

## NOTA

**THE EU RECOVERY AND RESILIENCE FACILITY: FEDERAL CONFLICTS IN THE DEVELOPMENT AND IMPLEMENTATION PROCESS IN GERMANY<sup>1</sup>**

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**I. INTRODUCTION**

To mitigate the health, social and economic consequences of the Covid-19 pandemic, the member states of the European Union (EU) agreed in December 2020 on a proposal from the European Commission (EC) to establish a joint recovery plan. It consists of the temporary NextGeneration EU (NGEU) financing fund as well as the long-term EU budget from 2021 to 2027. While providing an economic stimulus for the EU and its member states, the recovery plan also steers “the transition towards a modern, sustainable and resilient Europe” (European Commission 2021a: 6). In total, the temporary NGEU comprises EUR 806.9 billion. The largest spending instrument of NGEU is the Recovery and Resilience Facility (RRF), which provides the EU member states with support for national reform and investment projects. Of its EUR 723,8 billion, EUR 385,8 billion is to be distributed as loans and EUR 338,0 billion as grants to the member states. The remainder – around EUR 83,1 billion – is allocated to other EU funding programs (ibid.). For the first time in its history, the EU is authorized to take out loans for its refinancing at a significant level.

To ensure that the RRF is primarily used by the member states as an impulse for a green and digital transition, Regulation (EU) 2021/241 of the European Parliament and the Council of February 12, 2021, establishing the Recovery and Resilience Facility clearly defines the substantive objectives, the scope as well as the specific functioning and financing of the fund (Regulation 2021/241). It requires each member state to submit a national plan to the EC which will then evaluate it according to predefined EU targets: at least 37% of the expenditure must contribute to the climate change targets and 20% to the digital targets (Regulation 2021/241: 37). By April 30, 2021, member states were supposed to submit their national plans to the EC (Regulation 2021/241: 23). However, since this was a non-binding closing date, national plans continue to be accepted until mid-2022 (European Commission 2021b).

At the heart of the German debate on the EU’s RRF has been the question of the EU’s borrowing capacity (Bundesrechnungshof 2021; Feld 2020; Guttenberg 2020; Heinemann 2020; Matthes 2020). For the first time, under the NextGeneration EU Fund, the EC will be allowed to borrow up to EUR 806.9 billion on the capital markets on behalf of the EU. Starting in 2028, this debt must be repaid from the EU budget within 30 years. As the member states will have to assume liability for possible defaults in the amount of their share of the EU budget, there was considerable criticism in Germany - particularly from parties and economists with a conservative or neoclassical point of view. Concerns have been raised about entering a “transfer union” (Feld 2020; Heinemann 2020). For this reason, the Federal Constitutional

Court was also called upon twice to challenge the German Bundestag's decision to support the EU Councils' decision from December 14, 2020, on the system of own resources of the EU (Council Decision (EU, Euratom) 2020/2053).

## **II. THE IMPLEMENTATION OF THE RRF IN GERMANY: PRIORITIES AND VOLUME**

Germany intends to draw only on financial grants from the RRF (Hungerland et al. 2021: 37). Accordingly, Germany will receive around EUR 26 billion in grant allocations, amounting to approximately about 8% of the total volume of the RRF placing Germany as the fourth-largest grant recipient after Spain, Italy, and France (ibid.).

In line with the objectives defined in Article 3 of the EU Regulation establishing the Recovery and Resilience Facility, the German Recovery and Resilience Plan (DARP) identifies six different priority issues. The areas of climate policy and energy transition (EUR 12,5 billion) and digitization of the economy and infrastructure (EUR. 6,0 billion) are at the heart of the DARP (Bundesministerium für Finanzen 2021: 14-17). Key aspects are, for instance, investments in the development of climate-friendly construction with wood or in a major joint European project on microelectronics and communications technology. In addition, the plan focuses on the digitization of education (EUR 1,4 billion), administrative modernization and the removal of barriers to investment (EUR 3,5 billion), strengthening social participation (EUR 1,4 billion), and a pandemic-resilient healthcare system (EUR 4,6 billion) (ibid.). Within this focus, various measures include the expansion of childcare, the securitization of apprenticeship places, and the extension of federal coordination efforts to speed up planning and approval procedures.

