation where functions are transferred from national governments to the supranational level of government. This gives rise to multiple questions, such as how much of their autonomy should national governments renounce, who should perform the redistribution and stabilisation roles and how should the allocation role be shared between the Member States and the supranational level of government, thus turning the EU into an interesting case for examination of fiscal federalism.

The small size of the EU budget significantly limits the possibilities for a more active role of the EU in the performance of these functions. It amounts to only 1% of Member States' gross national income and thus stands in contrast to federal countries which redistribute a much larger part of their national income. Currently, the EU budget performs primarily the redistribution role coupled with the financing and provision of public goods, through cohesion policy and agricultural policy. With regard to the stabilisation function, the budget contributes to it indirectly, mainly through the long (7-year) programming periods which provide a constant level of investment independent of the economic cycle (European Commission, 2017b, p. 14).

Nevertheless, the potential advantages of increasing the powers of supranational institutions in the performance of these functions have been studied ever since the beginning of integration in Europe. Earlier studies drew upon the theory of optimum currency area and focused mainly on the integration of public finances as a necessary precondition for monetary integration. According to Kenen (1969), as cited in Mongelli (2002, p. 10), the countries sharing a supranational fiscal transfer system that would allow them to redistribute funds to a member country affected by an adverse asymmetric shock would be facilitated in the adjustment to such shocks. Also at an earlier stage, the MacDougall report (1977) concluded that in unitary countries income redistribution between regions arises automatically, whereas in federal countries inter-governmental grants and tax-sharing play a much more important role and achieve relatively large redistribution with relatively small amounts of federal expenditure (Commission of the European Communities, 1977, p. 13). The introduction of the euro was not accompanied by the establishment of a common fiscal capacity of a permanent nature, mainly because of the fears of moral hazard associated with such a capacity. The consensus at that time involved a combination of fiscal rules and market discipline through a commitment to no bail-out and no debt monetisation (Thirion, 2017, p. 1) to ensure the sustainability of Member States' public finances. After the euro area sovereign debt crisis there were significant developments in the euro area institutional and legislative setting, including the creation of the European Stability Mechanism (ESM) for conditional lending and the introduction of enhanced surveillance of Member States' public finances through the European Semester. Despite the important reforms carried out in response to the crisis, the EMU remained incomplete (Draghi, 2019). The necessity to deepen the EMU through a common stabilisation function was emphasised also in the Five

Presidents' report (Juncker et al., 2015). In response to the recommendation in the report, the European Commission elaborated concrete proposals for the creation of such a capacity at the EU level (European Commission, 2017a).

Integration in the field of public finances can be justified also by the potential benefits of pooling resources to carry out common policies and provide supranational public goods (Dabrowski, 2015, p. 9). In general, economic efficiency requires a decentralised provision of most public goods but the appropriate level of supply of any public good depends on factors such as consumers' preferences heterogeneity, the price elasticity of demand of the good and the existence of economies of scale in the supply of the good (Brussarski, 2007, p. 219). In the MacDougall report (1977) the transfer of some public sector activities to EU institutions was viewed as desirable on the grounds of economies of scale, spillover effects, and streamlining of expenditure (Commission of the European Communities, 1977, p. 15). Ever since, the supply of public goods at the EU level has been the subject of a growing body of literature (Buti, Nava, 2003; Dabrowski, 2014, 2015; European Commission, 2017b; Fuest, Pisani-Ferry, 2019; Nunes Ferrer, Katarivas, 2014; Buti, Papaconstantinou, 2022). In theory, public goods are defined as non-rival in consumption and non-excludable. A pure public good satisfies this definition exactly, whereas the consumption of an impure public good is to some extent rival and excludable (Rosen, Gayer, 2010, p. 55). Buti and Papaconstantinou (2022) suggested an alternative typology to be applied specifically to European public goods. These authors defined "pure" European public goods as such that are both delivered and financed at the EU level, such as the common procurement of vaccines or the programme "Horizon" for financing research. On the other hand, EU programmes that are either delivered or financed by the Member States can be considered mixed (impure) European goods.

At the turn of the century, new policy priorities came more prominently to the forefront, including climate, migration, research and innovation, but they have only slowly gained ground in the EU budget. The reason for this has been the overall stable size of the EU budget relative to GDP combined with a predominance of expenditures for agriculture and cohesion policies, which comprise pre-allocated national contributions and have been strongly favoured by Member States. The limited size can also be explained by the EU budget's strong dependence on national contributions in the absence of sizeable and genuine EU own resources (European Commission, 2021a, p. 7).

