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Reforms and Investments
The Benefits of Joint Implementation

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Abstract

The joint implementation of structural reforms and investments has gained traction in policy initiatives and recommendations, including those aimed at supporting productivity growth and the competitiveness of the European economy. This brief collects arguments, grounded in economic theory and empirical evidence, supportive of investment-reform complementarity: (i) reforms can improve the efficiency of public investment spending by improving the government's administrative capacity; (ii) structural economic transformations require reforms and investments to rebalance incentives and modernise the economy's production structure; (iii) reforms can help crowding in private investment; (iv) jointly implementing reforms and investments may improve macroeconomic stability; and (v) investment (funding) can act as material incentive facilitating the implementation of politically costly structural reforms. Depending on the policy area, the nature of reform-investment complementarity may vary.

JEL classification: D20, E22, H50.

Keywords: Investment, structural reforms, absorption, incentives, crowding-in, stabilisation.

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INTRODUCTION

Structural reforms and investments have often been mentioned in conjunction in recent years. Within the EU, Member States' Recovery and Resilience Plans (RRPs) under the Recovery and Resilience Facility (RRF) include reforms and investments, with progress on both dimensions measured by the fulfilment of milestones and targets. The EU's revised Economic Governance Framework stipulates that growth-enhancing reforms and investments shall be taken into account when assessing fiscal plans, given the potential of reforms and investments to address EU priorities and country-specific recommendations and to enhance the economy's growth potential and resilience, leading to a structural improvement in government finances over the medium and long term.

The report by Mario Draghi (2024), as final example, presents a large number of proposals for structural reforms coupled with large investment needs to close the EU's innovation gap, reconcile decarbonisation with competitiveness, and strengthen European (economic) security. The economic policy agenda of the new European Commission's, presented in the Political Guidelines (2024) and the Competitiveness Compass (2025) also combines both elements.

The combination of reforms and investments in policy strategies and individual initiatives could be coincidence, highlighting two dimensions along which progress is needed at the same time. Reforms and investments may also interact as part of an "optimal" policy package, however, in the sense of one element amplifying the impact or improving the chances of success of the other. The purpose of this brief is to discuss instances of reform-investment complementarity. As investment in the context of the RRPs and the EU's fiscal governance framework refers to public investment and given that private investment is an endogenous variable outside the direct control of policy makers, we focus on the nexus between structural reforms and public investment.

There are, broadly speaking, five cases of reform-investment complementarity that one can distil from the academic and policy literature and that suggest benefits from a joint implementation of reforms and investments: (i) reforms can improve the efficiency of public investment from the administrative perspective; (ii) both reforms and investments are necessary elements of structural change; (iii) reforms can help crowding in private investment to complement public capital formation; (iv) joint implementation of reforms and investments (fiscal-structural "policy mix") may improve macroeconomic stability; and (v) investments as material incentive may facilitate the implementation of politically costly reforms.

In the context of the RRF, European Commission (2023) refers to reform-investment complementarities, noting that reforms "are typically designed to have an enabling effect for both public and private investments, by setting the right framework conditions, removing absorption bottlenecks, addressing labour market mismatches and skills shortages, and improving the overall business environment." This brief discusses the rationale in more detail, including - without claiming completeness -references to relevant research and policy publications.

REFORMS AND PUBLIC INVESTMENT EFFICIENCY

The first nexus between structural reforms and public investment focuses on the *administrative and institutional capacity* of governments to effectively manage public investment projects and maintain the stock of public capital. Important elements are the ability to take political and implementing decisions, including rules for cost-efficient public procurement, and the proper monitoring of contract fulfilment. Public sector reforms that strengthen the administrative capacity and accountability of government, e.g. by improving skills, transparency, and anti-corruption safeguards, have a direct impact on governments' ability to efficiently deploy available funding.

European Commission (2021) stresses the need for Member States to improve their administrative capacities to reap the economic and social benefits of RRF and other EU funding. Reforms that relate to

the public sector account for more than half of the reform measures in the RRPs (Graph 1).[1] Research in Santos et al. (2025) finds institutional characteristics to affect the absorption speed of EU cohesion funds at the regional level. To strengthen the administrative capacity, Member States have, in the context of the RRPs, recruited additional staff, provided operational support to relevant governance levels and actors, and simplified administrative procedures, including via IT systems to manage and monitor implementation; challenges remain, e.g., concerning procurement frameworks and recruitment procedures (ECA 2024).

Graph 1: **Reform measures in the RRF by policy area, EU27 aggregate**

Note: The size of a given box illustrates the share of RRP reform measures tagged to the particular category. The calculation covers both primary and secondary policy taggings to link individual measures to the areas of public sector reforms. "Rest" refers to reforms not directly linked to the public sector.Source: European Commission.

