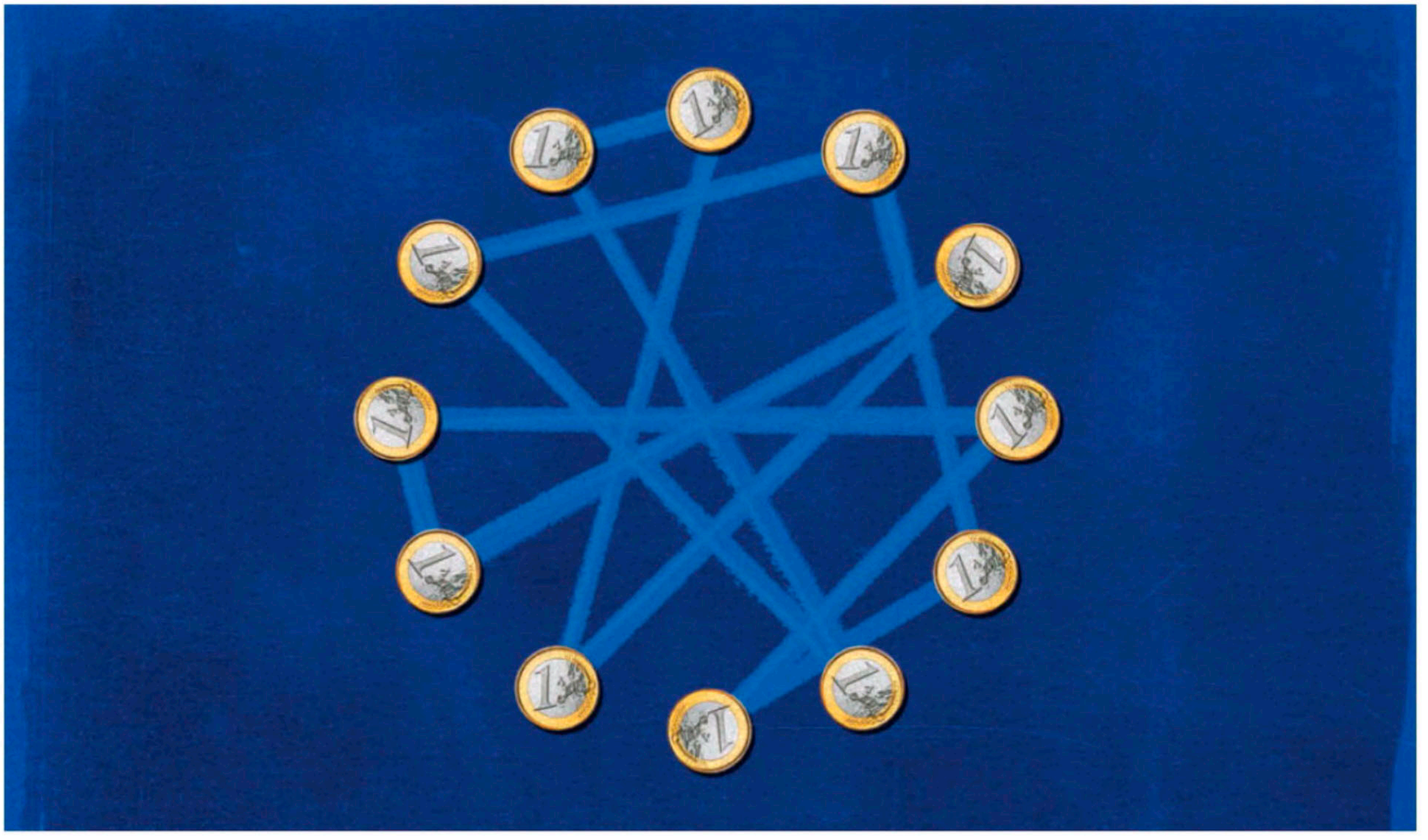


EU recovery fund

How to spend it

The EU's covid-19 recovery fund has worked, but not as intended

February 19th will mark three years since the European Union's recovery fund came into force. Known in Brussels jargon as NextGenerationEU (NGEU), this multi-year budget worth €832bn ($897bn, or 5.2% of the bloc's GDP in 2022) is funded by EU debt, previously a rare commodity. It is the main political innovation to emerge from the pandemic in Europe. Some called it Europe's Hamiltonian moment, invoking Alexander Hamilton, America's first treasury secretary, who masterminded the fiscal federalisation of the United States. But the EU is some way from a fiscal federation. Northern finance ministers insist that the recovery fund was a one-off. And the extent of its success is still unclear.

Next week the European Commission will present its first external review. The funds are still being spent, so the economic effect is hard to measure. More curiously, experts cannot agree on what the fund's purpose was. But that is not surprising. Just as national fiscal policy does not serve a single purpose, neither does its equivalent at the EU level.