Public goods tend to be underprovided on a supranational level because economic agents may not fully consider the benefits for society at large. Limited fiscal space in some countries may also exacerbate the risk of underprovision with negative spillover effects to other countries (Panetta, 2022, p. 5). At the same time, the range of possible new public goods with a European dimension is wide. Fuest and Pisani-Ferry (2019) suggested eight potential candidates for EU public goods in fields where changes in Europe's external environment and problems of collective action call for reform, including foreign economic relations, climate change mitigation, digital sovereignty, research and development, etc. According to Panetta (2022, p. 4), examples of public goods at the European level include energy security, defence, digital transition as well as technologies and infrastructure needed to protect strategic autonomy and underpin the Single Market. This author suggests further that European policies can also make an important contribution towards global public goods, such

as climate change mitigation. As D'Apice and Pasimeni (2020, p. 3) pointed out, the relevance and importance of European public goods may vary over time and the pandemic just triggered one of those turning points in which new priorities emerge.

3. Next Generation EU from the Perspective of Public Sector Main Functions

3.1. Context of NGEU creation

The unprecedented situation caused by the pandemic required a stronger common response and gave a strong push towards closer integration in the EU, including the introduction of new elements of a fiscal union. As the outbreak of the pandemic coincided with the final stages of the preparation of the Multiannual financial framework (MFF) for 2021-2027, it influenced the outcome of the negotiations in favour of more fiscal federalism. In the summer of 2020, the Member States reached a historic agreement on the creation of a recovery instrument to be adopted along with the MFF. It was the result of compromises achieved among several groups of Member States that had different positions on important aspects, such as the issuance of common debt, the provision of assistance in the form of grants instead of loans, conditionality and the rule of law (De la Porte & Jensen, 2021).

Thus, at the end of 2020, Next Generation EU (NGEU) was established as the biggest recovery instrument in EU history with an overall size of EUR 807 billion in current prices (EUR 750 billion in 2018 prices). If added to the long-term budget for 2021-2027, this brings the total amount of EU expenditure to over EUR 2 trillion or 6% of EU GDP in 2020 (ECB, 2022a, p. 93). The creation of NGEU reflected the reversal of the approach adopted during the sovereign debt crisis when fiscal consolidation was prioritised over solidarity and the lack of a supranational fiscal capacity was acutely felt. In this sense, NGEU represents a paradigm change, pushing the EU architecture of economic governance towards an arrangement akin to that of federal states (Fabbrini, 2022, p. 187). As De la Porte and Jensen (2021, p. 389) pointed out, this response to the consequences of the pandemic was perplexing not only because of the underlying political tensions, but also because NGEU broke with core norms of the EU, such as no common debt issuance and no large-scale redistribution to cushion economic crises. Wasserfallen (2022, p. 8) suggested that the radical change in Member States' position regarding common borrowing lies in the different causes of the two crises. The asymmetric shock triggered by the pandemic was seen as completely exogenous, while in the case of the euro area debt crisis, the narrative of self-inflicted problems blocked burden sharing. According to Howarth and Verdun (2020), the reason for this major paradigm shift was the necessity to address two asymmetries that had arisen in the integration process after the introduction of the common currency: the first one involves the asymmetric degrees of integration in "economic union" and "monetary union", while the second one, which emerged after the sovereign debt crisis, is between the "core" and the "periphery" countries of the euro area (Howarth & Verdun, 2020, p. 1). Thus, the responses to COVID-19 aimed at rebalancing between the economic and monetary pillars of EMU (Fabbrini, 2022, p. 193).

3.2. Structure and main characteristics of NGEU

NGEU is composed of seven programmes but at its core is the Recovery and Resilience Facility (RRF) which receives almost 90% of total funds. The remaining part of the funding is distributed along with six other programmes to reinforce the EU budget (Table 1). As the most important component, RRF was designed with a dual purpose. In the short term, its objective was to tackle the adverse economic and social effects of the COVID-19 crisis on the Member States. On the other hand, the reforms and investments financed by RRF aim at making the EU more resilient and less dependent as well as to generate European added value (Official Journal of the European Union, 2021). Both short-term goals (recovery) and long-term goals (resilience) are pursued through RFF's six pillars.

Table 1. Structure of Next Generation EU

Programme	Purpose	Amount (in EUR billions, current prices)
Programmes financed only by NGEU		
Recovery and Resilience Facility (RRF)	Provision of grants and loans to support reforms and investments in the Member States. Consists of six pillars.	723.8 (grants and loans)
Programmes to reinforce MFF 2021-2027		
Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU)	Addressing the immediate economic consequences of the pandemic. The funds are available for 2021-2022 through the Structural funds.	50.6
Horizon Europe	Promoting research	5.4
Invest EU	Support of private investments	6.1
European Agricultural Fund for Rural Development (EAFRD)	Support of farmers	8.1
Just Transition Fund (JTF)	Assistance for transition to climate neutrality	10.9
RescEU	Increased capacity for response to large-scale emergencies	2
Total amount of funds		806.9

Source: European Commission, 2021b.

Several important characteristics of the recovery instrument stand out. In the first place, NGEU is a temporary fund planned to exist only from 2021 to 2026. To ensure that the financial support is frontloaded in the initial years after the COVID-19 crisis, it was envisaged that 70% of the total amount of the grants would be committed by the end of 2022 and the remaining 30% to be committed by the end of 2023. The Member States were also given the opportunity to request a prepayment of up to 13% of the financial contribution by the end of 2021 in case of submission of their respective national recovery and resilience plans (Official Journal of the European Union, 2021).