Linking public sector reforms and public investment efficiency resonates with the large literature on the importance of institutional quality for long-term economic growth via TFP, investment, and employment (Garcia et al. 2024), and macroeconomic policy transmission (Emter et al. 2024).[2] Reforms, in this logic, must be commensurate to the funding, and address the administrative or regulatory bottlenecks to the envisaged investment (Bańkowski et al. 2024).

The concept of *absorptive capacity* connects with this aspect of investment-reform complementarity. Absorptive capacity, in a broad sense, refers to an economy's capacity to absorb available funding efficiently, i.e. to invest in projects with an acceptable rate of return (Adler 1965). This ability depends on the sufficient availability of complementary factors, such as private investment, knowledge (technology, data), labour, and skills. The higher the acceptable rate of return, the lower the associated absorptive capacity of the economy tends to be.

[1] For a detailed discussion of the investment dimension of the RRF, see Michels et al. (2025).

[2] The analysis by Emter et al. (2024) finds that contractionary monetary policy shocks have stronger impact on medium-term growth risks in euro area countries with weak institutional quality, implying risks of asymmetry in the policy transmission across the euro area.

In a narrower sense, absorptive capacity refers to the ability of the different levels of government to deploy available funding. This ability depends on administrative capacities, including institutional design and managerial experience, and the ability to fulfil co-financing requirements.[3] This narrow definition, targeted to public investment, is the one used, e.g., by ECA (2024), defining absorption in the context of the RRF as EU funding paid out to Member States.

The concept of absorptive capacity has received widespread attention in development economics. Keefer and Knack (2007) find that countries with weak institutions tend to have higher GDP shares of public investment. They associate the finding with attempts to distribute rents to government officials and their cronies through public contracts, emphasising the *quality* of investment as an important aspect when assessing economy-wide effects and the importance of institutional quality for the efficient use of public resources.

The results in Presbitero (2016), based on a large dataset of World Bank investment projects, suggest that with limited absorptive capacity (in terms of skills, institutions, and management) countries are unable to efficiently scale up public investment projects and translate the additional investment into sustained output growth. Gurara et al. (2020) focus on a large sample of infrastructure projects (road construction) in developing countries. They uncover a U-shaped relation between the size of public investment projects and project cost inflation (unit cost overruns), equally suggesting a limited capability of public administrations to scale up public investment.[4]

STRUCTURAL TRANSFORMATIONS

The second argument linking investments and reforms is the observation that far-reaching economic transformations tend to require a combination of the two to re-orient the productive infrastructure (capacity building) and adapt the "rules of the game" (incentives) for a self-sustained transition, or, in the typology of André and Gal (2024), to jointly address incentives and capabilities. Positive externalities (provision of public goods, innovation spillover) justify a public investment component or public support to private investment in this context.

An important example is the decarbonisation of economic activity ("green transition"), which requires large investments for a stable supply of low-carbon energy (including energy generation and distribution networks), improved energy efficiency, and the deployment of abatement technologies, as well as *incentives* shifting demand (including emission pricing, and energy pricing models to improve demand flexibility and mitigate price risks in the longer term).

Similarly, the digitalisation of public services and private sector activities requires infrastructure investments (ICT) as well as new legal frameworks and provisions regulating questions of safety and data protection, liability, and property rights, and issues pertaining to competition and competition policy enforcement.

Concerning labour market policies, as final example, reforms strengthening incentives to join the labour force (looking for a job) and take up employment may be complemented by reforms of and investments into public employment services (PES). There are clear synergies from combining these reforms and investments. Reforms of the benefit system, e.g., may increase labour supply, whereas the PES reforms

[3] Co-financing requirements intend to incentivise a productive use of external funds for public investment by obliging the country, region, or local authority to top them up with (scarce) own resources. Co-financing rules are disciplining devices, but they also constrain the disbursement of available external funding even where productive use could be made.

[4] Difficulties to scale up public investment projects could also be related to sectoral supply bottlenecks and economy-wide shortages (see the "macroeconomic stability" section), but the authors control at least partly for these factors, shifting the focus to governance and institutional quality.

and investments aim at improving the matching of job seekers to job opportunities. Box 1 provides cases of past labour market reforms in EU Member States that have combined such reforms and investments.

