IN-DEPTH ANALYSIS

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First lessons from the Recovery and Resilience Facility for the EU economic governance framework

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First lessons from the Recovery and Resilience Facility for the EU economic governance framework

Abstract

This study documents the poor track record of implementation of the European Semester country-specific recommendations and discusses the novelties the Recovery and Resilience Facility (RRF) could bring to EU economic governance. While it is too early to evaluate the success of the RRF, this study draws out lessons for the future of the EU economic governance framework from certain aspects of the RRF design and the European Commission's evaluation of the national recovery and resilience plans.

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LIST OF ABBREVIATIONS

CSR	Country-specific recommendation
ECA	European Court of Auditors
EU	European Union
FNLTC	Financing not linked to costs
GDP	Gross domestic product
MIP	Macroeconomic Imbalance Procedure
NGEU	NextGenerationEU
NRRP	National Recovery and Resilience Plan
RRF	Recovery and Resilience Facility
SGP	Stability and Growth Pact

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EXECUTIVE SUMMARY

Background

The record of implementation of European Semester country-specific recommendations (CSRs) has been poor. The European Union's economic governance review process, which was suspended because of the pandemic, was relaunched in October 2021, with the aim of improving EU economic policy coordination, while also learning lessons from the NextGenerationEU (NGEU) instrument, and its centrepiece, the Recovery and Resilience Facility (RRF). In November 2022, the European Commission published its reform outline for a new EU economic governance framework (European Commission, 2022). This proposal is subject to discussion at the time of writing.

There are significant interactions between the European Semester and the RRF. National recovery and resilience plans (NRRPs) had to address a substantial subset of recent CSRs, the national reform programmes for the European Semester fulfil one of the two bi-annual reporting requirements under the RRF, and RRF payments can be suspended if a country has not taken effective action to correct its excessive deficit or imbalance.

Aim

Against this background, this study evaluates the interplay between the RRF and the European Semester, draws out some first lessons from the interaction, and offers ideas for the future, relevant for a well-functioning EU economic governance framework.

Main findings

- The implementation of CSRs was initially mediocre and deteriorated ahead of the pandemic;
- CSR implementation has been influenced by market pressure, macroeconomic vulnerability, the quality of governance and political factors;
- The scope for economic policy coordination in the EU is limited, because national policymakers are accountable to their national parliaments and focus on national interests, which often differ across member states and do not necessarily coincide with CSRs;
- Despite the poor implementation record of CSRs, the analyses prepared for the European Semester and the consequent discussions were useful for raising awareness of the EU's fiscal and macroeconomic challenges;
- The RRF introduced two new elements into the European Semester process: conditioning RRF grants on the implementation of past CSRs, and linking funding to meeting milestones and targets rather than project cost;
- The NRRP design process (EU countries make proposals for investments and reforms, corresponding to a set of criteria, in consultation with the European Commission) is not a new feature introduced by the RRF, because the design of operational programmes for the regular EU budget structural funds is the same;
- While performance-based funding in the EU jargon, and also by other international organisations, is understood as a method to foster the achievement of results, the definition of milestones and targets in the RRF Regulation implies a focus on inputs and outputs, not on results;
- We found that some EU countries included very few indicators that refer to actual results in their recovery plans, while other countries included more;
- The incorporation of a large subset of the 2020 CSRs in the NRRPs was rather straightforward, because most of these 2020 CSRs recommended what member states were anyway doing in response to the pandemic;
- The European Court of Auditors detected major gaps in the incorporation of the 2019 CSRs in the NRRPs, which raises questions over the Commission's uniform best grade for CSR incorporation;

- The uniform medium-quality cost justification assessment for all 27 countries is hard to reconcile with the fact that the text of the Commission's assessments of cost justification varies considerably across countries;
- There is a risk that recovery money will not always be spent in a cost-efficient way, necessitating careful assessments of not just inputs and outputs, but also of results and value for money;
- Some studies found that the lasting impact of the RRF on green transition is not adequately assured, and milestones and targets are insufficient guarantees that RRF objectives will be met;
- There are large deviations between the initial indicative and final amounts of RRF grants, with some countries receiving 10% more and others 20% less funding than originally expected. While the Commission has encouraged countries receiving more to make their plans more ambitious, it needs to be seen whether this request will be followed; and
- The uneven distribution of RRF grants across EU member states may lead to uneven incentives for member states, and uneven power of the European Commission to promote reforms, but there are reform needs in countries with macroeconomic imbalances, and some of these countries obtain little money from the RRF.

Lessons

It is too early to draw conclusions about the RRF's impact in terms of its main goals (strengthening a sustainable and resilient recovery while supporting the EU's green and digital priorities). While lessons for European economic governance are also limited so far, we can nonetheless identify seven early lessons for the wider European economic governance structure:

1. Greater transparency of European Commission evaluation, as well as independent evaluation of NRRPs, would have been useful, and we recommend such measures for similar future programmes;
2. No definitive conclusion can be drawn about the RRF's funding methodology, which could be done after the recovery plans are implemented;
3. Whenever performance-based funding is used for EU programmes, result indicators should have a prominent role;
4. Large deviations in final funding amounts compared to initial indicative funding amounts are undesirable;
5. It is important to push reforms in countries that receive relatively small amounts of RRF funds;
6. The European Commission's November 2022 EU governance reform outline goes in the right direction by foreseeing a greater role for national authorities in the design of their fiscal and structural adjustment paths;
7. We do not recommend changing the Commission's role in proposing the CSRs, though we encourage the Commission to conduct consultations with national stakeholders before proposing the CSRs.

1. INTRODUCTION

Following the global financial crisis of 2008 and the subsequent euro-area crisis, the economic governance framework of the European Union (EU) was significantly revamped. Before these crises, EU economic surveillance mostly focused on fiscal sustainability according to the Stability and Growth Pact (SGP). This had limited success, since many EU countries entered the crises of the late 2000s in vulnerable fiscal positions. EU surveillance of private-sector vulnerabilities, such as credit and housing booms, structural imbalances as reflected in high current-account deficits and external debts, and financial sector fragilities, was missing.

The 2011 Six Pack reform of EU economic governance introduced a new macroeconomic and structural policy surveillance and policy coordination framework. A new procedure, the Macroeconomic Imbalance Procedure (MIP), was introduced to assess private-sector vulnerabilities and assist countries in designing remedies. It was combined with fiscal surveillance under a revised SGP in a single economic policy coordination tool, the European Semester. The European Semester is facilitated by the European Commission, which analyses common EU-wide and national challenges, national budget plans, macroeconomic conditions and structural reforms. Based on this, the Commission proposes country-specific recommendations (CSRs) to be adopted by the Council of the EU. The Semester starts with the Commission's publication of key economic and social priorities for the EU at the end of each calendar year, and concludes with CSRs in the subsequent summer. The Commission regularly evaluates the implementation of CSRs.

To date, the CSR implementation record has been rather poor. To foster greater effectiveness of the European Semester, its process and scope have evolved significantly, but the challenge remains of achieving more effective EU-wide policy coordination and advice.

To improve economic policy coordination in the EU, the European Commission launched a review of the economic governance framework in February 2020. This, however, was suspended amid the emergency of COVID-19 pandemic. The governance review process was relaunched in October 2021.

Meanwhile, in response to the pandemic, in July 2020 the European Council agreed to an unprecedented new instrument, NextGenerationEU (NGEU), with the goal of supporting a sustainable and resilient recovery of the EU economy, creating jobs and repairing the immediate damage caused by the COVID-19 pandemic while supporting the EU's green and digital priorities. The centrepiece of NGEU is the Recovery and Resilience Facility (RRF), which is composed of up to €312.5 billion in grants and €360 billion in loans (in 2018 prices). To request funding from the RRF, EU countries had to submit national recovery and resilience plans (NRRPs), explaining the investments and reforms they wish to implement, and how these comply with the priorities and criteria set out in the RRF Regulation.

There are significant interactions between the European Semester and the RRF. NRRPs had to address a substantial subset of the not yet implemented recent CSRs issued to each country. Progress reporting and monitoring of NRRP implementation is foreseen within the European Semester process. Furthermore, RRF payments can be suspended if a country has not taken effective action to correct its excessive deficit or excessive imbalance.