Furthermore, RRF's main purpose is to finance investments and reforms in the Member States aimed at increasing their competitiveness and preparing them for the challenges of globalisation. For this purpose, the Member States were required to prepare and submit national recovery and resilience plans (NRRPs) containing detailed reforms and investments along RRF's six pillars but also taking into account the specific challenges of the Member State concerned. NRRPs include also a set of measures for their monitoring and

implementation, including targets and milestones as well as estimated costs (Official Journal of the European Union, 2021).

Another prominent feature is the strict conditionality imposed on the Member States since the payments of country allocations depend on the fulfilment of the milestones and targets set out in their respective national plans. Although the specific reforms and investments are proposed and implemented by the recipient countries themselves, the European Commission has a decisive role both in the initial approval of NRRPs and the subsequent supervision on their implementation. For milestones and targets to show as satisfactorily fulfilled, the Member States have the obligation to send relevant proof to the Commission, which should give a positive assessment (European Commission, 2023). Since NGEU is directly managed by the European Commission it entails a certain amount of fiscal centralisation from the Member States to the EU by surrendering fiscal sovereignty in the decision of how to use these resources (Batini et al., 2020, p. 5).

Finally, unlike the long-term EU budget, NGEU is financed entirely with debt. Before 2020, the European Commission had limited capacity to borrow funds on capital markets and lend them at favourable conditions to countries experiencing difficulties. However, with NGEU the European Union became a major debt issuer as the Commission was empowered to borrow up to EUR 750 billion (in 2018 prices) from mid-2021 until 2026. Implementing common EU borrowing showed EU solidarity and has generated confidence in the resilience of the euro area. NGEU is also a useful tool to give an additional option to Member States to borrow more cheaply and to invest together in common priorities, such as the green and digital transitions (Christie, Claeys, & Weil, 2021, p. 29).

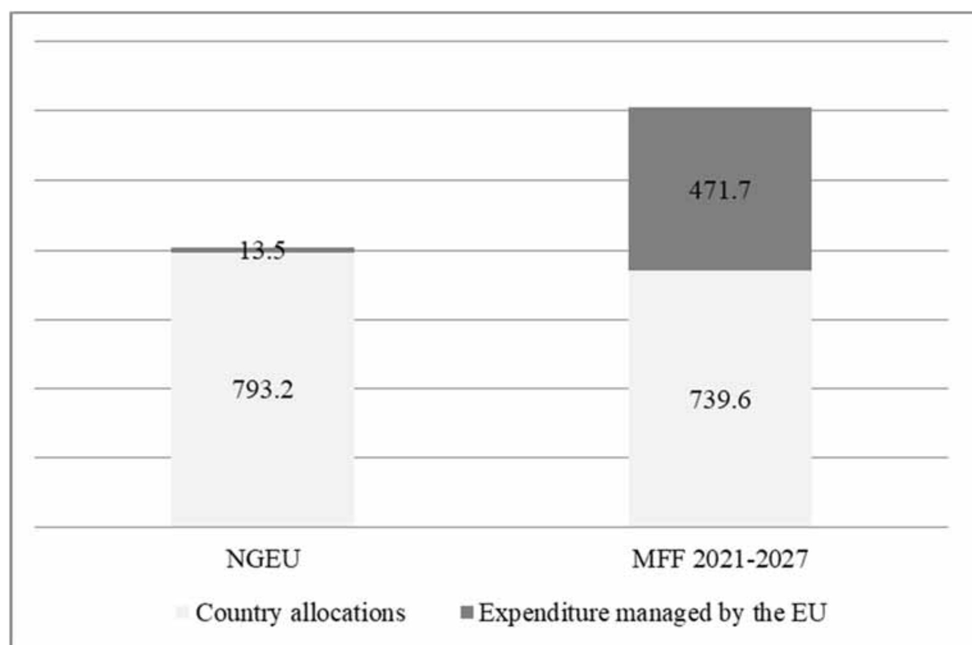
3.3. Analysis of NGEU expenditure side from the perspective of public sector main functions

RRF's short-term objective of boosting post-pandemic economic recovery suggests an enhanced role of the EU in macroeconomic stabilisation and income redistribution. At the same time, the concentration of its expenditure side on investments aimed at increasing long-term resilience indicates a more important role of the EU in the supply of public goods. Considering these ambitious tasks the following questions arise: whether NGEU brings fiscal integration to a higher level and how its creation influences the EU's capacity to perform the main functions of the public sector. To answer this question this section provides an in-depth examination of the structure of NGEU expenditure.

