Q&A

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Reforms and investment needs for the European recovery

Why has the Eurozone been impacted more in terms of lost economic growth by the pandemic in 2020 (-7.2%) than the United States (-3.4%), Japan (-5.1%) or China (+2.3%) and why are the future growth prospects for 2021 lower as well?

Several factors help explain these differences. Due to its nature, the Covid-19 crisis has disproportionately hit economies reliant on physical contact such as industry, transport, culture and hospitality. Some countries also had the misfortune of being exposed to the virus earlier and more severely than others, which resulted in stricter containment measures and further economic disruptions (e.g. Spain and Italy had an above-average GDP contraction of 11 and 8.8% respectively in 2020[1]). So there are significant differences between regions and countries to consider.

Three additional elements may explain the lower economic performance of the euro area as a whole compared with the United States (US). First, the greater openness of the European economy[2] acted as a drag when cross-border trade and global supply chains were disrupted. Second, given its older population structure[3] and higher population density[4], Europe was more vulnerable. Finally, Member States immediate stimulus responses were different in magnitude and speed.

By putting in place an unprecedented recovery package called NextGenerationEU (NGEU), the European Union (EU) responded decisively. In particular, the new Recovery and Resilience Facility (RRF) will take into account the different economic impact of the pandemic in Member States and contribute that we emerge stronger and more resilient from the crisis.

The EU recovery plan may be rolled out less rapidly than the US stimulus checks, but is calibrated to support long-term growth and address the challenges posed by the green and digital transitions.

Moreover, one should not overlook the role of national automatic stabilisers (enabled by the triggering of the SGP escape clause) and other important measures taken at European level to support employment and cushion the social impact of the crisis, such as the emergency aid by the Structural Funds, the SURE initiative, the temporary framework for state aid rules and the Pandemic Emergency Purchase Programme of the ECB.

What are the main structural impediments which hinder productive investment in Europe? What are the most urgent reforms to be carried out in the EU for fostering productive investment and sustainable growth?

The EU's ambition is to accelerate the recovery through growth-enhancing reforms together with future oriented and environmentally sustainable investments. The joint and coordinated impact of the multiannual budget (2021-27) with the NextGenerationEU, notably the RRF is a unique opportunity to trigger it. The new Technical Support Instrument (TSI) will complement the RRF, offering Member States expertise to design and implement reforms.

Reform needs are specific to each Member State and are detailed in the country-specific recommendations emanating from the European Semester. Three horizontal reforms are very dear to me: innovation; public administration, including digitalisation; and economic, social and territorial convergence. Building an economy fit for the next generation requires change, capacity to look ahead and adapt. The EU needs to invest in people to boost innovation and creation of value. Investments and reforms must encourage research and innovation. In order to benefit from cutting-edge technologies, we need to stimulate interactions between the business and research worlds fostering knowledge transfer. European capital markets are needed to make sure that the most innovative companies have access to capital to grow and compete on a global scale.

Efficient public administration is a key enabler for innovation, quality investment and growth enhancing reforms. Public administration may become a hindrance to growth if it doesn't keep up with organisational developments. Efficiency of public administration, namely through digitalisation and simplification of procedures is thus vital for competitiveness. Finally, the economic recovery must reduce imbalances within the EU and within Member States. The RRF will have an important role to play in combination with the new cohesion policy. Reforms and investment must take into account regional and local specificities to facilitate convergence, without which, economic, social and political fractures will be inevitable.

How will the EU's new €750 bn recovery fund contribute to addressing the post-Covid economic recovery of the EU and Eurozone?

National allocations under NGEU's largest instrument, the RRF, should contribute to make European economies and societies more resilient and better prepared for the challenges of the green and digital transitions. In addition, the Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU) extends the crisis repair measures delivered through the Coronavirus Response Investment Initiatives (CRII and CRII+) until 2023.

Thanks to its redistributive effects, these funds will contribute to a less divergent recovery of the euro area economies, and act (temporarily) as an anti-cyclical instrument, badly needed when, in a Monetary Union, national automatic stabilisers are structurally constrained. Long term bonds issued by the Commission to finance the NGEU will create a truly pan-European safe asset, contribute to financial stability and increase the recognition of the euro as an international currency. Importantly, the EU will become the world's biggest issuer of Environmental, Social and Governance (ESG) bonds and the benchmark for such instruments globally.

What are the major threats to the effectiveness of the Next Generation EU (NGEU) package? How to overcome potential "blockages" and ensure that the funds are well spent and go hand in hand with effective reforms?

There are two critical steps for the implementation of the NGEU package, the first of which is the ratification by all Member States of the Own Resources Decision, which will allow the Commission to borrow funds on the capital markets. Then, to be able to access the RRF, Member States need to prepare Recovery and Resilience Plans (RRPs) that have to be approved by Commission and Council.

Disbursements from the RRF will be based on the achievement of pre-defined and agreed milestones or targets. The capacity by Member States in identifying the right reforms and investments, but also the operative means for their implementation, both public and private, is therefore paramount for ensuring the good use of the funds. Reforms, in particular, must address structural bottlenecks to development.

A key success factor will be countries' broad ownership of these plans. Despite the urgency, Member States must engage with national stakeholders to bring out the best reform ideas and investment projects. This dialogue will also improve the quality of the implementation process.

Some countries of the EU have been unable to spend efficiently European structural funds over the period 2014-2020. Will the national plans presented in the context of the NGEU recovery instrument make better use of European funds this time round? Do all Member States have sufficiently effective administrative capabilities to manage the mass of projects needed to absorb these funds?

The unprecedented amounts of funds available under the NGEU and the new 2021-27 EU budget will be challenging also in terms of absorption capacity. The Commission is well aware of persisting issues in implementation and continues its efforts to address them. A significant effort of simplification was made in the legislation for the new EU cohesion policy for the 2021-2027. However, similar efforts are necessary from the Member States themselves as national "gold plating" is frequent.

As referred above, the quality of public administration is a critical factor not only for the absorption of funds but, more generally, for the success of all public policies. The TSI through which Member States can request technical support from the Commission to devise and implement policies, including to upgrade their public administration can play an important role. Having the possibility to finance the reform of public administration is, in itself, a major occasion to improve general efficiency including better management of the funds.

Above all, the need for a sustained and fast recovery will be the best stimulus to a good use of this unique historical opportunity.

1. Commission's Winter 2021 forecast
2. Trade openness of 26% of GDP in the U.S. vs. 88% for the euro area according to World Bank data.
3. 21% of inhabitants over 65 in the euro area vs. only 16% in the U.S. according to the Commission's AMECO database.
4. 36 people per sq. km of land area in the U.S. vs. 127 in the euro area according to World Bank data.