Box 1: **Examples of labor market reforms and complementary investments in EU countries**

Facing high unemployment during a sustained period, the German government introduced significant labour market reforms between 2003 and 2005. Important components included reforms of the unemployment and social benefits system, reducing its generosity and increasing the incentives for beneficiaries to search for employment. At the same time, the public employment services (PES) were revamped by a combination of reforms and investments, leading to the creation of the Federal Employment Agency (Bundesagentur für Arbeit), integrating employment and social services, and developing a management structure that incentivised job placement on the side of the PES. The reforms contributed to a marked improvement of the performance of Germany's labour market, including increased labour market participation and employment, and improved labour market matching (Burda and Seele 2020, Ehrlich et al. 2018, Fahr and Sunde 2009, Jacobi and Kluve 2007).

In the context of the Global Financial Crisis (GFC) and the euro area souvereign debt crisis, many EU Member States had to address significant fiscal and external imbalances and surging unemployment at the same time. Within its Economic Adjustment Programme, Ireland reduced unemployment and other welfare benefits, reversing a prior trend of significant increases over 2000-09 and increasing incentives to seek employment (overcoming so-called inactivity and unemployment "traps"; European Commission 2011a and 2011b). While the reforms achieved public savings and addressed some structural problems, the programme left Ireland's social safety net broadly unchanged (European Commission 2015). Instead, a fundamental reorganisation of the PES and the further education and training (FET) system took place at the same time, involving significant resources and investments. These investments included the rollout of "Intreo" offices, single contact points for income and employment services, as well as the development of activation policies. In addition, the number of case workers at the PES was boosted, and private service providers were contracted to contribute to the handling of surging unemployment and reallocation needs (European Commission 2013).

More recently, France has adopted reforms to both its unemployment insurance system and the PES in the framework of its Recovery and Resilience Plan. The reforms of the unemployment benefit system included both elements of increasing coverage (to the self-employed) and measures to incentivise job search (e.g., a modified formula to calculate benefits, and a reduction of the generosity of benefits after six months for workers with high previous earnings and, hence, relatively high levels of benefits; European Commission 2022). In addition, France introduced significant reforms to its PES (since 2024 France travail, previously Pole emploi). The measures included a better integration of employment and social services, improved diagnostics of job seekers' situation and needs, and targeted support for vulnerable individuals including people with disabilities. The reform was also coupled with reinforced funding (European Commission 2024).

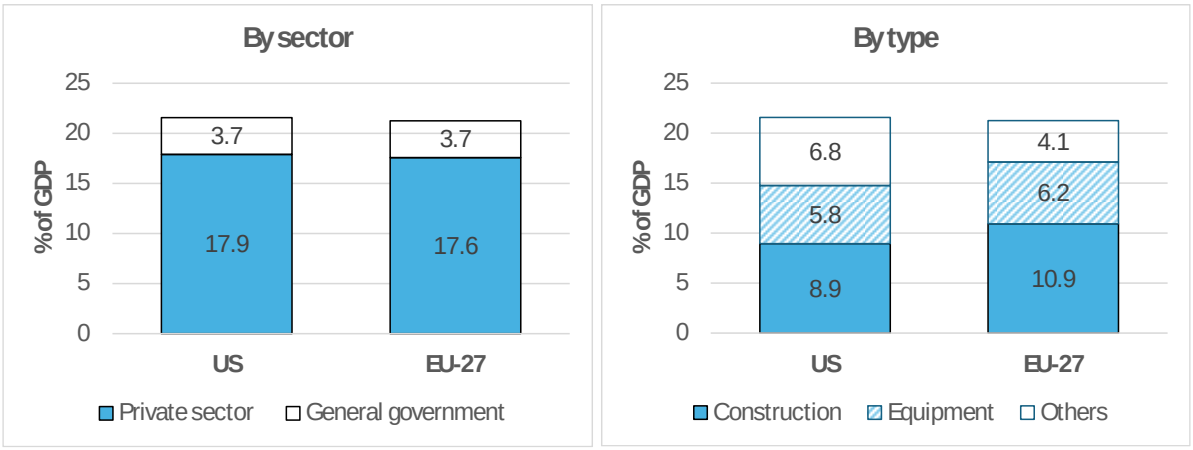
This Box has been contributed by Aron Kiss.

CROWDING IN PRIVATE INVESTMENT

The lion's share of investments in EU economies is private investment. Private investment accounted for more than four fifth and public investment for less than one fifth of the gross fixed capital formation in the EU27 in 2024 (Graph 2). The investment gap with the United States concerns in particular private intangible capital formation, including investment in R&D (e.g., Andersson et al. 2022, Gros et al. 2024). Policy makers also tend to agree that the the additional investment needed to foster productivity growth and advance the green and digital transitions must largely come from private sources. This is due also to the large financing requirements, as specified, e.g., in Draghi (2024), relative to the available fiscal

space, despite the well-justified role of public (infrastructure) investment to provide public goods and account for positive externalities from investments (e.g., Buti et al. 2025).