In the first place, it is worthwhile to look at the distribution of the financial resources between county commitments and expenditures managed by the EU. As can be seen in Figure 1, over 98% of total funds from NGEU are dedicated to the Member States primarily in the form of grants and loans from RRF. Thus, the remaining financial resources for other instruments managed directly at the EU level amount to less than 2%. In contrast, country allocations in MFF 2021-2027 are 61% of total funds while the remaining 39% of the expenditure are managed by the EU, including for research, external actions and aid and cross-border infrastructure (European Commission, 2021a, p. 7). The predominant share of country allocations in NGEU is a result of the unprecedented political consensus achieved during the

pandemic to prioritise the economic recovery and long-term growth potential of the Member States. This suggests a strong contribution of NGEU towards income redistribution among the EU countries.

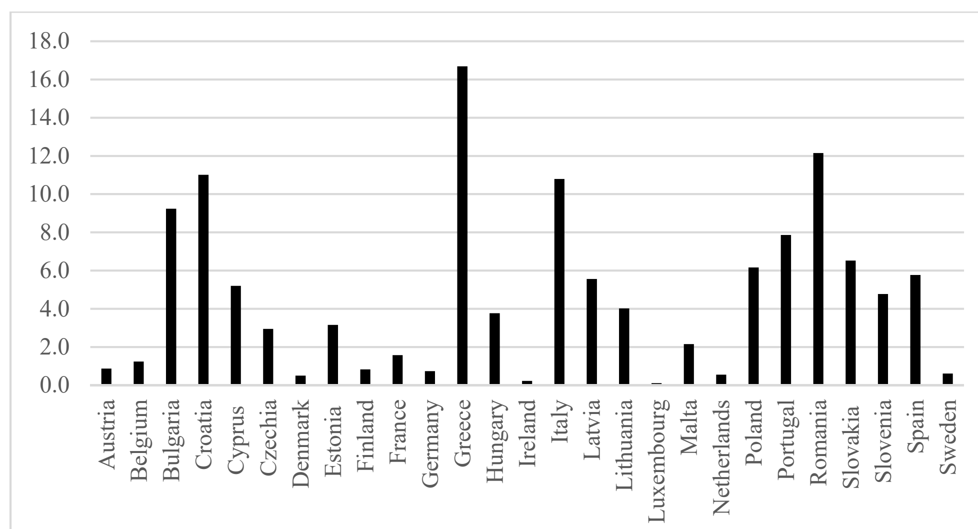
Figure 1. Breakdown of total funds between country allocations and other expenditures (in EUR billions, current prices)



Source: author's calculations based on European Commission data.

The main recipients from RRF, as measured in proportion to GDP, are the more vulnerable economies of the euro area as well as the new Member States from Central and Eastern Europe (Figure 2). This is achieved through the allocation formula which intends to ensure that more funds are made available for the countries with most economic difficulties and have been hit the hardest by the pandemic (ECB, 2022b, p. 9). In 2021-2023, the allocation of grants from RRF was based on three criteria, namely population, inverse GDP per capita and the average unemployment rate in 2015-2019. For the grants allocated in 2023 (around 30% of total), the average unemployment rate is replaced by the GDP losses in 2020 (15%) and over 2020-21 on a cumulative basis (15%), as projected by the European Commission. Due to the growth of GDP in most Member States in 2022, the amounts of the country allocations were reduced in accordance with the third criterion. With a view of providing immediate financial support at the height of the COVID-19 pandemic, the Member States were allowed to request prepayments of up to 13% of their respective national contributions by the end of 2021 (Official Journal of the European Union, 2021). Most countries, except Bulgaria and the Netherlands, received prefinancing.

Figure 2. Country commitments from RRF (in percentage of GDP)



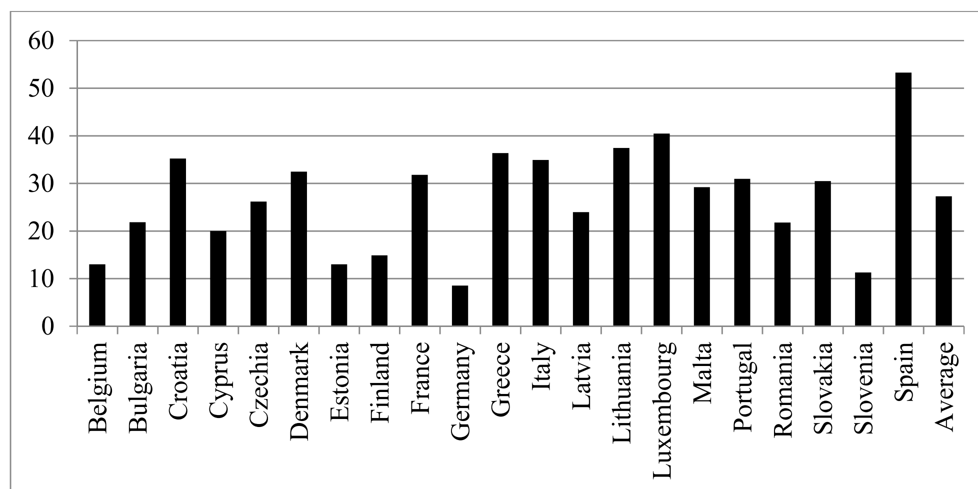
Note: The data is based on National Recovery and Resilience Plans and includes loans for the countries that have requested them

Source: European Commission (2023).