Despite the different priorities and measures, the funds are predominantly used for investment purposes. Therefore, further funding programs will be relaunched, and existing programs will be strengthened or refinanced with EU funds. Most of the funds will be spent in the form of investment grants (EUR 12.7 billion) to companies, municipalities, or other public sector entities (Clemens et al. 2021: 5). The administrative processing is carried out by the federal government's project management agencies within the framework of competitive tendering procedures.

## **III. THE FEDERAL DIMENSION OF THE EU RRF**

The Regulation (EU) 2021/241 establishing the Recovery and Resilience Facility already proactively considers the federal dimension of the EU's RRF. Thus, the EC and the member states shall "ensure complementarity, synergy, coherence, and consistency among different instruments at Union, national and, where appropriate, regional levels (...)" in both the drafting and implementation phases (Regulation 2021/241: 48). This is of particular relevance to leverage synergies with the NGEU's other funding instruments, such as the Just Transition Fund or the Rural Development program. Due to their structural and cohesion policy elements, they fundamentally affect the level of federal states (Länder) and regions (Bundesministerium für Wirtschaft und Energie 2021).

Additionally, in a federation such as Germany, the federal states play an important role in shaping and implementing EU policy measures. Certain funding priorities of the DARP entail concurrent and exclusive legislative competence of the Lander. Due to the strong administrative powers of the German Lander, most of the funding measures affect their competencies. Among others, climate protection and digitization as well as healthcare and administrative modernization belong within

the jurisdiction of the Lander. Thus, a strong involvement of the Lander would have been expected not only during the policy formulation process of the RRF but also during the planning, implementation, and use of funds under the DARP. However, the negotiations on the design of the RRF and its domestic implementation plan were essentially conducted between the federal government and the EC. The whole process was hardly noticed – beyond the expert community – by the public. Questions surrounding the intra-German management of the Covid-19 pandemic as well as its economic consequences overshadowed this debate, especially since the envisaged volume of financial grants from the RRF for Germany is relatively small compared to the intra-German Covid-19 response measures with a volume of around EUR 1.2 trillion (including all investment aid, grants, guarantees, compensation for tax shortfalls and social assistance, etc.) (Scheller 2021).

### **3.1. The intra-German development process of the DARP**

The DARP negotiation process can be divided into two phases. The first phase started once the German government's coalition committee (Koalitionsausschuss) agreed on the key points of the DARP on August 25, 2020. The development of the plan entered its second phase after the submission of the preliminary draft to the European Commission on December 23, 2020. During this step, the plan was revised and concretized before it was finally submitted to the European Commission on April 30, 2021. The overall process took a total of eight months and required a high level of coordination in particular by the Federal Ministry of Finance (Bundesministerium für Finanzen, BMF) – as it is the central point of contact for EU institutions and the Lander. The BMF formally coordinates the call for and the budgetary allocation of RRF funds by different ministries (Bundesministerium für Finanzen 2021: 1062).

Already during the first phase of the process, in November 2020, the social partners – employers' associations and trade unions – and the German Council of Economic Experts (SVR) had been consulted (Bundesministerium für Finanzen 2021: 1069). The Lander, however, were only informed about the key aspects of the preliminary DARP draft at the Standing Conference of the Ministers of Finance (Finanzministerkonferenz, FMK) at the beginning of December 2020 (Bundesministerium für Finanzen 2021: 1066). This was followed by the submission of a preliminary draft of the DARP to the European Commission on December 23, 2020, by the government.

However, the federal government did not officially submit the draft DARP to the Bundestag, its specialist committees, and the German Federal Council (Bundesrat) until the beginning of 2021. During the first quarter of 2021, the individual Lander, as well as welfare and environmental associations, had the opportunity to submit written comments on the DARP draft (Bundesministerium für Finanzen 2021: 1067). Only at this point, the Lander were explicitly given the chance to contribute their perspectives and ideas. In parallel, the German Federal Council published a statement on March 5, 2021, in which it welcomed the submitted draft DARP while simultaneously criticizing the federal government for the handling of the drafting process (Bundesrat 2021a). Before the whole process was concluded with the handover of the finalized DARP to the EU Commission on April 30, 2021, the individual German Lander submitted written comments on the draft DARP by mid-April (Bundesministerium für Finanzen 2021: 1067).