Graph 2: **Gross fixed capital formation as share of GDP (2024)**



Source: AMECO.

In addition, the output multiplier of public investment depends on the availability of complementary factors, including private capital. In textbook models, government spending tends to crowd out private sector investment through an increase in real interest rates when the economy operates close to capacity. Public investment has less of a tendency to crowd out private spending, especially in the medium and longer term. The reason is that productive public capital is a *productivity shifter* that improves the marginal return to private capital, hence lifting private investment demand.[5]

By implication, output multipliers of government investment tend to be higher than those of non-productive government purchases. Baxter and King (1993), and Leeper et al. (2020), e.g., provide model-based illustrations, and Matvejevs and Tkacevs (2022) empirical evidence on the crowding-out versus crowding-in of private sector investment in response to fiscal policy shocks. For a sample of 17 OECD economies (1985-2013), Abiad et al. (2016) show that the crowding-in of private investment by public one is stronger in periods of economic slack and increasing with the efficiency of public investment.

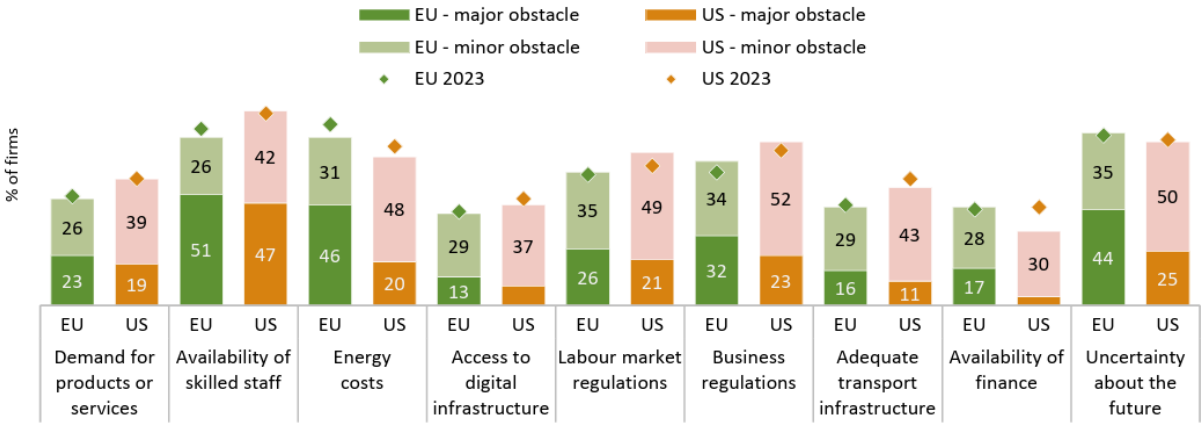
In theory and in practise, public investment is, hence, more likely than non-productive government spending to crowd in private investment. The crowding-in can be hampered by barriers to private investment, however. Those barriers include the access to financing, regulatory complexity, and compliance costs. Well-developed administrative capacity, by contrast, can streamline application, permitting and screening processes, thus reducing project delays and uncertainties that would tend to hold back investment otherwise (Filip et al. 2025).

The EIB Investment Survey 2024 highlights skill shortages, energy costs, and general uncertainty as major obstacles to corporate investment, cited by around half of the surveyed firms in the EU as factors holding back investment projects, followed by business and labour market regulations (Graph 3). Beyond fiscal incentives, structural reforms that address these bottlenecks (e.g., regarding the availability of complementary inputs, regulatory complexity, and the access to finance) give rise to reform-investment complementarity in the sense of supporting the crowding-in of private sector investment, improving the

[5] Public capital is usually modelled as an exogenous non-rival input (public good), combined with firm-level private capital and labour to produce firm-specific output. It therefore acts as productivity shifter like total factor productivity (TFP), increasing the return to private capital and labour. A mechanical crowding-out of private by public investment would be possible, instead, where the government takes over activities previously supplied by the private sector.

efficiency of capital allocation, and increasing the output multiplier of government productive spending as a result.

Graph 3: **Obstacles to private corporate investment in EU and US – EIB Investment Survey**



Note: Answers to the question: "Thinking about your investment activities, to what extent is each of the following an obstacle? Is it a major obstacle, a minor obstacle or not an obstacle at all?" Firms across all industries. Data not shown for not an obstacle at all/don't know/refused responses.

Source: EIB (2024).