Start with its short-term purpose: to prevent a re-run of the euro crisis of 2010-12. In early 2020 the European Central Bank (ECB) had to intervene forcefully to stop interest rates on the enormous debt of Italy, which was hit hard by the pandemic, from spiralling out of control. To complement the ECB's actions, the EU agreed to pool fiscal means to help poorer countries and those hit hard by the pandemic. The amount of aid ranged from 10.8% of GDP for Italy to 0.6% for the Netherlands (see chart on next page). The markets learned that the ECB does "whatever it takes" to preserve the euro (as it promised during the euro crisis), and that in a crisis the EU's richer countries will help its poorer ones. On this count, the fund has been a success.

The fund's second purpose was to aid the recovery from the depths of the covid recession. That was never going to work. Fiscal stimulus should focus on consumption, not investment—think American-style stimulus checks, or tax cuts. EU spending, which happens only via national governments and focuses on investment, could not possibly come fast enough to help. It might have had a signalling effect that money would flow and that governments and investors could start planning, argues Zsolt Darvas of Bruegel, a Brussels-based think-tank. In the end economists were glad the money was spent slowly: otherwise it might have fuelled inflation last year. But as a recovery tool, the fund made little difference.

What about the green and digital transformation of the European economy? The biggest recipients got huge sums. (Richer countries got little, and will end up disproportionately paying off the debt.) Greece's reform-minded government had already set up a commission headed by Sir Christopher Pissarides, a Nobel economics laureate, to use the money to make big changes. Some of that is working. Plans to digitise public administration and deploy solar panels grew more ambitious. Oversight by the commission prevented the most egregious white elephants, such as Italy's proposal to build a football stadium. This performance-based approach may well be applied to most EU spending from now on.

Still, there are problems. The EU sponsored some waste: Italy's ludicrously generous subsidies for green renovation of houses was co-funded by €14bn of EU money. Investments such as child-care facilities need permanent staffing; the NGEU is a one-off, so that funding is unsure. Since most of the money has yet to be spent, the final verdict will have to wait. But so far the results have been mixed. "It was too much money for Italy, and there was too little time to make sure it is spent well," argues Tito Boeri of Bocconi University.

The cash was also meant to help countries implement politically difficult reforms to boost growth. This shows more promise. Greece's government intends to reorder responsibilities of various levels of government, the health system and spatial planning. In Italy the government started reforming its byzantine judicial system. The money is an incentive to stick to agreed reforms, especially important in a country that changes governments frequently. But Italy has struggled to boost the level of competition in its economy. Other efforts, such as Spain's labour-law reforms, have been less ambitious. The real test will be whether the EU insists that countries stick to their promises.

The final purpose of the NGEU was to bribe the EU's outcasts, countries run by the populist hard right. The smell of billions in fresh cash from Brussels led Poland and Hungary to agree reluctantly to new powers for the European Commission, to monitor whether breaches of the rule of law threaten the union's financial interests. Both countries must pass certain "super milestones" to get any funds. (The EU's decision in December to unfreeze €10bn for Hungary was unrelated to these new monitoring mechanisms.)

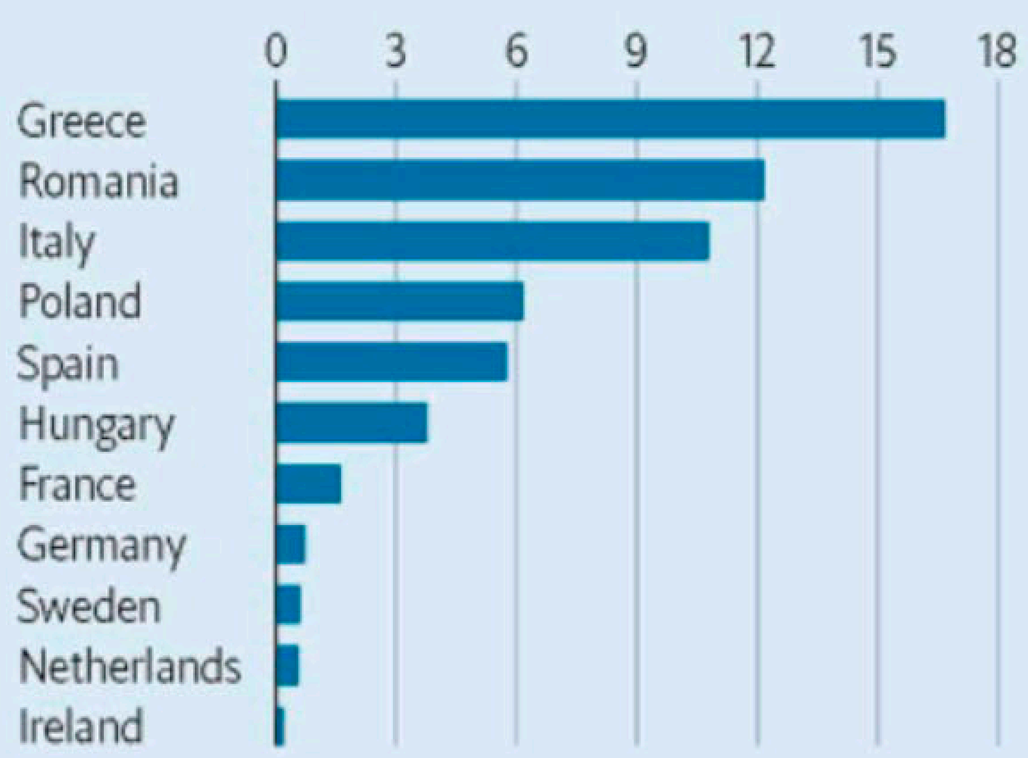
Critics argue that the milestones are superficial: in Hungary they cannot repair the damage to democracy; in Poland a new government is taking on that job itself. But for the first time, the EU has financial leverage to discourage countries from violating the rule of law. At the least, it can stop its funds from adding to autocratic governments' power.

