EU RECOVERY PACKAGE IMPLEMENTATION

The EU is working to turn its €750 billion Next Generation EU (NGEU) recovery package into action on the ground. In February 2021, the Council adopted a regulation establishing the Recovery and Resilience Facility (RRF) which lies at the heart of this EU's recovery plan. It will make €672.5 billion in grants and loans available for public investment and reforms in the 27 member states to help them address the impact of the COVID-19 pandemic, to foster the green and digital transitions and to build resilient and inclusive societies.

1. NGEU: a potential game changer for economic growth

1.1 Policy-makers acted quickly and comprehensively in Europe to find innovative solutions

A policy-maker summarised that the previous year demonstrated the strongest hits to the European economy since the Second World War, a large risk of divergences and a coordinated economic fiscal response ran through the EU budget. This is the first time the Union has reacted in this way, mobilising the budget on a macroeconomic scale. There was a volume of 5% of gross national income (GNI) here. The analysis of the risk of divergences in the euro economy was made early on and addressed directly.

1.2 A historic breakthrough

An official stated NGEU is the appropriate response to the crisis. This crisis differs from the last one because it has been possible to move much more quickly with new instruments. There has been more innovation. The clear intuition and assessment from Chancellor Merkel and Emmanuel Macron when they announced the idea of a stimulus plan of €1 trillion and €500 billion of grants from 18 May 2020 was that this crisis could have the potential to undermine the foundations of the European Union. This for at least three reasons. First, in the first wave countries were not hit in the same way by the health crisis. Second, there was a different share of sectors affected in different countries. Third, countries up to the crisis had different fiscal spaces and were not able to respond the same way.

The right features were found in order to deal with the crisis. Allocations were calculated on the impact of the crisis, taking into account the economic consequences of the pandemic. Beyond the current allocation, there will be adjustments that are already programmed in order to take into account the impact in 2020 and in 2021. Part of this support includes the grants, which are being financed through covered joint bonds by the European Commission. The Commission will reimburse Next Generation EU borrowing between 2028 and 2058.

NGEU will be reimbursed through new own resources. The notion of net beneficiaries and net contribution to the plan will fade away and the impact on national public finance will be considerably reduced. For the first time, the European Union has agreed to never let a crisis go to waste. Now the issue is implementation.

1.3 Next Generation, a performance-based instrument to face up to growth challenges

A policy-maker noted that the impact assessment last summer shows that, if implemented properly, the plan would lift gross domestic product (GDP) by about two percentage points structurally. Heavy lifting at the national level is also needed, but the effects could be macroeconomically relevant as well.

This is innovative in that it picks up on longstanding weaknesses in economies, both on structural reforms and investment deficits. A forward look is being taken because the investments that are being prioritised are those that will drive economic transformation in digital and in green. By linking this to the European Semester, it will significantly strengthen economic governance at the European level.

This is not a traditional cohesion policy instrument that pays for bills. This is a performance-based instrument. Payments follow only when milestones and targets are met. That is rather new when it comes to the implementation of the budget and it gives some assurances, both when it comes to absorption and results.

1.4 The Recovery and Resilience Facility (RFF) paves the way for supporting investment in the green and digital transition

A public decision maker noted that with the RRF and the multi-annual financial framework there is quite a comprehensive toolkit for facing the crisis ahead. Investment levels declined substantially in Q2 last year, and according to the European Investment Bank's (EIB) investment survey half of the companies in the EU say they are delaying or reducing their investment plans for the future. Here there is an important role for public entities to use these funds in a timely fashion and crowding in private funds too. The additional investment needed to meet the priority agreement targets before 2030 is estimated to be €260 billion per year and public money will not be enough. The climate bank roadmap, which is the definition of the European Green Deal, has the target of mobilising €1 trillion until 2030. That is about half the amount needed. The EIB is also very supportive of the RRF investment priorities: 37% of funds for climate action and 20% for digital transition. The EIB remains committed to a green, sustainable and digital recovery and engaged with the Commission and member states in bringing forward a very good implementation of the RRF.

1.5 Reforms and investment must go hand in hand

An official noted that Italy is not amongst the best performers in Europe in making use of the European funds. However, the new performance-based paradigm behind the RRF represents a strong incentive to perform better and therefore a unique chance to catch up for the country. The funds will indeed be disbursed once the ex ante defined outcome is achieved, but not as long as the expenditure proceeds. This calls for a review of administrative capacity. Reforming public administration is both one of the objectives of the plan and a fundamental means for implementing the plan itself. There will also be a comprehensive package of other structural reforms including those involving the justice system. Competition will also be part of the reforms in the plan. It is an opportunity to complement fiscal capacity, and to do so in a coordinated manner with the other European countries.

