GREENTERVENTION

Carbon neutrality, growth, economic policy and facility for recovery and resilience

On July 21st 2020, the European Council decided after lengthy discussions to set up a Recovery and Resilience Facility to help overcome the economic consequences of the COVID-19 pandemic as quickly as possible and in all Member States. We immediately expressed our concern on this site that the Recovery and Resilience Facility would not be calibrated to meet energy and ecological transition objectives, but would be oriented towards old fashioned objectives. We concluded that the European Parliament would be in the front line to steer the draft regulation tabled by the Commission in the right direction. And, indeed, this is the case.

Our suggestions for amendments to the draft regulation have one objective: European funds must serve the ecological transition. Beyond technical amendments, we have in particular insisted on the importance of abandoning the concept of “potential growth” as the flagship guide for this facility. We will elaborate further on this here.

The concept is used recurrently in the draft regulation for the facility (12 times, to be precise): “potential growth” that must be unleashed, restored, strengthened, promoted... The use of this concept to guide economic policies is not limited to this draft regulation. The concept is in fact central to the conduct of macroeconomic policies, in particular budgetary policies, and for the recommendations for reforms of the European Union.

We will see later on why “potential growth” is more of a metaphor rather than part of a an empirically validated theory. Notwithstanding, let us stress at the outset that the Commission is right on one important point: the economic crisis into which the pandemic has plunged us makes public intervention and support for investment and businesses indispensable to avoid lasting losses of jobs and productive capacity. However, we do not agree with the consequence the Commission is drawing out of it: that the Facility must support reforms and investments that “unlock” and “strengthen” growth potential, but it only has to “contribute to integrating climate action and environmental sustainability”[1]. On the contrary, we believe that the plan as a whole must be primarily oriented to the fight against climate change and in so doing contribute to the creation of sustainable jobs.

Is this only a semantic quarrel? We do not think so. As the French High Council for the Climate underlined in its 2020 report: “The challenge is not to integrate the climate into the framework of the recovery plan, but to insert the recovery plan within the limits of the climate”. Importantly, the evaluation criteria will not be the same in the two cases. In the former, we first look at growth and set a minimum for “green investments”. In the latter, we first look at ecological transformation to prioritize sustainable job creation.

But, what are we really talking about? Growth of what exactly? Strangely enough, without even spelling it out in a legally binding text, it seems to go without saying that it is about the growth of the Gross Domestic Product (GDP), that is to say, the value of the productions carried out on the national territory. Against all odds, this indicator remains the lighthouse of economic policy. Criticisms of this indicator are however accumulating.

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[1] Recitals 5,6, and 11 of the Proposal for a Regulation establishing a Recovery and Resilience Facility

A first criticism, taken up in the 2009 Stiglitz-Sen-Fitoussi report, shows that GDP is not an indicator of well-being for many reasons. Among these reasons is the focus on production rather than consumption. It is also worth noting that GDP is indifferent to income distribution, patterns of social security and access to public services. It is a poor guide for public policy.

A second, more technical criticism concerns the calculation of "potential". It is possible, for a given period of time, to observe and quantify the value of what has actually been produced. Nevertheless, the margin of uncertainty is not negligible. Some productions are excluded by convention, for example because they are non-market or domestic. Others are hidden from statisticians because they are criminal and/or involve tax evasion. On the other hand, the production potential of an economy, what might or could have been produced, is an unobservable variable. It has to be calculated through theoretical models, not based on direct observations. It is therefore understandable that this calculation is questionable and regularly contested among economists, including in the context of European budgetary procedures (see Tooze, Output gap non-sense and Buti & al., Potential output and EU fiscal surveillance).

To these two criticisms, a third must now be added: in the fight against climate change, economic activities are not equal. Some contribute to reducing the carbon footprint and policies must favor them. Others are incompatible with climate objectives and policies must encourage them to disappear or be transformed to make them compatible with climate objectives.

The art of economic policy can no longer be to maximize the "potential growth" of GDP. It is now a matter of differentiating between activities to be supported and those to be suppressed. It is about maintaining a balance between these two movements, to reduce the social cost and to give everyone the chance of a decent job and income. The right indicator of a policy's success is, less than ever, potential growth, but rather the speed of the transformation of production, the speed of the reduction of carbon dependency and the social and political acceptability of this transformation. No one can really predict how precisely this transformation will translate into a GDP growth figure. But it shouldn't matter. European economic policies should target carbon neutrality in 2050 and in any case remain within the limits of dictated by the climate.

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