Following the outbreak of the COVID-19 pandemic, the European Semester was temporarily adapted to the context of the crisis. To facilitate an effective fiscal response to the crisis, the general escape clause of the SGP was activated to allow EU countries to deviate from regular deficit and debt limits. CSRs issued by the European Semester likewise focused on areas related to the health crisis, such as investment in health-related issues, income liquidity support, ensuring an equitable recovery and the preservation of the Single Market (European Commission, 2020). The European Semester resumed its broad economic and employment policy coordination role in 2022, while integrating the facilitation of the Recovery and Resilience Facility (RRF). Starting from the 2022 European Semester cycle, the national reform programmes (which must be submitted by mid-April each year) also fulfil one of the two bi-annual reporting requirements of EU countries under the RRF.

In November 2022, the European Commission published its reform outline for a new EU economic governance framework. This proposal is subject to discussion at the time of writing (European Commission, 2022).

Against this background, this briefing paper evaluates the interplay between the RRF and the European Semester, identifies first lessons from the interaction and proposes suggestions for a well-functioning EU economic governance framework.

2. THE POOR IMPLEMENTATION TRACK RECORD OF EUROPEAN SEMESTER RECOMMENDATIONS

European Semester CSRs can be grouped into three main categories according to the strength of the legal base and the consequences of non-compliance:

- SGP recommendations;
- MIP recommendations; and
- other recommendations.

Within the SGP and MIP, the implications of non-compliance can be more severe when a country is under an Excessive Deficit Procedure (EDP) in case of the SGP and an Excessive Imbalance Procedure (EIP) in case of an MIP, which in principle could result in fines (only for euro area countries for EIP). So far, no EIP was launched and no EDP resulted in fines. For other recommendations, member states "*shall take due account of the guidance addressed to them in the development of their economic, employment and budgetary policies before taking key decisions on their national budgets for the succeeding years*".[1] Non-compliance with recommendations can lead to warnings, further recommendations, and enhanced monitoring.

2.1. Implementation deteriorated from an initially modest level

Implementation rates of European Semester CSRs was mediocre at the start and there was an almost continuous deterioration, with a temporary uptick in 2017 (Table 1). Table 1 was derived from the assessment by the European Commission, which is based on country analyses of national measures carried out by an interdisciplinary team of country analysts and is mostly qualitative in nature.

Building on the work of Deroose and Griesse (2014), Darvas and Leandro (2015) calculated a reform implementation index, which ranges between zero (no or limited progress on all recommendations) and one (full implementation of, or substantial progress on, all recommendations). The last column of Table 1 shows a substantial decline in this index by 2019.

Darvas and Leandro (2015) also observed that the rate of implementation of European Semester CSRs was not higher than the rate of implementation of the OECD's recommendations, despite the fact that CSRs are partly based on EU primary and secondary legislation (such as the TFEU, the SGP, and the MIP), are approved by Member States in the Council, and come with the risk of financial penalties being imposed in case of non-compliance (Hagelstam et al. 2019). The OECD on the other hand, only has bilateral discussions with EU countries. Overlaps between the European Semester and OECD recommendations only partly explained this similarity.

[1] See Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.

Table 1: Commission's assessment of CSR implementation (EU average, actions taken within a year)

	No/Limited Progress (% of CSRs)	Some Progress (% of CSRs)	Full/Substantial Progress (% of CSRs)	Reform implementation index
2012	29.0	59.4	11.6	41
2013	46.1	44.7	9.2	32
2014	51.6	44.2	4.2	26
2015	51.6	44.2	4.2	26
2016	54.7	43.0	2.3	24
2017	50.0	48.7	1.3	26
2018	60.6	36.6	2.8	21
2019	60.2	38.7	1.1	20

Source: first three data columns: adapted from Figure 1 of Angerer, Grigaitė and Turcu (2020). Last data column: calculated on the basis of Darvas and Lenadro (2015).

Note: Based on the European Commission assessment of actions taken, rather than outcomes that may materialise with a lag. SGP-related recommendations are excluded.

Certainly, some issues limit the comparability of CSR implementation rates across time and across countries, as highlighted by Deroose and Griesse (2014). Not all recommendations have the same importance or difficulty. Countries might implement the easier reforms first and postpone the more difficult ones to later years. Implemented recommendations are not repeated in later years, but non-fully implemented reforms might be recommended again. Thus, the difficulty of implementing recommendations might increase over time.

Nevertheless, very few recommendations have been fully implemented and partial implementation of a recommendation in one year might be followed by the same recommendation the next year, which would be easier to implement given the partial implementation of the previous year's recommendation (Darvas and Leandro, 2015). During the 8-year long period included in Table 1, new 'easier' reform needs might have emerged, so it is not very likely that the difficulty of CSRs has continuously increased over this period.

Partly driven by questions of lacking effectiveness and national ownership, several reforms were introduced in 2015. With the aim of increasing ownership, discussions with national parliaments and other stakeholders were extended. The absolute number of recommendations was reduced[2], and recommendations were refocused, with greater emphasis put on the objective to be achieved, while leaving the definition of specific measures largely to the discretion of national authorities (Angerer et al., 2020).

[2] However, as Angerer, Grigaitė and Turcu (2020) note, some policy areas that were covered separately in earlier CSRs have been merged, so one CSR may cover several policy areas that were previously addressed in separate SCRs. In such cases, the lower number of total CSRs does not represent a decrease in terms of content.

CSRs were introduced for the entire euro area. In addition, social and employment indicators were included into the Annual Sustainable Growth Survey.

2.2. Possible explanations for the low implementation rates

Derose and Griesse (2014) found that implementation appears to vary with countries' electoral cycles and is stronger in policy areas where market pressure requires an imminent policy response, like banking sector reform, or where the recommendations are backed by enforceable EU rules, like public finances. Low scores in areas like tax reform point to a reluctance to implement reforms.

The role of market pressure in increasing the likelihood of implementation was confirmed by Darvas and Leandro (2015), who also found that countries facing high unemployment tended to undertake more reforms. While SGP-related recommendations had only a modest implementation rates, MIP-related recommendations had a lower score, and other types of recommendations an even lower score. In addition, the study found that, except for services markets reforms, euro-area recommendations were not well reflected in country-specific recommendations. References to the aggregate fiscal stance in the country recommendations were vague and lacked consistency, with highly indebted countries receiving recommendations to consolidate but countries with fiscal space not being recommended to expand.

Darvas and Leandro (2015) were sceptical about the potential to improve economic policy coordination in the EU, because national policymakers are accountable to their national parliaments and focus on national interests, which often differ widely in different member states and do not necessarily coincide with CSRs. Nevertheless, they suggested decentralisation as an option to improve compliance by increasing the involvement of national stakeholders.

An analysis by Hagelstam et al. (2018) draws similar conclusions based on a survey of staff dealing with the European Semester in the 28 EU countries, of which three countries provided separate answers from two federal chambers, and one country provided separate answers for both the federal chamber and one regional chamber (altogether 33 parliaments). By constructing a parliamentary involvement score ranging from 0 to 1, they found that 17 parliaments fall within the range from 0.4 to 0.7 ('most involved'), 11 within the range from 0.2 to 0.4 ('involved'), and five within the range from 0.0 to 0.2 ('less involved')[3]. For the 2017 CSRs, they found that across countries a higher involvement of national parliaments in the European Semester was associated with a slightly higher CSR implementation rate. This suggests that greater involvement of national parliaments could improve the implementation of CSRs.

The important role of domestic political factors is highlighted by Maatsch (2017), who analysed national parliamentary participation in Austria, France, Germany, and Ireland in two budgetary cycles of the European Semester (2014 and 2015). She finds that in France and Germany, compliance within the European Semester has been subject to strong politicization. Such politicization coincided with the contestation of CSRs by national parliamentary parties. The willingness to comply with recommendations was found to depend mostly on the coherence of their content with the parties' economic preferences.