Concerning "non-monetary" factors, empirical research has established a negative impact of regulatory constraints and complexities, in particular, on the incentive for businesses to invest and innovate (e.g., Alesina et al. 2005; Dawson and Seater 2013; Coffey et al. 2020), with the potential to also dampen total factor productivity (TFP) growth (Aghion et al. 2023).[6] Alesina et al. (2005) illustrate the impact of regulatory reform on private investment and attribute an important supportive role to market entry liberalisation. Dawson and Seater (2013) report a negative impact of regulatory complexity, measured by the volume of legal texts, on TFP, capital and employment. The survey by Masuch et al. (2018) underscores the importance of administrative and judiciary efficiency (legal certainty) for investment in general and, particularly, for foreign direct investment (FDI). In line with the EU-US comparison (Graph 2) and the discussion in Gros et al. (2024), particular attention may be paid to policies and reforms that support investment in intangible capital and particularly R&D.

De Santis et al. (2022) discuss implications of NextGenerationEU (NGEU) *funding* for private investment and link the potential for crowding-in to: (i) the public (NGEU) investment in infrastructure (transport and communication) that better connects rural areas, making them more attractive for private investment, (ii) the fact that EU funding often goes to underdeveloped sectors of the economy, including advanced technologies, where returns may be high and attract additional investors, and (iii) co-financing, which requires additional public or private investment at the national level. Results in de Santis et al. (2022) for the European Structural and Investment Funds (ESIF), based on a panel of 28 EU Member States during 1994-2018, suggest that, overall, €1 of ESIF spending is associated with €2 of private investment over a two-year horizon.

[6] Bombardini et al (2024) provide a survey on how to measure the costs and benefits of regulation. While regulatory constraints and complexities affect the investment costs and have, as such, a monetary equivalent, they are not direct and transparent financial incentives comparable to investment subsidies or corporate tax reduction.

Draghi (2024), Letta (2024) and the Commission's Competitiveness Compass (European Commission 2025) have emphasised the need for completion of the Capital Market Union and the Banking Union and the further deepening of the Single Market, including through a 28th regime for corporate law, as EU-level action to support private investment, combined with regulatory streamlining, corporate tax reform, and a general improvement of framework conditions for businesses at the national level. Box 2 summarises results on reform-related crowding in of corporate investment from macroeconomic model simulations.

Box 2: The impact of structural reforms on corporate investment

Empirical research has illustrated how regulation, especially the regulation affecting market entry and exit, and access to finance, expected returns, and financial incentives affect investment decisions of the corporate sector (e.g., Aghion et al. 2022, Alessina et al. 2005).

Empirical studies tend to focus on reforms directly targeted at supporting private-sector investment. Other structural policies may also affect investment indirectly, however. The corporate investment response to a larger set of structural policy measures can be illustrated through macroeconomic model simulations where corporate investment is an endogenous variable reacting to all sorts of shocks (e.g., Pfeiffer et al. 2024):

- Reducing market entry costs for firms and product mark-ups (often a proxy for more competition, increasing the substitutability between product varieties and, hence, lowering steady-state profit margins) increase private investment already in the short term in line with the empirical evidence.
- Investment subsidies and corporate tax cuts increase the expected net return on investment, which also increases private investment demand already on impact, but with a fiscal cost.
- Reforms that increase labour supply (such as a tax shift from labour to consumption, benefit system reforms, and measures increasing the labour market participation of second earners) have a positive long-term effect on private investment because they increase the marginal return to capital. The same is true for improvements in the skill level of the labour force (human capital). Investment demand may contract in the short and medium term, however, if the substitution effect dominates. When price rigidities hold back aggregate demand, an increase in labour or skill supply (which also reduces the real wage) will lead to substitution of physical capital by labour and/or human capital that would temporarily reduce corporate investment demand.
- R&D policies, such as R&D subsidies, strengthen private R&D investment, but may temporarily reduce corporate investment elsewhere. If aggregate demand does not catch up with the innovation-led increase in potential output, the same amount of goods and services can be produced with less capital, which would dampen investment demand in production temporarily.

