EU RECOVERY PACKAGE IMPLEMENTATION

HARALD WAIGLEIN

Director General for Economic Policy, Financial Markets and Customs Duties, Federal Ministry of Finance, Austria

RRF will address structural reform needs, but key problems remain unresolved

The European Recovery Instrument, with the Recovery and Resilience Facility (RRF) at its heart, provides an unprecedented opportunity to foster structural reforms in Member States, while addressing investment needs of the green and digital transition. A lot depends on the EC's guidance to Member States during the preparatory phase, in particular the extent to which the EC insists on ambitious reform agendas, on the one-off nature of expenditures included in Recovery and Resilience Plans (RRPs), their relevance, effectiveness and efficiency, and the way the DNSH principle is applied.

Our impression so far is that the EC takes its job very seriously, steering national authorities towards making the best of the use of the funds, including via structural reforms, and pointing to areas in which further work needs to be done to make the Plans eligible for financing. We are thus confident that the RRF addresses the short-term economic priorities resulting from the pandemic, and medium- to long-term structural challenges identified during the past two years, including the green and digital transition.

Three factors support our view that the conditions are in place for effective use of RRF funds: First, the EP has taken an important role in improving the governance framework, addressing some of the weaknesses of the original proposal in the areas of monitoring the overall impact of the Facility on common EU targets. The Recovery and Resilience Scoreboard that is being developed by the EC until the end of the year will reflect to which extent RRF funds are living up to their expectations. Second, the EC seems to have learned from experience with the SURE Instrument, which unconditionally supports Member States' measures to protect incomes of workers and the self-employed during the COVID crisis.

> Once the recovery is on track, we have to focus attention on debt stocks, public and private.

Without doubt, many of the measures that are being financed via SURE would not comply with the criteria for RRF funding with regard to relevance, effectiveness and efficiency. The high level of detail in the RRF Regulation, together with the assessment criteria and minimum ratings, provide assurance that only the best projects can benefit from RRF funding. Third and perhaps most importantly, we all know that if the RRF goes wrong, the idea of a common budget is dead.

The governance framework is ambitious and promising, but also work-intensive. The preparation of high-quality national plans requires huge administrative efforts on the part of Member States and the EC. Given the many requirements for RRPs, not all national Plans may be ready for submission by end April. The pay-out of funds may thus be delayed. However, liquidity is not a major constraint to any Member State right now, and a somewhat delayed approval of RRPs shall not be a concern if this comes in exchange for high-quality plans.

Yet a fundamental problem of the euro area remains unresolved. That is extremely high levels of public and private debt in a number of Member States. The measures to address the fallout from the pandemic crisis are adding to debt stocks, while NGEU and the ECB's monetary policy are changing some of the parameters determining debt sustainability. Public support is imperative in the current situation, but we need to be mindful that the problem of high debt is being shifted into the future and partially onto the EU level. It will hit back at some point at the younger generations, who are at the same time taking the largest hit on their personal economic trajectories due to COVID.

Once the recovery is on track, we have to focus attention on debt stocks, public and private. Efficient insolvency mechanisms are key to avoid that capital remains trapped in unviable firms. We need to be aware that not all of the support that is being granted now, with or without EU support, will be used efficiently, as some firms may have been unviable even without COVID.

The urgency of support during the current crisis has not always allowed proper assessments of every firm, so there will be sunk costs that put pressure on public balance sheets. During the past decade, we have accumulated sufficient experience with unsustainable debt to image the potential consequences for individual euro area Member States. The fact that today's increases in debt stocks are policy-driven does not reduce the risk related to it. And markets will not be calm forever.

EMMANUEL MOULIN

Director General of the Treasury, Ministry of the Economy, Finance and the Recovery Plan, France

Delivering on the EU recovery fund

Right after the emergency response to the crisis, France, jointly with Germany, strongly advocated for an ambitious recovery fund to make Europe bounce back stronger than before the crisis. The Commission's proposals followed suit and their formal approval at the July 2020 European Council was a historical breakthrough and a step towards deeper economic integration of the EU in many regards.

Indeed, the Commission had already borrowed on financial markets in the past to on-lend the funds to Member States requesting financial assistance. The latter remained however entirely and ultimately liable for these back-to-back loans. With NGEU, the Commission will still issue bonds – though at a much larger scale - which means Member States will again benefit from the Commission's good credit rating.

Yet, this time, common indebtedness (through a temporary and exceptional increase of the own resources ceiling for tackling the Covid19 crisis) - combined with a long grace period before redemption of principal kicks in - allows for swiftly raising significant amounts of money to fund the recovery in the short term while only incurring the costs down the road when growth has returned and is solidly entrenched.