Decentralisation to improve implementation of CSRs was also recommended by Alcidi and Gros (2017), stressing the need to move from coordination to more national ownership. The authors argue that while policy coordination is essential in times of crisis when cross-country spillover effects are large, policy coordination may be less effective under normal economic conditions, thus presenting only a

[3] Hagelstam et al. (2018) construct the score based on questions like "Were the CSRs presented to you by the government?", "Did you provide an opinion/mandate to the government on the CSRs before their approval/adoption in the Council in June/July?", "Did you discuss the Commission assessments on the progress made in the implementation of the previous year's CSRs?".

minor incentive for countries to implement recommendations. Increased national ownership should lead to better implementation of CSRs regardless of the economic conditions. It would remove the perception that rules are hierarchically imposed. To this end, they suggest involving the national fiscal councils and the national productivity boards explicitly in the elaboration of EU recommendations for national governments.

Formal econometric analysis of CSR implementation was conducted by Brincogne and Turrini (2017) and Efstathiou and Wolff (2022). Brincogne and Turrini (2017) concluded that recommendations are more likely to be implemented in the face of financial market pressure as indicated by interest rate spreads or when countries' imbalances are classified as more serious as part of the MIP. In addition, implementation rates are higher after elections and lower when elections are forthcoming. Efstathiou and Wolff (2022) confirmed the role of financial market pressure that they measured with credit default swap spreads. They also found that larger fiscal and current account deficits increase the likelihood of implementation, as well as the quality of governance, the fragmentation of government coalitions and fewer recommendations received. Stronger surveillance under the MIP, however, does not appear to drive implementation rates, in contrast to the findings of Brincogne and Turrini (2017). As regards the thematic areas of CSRs, Efstathiou and Wolff (2022) found that recommendations on financial services have a much greater chance of being implemented, whereas those on broadening the tax base, the long-term sustainability of public finance and pension systems, and competition in services are much less likely to be implemented.

Overall, the low and deteriorating implementation rates of CSRs are discouraging for the effectiveness of EU economic policy coordination. Macroeconomic vulnerability, market pressure, and political economy factors influence implementation, but except for SGP-based recommendations that have a strong legal base, the potential for successful economic policy coordination within the EU is limited.

3. THE IMPACT OF THE RRF ON EU ECONOMIC GOVERNANCE

The Franco-German recovery fund proposal of 18 May 2020 was rightly hailed as a defining moment in the European Union's history. It proposed €500 billion joint borrowing to finance EU budgetary expenditures for the most affected sectors and regions, involving redistribution between EU countries. Before 2020, the EU had never borrowed to finance expenditures throughout the Union. The ensuing European Commission proposal on 27 May 2020 for NextGenerationEU (NGEU) topped-up the €500 billion grant proposal with €250 billion loans (at 2018 prices), while the July 2020 European Council lowered the grant component to €390 billion and increased the loan component to €360 billion. The largest component of NGEU is the Recovery and Resilience Facility (RRF) amounting to €312.5 billion grants and €360 billion loans (at 2018 prices) to finance reforms and investments between February 2020 and the end of 2026. The RRF Regulation entered into force on 19 February 2021.

EU countries had to submit national recovery and resilience plans (NRRPs) that describe the reforms and public investment projects they plan to implement with the support of the RRF. The Commission assessed these plans before they were approved by the Council of the European Union on a case-by-case basis. Fulfilment of agreed milestones and targets towards achieving the reforms and investments is the condition for RRF payments.

The implementation of NRRPs is guided and complimented by the European Semester. Since its 2022 cycle, the European Semester process has been reformed to take into account this added responsibility. Specifically, streamlined country reports give an overview of economic and social developments, resilience, and challenges that are insufficiently addressed in the NRRPs. These challenges are flagged in the CSRs passed to the Council of the European Union together with the country reports. In addition, national reform programmes submitted by countries in the context of the European Semester fulfil one of the two bi-annual reporting requirements under the RRF. Moreover, RRF payments can be suspended if a country has not taken effective action to correct its excessive deficit or excessive imbalance.

3.1. Novelties of the Recovery and Resilience Facility for EU governance

The Recovery and Resilience Facility brought two main new elements compared to the earlier European Semester process:

- conditioning RRF grants on the implementation of past (2019-2020) CSRs; and
- funding is linked only to meeting milestones and targets, not to the actual cost of an investment.

CSRs were approved by the Council consisting of representatives of EU member states and thus reflect their shared views. Except for the legally binding SGP and EIP recommendations, lack of implementation of CSRs would not result in major consequences, beyond warnings, monitoring and further recommendations (see Section 2). But one condition to obtain RRF grants is to implement at least a large subset of past CSRs, which provides a strong financial incentive.

The funding method is largely new. While the RRF Regulation states the RRF is "*performance-based*", in Section 3.3 we argue that the definition of milestones and targets implies that the focus is on inputs and outputs, not on results.

Sometimes it is also argued that the process for designing the recovery and resilience plans (member states make proposals after consultation with the Commission) is also novel, but this is not the case, as we highlight in the next section.

3.2. The design of recovery plans and operational programmes of the EU's regular structural funds is rather similar

The method of designing the recovery and resilience plans, whereby EU countries make proposals following a consultation with the European Commission, is rather similar to the design of the operational programmes of EU structural funds.

EU structural funds are financial instruments used by the European Union to support the development of disadvantaged regions and sectors within member states. These funds are distributed through EU partnership agreements and operational programmes. Partnership agreements are negotiated between the EU and national authorities and outline the general framework for the use of structural funds in each member state.

Operational programmes divide the overarching strategic goals stipulated in the partnership agreement into investment priorities, precise targets, and ultimately into concrete steps for implementation. They are drawn up by the member states (or any authority designated by them) in coordination with the European Commission.

Operational programmes are assessed by the European Commission based on their consistency with relevant rules and regulations, their effective contribution to set objectives, and their consistency with the partnership agreement, in which programme objectives, funding, and the timeline are set out. The assessment takes into account CSRs, relevant Council recommendations, and the ex-ante evaluation carried out by the Commission.

Upon approval, member states set up a committee to monitor the implementation of the programme. Countries must submit annual reports on the implementation to the European Commission as well as a final report on implementation of the programme (European Parliament and Council of the European Union, 2013).

Thus, it is not a new feature of the RRF that EU countries make proposals for investments and reforms, corresponding to a set of criteria, in consultation with the European Commission. Obtaining a financial reward (i.e. RRF grants) for implementing the recovery plan is not a novel aspect either, since EU countries also obtain financial reward (i.e. structural funds) for implementing operational programmes of the EU budget.

3.3. The RRF funding method focuses on inputs and outputs, not on results

Performance-based funding seeks to move the focus of decision-making in budgeting away from inputs, i.e., the financial resources received, towards measurable results, i.e., what can be achieved by means of these resources (OECD, 2007). There has been a growing focus on the achievement of results in the EU budget. Important steps in this process were the 2010 Budget review, the 2015 'EU budget for results' initiative, and the 2018 revision of the EU budget financial regulation (European Court of Auditors, 2019). As Kristalina Georgieva, who was the Vice-President of the European Commission when the 'EU Budget for results' initiative was launched in 2015, vividly expressed[4]: "*There is a real urgency for systemic change in how we budget, how we implement the budget, how we use the resources. … One, most important, to look at what the project delivers, in terms of outcome and even better, impact. We can build a road with 0 % error rate but if it goes nowhere, it is still a road to nowhere, and it is a 100 % waste of our taxpayers' money. So we have to bring this, what is the use, what is the impact, how are we generating*

[4] https://data.europa.eu/doi/10.2761/900943

household income, how are we lifting standards, how are we generating jobs? These are the measurements we need to get accustomed to."

The European Court of Auditors (2021) defined the main concepts for thinking about inputs and achievements:

- Input: The financial, human, material, administrative or regulatory means used to implement a project or programme.
- Output: Something produced or achieved by a project, such as the delivery of a training course or the construction of a road.
- Result: The immediate effect of a project or programme upon its completion, such as the improved employability of course participants or improved accessibility following the construction of a new road.
- Impact: The wider long-term consequences of a completed project or programme, such as socio-economic benefits for the population as a whole.

Since 2019, the 'financing not linked to costs' (FNLTC) method is a possible option to support performance-based funding for EU structural funds[5]. The 2021-2027 Multiannual Financial Framework continues to allow this financing option[6]. Under this method, payment depends on the fulfilment of conditions or on the achievement of results. The actual cost of the intervention does not matter. While there is a rationale for wider use of performance-based funding as we argued in or earlier work (Darvas, Mazza and Midões, 2019), the financing of the entire RRF in this way was a giant leap, for two reasons.