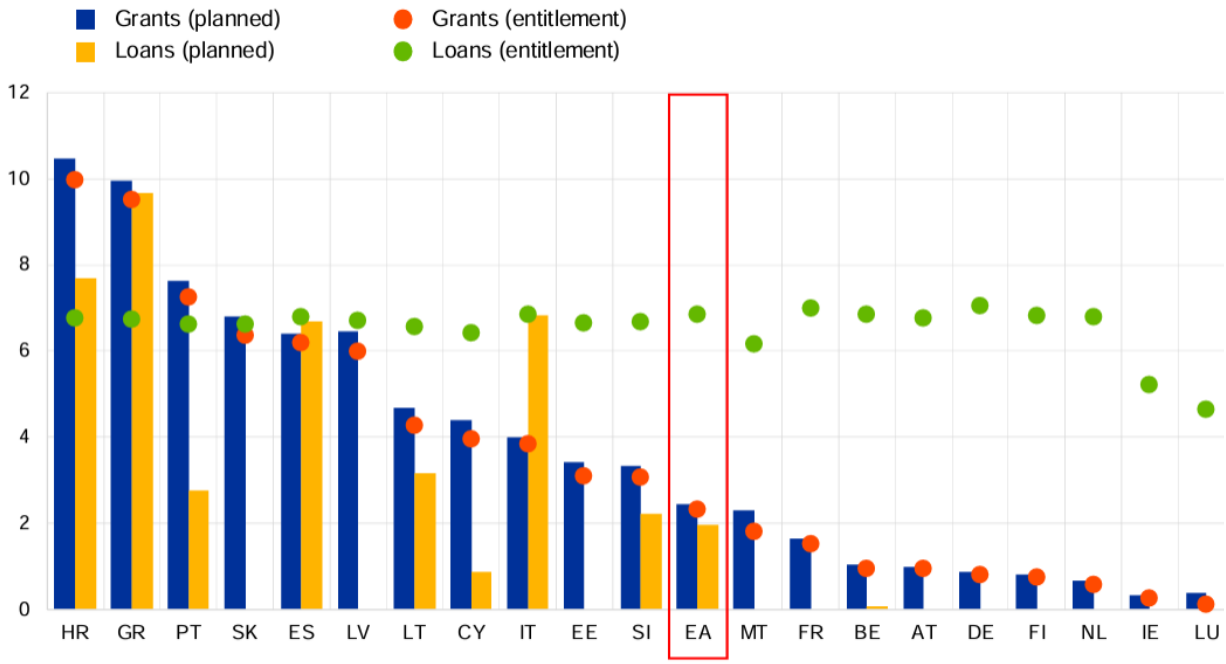
The impact of credit market frictions, with access to credit depending on the value of collateral, on investment and the volatility of investment demand over the business cycle has been analysed in macro models since the pioneering work of Bernanke et al. (1999), and Kyotaki and Moore (1997).

MACROECONOMIC STABILITY

Public and private investments build the economy's capital stock, which is an important determinant of its future potential output. Investment is also part of aggregate demand, however, which tends to dominate its impact on the economy in the shorter term. An increase in public investment, possibly complemented by crowding-in of private investment, can be interpreted as a positive shock to aggregate demand. If sufficiently large, investment shocks can be macroeconomically relevant, in the sense of significantly affecting the level of capacity utilisation and inflation dynamics.

The estimate in Draghi (2024) of additional investment needs of around 5% of GDP per year over the medium term is certainly macro relevant. The same is true for the RRF, where available funding is large in relation to domestic GDP for several EU Member States (Graph 4).

Graph 4: **RRF grants and loans allocated to euro area countries (% of 2019 GDP)**



Note: "Entitlements" refer to the maximum amount of RRF grants and loans that each Member State may use, as specified by the European Commission in June 2022. "Planned" refers to the amounts specified by each Member State in its revised RRP. Planned loans may exceed entitlements (GR, HR) if requests can be justified by exceptional circumstances, endorsed by the Council. Grants are (slightly) higher than grant entitlements for several countries due to the inclusion of REPowerEU chapters.

Source: Bańkowski et al. (2024).

A macro-relevant investment shock shifts the aggregate demand (AD) function in Graph 5 to the right. In the normal case (left panel), the shift leads to an increase in output and inflation (the economy moves from A to B). The steeper the supply curve, the weaker is the output effect and the stronger the inflation response. Structural reforms that improve supply conditions shift aggregate supply (AS) outwards, dampening the inflation effect and amplifying the output expansion (C).