The overall verdict, then, is cautiously positive. Some want more such schemes. "Whatever the issue in the EU these days, NGEU is the answer," quips Mujtaba Rahman of Eurasia Group, a consultancy. European federalists hope collective debt, in the words of Hamilton, "will be to us a national blessing; it will be powerful cement of our union." But another Hamilton provides better guidance. A Hamiltonian cycle in mathematics is a line that, after visiting all nodes once, returns to its origin. This is where the recovery fund will end up, too. Having spent €832bn in 27 member states, the EU will have to make the case for a larger budget and more authority anew. ■

Aid to the needy

EU recovery fund, grant allocation

Selected countries, 2020-26, % of 2021 GDP



Source: European Commission

Bessarabia

Going full Ukrainian

IZMAIL

A partly pro-Russian region changes its tune

WHEN RUSSIA first attacked Ukraine in 2014, less than half of the inhabitants of Bessarabia identified as Ukrainian. The region was poor and, for historical and economic reasons, many people thought that Vladimir Putin might be their saviour. But Russia's endeavours to stir up trouble in this strategic Ukrainian borderland have failed. Ukrainian forces beat back Russian attempts to land commandos at the beginning of the full-scale invasion in 2022, and security services arrested dozens of agents. The Russians damaged one of the two bridges linking Bessarabia to the rest of the country, but failed to shut down the other.

In just over 200 years the ownership of Bessarabia has changed nine times. It is bounded by the Danube and Dniester rivers, the Black Sea to the south and Moldova to the north. Seized from the Ottomans by Russia in the early 19th century, it became Romanian between the world wars and part of Soviet Ukraine after that. Apart from Ukrainians its people include Russians, Moldovans, Gagauz, Bulgarians and Albanians; their lingua franca is Russian rather than Ukrainian.

Oleh Kiper, the governor of the Odessa region, which includes Bessarabia, says that pro-Russian sentiment there dwindled after 2014 and "crashed" after February 2022; "Russian satellite TV propaganda" has been blocked since 2015. Since then Bessarabia has been not only peaceful, but a crucial lifeline for Ukraine. Hundreds of lorries thunder through it daily, loaded with grain and other goods. They carry vital currency-earning exports to the Danube-river ports of Izmail and Reni, or into Romania and onwards.

A decade ago the main road across Bessarabia from Odessa was awful, and Izmail felt like the dingy end of the world. No longer. The road has been improved and a ferry service opened in 2020, linking the region to Romania. On the Danube in Izmail a Togolese-flagged grain ship rests at anchor; hardy old men do squats on the riverbank nearby before swimming in the river. Others prefer a dip in Izmail's smart new municipal sport centre.

In the past few years wineries and tourism have flourished, though the post-Soviet recovery has been patchy. In Izmail money has poured in from up to 8,000 sailors who call this port home. Most of those who were at sea when the war started have stayed abroad. Although it has been hit by Russian rockets, Izmail has had a good war. Businesses and refugees from now-closed Black Sea ports like Kherson and Mykolaiv have moved here. "People got a sense of pride in being Ukrainian," says Andriy Abramchenko, the mayor.

In the predominantly Moldovan village of Hlyboke, history comes alive at the cemetery. The village lies on the banks of Sasyk, a lagoon that suffers from a disastrous Soviet attempt to turn it into a freshwater lake. The water is rising and the shoreline is eroding. The bones of Cossacks buried here in the 18th century jut out of the graveyard's sandy cliff edge. At the other end of the cemetery lies Sasha Gorun, the school's history teacher, who died fighting the Russians last May. Maria Chekir, aged 80, who taught Mr Gorun when she was the headmistress of the school, says she knows no one in the village who supports Russia. Now, says Mrs Chekir, "when I hear people speaking Russian I tell them off. Our guys are fighting Russians and I don't want to speak Russian any more."

Hanna Shelest, a security analyst in Odessa, is not surprised. The war in Donbas, in the east, destroyed any local faith in the Kremlin's propaganda about a peaceful "Russian World". Meanwhile, the government in Kyiv began paying attention to the region. Ten years ago farmers here sold their cabbages to Russia, and blamed Ukraine's government when war killed that business. Now they have found other markets, and resentment has dissipated.

Although the fear of separatism has evaporated, the threat from corruption has not. Ivan Rusev, an environmental researcher and activist, says that the army has sealed off parts of Bessarabia's national parks. Inside, he says, people with connections are grabbing land for farming or hunting. Asked about Mr Rusev's allegations, Mr Kiper, the governor, said simply: "Thank you for informing me." ■