First, EU countries have almost no experience in using the FNLTC method for EU-funded projects (even if some have tried similar approaches in national budgeting). The European Court of Auditors (2021) noted that while EU countries could have used FNLTC in the final two years of the 2014-2020 Multiannual Financial Framework, they did not, with the sole exception of Austria, where a single pilot project using FNLTC was launched (paragraph 93 and Box 8). While the Commission and the ECA identified several reasons for this lack of interest (late introduction of FNLTC, burdensome setup, concerns about their legal certainty of subsequent checks and controls), the lack of experience using FNLTC for EU-funded projects remains.

Second, a global comparison of experiences with performance-based funding (also referred to as results-based budgeting, or performance budgeting) is not encouraging. Moynihan and Beazley (2016) analysed the experiences of seven countries (Australia, Estonia, France, the Netherlands, Poland, Russia and the US) and found "*a general pattern of disappointment with the results of performance budgeting, balanced by a strong belief in the underlying logic*". Thus, the design and implementation of results-based budgeting, including FNLTC, is not straightforward.

Several ECA reports have highlighted that existing performance-based instruments for the EU budget do not focus on results, but rather on outputs and inputs. The European Court of Auditors (2017) emphasised that "*The results-based approach to public policy relies on the principle that the focus of public interventions should be on the delivery of results, rather than on activity or process management.*" More recently, the Committee on Budgetary Control of the European Parliament called for promoting "*a profound culture of result orientation*"[7].

[5] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32019R0694

[6] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021R1060 See Articles 51 and 95.

[7] https://www.europarl.europa.eu/doceo/document/A-9-2022-0241_EN.html

The RRF Regulation is ambiguous about "*the performance-based nature of the Facility*". Here, the question is whether the expression "*performance-based*" follows the general definition of performance-based funding used in the literature (i.e., achieving results as defined by the ECA and the OECD). The preamble of the Regulation refers to "*financing based on the achievement of results measured by reference to milestones and targets indicated in the approved recovery and resilience plans*". Article (2) on the Regulation defines these terms as: "*'milestones and targets' means measures of progress towards the achievement of a reform or an investment*". The expression "*measures of progress towards*" thus indicates a process, not necessarily the achievement of results in the sense of the ECA definition.

An argument in favour of a reduced focus on result indicators is that such indicators would introduce uncertainty for member states, since the achievement of results might not necessarily follow from the completion of outputs, partly due to risks beyond the control of those who implement the project. The Commission's involvement in the development of the NRRPs might have reduced the risk of adverse selection, whereby member states focus on input and output indicators that are easy to achieve irrespective of the resulting social value. While this argument has merit, the process-focused approach has several caveats.

First, it is questionable whether the Commission's involvement in the development of the NRRPs was indeed sufficient to avoid adverse selection. The Commission had to negotiate 27 plans, which were often very lengthy, and the time available for negotiations was relatively short. Whether the Commission had the capacity to evaluate each project in each plan thoroughly is not beyond a doubt. An at least partial reliance on result indicators could incentivise countries to focus on the social value of projects.

Second, the EU's vocal championing of results-based approaches is in conflict with an input and output focused RRF. The expression 'performance-based financing' is generally understood both in the EU jargon and in the literature as a method to partially condition the financing on the achievement of results (only partially, because even in existing performance-based instruments, some instalments are made against meeting input and output targets). The use of result indicators could contribute to meeting public expectations about the focus on social value added of performance-based instrument.

Third, the use of result indicators and monitoring could help to address criticism about the ability of national authorities to invest EU money into desirable projects, and the capacity of EU institutions to detect inappropriate projects. In the face of such scepticism, the use of result indicators could serve to demonstrate that EU funding is indeed expected to yield positive outcomes.

One conclusion arising from the preceding discussion is that any future instrument using a 'performance-based' approach should clearly define what is meant under performance. We suggest that this term be reserved for instruments that focus on achieving results, in line with the general interpretation. Since achieving results may take time and involve a higher risk of not meeting goals after project completion, input and output indicators should still be included in a performance-based framework. Result indicators, however, must not be omitted.

To shed light on the practical implementation of the RRF, we analysed the targets of the five largest EU countries as well as Romania, and categorised them according to the above-listed input, output, and result indicator definitions of the ECA. Impact indicators were excluded, and are indeed absent from NRRPs, since such impacts often become observable only several years after the projects are completed.

Selected examples of input, output, and result indicators are presented in Table 2. Our categorisation of all target indicators for the six selected countries is displayed in Table 3.

Table 2: Examples of input, output, and result indicators from the six recovery plans

	Input	Output	Result
France	Number of projects for which a grant has been signed for recycling operation of wasteland or of urbanized area: 90 by 2022Q1 and 200 by 2023Q1	Number of new identity cards produced and in circulation: 3 million by 2022Q1	3.5 MtCO2eq by 2021Q2 and 5 MtCO2eq by 2022Q4 greenhouse gas emissions avoided, as calculated in comparison of the "before investment" situation
Germany	Of the EUR 227 000 000 allocated to the measure, at least EUR 215 650 000 of rail purchase projects have been approved by 2024Q3.	100 consultations with funding programme beneficiaries, which may also be part of a more encompassing investment advisory service, have been completed or are in the process of being carried out, by 2024Q3	At least 35% (by 2023Q4) and 70% (by 2026Q3) of public health offices have improved their digital maturity by at least two levels in at least three categories in the employed digital maturity system, as compared to their digital maturity level of 2021
Italy	At least 10000 (by 2024Q4) and 15000 (by 2026Q2) enterprises have received support for paid investment in innovation in the circular economy and bio-economy	180km of high-speed rail for both passengers and freight in the lines Brescia- Verona-Vicenza- Padova; Liguria- Alpi and Verona- Brennero, by 2026Q2	Reduce by 20 percentage points of the variation between the average three best-performing regions and the three worst-performing regions in separate waste collection rates by 2024Q4
Netherlands	75 000 digital devices shall be provided to schools to support online and hybrid education for students in primary education, secondary education, and vocational education, by 2021Q4	At least two static monitoring stations and at least 10 mobile monitoring stations in the North Sea shall be installed and operational by 2026Q1	For at least 12.5 in every 100 kilometres driven in the Netherlands, road users shall be able to receive Safety Priority Services provided by car manufacturers or navigation devices by 2025Q1, from 7% in 2022
Romania	100 projects led by top international researchers shall be financed by 2023Q4 to attract highly specialised human resources from abroad	Length of completed and operational cycling runways, including road safety measures: 546 km by 2024Q4 and 1091 km by 2026Q2	Reduction by 25% in the number of people killed or seriously injured as a result of road accidents in urban municipalities compared to the reference year 2019
Spain	100 % of the budget EUR 300 000 000 committed to SMEs in 'Agents of	Creation of at least 50 centres for excellence	Completion of residential dwelling renovation ac-

	Change Programme' by 2023Q4, to support at least 15 000 SMEs in their digital transformation processes	and innovation in vocational training by 2024Q4	tions, achieving on average at least a 30 % primary energy demand reduction (at least 231 000 actions in at least 160 000 unique dwellings by 2023Q4 and at least 510 000 actions in at least 355 000 unique dwellings by 2026Q2), demonstrated by energy performance certificates of completed works

Source: Authors' evaluation based on the target indicators listed in the Council implementing decisions on the recovery plans of the six countries.

Table 3: Classification of recovery plan target indicators of six EU countries (number of targets)

	France	Germany	Italy	Netherlands	Romania	Spain
Input	51	41	62	20	25	67
Output	51	29	191	31	190	107
Result	3	5	59	3	39	20
All	105	75	312	54	254	194

Source: Authors' evaluation based on the target indicators listed in the Council implementing decisions on the recovery plans of the six countries.

France, Germany, and the Netherlands adopted very few result indicators, both in absolute number and as a share of total indicators. Input indicators account for more than half of all indicators for Germany and almost half for France, and more than a third for the Netherlands.