The other defining feature of NGEU is that 390bn€ out of the 750bn€ raised will be passed on to Member States in the form of grants via EU budget programs, and in particular via the new Resilience and Recovery Facility.

The allocation criteria ensure that the size of the shares each Member State will receive will depend, to some extent, on the severity of the crisis. As such shares may end up differing from the countries' eventual contributions to the reimbursement of these sums, this mechanism will lead to money transfers to the benefit of Member States most hit by the crisis.

However, several safeguards were attached to this mechanism to insure its legal soundness and political acceptability. First, the instrument is meant to be temporary, one-off and designed exclusively to deal with the effects of the Covid19 crisis. The introduction of new own resources to refund NGEU bonds will also be critical in avoiding an undesirable increase in Member States' contributions to the EU budget between 2028 and 2058. Second, the money will finance, to a large extent, investments in the green and digital transitions and reforms to boost resilience and competitiveness.

> The EU agreed on a borrowing-for-spending mechanism to tackle the Covid crisis. We must now strive to implement it thoroughly and swiftly.

In this respect, we now need a swift implementation of the RRF to ensure it effectively contributes to the recovery. This is the main challenge ahead and the clear priority. Third, the governance of the RRF was extensively discussed as part of the political agreement. The solution that has been crafted ensures that the Commission and the Member States have a say on the implementation of those measures, while ensuring national ownership in the design and the implementation of national policies. Respecting these principles is key to success.

The implementation of the RRF will help maintain a supportive fiscal stance in the coming years and achieve a more balanced policy-mix after the crisis. Indeed, in the wake of the 2010 sovereign debt crisis, the EU embraced fiscal consolidation too soon, hence hampering the return of growth.

This time, backed by the activation of the General Escape Clause in 2021 and its likely extension in 2022, Member States ought to keep in place support measures as long as necessary and coordinate fiscal policies to maintain an expansionary aggregate fiscal stance. The Commission should also address differentiated fiscal guidance to Member States namely to encourage those with fiscal space to invest in support of domestic demand.

Finally, we must foster strong and well-supervised European financial actors and deeper capital to help fund the recovery and also promote the international role of the euro. Therefore, we must strengthen the Capital Markets Union by simplifying and bringing closer our 27 legal frameworks and make our Banking Union more credible by simultaneously advancing crisis management, EDIS and cross-border integration.

The issuance of NGEU bonds is also an opportunity to create a euro-denominated safe asset which will help in propping up the international role of the euro.

JÖRG KUKIES
State Secretary,
Federal Ministry of Finance,
Germany

NGEU and RRF – Implementation will be key

In a historic step, EU leaders decided in July 2020 to establish the temporary European Recovery Fund Next Generation EU (NGEU) worth 750 bn Euro – more than 5% of EU GDP in 2019. In its autumn forecast 2020, the EU Commission showed that the EU package could contribute to a significantly quicker and more sustainable recovery, resulting in an up to 2% higher GDP in the coming years. The Recovery and Resilience Facility (RRF) is going to be the main distributing instrument of NGEU with a volume of up to 672.5 bn Euro, representing 90% of total NGEU.

The disbursement of funds is conditional on the implementation of reform and investment packages by Member States, set out in individual national Recovery and Resilience Plans (RRP). Member States are currently drafting their RRP that should be submitted to the EU Commission by end of April.

We are, hence, at a crucial moment of the RRF process. Member States should now set up ambitious plans in line with the conditions laid down in the RRF regulation. Those include in particular a climate target of 37% and a digital target of 20% of RRF funds. This means, in total around 250 bn Euro of the RRF will be spent on the green transition in the next years, and over 130 bn Euro on the digital transition. A big step towards making our economies more resilient and fit for the future. Furthermore, the RRF aims at strengthening economic and social cohesion while enhancing the growth potential in the aftermath of the crisis.

That requires a country-specific approach. Therefore, Member States will have to address their national challenges and priorities identified in the European Semester. Comprehensive national reforms in combination with investments in key policy areas create a unique chance to emerge substantially strengthened from the crisis.

> The RRF is the right instrument at the right time. Joint efforts are needed to make it work properly.

Challenges for Member States arise inter alia from the time constraints under which adequate reforms and investments need to be identified now. However, Member States that already took decisive steps towards their recovery before the creation of the NGEU (i.e. since February 2020) are allowed to include those in their plans. This will help to make funds flow as soon as possible.

Meeting predefined milestones and targets is a prerequisite for the payout of the funds. Given the highly uncertain economic outlook as well as internal imponderables, including possible bottlenecks and absorption problems, there is a risk that some of them might be missed, especially further down the timeline.