1.6 A big leap forward in terms of greater European integration

A public representative stated that this is a big leap forward in terms of greater European integration. What is observed in the markets is actually a signal of how important it is to also have a strong European capital market. The hope is that the Commission can be on the market before the summer because time is of the essence. Member states need to start the investments, so the NGEU package is on the ground as soon as possible. In this respect, it is appropriate that a new freeze of the pre-financing was negotiated, because many countries will need to have strong pre-financing as soon as the grants are approved.

1.6.1 A bold and unprecedented step

A public decision maker stated that the EIB welcomes the NGEU. There is quite a substantial amount of funds that, used properly to implement coherent packages, should lead to structural reforms that deliver and that may contribute to increased potential output. The RRF is the right answer to the problem that was raised by the pandemic, but it has to go hand in hand with a strong focus on delivering quality investment beyond volumes.

1.6.2 The right instrument at the right time

An official added that the right direction is being pursued, and all of the plans are going well. The plan is being integrated and there is toughness in requesting reforms.

1.7 Next steps: NGEU should start in the summer of 2021; the German Karlsruhe legal challenge should not delay the process

A policy-maker stated that a robust machine has been put in place. It is ready to go on 1 June. Two key conditions have to be met. First is the ratification of the Own Resources Decision (ORD). The hope is it is on track for finalising in May. Second, the plans need to be submitted by the end of the month. If all of that happens, the Commission will be in the markets in June.

An official noted that there is a lawsuit in Karlsruhe. It is strongly believed there will be a legal victory in this case. The legal position has also been strengthened by 2/3 majority in the German Parliament. The German Government will do all it can to defend this before the Constitutional Court. It is impossible to guarantee the timings of the case, because that is a matter for the Court, though there is an attempt to have an accelerated procedure.

Additional own resources is where it becomes really exciting if, as a next step in this, there can also be assurance of the repayment of the funds through sensibly designed and structured own resources for the European Union. The fact that all agree on the goal of establishing own resources is already a strong signal. With the recent movements on minimum taxation at the global level, there is optimism for getting a good test case quickly, and that this concept of minimum taxation at the global level will also increase the inspiration for agreeing on own resources in Europe as well.

1.8 This EU package has impressed markets

An industry representative noted that the market has been very impressed by the speed and depth of the decision that Europe as a whole and the single members were able to achieve. While the market looks at many things debt is issue number one. There is the size of debt, and how that is eventually deleveraged, and the quality of debt. This is a real change, now that the Commission and the budget of Europe is out and getting direct funding from a market in size and becoming basically the largest debt issuer. It is already changing the dynamic of debt issuance in Europe.

1.9 This move towards fiscal cohesion and solidarity is reassuring

An official stated that this significant EU fiscal deal has been a crucial reassuring on the perspective of the Union and the monetary union. This has proved the capacity of the European member states to react together and otherwise it would have been very difficult to respond to this crisis, with the different situations there were, with the symmetric shock but very different fiscal spaces available in single member states. It has been effective. Markets have reacted very positively and are continuing to do so. This is benefiting the Union and all member states. It is confirming that the business environment is safer. It is more resilient and able to find solutions to these new and very challenging problems. There can be certainty that Europe will become more attractive to investors and this is going to facilitate the economic convergence process across EU Member States. This is crucial for the monetary union.

2. NGEU: a potential game changer on capital markets

NGEU is a significant added value to EU capital markets. It will turn the EU into a major player on the global capital markets and strengthen the international role of the euro. The European Commission acting on behalf of the member states becomes the legal borrower responsible for the servicing and the repayment of the issued bonds. As the Treaty imposes the balancing of European budgets, the ultimate guarantee on the bonds issued by the Commission will eventually fall on all Member States.