Both the number of result indictors, and their share in total indicators, are much larger in the Italian and Romanian plans than in the other four plans. Spain is somewhere halfway between the groups of France/Germany/Netherlands and Italy/Romania.

Thus, the plans of France, Germany, and Netherlands largely correspond to the process-focused definition of milestones and targets, while the plans of Italy and Romania have a meaningful result-orientation.

The low number and share of result indicators of France and Germany are not related to the low amount of money obtained from the RRF. France (€37 billion in grants) and Germany (€28 billion in grants) obtain more RRF funding than Romania (€12 billion in grants and €15 billion in loans), yet Romania included a much larger share of result indicators and a much lower share of input indicators than France and Germany.

A further disparity is related to the number of target indicators per RRF funding: despite receiving less funding from the RRF than France and Germany, Romania has more indicators (254) than those two countries (105 and 75, respectively). This discrepancy is even more pronounced when comparing France and the Netherlands, with France receiving 8-times the amount of funding yet having only twice as many targets.

Aside from the types and number of target indicators included in NRRPs, the content of targets deserve attention. In our assessment, the quantitative targets in national recovery plans vary significantly in terms of their nature, scope and number, limiting cross-country comparability, which is also concluded by the European Court of Auditors (2022). The 14 common indicators of the RRF scoreboard[8] allow cross-country comparisons, but these indicators cover only a subset of the activities financed by the RRF[9].

Studies analysing the content of targets have found their ambition to be lacking at times, a finding that points to the adverse selection problem mentioned above. Corti and de la Ossa (2023) scrutinized the Italian NRRP and documented that the recovery plan target of assisting 300 000 jobseekers by December 2022 was just half of the national target of 600 000 jobseekers, indicating that the recovery plan target had a low ambition to secure its easy achievement. They reported similar anomalies for a programme on early childhood education.

Our analysis of the target indicators is in line with these findings. We find that some targets were easy to meet, since they relate to programmes that began well before the submission of the plan. For example, one of the three French result indicators aimed to reduce CO2 emission by 2021Q2. The French plan was submitted on 29 April 2021, endorsed by the Commission on 23 June 2021, and approved by the Council on 13 July 2021. Thus, this target was supposed to be achieved in the quarter the plan was submitted, and the Council's approval happened even after the achievement of the target. One of the five results indicators for Germany was "*Approval requested from the European Medicines Agency for a vaccine against SARS-CoV-2 by a second company of the three supported by measure 5.1.3, by 2021Q3.*" The German plan was submitted on 28 April 2021 and approved by the Council on 13 July 2021, i.e., already in 2021Q3, the deadline for meeting this target. These French and German programmes were launched well before the submission of the recovery plans. There were even targets with a deadline before the submission of the plans for France (two input targets by 2021Q1), for Germany (two input targets and one output target for 2021Q1), and for the Netherlands (an output target for 2020Q4, another output target for 2021Q3, and an input target for 2021Q4 – the Dutch plan was submitted in July 2022).

While the RRF Regulation allowed for the inclusion of programmes that began as early as February 2020, the selection of targets which were already achieved or nearly completed by the time of the submission of the plans underlines efforts to select some targets that are easy to meet. This practice also questions whether recovery plan projects are additional to projects that countries would have implemented without the RRF – even though the preamble of the RRF Regulation states that "*The Facility should support projects that respect the principle of additionality of Union funding.*"

The goal of receiving good value for EU recovery money is thus put at risk by several factors: the lack of experience of EU countries with performance-based funding, the generally disappointing international experience with this method, the non-comparability of recovery plans across EU countries, a large reliance on output and input indicators instead of result indicators, and the selection of some unambitious targets. It is, however, too early to assess whether this risk has materialised. Further research should

[8] https://ec.europa.eu/economy_finance/recovery-and-resilience-scoreboard/common_indicators.html?lang=en

[9] Moreover, some of these common indicators reflect inputs (e.g. the number of young people receiving support) and outputs (e.g. capacity of new and modernised healthcare facilities) rather than results (savings in primary energy consumption).

analyse this issue after a larger share of recovery projects has been completed. Future similar EU programmes should aim to minimise these risks.

3.4. The uniform assessment of incorporation of CSRs in the recovery plans is questionable

The Commission assesses the plans against 11 criteria defined in Annex 5 to the RRF regulation[10], including whether they offer a comprehensive and balanced response, properly incorporate country-specific recommendations from the European Semester, foster growth and the green and digital transitions, and include proper cost justifications and adequate measures for prevention of corruption and fraud.

Thus, one of the requirements for the recovery plans was to address all or a significant subset of challenges identified in the relevant CSRs. For the first 25 evaluations, the 2019 and the 2020 CSRs were considered by the European Commission, while for the Netherlands (evaluation published in September 2022) and for Hungary (evaluation published in November 2022), the 2019, 2020 and 2022 CSRs were considered.

We note that meeting the 2020 CSRs was rather straightforward, because most of the CSRs recommended what countries were anyway doing: addressing the emergencies caused by the pandemic. The first two sentences of CSR1 for each EU country was identical:

"*In line with the general escape clause, take all necessary measures to effectively address the pandemic, sustain the economy and support the ensuing recovery. When economic conditions allow, pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.*"

The third sentence of CSR1 for each country recommended strengthening the resilience of the health system, with slightly different wording across EU countries.

For most countries, CSR2 recommended the provision of adequate income replacement, access to social protection, and mitigating the employment impact of the crisis. CSR3 for most countries recommended measures to provide liquidity to the real economy and front-load public investment and promote private investment with a focus on green and digital transition. Some specific sectors for investment were listed for certain countries.

In response to the extraordinary public health and economic crisis caused by the pandemic, EU countries were doing all these measures irrespective of the European Semester cycle. Thus, addressing a significant subset of 2020 CSRs was straightforward. Only the last 2020 CSR for each country included issues which were indeed country specific. Examples include reducing the regulatory and administrative burden for businesses (Germany), improving the efficiency of the judicial system and the effectiveness of public administration (Italy), safeguarding judicial independence and involvement of social partners in the policy-making process (Poland) and improving the effectiveness of anti-money laundering supervision (Sweden).

Thus, the incorporation of a large subset of the 2020 CSRs in the national recovery plans was rather straightforward, because most of these CSRs recommended what member states were anyway doing in response to the pandemic. The incorporation of the 2019 CSRs was the real challenge.

[10] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021R0241

European Court of Auditors (2022) formulated some critical remarks about the Commission's assessments of the proper incorporation of CSRs in the recovery plans. The auditors found more gaps than what the Commission has identified. Table 4 shows that for a sample of six countries, the European Court of Auditors (2022) found quite notable gaps in the incorporation of 2019 CSRs in the recovery plans.

For example, in the case of Germany, the ECA highlighted four important gaps:

- the RRP does not include measures to support the deployment of very high-capacity broadband networks (CSR 2019.1.2);
- the RRP does not include measures to strengthen competition in business services and regulated professions (CSR 2019.1.4);
- further efforts are needed to eliminate disincentives to work for second earners (CSR 2019.2.1); and
- the RRP does not include binding milestones and targets or specific reforms of the pension system (CSR 2019.2.2).

In light of these gaps, it is surprising that all member states uniformly received the best A grade for incorporating CSRs in the recovery plans (Table 5), which questions these uniform Commission's assessments.

Table 4: ECA's assessment of the extent to which sampled RRPs address CSRs for 2019 and 2020

CSRs	2019						2020					
Member State / Category	DE	EL	ES	FR	HR	IT	DE	EL	ES	FR	HR	IT
Substantially addressed	0	2	2	1	4	3	2	4	3	3	4	4
Substantially addressed apart from minor elements	0	0	0	2	0	0	0	0	1	1	0	0
Partially addressed, with one or more subparts not addressed	2	0	2	1	0	1	0	0	0	0	0	0
Not addressed	0	0	0	0	0	1	0	0	0	0	0	0
Total number CSRs	2	2	4	4	4	5	2	4	4	4	4	4

Source: Table 3 of European Court of Auditors (2022).

Note: Due to the activation of the Stability and Growth Pact's "general escape clause" in the context of the COVID-19 pandemic, the 2019 CSRs on compliance with the Stability and Growth Pact and the 2020 CSRs to make sufficient progress towards their medium-term budgetary objectives, were no longer relevant and thus not considered a gap.