NGEU (combined with the EU budget) is expected to exert positive macroeconomic effects both in the short term – through boosting aggregate demand and supporting the countries that were most affected by the pandemic, and in the medium-to-long term - through strengthening growth potential due to investments and reforms (European Commission, 2021a, p. 17). Empirical studies (Codogno, van den Noord, 2021; ECB, 2022b; EIB, 2022) provide evidence that the disbursements from RRF will contribute to the economic growth in EU countries and especially the main recipients. The European Investment Bank estimates that RRF will have the highest impact in Southern Europe, where GDP is expected to rise about 5% by 2030 and 2.7% by 2040. In Eastern Europe, the impact will be about half the size relative to GDP for both periods and in Western and Northern Europe about 0.7% of GDP (EIB, 2022).

Nonetheless, the European Commission has acknowledged that despite its positive impact NGEU is not fully a macroeconomic stabilisation instrument as the disbursement of the funds has started after the peak of the crisis (European Commission, 2021a, p. 17). Furthermore, the expected effects on economic growth depend on the successful implementation of the national plans and the payment of the full amounts committed to the Member States. As can be seen in Figure 3, as of July 2023 the average amount of disbursements stands at 27.3% on total committed funds which is in contrast with the initial intentions. The Member States that have received the largest parts of their allocations are Spain (53.3%), Luxembourg (40.5%), Lithuania (37.5%), Greece (36.4%) and Italy (34.9%). It should be noted that although all Member States have submitted their NRRPs, five of them (Ireland, the Netherlands Sweden, Poland and Hungary) have not received any payment.

Figure 3. Disbursements to Member States as a share of total country allocations as of July2023 (including loans)

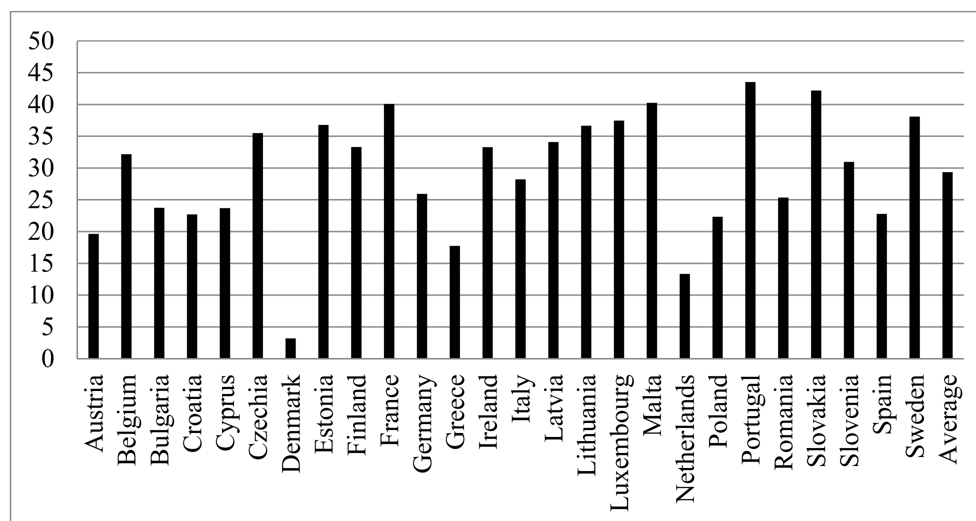


Source: author's calculations based on European Commission data.

NGEU's strong orientation towards income redistribution among and within the Member States is also evidenced by the significant share of social expenditure in NRRPs. In particular, RRF pillar four is dedicated to social and territorial cohesion, but social expenditure is incorporated in the other RRF pillars as well and it is divided into four categories: social policies, employment and skills, health and long-term care and education and childcare. Overall, social expenditure amounts to 29.3% of the total expenditure of Member States' NRRPs (Figure 3). However, significant differences are observed among the Member States as there is no minimum required level. In four countries social expenditure exceeds 40%, namely Portugal (43.5%), Slovakia (42.2%), Malta (40.2%) and France (40.1%) and in another ten countries its share is over 30%. On the other hand, the lowest levels of social expenditure are set in the national plans of Denmark (3.2%) and the Netherlands (13.3%). The observed variety can be explained by the characteristics of the existing welfare systems in the individual EU countries as well as the condition of their public finances.

Corti, Liscai & Ruiz (2022) conducted a study of the effects of RRF disbursements on social expenditure in six Member States. The authors' conclusion was that RRF has fast-forwarded the implementation of social investments in the countries with limited fiscal capacity (Portugal, Italy and Spain), whereas in the other countries of their sample, particularly Austria and Germany social spending has been used mainly to replace already planned investments.

Figure 4. Estimated social expenditure in national recovery and resilience plans (in percentage of total)



Source: author's calculations based on European Commission data.

Finally, the structure of the RRF expenditure side implies a stronger role of the EU in the allocation function. The funds are distributed along six pillars, namely:

- green transition;
- digital transformation;
- smart, sustainable and inclusive growth;
- social and territorial cohesion;
- health, and economic, social and institutional resilience;
- and policies for the next generation.