### **3.2. Criticism of the federal states and position of the Federal Government**

The Bundesrat's criticism of the federal government's approach to the drafting process was threefold (Bundesrat 2021a: 2): First, the Länder highlighted that several

planned projects under the DARP affected their concurrent and exclusive competencies. Second, they criticized the growing coordination requirements to avoid overlaps – and hence double financing – with other funds already being provided by the EU. Finally, the Länder emphasized that the EU's RRF aims for a comprehensive economic transformation for which an extensive involvement of the regional perspective is indispensable.

The German federal government, however, rejected the points of criticism, noting that the Länder were involved through the usual procedures in the formulation of measures if they were directly affected by them or if these fell within their area of responsibility (Bundesrat 2021b: 1). Moreover, the federal government argues that the perspective of the Länder has been additionally considered since the Länder may participate in the development of the National Reform Program (NRP). That is drawn up by the member states every April as part of the European Semester and aims to serve as a complementary document to the DARP in the coming years (Bundesrat 2021b: 2). Nevertheless, even if, following the argumentation of the federal government, the legal participation rights of the Länder were respected, the design of the drafting process for the DARP and its focus areas cannot conceal the fact that the procedure and the policy formulation was predominantly shaped at the federal level. The participation of the Länder is to be viewed as advisory – at best corrective. Against this background, the question arises as to how the federal government and the Länder intend to cooperate to implement the DARP in the coming years.

### **3.3. Planning for federal implementation of DARP**

The role of the Länder, during the execution phase of the DARP, is outlined in the plan but focuses on their contribution to the implementation of the various projects while the federal government is in charge of its coordination (Bundesministerium für Finanzen 2021: 1062-1072). To this end, a “structured communication channel” is to be established between the federal government and the Länder. For this purpose, a coordination unit is to be set up at the Federal Ministry of Finance, which will hold regular meetings to evaluate the state of the DARP implementation with the Länder as well as with other relevant federal ministries. This structure has its origin in the fact that the different projects for the individual thematic priorities of the DARP are designed by the responsible federal ministries. In this context, they are to involve the Länder and local authorities in the further specification of individual measures, in particular on issues of digitization, the design of a digital education offensive, and measures to strengthen a pandemic-resilient healthcare system.

The DARP also provides for improved coordination between the federal levels, not least to implement the DARP funding measures themselves more quickly and effectively. As early as December 2020, the Länder's Prime Ministers Conference (Ministerpräsidentenkonferenz, MPK) had agreed with the then Chancellor on a Joint Program of the Federal and State Governments for a High-Performance, Citizen- and Business-Friendly Administration (Bundesregierung 2020a, 2020b). Given the massive increase in the number of federal funding programs in recent years – and here in particular during the Covid-19 pandemic – the aim was to promote an accelerated outflow of funds. To this end, Länder and local governments were to identify “concrete procedure-specific obstacles to a speedy outflow of funds together with the federal government” by May 2021 (Bundesregierung 2020b: 1 – own translation).

Another aspect that intends to increase the effectiveness of the plan's implementation is that “barriers to investment should be specifically reduced by expanding the range of advisory services offered by the ‘PD – Berater der öffentlichen Hand (PD)’” (Bundesrat 2021b: 1 – own translation). PD is a consulting agency that was founded in 2008 as a spin-off from the Federal Ministry of Finance and is 100% publicly owned. The

federal government holds just under 75 percent of the shares. However, the structure and operation of the PD are still not without controversy, especially since it has grown rapidly in recent years and has taken on countless consulting mandates at the federal, state, and local levels. Ultimately, the federal government, with its strong position as a shareholder in the PD, has created an institution with which it can at least indirectly influence the administrative actions of the Lander and municipalities – even if the PD always emphasizes its independence.