A generally 'good' rating of the recovery plans along various dimension by the Commission could have been expected, because most plans already incorporate significant comments from numerous meetings between the European Commission and EU countries, which took place before submitting the plans. The surprising result is that 24 plan assessments were identical, with only minor differences for the remaining three countries, Belgium, Czechia, and Estonia (Table 5). Even Hungary, a country under close scrutiny for its tools for an effective control of corruption, fraud, and conflict of interest, obtained identical ratings to the 23 other EU countries. Lack of cross-country differences in ratings raise doubts regarding the objectivity of the assessments.

Table 5: The European Commission's assessment of the recovery plans

	(1) Comprehensive and balanced response	(2) Country-specific recommendations	(3) Growth, jobs, economic, social and institutional resilience	(4) Do no significant harm to environment	(5) Green transition	(6) Digital transition	(7) Lasting impact	(8) Monitoring and implementation	(9) Cost justification	(10) Preventing corruption, fraud and conflicts of interests	(11) Coherence
Austria	A	A	A	A	A	A	A	A	B	A	A
Belgium	A	A	A	A	A	A	A	A	B	A	B
Bulgaria	A	A	A	A	A	A	A	A	B	A	A
Croatia	A	A	A	A	A	A	A	A	B	A	A
Cyprus	A	A	A	A	A	A	A	A	B	A	A
Czechia	A	A	A	A	A	A	A	B	B	A	B
Denmark	A	A	A	A	A	A	A	A	B	A	A
Estonia	A	A	A	A	A	A	A	A	B	A	B
Finland	A	A	A	A	A	A	A	A	B	A	A
France	A	A	A	A	A	A	A	A	B	A	A
Germany	A	A	A	A	A	A	A	A	B	A	A
Greece	A	A	A	A	A	A	A	A	B	A	A
Hungary	A	A	A	A	A	A	A	A	B	A	A
Italy	A	A	A	A	A	A	A	A	B	A	A
Ireland	A	A	A	A	A	A	A	A	B	A	A
Latvia	A	A	A	A	A	A	A	A	B	A	A
Lithuania	A	A	A	A	A	A	A	A	B	A	A
Luxembourg	A	A	A	A	A	A	A	A	B	A	A
Malta	A	A	A	A	A	A	A	A	B	A	A
Netherlands	A	A	A	A	A	A	A	A	B	A	A
Poland	A	A	A	A	A	A	A	A	B	A	A
Portugal	A	A	A	A	A	A	A	A	B	A	A
Romania	A	A	A	A	A	A	A	A	B	A	A
Slovakia	A	A	A	A	A	A	A	A	B	A	A
Slovenia	A	A	A	A	A	A	A	A	B	A	A
Spain	A	A	A	A	A	A	A	A	B	A	A
Sweden	A	A	A	A	A	A	A	A	B	A	A

Source: Bruegel based on European Commission Staff Working Documents for each country, which are available at: https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility_en#national-recovery-and-resilience-plans .

The RRF Regulation requires an A-grade for CSR implementation, and thus the Commission would have had to reject a plan in case of a B or C grade on this criterion. Apparently, the Commission did not wish to reject any plan, but instead gave a uniform A grade to all plans. The requirement for the best grade for CSR implementation constrained an objective assessment in case the Commission did not wish to reject the whole plan [11].

3.5. The uniform assessment of cost justification of the recovery plans is questionable

According to Annex V of the RRF Regulation, the assessment of cost justification had to consider four elements:

- The Member State provided sufficient information and evidence that the amount of the estimated total costs of the recovery and resilience plan…
    - … is appropriate (reasonable);
    - … is in line with the nature and the type of the envisaged reforms and investments (plausible);

[11] Beyond criterion 2 (CSR implementation), the highest score is required for criterion 3 (growth potential, job creation, resilience, the implementation of the European Pillar of Social Rights) as well. Effective contribution to the green transition (criterion 5) and digital transition (criterion 6) is also a prerequisite for a positive assessment, though the RRF regulation does not specify whether the effective contribution should be large (grade A) or moderate (grade B) contribution would be sufficient.

    - … to be financed under the Facility is not covered by existing or planned Union financing;

- the amount of the estimated total costs of the recovery and resilience plan is commensurate to the expected social and economic impact of the envisaged measures included on the Member State concerned.

Rating has been graded on a scale of three: A – to a high extent, B – to a medium extent, or C – to a low extent.

Darvas (2022a) investigates European Commission's assessments of the cost justification of NRRPs, which resulted in a medium-quality rating for all 27 EU countries (Table 4). He collected the critical remarks made in the Commission's assessments, such as varying degrees of detail and depth of calculation; gaps in the information and evidence provided on reasonability and plausibility of the estimated costs; insufficiently described or less robust methodologies; lack of independent validation for cost estimates; unclear funding criteria; and risk of double EU funding. The main finding is that these assessments vary significantly across countries. For example, there is a striking difference between the assessment of the Italian plan, which included three paragraphs listing problems in the two-page long section assessing cost justification, and the assessment of the Austrian plan, which hardly included any criticism.

Since the text of Commission assessments was most likely drafted very carefully, it seems implausible that there were no cross-country variations in the quality of cost justification. It is similarly implausible that no EU government can justify costs properly. The hypothesis that it was a deliberate decision to grade cost justification at medium-quality for all countries cannot be excluded, questioning the objectivity of the assessment.

However, if some or many plans are indeed based on medium-quality cost planning, then there is the risk that the recovery money might not be spent in a cost-efficient way. Minimizing this risk necessitates very careful assessments of not just the inputs and outputs, but also the results and the value for money. This conclusion has implications for EU economic governance reform: whenever performance-based budgeting will be used more widely in the EU programmes, independent evaluation of national plans and the results of the interventions would be essential.

3.6. Milestones and targets may be insufficient guarantees that RRF green objectives will be met

Hindriks et al. (2022) assess NRRPs regarding their contribution to the 'Green Transition' pillar. The authors focus on five ‘sustainable mobility’ measures implemented in five countries: France (support for clean vehicle demand), Denmark (investment in bike paths and bicycle subsidy schemes), Estonia (construction of a multimodal terminal in Tallinn), Spain (safe, sustainable, and connected mobility strategy), and Slovakia (supporting faster roll-out of renewable investments). They find that while the measures are generally coherent and balanced, their 'lasting impact' is not adequately assured, and that milestones and targets are insufficient guarantees that RRF objectives will be met. In France and Denmark, for example, measures are once off and do not imply structural changes in administration, institutions, or policies. They are thus not seen as having lasting impacts.

Many of the measures use input-related milestones, which makes it difficult to evaluate their actual performance and the extent to which they achieve EU policy objectives. Additionally, in cases where output-related targets are used, they are not clear enough to guarantee the desired outcome. For example, in France, the intention is that the subsidy will mainly benefit households, but this is not specified in the defined target. Furthermore, the timelines of the milestones and targets defined until 2026 do not match the time when the impacts of the measure will be felt, particularly in the case of Spain, Estonia, and Slovakia. This creates additional challenges in evaluating whether the desired outcomes of the measures have been achieved.

Hindriks et al. (2022) stress the importance of more results- and impact-focused indicators, attention as to whether the objectives of the measure have been achieved, and if plans align with RRF and EU priorities. In addition, they suggest the provision of guidance on milestone and target setting to ensure they are easily measurable but also indicative of their impact. This could be done by providing examples or setting requirements for milestones and targets for specific types of measures, which would help reduce the administrative burden on member states associated with setting quantitative, result-related targets.