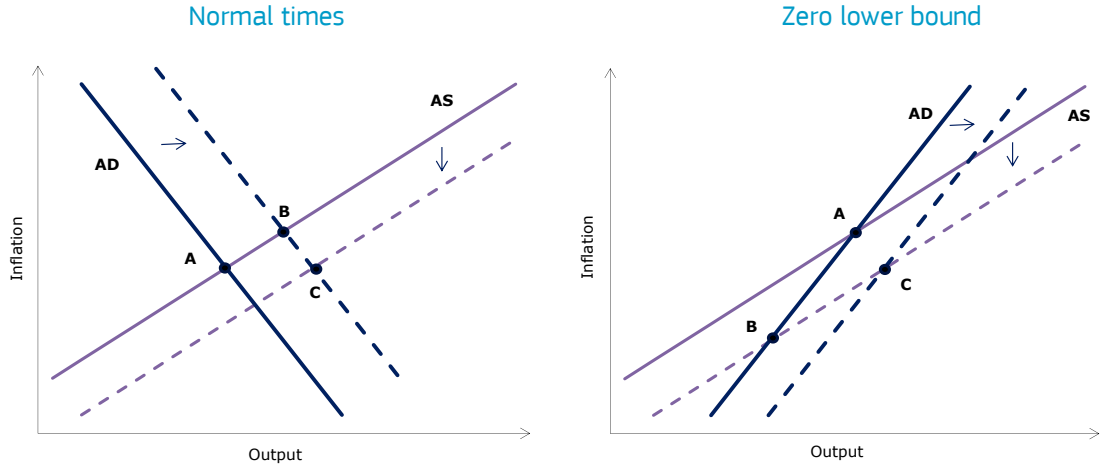
Structural reforms can, hence, help stabilising price level dynamics in a situation of strong aggregate demand, which, in turn, reduces the need for monetary policy to tighten demand in order to control inflation. Reforms susceptible to shift the AS curve are those that increase labour supply and the skill level of the labour force, reduce the costs of doing business (e.g., regulatory simplification), strengthen competition to reduce corporate market power, and foster TFP growth through innovation and technology diffusion to improve the efficiency of input use.

The joint AD-AS expansion also dampens transitory adjustment costs associated with nominal rigidities in the economy (nominal price and wage stickiness). It also implies less reallocation of resources across sectors compared to a situation where reallocation is the only way to match a particular increase in

demand. Finally, supply-side adjustment has gained importance for dealing with country-specific (asymmetric) demand shocks in EMU given the common monetary policy (Masuch et al. 2018).[7]

Macroeconomic shock transmission changes at the zero lower bound. Eggertsson et al. (2014) argue that the aggregate demand curve becomes upward sloping at the zero bound (right panel of Graph 5). The reason is that with nominal interest rates "trapped" at the lower bound, inflation lowers the real interest rate, which stimulates aggregate demand. The implications of an outward shift of AS change in this context, with the economy moving to a new equilibrium with lower inflation and lower levels of economic activity (from A to B). An outward shift of AD, caused, e.g., by a positive investment shock, can help shifting the economy to an equilibrium with higher activity and more stable inflation (C). Hence, in the Eggertsson et al. (2014) model, the logic of investment-reform complementarity changes direction. At the zero bound, the emphasis is not on increasing AS to match an increase in AD, but to increase AD to dampen negative implications of an AS outward shift.[8]

Graph 5: **Short-term effects of demand and supply shocks**



Source: Based on Eggertsson et al. (2014).

Further than stabilising short-term output-inflation dynamics, complementing investment by supply-side reform can also improve macroeconomic conditions with respect to the long-term sustainability of debt. As shown by Motyovszki et al. (2024), public investment is generally not self-financing (no "free lunch"), i.e. not generating additional tax revenue at the level of or above the initial spending on investment. Structural reforms that raise potential output can contribute to improving public debt sustainability in

[7] There are, of course, other policy goals of structural reforms besides macroeconomic stability, including allocative efficiency and distributional objectives. Macroeconomic implications may often be rather a side effect. Blanchard and Giavazzi (2003) have focussed on the appropriate sequencing of reforms to contain negative distributional implications and increase political acceptability; see also Berger and Danninger (2005).

[8] The Eggertsson et al. (2014) case of contractionary structural reforms is a theoretical possibility. Its practical relevance is attenuated by the investment and exchange rate channels absent in the simple theoretical model (Vogel 2017). Regarding private investment, the higher expected future returns associated with supply-side reforms should stimulate investment demand. Regarding openness, deflationary effects of supply-side reform depreciate the real effective exchange rate, which improves trade price competitiveness. Empirical evidence in Bouis et al. (2012) does also not support the view that reforms should as a rule be accompanied by monetary or fiscal policy easing to deliver short-term gains, except for tentative evidence that some labour market reforms (e.g., of unemployment benefit systems and job protection) pay off more quickly in good times than in bad times and can entail aggregate short-term losses in severely depressed economies.

the medium and long term through positive tax base effects. In this sense, reforms can create "fiscal space" for public investment.[9]

CARROTS AND STICKS

The political economy literature argues that the sluggish implementation of socially beneficial structural reforms is in many cases due to strong opposition from vested interests and from those fearing to incur welfare losses (Masuch et al. 2018). When structural reforms are costly, e.g., in terms of adjustment frictions, redistribution, and political popularity, combining them with financial support can provide incentives and increase the chances of implementation. Financial support could address cost factors, directly, or build policy packages with net gains for different actors.[10]