Although the Member States have the responsibility for their provision through the implementation of their respective NRRPs, the activities covered in the six pillars are closely linked to common priorities and objectives. It should be noted also that some of the investments in NRRPs contribute to more than one pillar at a time. Some of the activities under these pillars can be considered pure public goods because of their non-rivalry and non-excludability. This is the case, especially of the green transition as well as research and development. Other policy areas, such as digital transformation, education, health and infrastructure construction, exhibit traits of mixed goods as they create positive spillover effects but are excludable. On the other hand, following the distinction of Buti and Papaconstantinou (2022) the programmes comprising NGEU cannot be defined as "pure" EU public goods because the Member States have the primary role in their implementation. The

breakdown of total funds presented in Figure 1 confirms that indeed a very small share of the funds (around 2%) is devoted to the provision of "pure" European public goods. However, according to NGEU can be viewed as a public good "by aggregation" where delivery takes place at a national level while the reforms and investments respond to European priorities (Buti, Papaconstantinou, 2022, p. 3).

Pillars one and two are of particular importance as the EU countries are required to allocate at least 37% of RRF-related expenditure to green transition and at least 20% to digitalisation (Official Journal of the European Union, 2021). The breakdown of estimated costs in NRRPs among the six pillars, presented in Figure 4, confirms that these levels are achieved by all Member States and in some cases they have even been exceeded.

Reforms and investments under pillar one "Green transition" are related to the implementation of the Green Deal which aims at achieving climate neutrality by 2050. Thus, they are expected to create significant positive spillover effects from an environmental perspective. After the beginning of the war in Ukraine, this pillar became even more important as it contributes also to enhancing the EU's autonomy and security in energy supply. In response to the war, RRF has been placed at the heart of the so-called REPowerEU Plan for financing cross-border and national infrastructure as well as energy projects and reforms (European Commission, 2022). On average, expenditure related to this pillar amounts to 55.3% of the national recovery and resilience plans and its share varies from 76% in Croatia to 39% in Latvia.

The main objectives of pillar two "Digital transformation" include the introduction of e-government and digital public services, digitalisation of businesses and creation of human capital in the digital economy (European Commission, 2023). The expenditure related to this pillar stands at 27.8% on average with the highest value in Germany (53%) and the lowest in Romania and Slovakia (21%).

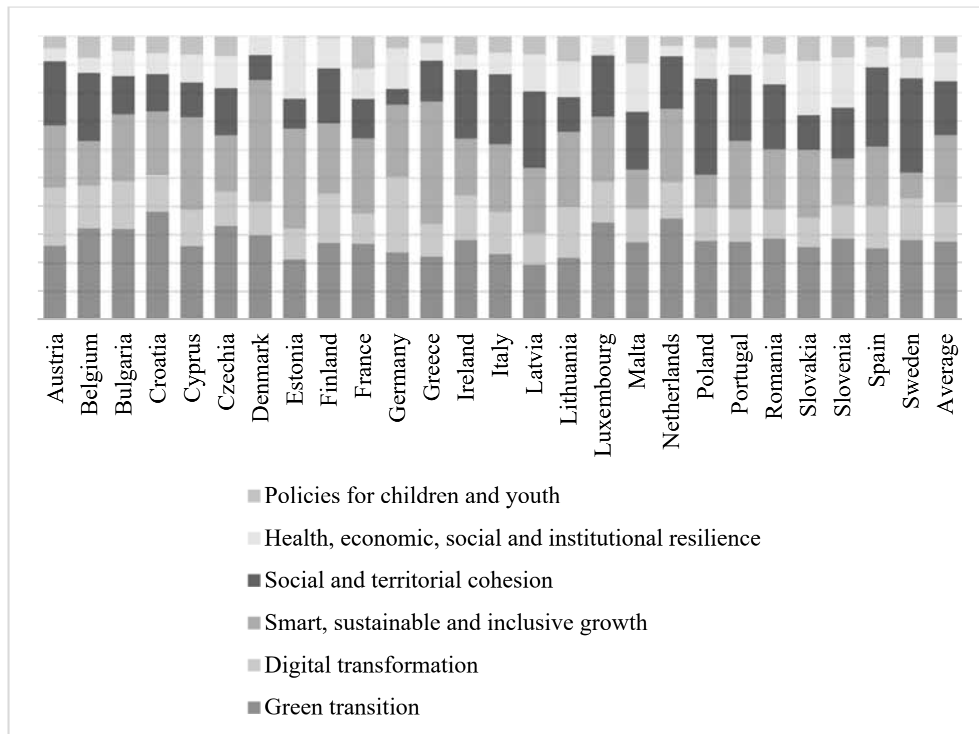
In most Member States pillar three "Smart, sustainable and inclusive growth" is the second largest expenditure heading. On average it accounts for 47.6% of NRRPs' estimated costs and in Greece and Denmark, it amounts to approximately 86%. On the other hand, in Sweden its share is relatively low at 18% Among the main objectives of this pillar are to promote economic cohesion and job creation, increase competitiveness and support the EU internal market (European Commission, 2023).