3.7. Large deviations of final funding from the initially indicated amounts risk a uniformly good value for EU money

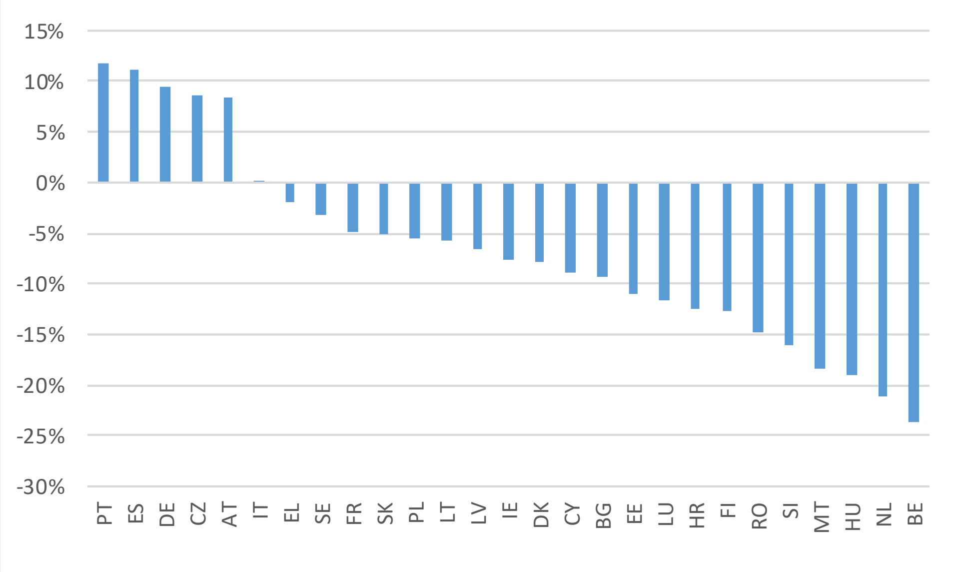
The cross-country calculation of the grant component of the RRF is divided into two portions. The first portion, 70% of the grants, amounting to €234.5 billion at current prices, is allocated on the basis of historical data (population in 2019, GDP per capita in 2019 and unemployment in 2015-2019). The exact value of this component was included in the February 2021 RRF Regulation.

The second portion, 30% of RRF grants, amounting to €103.5 billion, are allocated on the basis of both 2019 data (population in 2019 and GDP per capita in 2019) and more recent data: GDP decline from 2019 to 2020 and from 2019 to 2021. The Regulation included indicative amounts for this second portion, which were based on the European Commission's Autumn 2020 forecasts, and it was stated that the final amounts will be updated using Eurostat data on the 2020 and 2021 GDP by 30 June 2022. Annex IV of the RRF Regulation listed the indicative amounts of RRF grants.

GDP development is considered in a non-linear way: only countries facing GDP declines get a share of the 30% component of the funds (see annexes I and III of the RRF Regulation). As Darvas (2022b) highlighted, this non-linearity could in principle imply large variation: in an extreme case if GDP rises in 26 countries and drops in only one country, that single country would obtain the full €103.5 billion, corresponding to 30% of the RRF grants. While such an extreme scenario was unlikely, the formula in principle had the potential to result in large swings in the final allocation compared to the indicative allocation. This issue was not well perceived in early 2021 when most of the recovery plans were finalised.

Thus, while EU countries drafted their recovery plans based on the indicative amounts listed in the RRF Regulation, the final RRF grant amounts were very different for many countries. Some countries will get 10% more and others 20% less than initially expected (Figure 1).

Figure 1: RRF grant allocation: % difference between final allocation and the indicative allocation included in the RRF Regulation



Source: Bruegel based on the RRF Regulation and the European Commission's updated calculation: https://commission.europa.eu/system/files/2022-06/2022_06_30_update_maximum_financial_contribution_rrf_grants.pdf

Article 18(2) of the RRF Regulation stated that after the Commission presents the updated allocations, "*a Member State may update and submit the recovery and resilience plan referred to in paragraph 1 of this Article to take into account the updated maximum financial contribution*".

Referring to cases for which the updated amount of grants exceeds the initially planned costs, the Commission' guidelines[12] of May 2022 expressed that "*Member States benefitting from a higher maximum financial contribution are strongly encouraged to make full use of the additional funds available by proposing relevant new reforms and investments or scale up the ones already envisaged.*" Among the five countries that obtain about 10% more funding), this applies to Portugal, Spain, and Czechia, because the Austrian and German NRRPs planned to spend more than the indicative amount of grants, and the final amount of grants are almost at the initial spending plan (Germany: €28.0 billion updated funding versus €27.9 billion initial spending amount), or still below it (Austria: €3.8 billion updated funding versus €4.5 billion initial spending amount).

For downward revision of grants, the guidance states that: "*Member States are encouraged to continue implementing their adopted RRPs, relying on alternative sources of funding. … Should a Member State nevertheless wish to adjust the investment or reform agenda of its RRP, it would need to submit an updated plan.*" Luxembourg was the first country that requested the elimination of a programme and two related milestones and one related target from its NRRP due to the reduced amount of grant funding, which request has been endorsed by the Council[13].

Thus, the RRF Regulation allows the possibility of an NRRP update, while the Commission guidelines (which are not legally binding) "*strongly encourage*" member state to increase their ambition in case they get more money, and "*encourage*" member states receiving less not to reduce ambition. It remains

[12] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52022XC0531(01)

[13] https://www.consilium.europa.eu/en/press/press-releases/2023/01/17/recovery-fund-council-adopted-update-to-luxembourg-s-national-plan/

to be seen whether Portugal, Spain, and Czechia will increase the level of ambition of their NRRPs by about 10%, and whether other countries that, like Luxembourg, receive less funding will reduce their efforts. It will be possible to assess whether the value for EU money substantially deviates from initial expectations once NRRP revisions are submitted and approved. Nevertheless, a lesson for future similar EU instruments is that large deviations of the final allocation from the initial amounts should be avoided.

3.8. Uneven RRF use must not lead to uneven coordination

RRF grants are very unevenly distributed across Member States: southern and central European countries receive transfers between 4-12% of their annual GDP in total up to 2026, while western and northern EU countries obtain just about 1% of the annual GDP in total. Nguyen and Redeker (2022) stress that such differences translate to asymmetric discretionary power held by the European Commission across EU countries. Generally, those countries that are eligible for the most funds from the RRF as a share of their GDP are expected to develop more expansive reform agendas in order to be given the Commission's approval. In contrast, countries that receive fewer RRF funds relative to GDP, or have a higher degree of fiscal manoeuvrability, will be less pressured to comply with the Commission's wishes. Our comparison of target indicators presented in Table 3 corroborate this conclusion: Romania has a much larger number of target indicators to meet (254) than France (105) and Germany (75), even though Romania receives less funds than France and Germany, but relative to GDP, Romanian funding is larger than that of the other two countries.

This discrepancy in terms of RRF dependence can be problematic from a coordination perspective, as the reform needs may not always correlate with the RRF's allocations. For example, the 2022 Alert Mechanism report[14] named twelve countries as having macroeconomic imbalances, of which Ireland, Sweden, the Netherlands, and Germany receive less than one percent of their annual 2021 GNI in total in the form of RRF grants, while France receives 1.5 percent. There are enhanced reform needs in these five countries with macroeconomic imbalances, but the potential of the RRF to boost reforms in these countries is limited by the relatively small amounts these countries receive. In Section 3.4 we cited the ECA assessment concluding that Germany has hardly included 2019 CSRs in its recovery plan, which underlines the risk of limited impact of the RRF on the reform process in countries receiving relatively small RRF payments.

3.9. The Commission’s EU economic governance reform outline includes useful elements

European Commission (2022) presented a reform outline for the EU economic governance framework. In this section, we review the parallels between this reform outline and the RRF, which necessitates a brief introduction of the reform outline.

The reform outline focuses on fiscal rules, but also formulates some ideas for the MIP. An important feature of the proposal is an integrated assessment of public debt sustainability and sustainable economic growth.

Radical reforms are proposed for the fiscal rules. Instead of the current system of multiple rules, partly based in unobserved variables (potential output and structural budget balance), a country-specific debt sustainability analysis would inform the medium-term direction of fiscal adjustment, and a single operational target – an expenditure rule – would be used to achieve the desired change in fiscal policy.

[14] https://ec.europa.eu/info/publications/2022-european-semester-alert-mechanism-report_en

For countries with high debt risk, the public debt to GDP ratio should be on a "*plausibly and continuously declining path*" for at least 10 years after a four-year long adjustment period under unchanged policies, while countries with medium debt risks would get an extra three years before debt must start continuously declining.