However, timing is key to support the recovery effectively. That is why all funds have to be allocated by the end of 2023 and disbursed by the end of 2026. Member States will have the possibility to update their national plans in 2022, when 30% of the RRF funds are newly distributed based on the latest economic data. While necessary, calculating plausible cost estimates and ensuring effective control and audit procedures is also not an easy task.

Against this background, it is important to minimize impediments for the proper functioning of the instrument wherever possible. This means inter alia, that milestones and targets should be defined in a way that avoid frequent amendments of the plans. Attention should also be paid to the administrative burden for Member States when drafting their plans and implementing their projects. At the same time, this is precisely the moment for Member States to not only invest but also address reform bottlenecks.

Member States can make requests for payments twice a year, leading to up to over fifty requests per year. Given that, it will be important, that the Commission and the Economic and Financial Committee (EFC), representing the Member States, handle the assessment of the requests in a pragmatic way. The fact that the process builds on well-established structures of the European Semester should help in this regard.

The EU recovery package is the right instrument at the right time. Making the best out of it requires joint efforts from all sides.

GERT-JAN KOOPMAN
Director-General,
DG Budget, European Commission

Making the recovery work: NextGenerationEU as a game changer on the capital markets

2020 was an extraordinary year in EU policy making. The EU was hit by an unprecedented crisis. Politicians and policy-makers had to act quickly and comprehensively to find and offer solutions.

NextGenerationEU – a game changer

The EU provided a very concrete response. At the heart of this was an unpreceded €1.8 trillion package – backed by the EU budget - to support the economic recovery and build a greener, more digital and more resilient future. To finance a part of it - the €750 billion NextGenerationEU instrument - the EU will borrow on the capital markets.

The European Commission, on behalf of the EU, has been present on the capital markets for years. We have been running lending programmes to support EU Member States and third countries.

In 2020, the Commission also started borrowing for SURE – the up to €100 billion instrument to help protect jobs. As of mid-March 2021, we had raised 2/3rds of EU SURE funds in 5 very successful issuances. All EU SURE bonds benefit from the social bond label.

NextGenerationEU is a game-changer. With volumes of €150-200 billion per year, it will make the Commission one of the biggest issuers in euro, at par with the largest sovereigns.

Facing the growth challenges

This has called for a fundamental change in our approach. Given the volumes, frequency and complexity of the borrowing, the Commission will have to act like a sovereign borrower.

We will, therefore, implement a diversified funding strategy. This will allow more flexibility in the timing of funding transactions and the choice of funding instruments and maturities. As part of this, we will also be using short-term debt instruments – EU-Bills. Recourse will also be given to auctions as an issuance channel, in addition to syndication. The Commission intends to raise 30% of the funds as green bonds.

Our ambition is to have a regular presence on all parts of the yield curve with large, liquid and safe EU-Bonds.

In this way, we will be able to reconcile the demands and constraints of the NextGenerationEU funding, and deliver all funds as required on the most advantageous terms for the EU.

Next steps

The Commission intends to start issuing funds under NextGenerationEU in the summer of 2021.

For this to happen, two key conditions have to be met. First, Member States need to complete the ratification of the Own Resources Decision, the piece of legislation that will enable the Commission to borrow. Good progress is being made and we expect the process to be completed in due course. Second, for Member States to received funding under the €672.5 billion Recovery and Resilience Facility (RRF), their Recovery and Resilience Plans need to be submitted and approved, with all relevant details settled. The RRF accounts for 90% of the funds under NextGenerationEU, the rest will go to several EU programmes that will all be up and running in the summer. Once the plans have been approved, the Commission will be able to start disbursing the first funds.

The big picture

NextGenerationEU gives an ambitious answer to an unprecedented crisis. It demonstrates solidarity at difficult times. It has shown that the EU can and will stand together to face challenges. It will help transform our economies and societies for the better.

There is more. NextGenerationEU – building on the success of SURE – will turn the EU into a major player on the global capital markets. The EU bonds represent safe financial instruments in euro, which are appealing for international investors as we see in the huge oversubscription rates of our recent issuances. Financial market participants tell us that they will look at the EU-B yield curve as they price other paper. Should this materialise at scale, then the issuances will further the EU capital market integration. Finally, the bonds are making euro denominated paper a much more attractive investment destination and, in the process, strengthening the international role of the euro.

The EU SURE social bonds and the future NextGenerationEU green bonds are making the EU one of the biggest Environmental, Social, and Corporate Governance (ESG) issuers – which is inspiring others to choose this approach.