As already mentioned, pillar four has as its main objective to boost territorial and social cohesion. The predominant share of expenditure under this pillar is devoted to investments in territorial infrastructure and services and a smaller part of the funds is allocated for social cohesion and protection in the Member States. On average, the estimated costs for this pillar amount to 38.2% of NRRPs but again there are significant differences among the Member States. In Poland pillar four accounts for almost 68% of the expenditure while in Germany its share is 11%.

Pillar five comprises a variety of policy areas, including health, effectiveness of public administration, long-term care, crisis preparedness and others. Its share in total expenditure is 20.4% on average with the highest value in Estonia (43%) and the lowest in the Netherlands (7.2%).

Finally, pillar six "Policies for the children and young people" finances investments primarily in the areas of education and youth employment. Its overall share is 11.6% of total expenditure ranging from 23% in France to only 1% in Estonia. The national plans of Denmark and Luxembourg do not allocate any funds for this pillar.

Figure 5. Estimated expenditure for the six policy pillars in national recovery and resilience plans (in percentage of total)



Note: As each measure contributes towards two policy areas of the six pillars (primary and secondary assignments), the total contribution to all pillars amounts to 200% of the RRF funds allocated to the Member States (See Recovery and Resilience Scoreboard, Country overview)

Source: author's calculations based on European Commission data.

4. Challenges arising from the establishment of NGEU

Without a doubt, NGEU has been a major advance in the integration process and some authors (Fuest, 2021; De la Porte, Jensen, 2021) even suggest that it will ultimately become a permanent structure. Nevertheless, the creation of this fund gives rise to several issues that might negatively influence the realisation of its objectives.

4.1. The duality of NGEU

The ambitious dual goal of "recovery" and "resilience" in itself constitutes a potential obstacle to the success of this instrument. NGEU was established in the unprecedented context of a global pandemic and the obvious reason for its creation was to provide financial support to the Member States. This support, however, was not immediate but rather it was designed as investment projects along the six pillars. In this sense, defining the precise place of NGEU in the integration project constitutes a challenge. This complexity of NGEU can be explained by the necessity to avoid moral hazard. A reflection of this approach is the requirement for the recipient countries to carry out reforms in exchange for receiving their corresponding allocations from RRF.

Considering the rising number of common challenges facing the Member States in a globalised world, in the future the EU will have a more active involvement in the performance of public sector main functions. However, their more effective provision requires clearer delineation of the approaches to their provision.

On the one hand, a common fiscal capacity for macroeconomic stabilisation would have as a primary role to provide financial assistance to Member States in case of economic shocks. The existence of such a mechanism is especially important for the euro area countries but it can also involve the rest of the Member States under exceptional circumstances. Its key characteristic is that transfers to countries are automatically triggered by a cyclical indicator (Arnold et al., 2018, p. 10). Over the years, and especially after the euro area sovereign debt crisis, there have been multiple studies in this area with concrete proposals for a permanent supranational fiscal capacity for reaction to macroeconomic shocks (Commission of the European Communities, 1977; Inman, Rubinfield, 1992; Beblavy, Lenaerts, 2017; Arnold et al., 2018; Codogno, Van den Noord, 2021). According to Berger, Dell'Ariccia & Obstfeld (2018, p. 41) when some formal but partial risk sharing is introduced, the amount of expected (or de facto) overall fiscal risk sharing drops, and the associated level of moral hazard falls.

On the other hand, the supply of public goods at the EU level involves long-term investments that do not depend on the business cycle but rather reflect common priorities and objectives in different areas, such as environmental protection, health, security, external affairs and others. Moreover, some projects require significant capital but afterwards produce benefits for many years. If the provision of EU public goods follows the subsidiarity principle and avoids duplication with activities financed by Member States' budgets, it could streamline the expenditure both at the EU level and national level and improve the state of Member States' public finances. As Nunes Ferrer and Katarivas (2014) put it, the core issue is not the size of the EU budget, but rather its economic impact in terms of contribution to the achievement of EU policy objectives in areas such as energy and environmental protection (Nunes Ferrer & Katarivas, 2014). According to Panetta (2022), NGEU has demonstrated that the emergence of shared interests, such as the need to address the pandemic and the challenges of climate change and digitalisation, can provide the impetus that was missing in the past. This author suggested a possible design of a European fiscal capacity that supports projects with genuine European added value. Moreover, in terms of its contribution to allocative efficiency, it would be desirable for NGEU to draw a clearer line between areas where public expenditure may be justified or needed and areas where private investors should act (Fuest, 2021, p. 5).