2.1 Given the volumes frequency and complexity of the borrowing, the Commission will have to act like a sovereign borrower

A policy-maker noted that funding on the capital markets against a guarantee given by the budget itself will make the European Union one of the biggest issuers on the capital markets in Europe. That transforms the Commission into one of the biggest debt management offices and requires it to put forward a very different way of financing the plan. The Commission is also putting in place a modern borrowing policy. This will be backed up by a completely overhauled governance framework. The expectation was for anything between €15 billion and €20 billion per month to be raised to finance the machine, bringing over €100 billion this year if the Commission gets into markets in June. Next year and the year after it could be anything between €150 billion and €200 billion of disbursements. The Commission will use multiple funding instruments - medium and long term bonds as well as (short term) EU bills - to maintain flexibility in terms of market access and to manage liquidity needs and the maturity profile.

An official added that the programmes are already in the guarantee and the guarantee structure figured out in the ORD will greatly interest and inspire capital markets.

2.2 NGEU should promote the international role of the euro

A policy-maker noted that a very important side effect of this new funding machine is that it strengthens the role of the euro in the international capital markets. Banks have put this borrowing not at their sovereigns, supranationals and agencies (SSA) desks but at their sovereign desks. Quite a few actors in the system say they want to use this as a reference point: a European yield curve as a pricing reference in the markets. €800 billion will have to be raised between now and 2026, which is a challenge but there is confidence it can be done.

2.3 An opportunity for enhancing the euro as a reserve currency and developing a safe asset

An industry representative remarked that this provides an opportunity to fill some gaps in European financial markets and to provide the right tools for the euro to strengthen as a credible reserve currency. Here there has to be a large quantity of common European AAA state assets. The number before this programme for AAA single countries in Europe was less than 29% of total European debt. With this programme, that will go over 35%. This will make a difference to the ability of the euro to grow into a reserve currency. At the same time, a safe asset will be developed, which will be very useful technically to work the monetary market better. That would be a much better way to run monetary policy. There are many technical issues that will become easier.

2.4 An opportunity for a deepened and more liquid EU green bond market

An IFI representative stressed that, given the objectives of the green transition in the RRF, there is also an opportunity to move forward in terms of looking at the green bond market and to allow this market to be even larger and deeper This is also an opportunity to look at the Capital Markets Union and to try to bring forward a Green Capital Markets Union.

3. The main risks, challenges and key success factors

3.1 The main risks

3.1.1 The risk related to the recovery if new structural effects following the pandemic are not considered

A public representative noted that much attention is placed on how to go through the Next Generation recovery and address the existing structure of problems. It may be that there is not enough thinking about what kind of structural changes there will be as a result of the current crisis. There might be issues that will not come back as they were before. There might be some structural issues that will require a different kind of intervention that is not sufficiently taken into consideration.

3.1.2 The risk related to the long-run sustainability of the recovery

A public representative noted that the idea that the aggregate will be looked at to see how fast to get to pre-crisis level is an objective, but there is also a need to look at how this happens at a more disaggregated level to make the recovery sustainable. If the inequalities and social problems are not narrowed down then this is a huge transformation of the economy and society being observed in terms of ecological transition and digital transition, and consideration must be given to the divergence and inequalities that could lead to the recovery not being socially and politically sustainable.

3.1.3 The main risk is that member states do not implement structural reforms

An official stated that the biggest risk is not achieving the growth targets. If this becomes a pure spending programme with no impact on structural growth opportunities and structural growth rates across Europe, then the programme will end up unsuccessful.

3.1.4 Parliament's powers within NGEU will not allow it to avoid a possible fragmentation of the internal market

A public representative noted that Parliament had to fight its own battles on the RRF regulation and had fought for a stronger role scrutinising the RRF. Parliament has a strong European role on the financing part, but the expenditure part is more decentralised. Parliament would have preferred to see a stronger role for European institutions in the spending part as well. The risk of this decentralised approach is that there may be some fragmentation in the single market. Parliament tried to put in the six pillars to make sure that investments would work and really invest in social cohesion.

3.2 The main challenges and key success factors

3.2.1 Quickly Implementing the NGEU package remains challenging

An official stated that the crucial phase is being entered where everything depends on implementation. A process that really increases productivity has to be started in such a way that the debt load seen in some countries becomes sustainable in the long run. Sustainability depends on the additional growth created with NGEU, and for that implementation is crucial.

An official sees two risks. The first is taking too long to implement NGEU. Then there is the regulation of the facility. The ORD has to be ratified.

3.2.2 Two years for implementing reforms and investments is short

A public representative noted that there will be implementation challenges, especially because of bureaucratic issues within member states, and because many of the plans are linked to addressing structural reforms. The risk is delays in the implementation that could hamper the timing of the recovery.