The big challenge now is to make all of this start on time. The Commission is working hard to that end – and we count on the support of all interested stakeholders. Together, we stand stronger.

IRENE TINAGLI

Chair, Committee on Economic and Monetary Affairs, European Parliament

Three challenges for the implementation of Next Generation EU

Next Generation EU (NGEU) has rightly been hailed as a paradigm shift in EU governance, or at least the first step that hopefully will not fade with the pandemic. NGEU is not just the money made available to Member States. It represents also a paradigm shift in terms of defining the cornerstones of future economic development and the role of public policies in the next decade.

There are three keywords to frame the NGEU method: programming, direct intervention, resource allocation. The accompanying documents of NGEU define a lot of detail required in the control and in the governance of the processes, and this represents an ambitious challenge for all Member States. National governments have to present national plans aimed at two objectives: recovery and resilience.

The first is a shorter-term objective that requires well-designed fiscal measures aimed to reduce as much as possible the economic and social damages created by the pandemic, and to restart economic activity. The second is a longer-term objective concerning the ability to favour structural changes in the economic system. Obviously, the two objectives, and the related tools, are and must be interconnected, but they also require diversified approaches and tools, and each will have to be evaluated with appropriate criteria.

I see three risks here. The first relates to the recovery. This recession is peculiar because it simultaneously affects the demand and supply side. But the implications for the recovery of this aspect - and of other no less relevant ones - are usually not adequately discussed. Attention seems to be focused almost exclusively on what are considered the structural problems pre-existing to the pandemic. This is not wrong, but it may not be enough if the specific structural effects of the recession on production methods, on the composition of aggregate demand or on expectations for the future are also hampering recovery. These new structural effects must also be considered.

The second risk relates to the link between recovery and resilience. Structural problems to be removed are rightly the core of the current discussion, but few seem to care about the intensity and speed of the effects such projects may have on economic recovery and their ability to remove the additional structural obstacles created by the recession itself. Delaying and weakening recovery can have devastating effects in the long run, especially for those young people to whom we all pay great attention.

> Recovery and resilience are and must be interconnected, but they also require diversified approaches and tools.

As numerous studies show, delayed entry into the labour market or an entry in a depressed state of the economy has negative effects on the entire (working) life of young people. This does not seem to be a secondary effect and it would be good to take it into account in a conscious and responsible decision-making process. Here our challenge is how to combine reform and recovery in national plans, and what is the best sequence of reform and recovery interventions.

The third risk relates to the long-run sustainability of the recovery. Too often we talk about recovery by focusing entirely on aggregate variables. However, this approach is insufficient and dangerous. If GDP returns to pre-crisis levels but inequality in income and wealth distribution is even greater than before the crisis, this risk jeopardizing the economic and social sustainability of the recovery itself, undermining the European long-term growth. Therefore, when preparing national plans, we should also take this dimension into account.

As European Parliament, over the next years, we will be vigilant to ensure that the Commission carries out the tasks assigned in appropriate ways so that the facility reaches its objectives, especially in terms of digital and environmental transformation, social impact and the Next Generation policies that we have envisaged for the Union.

RICARDO MOURINHO FELIX

Vice-President and Member of the Management Committee, European Investment Bank (EIB)

Challenges and opportunities of the new Recovery and Resilience Facility

The European Union's (EU) package for supporting the recovery of a European economy devastated by the coronavirus crisis is a very bold step. It is totally unprecedented.

The Recovery and Resilience Facility (RRF) will contribute to the EU's economic recovery, supporting productive public investment and the implementation of structural reforms. Despite being a temporary policy, the RRF impact should be a permanent oneand will contributeto an increase in productivity and to sustainable growth prospects. Governments and companies have the duty to seize this opportunity to change gears and foster a greener, smarter and more resilient economy for the EU citizens. A more inclusive economy with lower inequality and ready for the forthcoming challenges, leaving no one behind. This is an imperative!

The COVID-19 crisis led to an extraordinary financial support to the economy by EU governments, in the context of temporary waivers of the State Aid rules, and by central banks. These support schemes have taken the form of public guarantee schemes, debt moratoria and direct support to some firms via outright state aid. Central banks expanded their balance sheets further through asset purchase programmes ensuring the maintenance of liquidity, and micro- and macro-prudential supervisory rules for banks were temporarily loosened.

While this support has been crucial to keep the economy afloat, it has invigorated a debate on whether such policies are appropriately targeted at economically viable firms hardly hit by the crisis, or if their broad base may induce the risk of some "zombification" of the European economy.