Nevertheless, the role of the PD is to be strengthened during the implementation of the DARP. The federal government states: “Many Lander and municipalities are familiar with PD because they are shareholders themselves or have already cooperated with it in the past. In this way, PD could increasingly act as a pilot between the funding provider and the funding recipient to make the retrieval of provided funding more effective. PD can also provide targeted and flexible support in the implementation of specific funding programs on a broad scale. In the spirit of partnership, suggestions and proposals from the federal states are welcome to support municipalities more effectively” (Bundesrat 2021b: 2 – own translation).

### **3.4. Substantive criticism of the DARP**

In addition to the criticism of the DARP drafting and implementation – particularly by the Lander and municipalities – various stakeholders expressed further concern about the plan. For instance, the German Council of Economic Experts (SVR) prepared a statement on behalf of the German government to evaluate the proposed measures (Sachverständigenrat 2021). In this paper, the Council criticizes above all the lack of a fundamental reform agenda to improve the general political framework to foster sustainable economic growth and to strengthen Germany’s innovative capacities. The SVR claims that the DARP unilaterally focuses too strongly on individual technology-specific investment projects without a clear overall strategy (Bundesministerium für Finanzen 2021: 1225). The Bundesrat, furthermore, stressed the lack of political measures to promote the competitiveness of companies whereby missing the opportunity to incentivize businesses to invest. Finally, the Bundesrat noted that too little consideration had been given to the principle of additionality or complementarity of EU funding since a large proportion of the financial grants applied for under the DARP are used to refinance or top-up previously existing programs. The generation of “additional innovative impulses” thus hardly succeeds (Bundesrat 2021a: 3).

## **IV. CONCLUSION**

Taking the perspective of federalism theory and practice, the development process of the EU’s RRF, including German participation, development, and implementation is characterized by several weaknesses. Such EU programs illustrate a fundamental dilemma: while the federal governments have the largely exclusive rights of external representation vis-à-vis the EU, the implementation of the EU’s RRF takes place at the state and local levels. This creates tensions between time-critical decision-making processes at the EU level on the one hand and the granting of proactive rights of co-determination and co-design to sub-state authorities on the other. The intention to quickly mitigate the consequences of the Covid-19 pandemic with the EU’s Recovery and Resilience Facility as well as its German subpart appears to have led to a reduction in participation opportunities for the Lander and the municipalities.

The German Recovery and Resilience Plan consists of various new, earmarked, and time-limited investment programs by the federal government and does not include a

provision of general and untied financial allocations to financially weak local entities. Instead, the Länder and municipalities must apply for project-related grants from project management agencies in a competitive process. One disadvantage caused by temporary project financing is that financially stronger states and municipalities are usually favored, as they often have the capacity and flexibility to respond rapidly to calls for tender. Financially weaker municipalities, which in any case usually have significantly lower investment ratios and resulting investment backlogs, lose out (Raffner and Scheller 2021). In addition, the Länder and municipalities have complained for years about the complex application and accounting procedures for these funding programs (Scheller et al. 2021).

Even today, municipalities barely have the staff capacity to apply for the relevant funding and use it in the allocated time, as the number of programs has increased significantly in recent years. In addition, the Federal Audit Office was granted special audit rights as part of the last Reform of the Fiscal Equalization Scheme of 2017, enabling it to audit down to the level of the municipalities. The ambivalence that results under aspects of federal theory is reflected in Art. 114 Abs. 2 GG: „(2) The Federal Court of Audit, whose members shall enjoy judicial independence, shall audit the account and determine whether public finances have been properly and efficiently administered by the Federation. For the purpose of the audit pursuant to the first sentence of this paragraph, the Federal Court of Audit may also conduct surveys of authorities outside the federal administration; this shall also apply in cases in which the Federation allocates to the Länder ring-fenced financing for the performance of tasks incumbent on the Länder. (...)“. Thus, – following Scharpf’s formulation of the “shadow of hierarchy” – a “shadow of auditing” has been established, in which Länder and above all municipalities are confronted with significant uncertainties pertaining to possible misuse of subsidies (Scharpf 2000).

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