10 PRINCIPLES FOR A SUSTAINABLE RECOVERY

Finance Watch report, October 2020 - Executive summary

SETTING THE CONTEXT

1. Resilience defined as avoiding future disruption of the world

The covid-19 crisis has shown us the fragility of our economic system and just how exposed we are to its disruption. But pandemics are only a part of the disruption that man-made climate change is likely to bring. The IPCC has predicted that business as usual will mean warming of 3.7 - 4.8°C by the end of the century, leading to massive disruption – from droughts, wild fires, massive climate induced migrations and loss of pollination, to battles for access to fresh water and food, rising sea levels, floods, hurricanes, pandemics and more.

The covid-19 crisis has also shown us what we already knew: running the world economy as we were before the pandemic and building a sustainable future for the world are incompatible. The sharp economic contraction we have seen, 5.2% for the world economy with many places hit much harder, came with an 8% reduction on Global CO2 emissions. **The lesson is clear – a reduction in CO2 is possible but things need to change.**

In short, a return to "business as usual" will mean soon the end of "business as usual" amid great suffering and disruption. We need to change direction and make the transition to a sustainable economy. And fast. **Amid the suffering, the covid-19 crisis also offers us an opportunity - in this report we ask how we can shape the recovery in a new direction.**

2. The RRF: more about recovery than resilience

To do so we examine the EU's flagship policy, agreed this summer, the €750 billion Next Generation EU (NGEU) – and more particularly its core: the Recovery and Resilience Facility (RRF). Unfortunately, as things stand **we find that the priority of the RRF is short-term economic growth and the recovery of "business as usual".** Resilience and sustainability come a poor second. For example, jobs and growth come first with only secondary consideration to whether these jobs and growth will be in sustainable or unsustainable activities. The result is a **recovery-resilience paradox: a recovery to business as usual will not be resilient.** The better news is that **with changes the NGEU and the RRF can be made into a powerful tool of pan-European solidarity that sets a new and sustainable direction for Europe.**

WHAT DIRECTION OF TRAVEL?

3. Support sustainable activities, including transition and enabling activities

Building a resilient recovery implies that the **entire RRF should be dedicated to supporting sustainable activities – and these must be clearly defined.** Astonishingly the proposal for a Regulation establishing a Recovery and Resilience Facility neglects to make use of the EU's own Taxonomy Regulation which could provide an effective and pragmatic framework for the RRF. **The inclusion of transition and enabling activities** (in addition to low carbon activities) **in the taxonomy in particular makes it appropriate for the RRF.** As well as targeting new sustainable activities it would also mean supporting those traditional (and currently unsustainable) businesses that invest to transform their way of operating or enable other activities to become sustainable. This would mean funds could be applied across much of the economy and would go a long way to overcoming the contradiction between recovery and resilience in the current version of the RRF.

4. Do not support unsustainable activities (at all)

The counterpart to supporting sustainable activities should be to offer **no support to unsustainable ones. Support for unsustainable activities would work directly against the efforts to encourage sustainable activities** (and waste the loans and grants given for that). And, it would be doubly wasteful as **there is no future for unsustainable business: either we phase them out or the resulting disruption will end them.** In summary, supporting unsustainable activities creates a triple loss: money will soon be lost, related jobs will subsequently also soon be lost, and the future disruption of society will grow.

5. Support people whatever it takes

A transition on the scale required to avoid the worst consequences of human-made climate change will of course create disruption of its own. Encouraging unsustainable activities to disappear will mean jobs disappear too. Instead of the RRF supporting these activities **it should support those that currently work in these areas.** Money should be spent on **retraining** but also on providing support for those that cannot retrain in the form of a **guaranteed income,** fixed at a level sufficient to ensure the preservation of human dignity.

RECONCILING RECOVERY AND RESILIENCE

6. Define 'green' and 'do no harm' precisely

NGEU and the RRF have been given the objective of being at least 30% 'green', with the entirety of the package respecting the 'do no harm' principle. Again, the **Taxonomy Regulation should be used to provide tighter definitions.** First 'sustainable' (as defined in the Taxonomy Regulation) should replace 'green'. Second, the 'do no significant harm' logic developed in the Taxonomy Regulation should be applied, by ensuring that activities either enable other activities to become sustainable or they transition to the highest environmental performance possible for their sector. This would offer a **pragmatic and effective approach that incentivises many existing activities to begin their transition towards sustainability.**

7. Assess Member States' recovery and resilience plans for sustainability

The European Council has stated that "all EU expenditure should be consistent with Paris Agreement objectives" – but this has not been incorporated in the Commission's assessment criteria for recovery and resilience plans. It should be. In particular the entire budget of the recipient country should be assessed and not just the marginal projects put forward for the RRF - anything else risks waste and contradiction. **More precisely overall budgets should be judged by the 'do no harm' principle – and in particular fossil fuel subsidies must be considered incompatible with RRF funds.** Overall coherence should also be considered - for example payments for activities which are subject to the Emissions Trading System should not be compatible with receiving RRF funds in the absence of a credible transition plan. For all its significance, the total amount of RRF represents a small fraction of the budget countries will allocate to recovery – **assessing entire budgets allows the EU to leverage RRF funds to act as a catalyst for change.**

8. Ensure the coherence between resources and the use of proceeds

The empowerment of the European Commission to borrow up to €750 billion for the NGEU was a step forward for pan-European solidarity but the nature of this borrowing should be consistent with the aims of the facility. **The Commission's target for 30% of the borrowing to be via green bonds is much too low.** There is no reason not to raise 100% of the money using green bonds. It is also imperative that the EU uses its own (yet to be adopted) standards for green bonds (and in the meantime follow the existing Technical Expert Group recommendations). **Any funds not raised through green bonds should be transparent about their level of compliance with the taxonomy. Transparency is essential for the entire NGEU process to make a difference and providing Taxonomy Regulation related transparency through the funding structure is, in that respect, indispensable.**

9. Reform the EU economic governance rules to embed sustainability

The EU urgently needs a review of its economic governance, especially with regard to fiscal rules. **EU fiscal constraints were never a good idea,** helping impose damaging austerity after the financial crisis. Now more than ever they make no sense and have rightly been suspended in light of the covid crisis. **They should be scrapped altogether.** Future public deficits and debt levels will be above the 3% and 60% thresholds, either because public authorities will have invested, as they should, to build a sustainable and just society, or because the economy will have collapsed if they have not. In addition, **EU economic governance should enhance sustainability and social inclusion criteria as part of the 'green and just transition'** and these should be included in the assessment of resilience and recovery plans.

10. Money can grow on trees (for sovereign entities)

The case for scrapping the EU's fiscal constraints is further boosted because **governments face low or even negative borrowing costs while inflation is also stubbornly low** or even negative (and the ongoing recession is likely to add to deflationary pressure). Even an unprecedented expansion of the balance sheet of the ECB and other central banks has failed to produce any meaningful inflationary pressure, making direct financing of budget deficits by central banks a further tool available to governments. **Given the urgent need to transform our economies, now is the time to borrow and invest in a just, green transition to a sustainable future.**