4.2. Absorption difficulties in the Member States

The slow progress in NRRPs implementation and disbursement of funds to the recipient countries is another important challenge to the success of NGEU. Historically, there have been issues regarding the recipients' capacity to absorb EU funding, especially in the new Member States from Central and Eastern Europe. As Bisciari et al. (2021, p. 45) pointed out, the combination of MFF and NGEU adds to this challenge, especially because NGEU funds need to be absorbed by the end of 2026, which is faster than cohesion funds under MFF. Further complications arise from the strict conditionality related to RRF payments. As already mentioned, disbursements depend on the satisfactory fulfilment of the milestones and targets set in NRRPs as determined by the European Commission. Moreover, after the adoption of the rule of law conditionality regulation in 2021 the payment of country allocations both from MFF and NGEU is conditional upon the fulfilment of a set of political requirements (Official Journal of the European Union, 2020). Due to incompliance with rule of law conditionality Hungary has not received any payments from NGEU.

Statistical data indicates both a slow advance in reforms and investments in the Member States and a low rate of disbursement. As of July 2023, three years after NGEU's creation, the level of fulfilment of the targets and milestones set in NRRPs stands at only 11% on average (European Commission, 2023). On their part, total disbursements to the Member States amount to approximately 27% of total RRF funds (including loans) which is significantly below the goals set upon the establishment of NGEU.

4.3. Legitimacy issues

The creation of NGEU, like most major reforms in the EU over the past years, has occurred outside the existing EU institutional framework, thus raising questions regarding its legitimacy. A number of observers (Fabbrini, 2022; Howarth, Verdun, 2020; Leino-Sandberg, Vihriälä, 2021) have expressed the view that formal changes in EU legislation might be necessary given the transfer of significant new powers to the European Commission, and especially the power to borrow in financial markets. The Treaty for the Functioning of the EU (TFEU) explicitly requires that the Union provides itself with the means necessary to attain its objectives and carry through its policies and the budget is to be financed wholly from its own resources (Official Journal of the European Union, 2012). Although the requirement for a balanced budget formally was not breached, as NGEU was created as a separate programme outside the EU budget, the legitimacy of the decision to borrow funds to finance NGEU was questioned in the German Constitutional Court. The final ruling of the Court was that the issuance of common debt was related to exceptional circumstances and did not represent overstepping of EU competences (Euractiv, 2022). Nevertheless, all important steps in the integration process need to have a solid legislative base with a view of legitimacy and gaining support for further advances.

4.4. Risks to financial sustainability

The issuance of common debt to finance NGEU creates an asymmetry between EU expenditure and revenue and puts at risk its financial sustainability. In case new own resources are not introduced in the following years, the repayment of the loans under NGEU would require an increase in Member States' GNI-based contributions which will negatively affect their public finances. However, the adoption of new own resources is a difficult task considering the declining share of genuine own resources in the budget revenue over the past decades. The only new financing method for 2021-2027 is the Own resource based on plastic packaging waste. The entry into force of this new own resource was an important step as it reflects the European Commission's plans to bring the budget revenue in line with new EU priorities related to the green transition. The fiscal receipts from this resource, however, amount only to 3.5% of the total revenue in the EU budget in 2022, which is insufficient to cover the EU's increasing expenditure. In 2021 the European Commission proposed the adoption by the beginning of 2023 of other three new own resources to help repay the debt under NGEU: an own resource based on carbon border adjustment mechanism; an own resource based on the reallocated profits of multinational enterprises and an own resource based on the emissions trading system (European Commission, 2021c). However, as of 2023, these new own resources are not in place yet. Their entry into force is difficult because of the technical complexities involved and also because their introduction affects third countries. The only new own resource that can be introduced relatively fast is the own resource based on the emissions trading system as this system already exists and it involves only the Member States.

5. Conclusion

The creation of the Next Generation EU has been a major milestone for the European integration project leading to an increased role of the EU in fiscal affairs. The detailed analysis of its expenditure side has confirmed that NGEU contributes mainly to income redistribution among the Member States and at the same time it boosts social investments in the individual countries. With regard to its macroeconomic effects, NGEU cannot be viewed as a mechanism for adjustment to asymmetric shocks because of the slow payment of funds to the recipient countries and its linkage to the implementation of reforms that require time. It implies a stronger involvement of the EU in the allocation function because the investments along NGEU's six pillars correspond to common priorities and create positive spillover effects. Although the latter cannot be considered pure European public goods because of the decentralised approach in their supply, the relative autonomy delegated to the Member States with regard to the spending decisions is in line with economic efficiency in a multilevel governance system.

Finally, several important challenges have been identified in the article in relation to NGEU's specific characteristics and complex organisation. In particular, its ambitious tasks, namely short-term recovery and long-term resilience, make it difficult to define the precise place of this financial instrument in the integration process. It can be characterised neither as a fiscal capacity for macroeconomic stabilisation nor as a facility for the provision of EU public

goods. Given the increasing interconnection of the Member States' economies, further integration in fiscal affairs should be based on a clear distinction between short-term financial assistance in response to macroeconomic shocks, on the one hand, and long-term financing of EU public goods, on the other hand. Some other challenges related to the establishment of NGEU are difficulties in the absorption of the funds, legitimacy issues and risks to EU financial sustainability.

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