Boyer et al. (2024) argue that the decision to raise public debt plays a key role in shaping the political incentives around reform implementation. In particular, they argue that socially beneficial reforms are more likely to be implemented if debt can be raised for targeted spending to overcome resistance, i.e. public debt facilitates reform implementation by enabling politicians to smooth transitory costs over time. Cost smoothing could take the form of direct compensations (transfers) to affected households. Alternatively, it could consist of public investments that also benefit affected groups and regions (e.g., targeted investment in human capital and infrastructure). Productive government spending that also increases the size of the tax base has the advantage of facilitating the repayment of government debt in the future.[11]

Even less fiscally costly for national governments is external financial support in the form of grants or loans at favourable conditions. In a way, this is built into the RRF. By linking direct financial support to investments and structural reform implementation, the RRF provides incentives for Member States to make their economies more resilient and sustainable (Aphecetche et al. 2022). The idea of linking, in the future, financial flows from the EU budget to Member States to the implementation of priority reforms and investments goes in the same direction, including public sector reform to improve the efficiency and transparency of public spending, the rule of law, or the fight against tax evasion.

An illuminating example from history is the Marshall Plan for post-WW II recovery in Europe. De Long and Eichengreen (1991) argue that the financial aid of the Marshall Plan helped cushioning the distributional conflicts that could otherwise have delayed the economic restructuring on which the aid was conditioned, and which helped European economies to restore financial stability and move from heavy State interventionism to a more market-based system, with beneficial implications for the crowding-in of private investment.

[9] That said, public investment (e.g. infrastructure and public R&D) is certainly an expenditure category with a relatively high fiscal mulitiplier and, by implication, more benign consequences for public finances compared to consumptive spending and average transfers, due to its positive long-term productivity and growth effects (e.g., Antolin-Díaz and Surico 2025, Auerbach and Gorodnichenko 2012, Baxter and King 1993, Leeper et al. 2020). The public finance implications of government spending also critically depend on the interest-growth (r-g) differential (e.g., Blanchard 2019, Motyovszki et al. 2024). EU economic governance therefore puts particular emphasis on the composition ("quality") of investments to improve their overall return, which in turn increases the countries' ability to add to its capital stock in the future as investment costs are lower in "net terms".

[10] Empirical evidence on the political costs of economic reforms is discussed and summarised in, e.g., Ciminelli et al. (2019).

[11] This requires, of course, public investment to be sufficiently productive at the margin as discussed above and, in detail, in Motyovszki et al. (2024). As mentioned, one must be mindful about the structure and quality (efficiency) of additional investments in this context, also since from a comparative perspective (% of GDP) Europe does not appear to suffer from too little government investment overall (Graph 2). Financial incentives to private investment can be an alternative where they are likely to generate higher aggregate yields, which should then also be reflected in positive tax base effects. Berg et al. (2015) provide a detailed discussion on public investment efficiency and the marginal return to public capital.

CONCLUSIONS

The joint implementation of structural reforms and investments has gained traction in policy design and policy recommendations, including those aimed at fostering productivity growth and the competitiveness of the European economy. This brief has collected five arguments pointing to complementarity between public sector investments and structural reforms:

(i) Public sector reforms improve the efficiency of public investment spending (absorptive capacity).
(ii) Structural economic transformations tend to require both reforms and investments in order to rebalance incentives and modernise the economy's production structure.
(iii) Reforms can increase the economic impact of government spending by crowding in private investment.
(iv) The joint implementation of reforms and investments may improve macroeconomic stability by shifting aggregate supply together with demand, thereby mitigating inflation pressure, reinforcing the positive output response, and improving the sustainability of public debt.
(v) Investment (funding) can act as material (financial) incentive facilitating the implementation of politically costly reforms.

Each aspect of reform-investment complementarity relates to specific reform areas. Improving public spending efficiency and absorption capacity, e.g., relates to improving the administration's ability to manage and oversee projects. Reforms for structural transformations tend to have a focus on specific sectors or activities (e.g., energy, or digital services). The crowing-in of private investment, by contrast, relies on firms' access to finance and sufficient investment incentives, shaped by the availability of complementary factors of production (labour, skills, intermediate inputs), expected returns (affected, e.g., by corporate taxation), regulatory simplicity, and economic risks. The macroeconomic stability aspect relates primarily to reforms that increase potential output, including measures to strengthen labour supply and employment, skill levels, innovation, and technology diffusion, and by reforms reducing adjustment frictions. The political economy perspective, finally, argues that investments and related funding facilitate the implementation of politically costly reforms, i.e. reforms with important distributional implications or significant up-front restructuring costs.

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