This proposal is rather similar to our earlier proposal in Darvas *et al* (2018), in which we suggested country-specific 5-year long debt reduction target based on an economic analysis as an anchor and an expenditure rule as the single operational target. The proposal also borrows from Blanchard *et al* (2021), who proposed replacing numerical fiscal rules with standards, which are qualitative prescriptions that leave room for judgment.

In implementation, the Commission would set an initial reference adjustment path for each country and then invite the member states to submit a medium-term fiscal/structural plan, outlining fiscal adjustment, reform, and public investment commitments. These national plans may include a justified deviation from the initial reference path set by the Commission. Thus, the preparation of these national plans bears some similarity to the preparation of the recovery and resilience plans and aim to increase the ownership of the plan.

An important difference from Darvas *et al* (2018) is that we proposed the initial plan to be prepared by the national government, in consultation with the national fiscal council and a new European fiscal council, while the Commission's reform outline foresees that the Commission would set the initial reference path. Blanchard *et al* (2022) argue that this, along with the Commission's role in assessing the country's counteroffer and recommending a modified plan for approval to the Council of the EU, would concentrate too much discretion in the hands of the Commission. Hagelstamm and De Lemos (2022) similarly highlight the need for checks and balances in the face of larger Commission discretion and point to an enhanced role of the European Fiscal Board as potential remedy. A second main drawback of the Commission's reform outline, as highlighted by Blanchard *et al* (2022), is that the "*plausibly downward*" debt path is not properly defined by the Commission (2022). These two main drawbacks, as well as some unclear elements of the proposal, can be fixed.

Other useful elements of the reform outline include building ownership and commitment through dialogue between the Commission and Member States; using the medium term fiscal structural plans as the basis for surveillance by the Commission and the Council with annual monitoring under the European Semester; the forward looking approach that would put more focus on emerging risks, the evolution of imbalances, and the underlying policy responses; and the consideration of systemic challenges, such as climate change, environment and energy transition when these have a clear link with macro imbalances.

If a national fiscal-structural plan is being developed for a 14- or 17-year timeframe, the possibility of a change in government and subsequent shifts in priorities should be taken into consideration. Such changes could be incorporated by modifying the national fiscal-structural plan. However, it is important to note that such alterations do not negate the value and necessity of long-term planning, nor do they eliminate the risks and fiscal and macroeconomic challenges that a country faces.

4. RRF LESSONS FOR EUROPEAN ECONOMIC GOVERNANCE

Since only a quarter of RRF grants had been disbursed by the time of writing, and NRRPs will be implemented up to 2026, it is too early to draw conclusions about the RRF's impact in terms of its main goals: strengthening a sustainable and resilient recovery whilst supporting the EU's green and digital priorities.

The lessons for European economic governance, which is the main scope of this briefing paper, are also limited so far. Our review of the European Semester's performance has shown that overall implementation has often been poor and deteriorating. While macroeconomic vulnerability, market pressure and political economy factors influence implementation, the potential for successful recommendations without a strong legal base, i.e., those outside the SGP, is limited. Implementation of the RRF, on the other hand, has so far been judged as relatively successful. Our assessment of the novel governance and regulatory structure introduced by the RRF, as well as our analysis of the NRRPs and investigation of the European Commission's NRRP assessments, allow us to draw out seven early lessons for the wider European economic governance structure.

First, greater transparency of European Commission evaluation, as well as independent evaluation of NRRPs, would have been useful, and we recommend such measures for similar future programmes. The European Commission has a crucial role in all stages of RRF governance: making proposals for priorities and criteria, negotiating the plans with national authorities, evaluating the plans before the Council of the EU approves them, assessing whether milestones and targets are achieved, and evaluating the overall success of the RRF. While the Commission did a great job and deserves praise for all its efforts to set-up and run the RRF, under the difficult circumstances of the pandemic, the Commission's intense involvement also creates a strong interest in portraying the RRF as a success. In section 3.3, we found that the Commission has endorsed plans with very few result indicators; in section 3.4 we raised concerns about the Commission's assessment of the incorporation of past CSRs in the NRRPs; in section 3.5 we raised concerns about the assessment of cost justification; and in section 3.6 we asked whether milestones and targets can ensure a lasting green transition. Greater transparency around the Commission's assessment process would help ensure a higher level of credibility (e.g., the Commission should not just say "*In a limited number of cases, the methodologies and assumptions are less robust.*", but should make its assessments fully transparent by making its detailed assessment public). Moreover, setting up an independent committee to evaluate the plans, and after the programme ends, the achievements, would greatly help the proper scrutiny of any similar new programme.

Second, no definitive conclusion can be reached about the funding methodology of the RRF. We noted an ambiguity whether the RRF Regulation requires the achievement of results in the sense this expression is understood in the literature on performance-based funding, or merely any kind of input and output targets and milestones. Nevertheless, since the recovery plans are hardly comparable across EU countries, and for some countries the performance indicators mainly measure inputs and outputs instead of results, there is a risk of not getting a good value for EU recovery money. Once the NRRPs are completed, a thorough analysis should scrutinise the usefulness of the RRF's funding method and the value for EU money.

Third, whenever performance-based budgeting is used for EU programmes, result indicators should have a prominent role beyond input and output indicators. In principle, the Commission's prior assessment of the plans could limit the adverse selection problems (project selection not based on the best social value), in which case outputs will likely lead to good results. However, earlier disappointing experiences with EU-funded project selection necessitates convincing the general public that this time only socially useful output will be delivered, which requires result indicators. Similarly to the European

Court of Auditors (2022), we found that NRRPs became very different across countries, also in terms of milestones and targets. The Commission concluded that it was impossible to make a proper comparison of NRRPs across countries, so such an evaluation has not been done (or at least has not been published). We recommend a much greater use of results indicators for any future performance-based EU programmes, which would also enable greater comparability of plans and outcomes across EU countries and the evaluation of the value for EU money. For programmes and projects that are primarily based on input indicators, we recommend a traditional cost-based financing method.

Fourth, large differences between final funding amounts and initial indicative funding amounts are undesirable. Some countries get 10% more from RRF grants, and others 20% less, than suggested by the indicative amounts included in the RRF Regulation. The RRF Regulation allows plans to be changed in case the final funding amount deviates from the earlier indicative amounts, but does not make such changes obligatory. The Commission guidelines "*strongly encourage*" countries that received more funding than initially expected to increase the ambitions of their plans, and "*encourage*" countries receiving less funding not to reduce the ambition. It needs to be seen to what extent countries will follow these Commission's guidelines. The value for EU money could deviate from expectations when the plans were drawn up if the ambition of the plans do not change proportionally with the change in funding.

Fifth, it is important to push reforms in countries that receive relatively small RRF fund amounts. The varying RRF grant distribution across countries can translate into uneven incentives and enforceability of CSRs, and can thus hamper effective economic coordination across EU countries. Therefore, being attentive to, and pushing for, reforms in countries receiving small amounts of funds is important.

Sixth, the way NRRPs are designed (EU countries make proposals for investments and reforms, corresponding to a set of criteria, in consultation with the European Commission) is not a new feature of the RRF. The design of operational programmes for the regular EU budget structural funds is the same. Nevertheless, it seems that national ownership of the NRRPs has been increased by the initial national design. Thus, it is welcome that the Commission's November 2022 EU governance reform outline foresees a greater role for national authorities in the design of their fiscal and structural adjustment paths.

Finally, an important remaining question is whether Commission should continue to make initial proposals for the European Semester CSRs, or whether these should be put forward by member states. Such a shift would have both advantages and disadvantages, but on balance, we recommend that the Commission should continue to play this role. Greater national ownership of CSRs could be increased by nationally set CSRs, but at the risk of countries proposing reforms that they can reach easily, instead of more difficult reforms which would have greater societal and economic benefits. The Commission could formulate a more independent view of a country's challenges than national authorities, though we encourage the Commission to conduct consultations with national stakeholders before proposing the CSRs.

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This study documents the poor track record of implementation of the European Semester country-specific recommendations and discusses the novelties the Recovery and Resilience Facility (RRF) could bring to EU economic governance. While it is too early to evaluate the success of the RRF, this study draws out lessons for the future of the EU economic governance framework from certain aspects of the RRF design and the European Commission's evaluation of the national recovery and resilience plans.
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