Resources are scarce, so any support to the economy should be targeted at viable companies. Lending and supporting non-viable companies on the back of public guarantees erodes the public purse, artificially preserves firms with no future and retains their workers, instead of putting their productive capacity at the service of viable value-added projects. Support to companies should never be a substitute for unemployment insurance schemes, which were long ago designed to ensure a better job matching. Schumpeterian creative destruction is a critical part of a sound and competitive internal market and key for a green and smart recovery that boosts productivity, growth and generates well-being for our citizens.

The RRF paves the way for future growth by supporting innovation, promoting viable companies and, thereby, contributing to a green and smart recovery.

The RRF opens up new opportunities to leverage the scarce public resources. Achieving an effective and efficient allocation of resources is of the essence, and it is intrinsically linked to several factors.

Firstly, the rigorous selection of the most productive public investment projects and an effective implementation of reforms will determine the overall economic impact of the RRF. Secondly, the successful combination of the conventional EU programmes, as Cohesion policy, and the RRF and the institutional and administrative capacity of the Member States to put in place high impact projects quickly. Thirdly, additionality. The RRF funds must enable the deployment of investment projects that would not be possible to deploy otherwise. If RRF grants are simply used to finance investment that already has other funding sources or to crowd out private investment, then the RRF will simply be a missed opportunity.

The RRF Regulation provides the opportunity to deploy and use resources through financial instruments. Financial instruments increase the overall impact of the resources, thus fully unleashing the growth potential of the EU economy above pre-crisis levels.

The extensive experience of the EIB Group in delivering financial instruments and our technical assistance platforms can act as important levers for Member States to evaluate investment needs, assess barriers and setup the most adequate financial instruments. The advisory capacity of the EIB can support the design and the development of funds and financial instruments under RRF, including national recovery funds or the implementation of financial instruments through the national compartment of the Invest EU.

The EIB stands ready to provide its support, its expertise and its capacity to governments and companies that want to fully seize the opportunities of the new RRF. As the EU bank, we stand together with the other EU institutions to deliver on the Union policy priorities to grant citizens a future of Freedom, Solidarity and Prosperity.

VITTORIO GRILLI

Chairman of EMEA Corporate and Investment Bank, J.P. Morgan

Strengthening the internationalisation of the euro and the EU's future competitiveness through common debt issuance

The unprecedented EU recovery package was a milestone for deeper fiscal integration, with extraordinary measures enacted to support Member States grappling with the fallout of COVID-19. Common debt issuance is a potential game-changer for Europe's economic growth dynamics through the Recovery Fund, with the potential to strengthen the internationalisation of the euro and the EU's future competitiveness.

The recovery package's focus on investment could lift Europe out of secular stagnation. Average annual (inflation-adjusted) growth in EU investment declined from c.3.4% (1999-2007) to c.2.6% (2011-2019), whilst the euro-destabilising variance in investment across Member States has been even more dramatic across the same period. Italy, Greece, and Portugal have experienced negative average investment growth, and even France and the Netherlands saw a decline in investment growth of nearly half. The package could help hard-hit Member States improve levels of investment which could bring GDP growth in-line with the rest of the EU and thus strengthen the entire compact.

If the EU were inclined towards the creation of a "safe asset", common debt issuance could contribute to this goal, possibly facilitating ECB monetary policy. There is likely appetite for a safe asset since debt issued by highly-rated EU countries represented only c.29% of outstanding sovereign EU debt as of end-2020; with €750bn, that would increase to c.35% of 2020 debt. Continued, regular issuances and a liquid curve will also be necessary for the full development of a safe asset.

Though implementation of investment and reform will remain critical, a safe asset coupled with a more dynamic, balanced and cohesive EU economy could lessen concerns of tail risks and thus support the international role of the euro.

> Common debt issuance is a potential game-changer for Europe's economic growth dynamics through the Recovery Fund.

SURE has proved a successful instrument for debt issuance due to the clear communication to the market on deal sizes, tenors, timetable and "what" investors would be buying, as well as co-ordination with other supranationals. The use of a Social Bond Framework proved fruitful given the thematic dominance of ESG amongst global investors, whilst the general market backdrop was favourable and led to record order books for SSA issuers in recent months.

J.P. Morgan was delighted to be appointed as joint-lead on a SURE transaction and we endeavour to continue supporting SURE and the deployment of the Recovery Fund. We have operated in the region for close to 200 years and our commitment to companies and our clients remains unwavering.

As the Recovery Fund goes live and with a view to a common debt instrument, we are confident the EU will continue to work with best-in-class arrangers to be well-positioned for successful issuance in different market conditions. This will allow access to a diverse and increasingly global investor base, in terms of type and geography, and the broadest possible market intelligence for future transactions. It would be reinforcing to see more EU countries making use of these programmes.