An IFI representative noted that the crisis has lasted longer than expected. However, in terms of recovery there is a need to be ambitious. It is not just recovering to the previous level; it is recovering to the previous trend such that this is not a missed opportunity for growth. The implementation challenges are mainly related to high-cost rates. The deadline for a project is 2023; the deadline for payments is 2026. The time is so short that it might be a challenge to achieve the outcomes of reforms and the deadlines may have to be reconsidered.

3.3 Key success factors

3.3.1 The need for credible plans being appropriately implemented

A policy-maker stated that there have to be credible plans, which are not yet there but are due in two weeks. Then robust and rigorous implementation is also needed. Ultimately, it is about results and being put on the trajectory of higher growth and productivity. There is execution risk on the funding side, but every possible insurance has been taken out and there is a great deal of support from the European Central Bank (ECB), the European Supervisory Mechanism (ESM) and the member states.

The Chair asked whether delays would also be a risk. A policy-maker confirmed that there are regulatory delays which could hold things back. The ORD needs to be put in place, otherwise borrowing will not be possible and nothing will happen. In principle, though, in two months the Commission could realistically be very active in the capital markets. Then the money will flow very quickly. There is nothing in the Commission that is holding things back.

3.3.2 Spending wisely

An official noted that an inside factor is that the auditing and milestone exercise cannot deteriorate into political mission creep. It has to be a high-quality exercise. In essence it is similar to an ESM or IFM programme where there are targets that need to be reached and there might be a situation where 95% of all targets have been fulfilled but some crucial parts are missing. In that case, the question is whether the money is still spent, or if there will be a wait to look for quality. Speed is important, but quality is even more important.

An official added that there are issues of governance, transparency, accountability and the proper incentives. If it is not possible to deliver on the objectives introduced in the plans, there is a clear threat to credibility in a rather wide sense, including credibility of the capacity to provide solutions for citizens. The risk of failure is backtracking not only on NGEU, but possibly on other dimensions as well when there is a need to proceed on many open matters: Capital Market Union, Banking Union and the safe asset. There is also a need to think of additional resources to strengthen the European capacity for feeding the new tasks and challenges that the EU would be undertaking.

A public decision maker hoped that any support will be based on a rigorous selection of the most productive investment projects and that the RRF funds will enable the deployment of investment projects that would not be possible to deploy otherwise. There has to be additionality, and existing funding sources should not simply be replaced by this cheaper funding source.

One lesson learnt by the EIB from the financial crisis is that investment barriers are quite prevalent, particularly at sectoral and geographical levels. Attention must be paid in the context of the discussion of the reforms so the investments have their impact. On regulation, taxation and the scale of investments, in particular in green technologies, this seems to be quite important. This also holds for the capacity of the public sector to generate bankable projects. Value can be added by advisory, technical terms and financial terms such that the projects are implemented faster in the right manner for reaching the desired objectives.

4. Critical problems unresolved

Fundamental problems of the euro area remain unresolved with NGEU, including extremely high levels of public and private debt in a number of member states. Additionally, very low interest rates favour liquid assets over productive investment in Europe.

4.1 A fundamental problem of the EU remains unresolved: the high level of public and private debt

An industry representative stated that the quality of debt was an opportunity; the major challenge is the quantity of debt. After this crisis, Europe as a whole, both the public sector and the private one, will have a substantial accumulation of debt. It is not a problem right now for the market, but the question is there. Europe has a credible strategy to deleverage and get out of this increased debt. The only credible strategy is growth. The answer has to be how Europe will deliver a substantial change in the pace of growth. Even if there is a good job of implementing and spending €750 billion, that is not going to be enough. It is clearly going to be part of the answer, to fill the gap in productivity and competitiveness compared to other parts of the world in terms of technology, human capital and infrastructure, but it is not enough.

A better strategy is still needed in the case of doing business in Europe. Deepening the single market, especially in the service sector, is key. Without it not enough will be done to improve growth. Some countries have to do more than others, but when thinking about a single market in services there are many things that prevent a truly single market in all services. Financial services are part of how public administrations work nationally and how they interlink with each other. For the justice systems in financial markets, some areas are rudimentary. The answer is to work hard with the resilience and recovery plan, and taking it as an opportunity to introduce reforms that will deepen the single market European-wide, especially in services.

4.2 Achieving a balanced mix after the crisis is not a given

An official stated that the RRF can help maintain a supportive fiscal stance in the coming years and achieve a more balanced policy mix after the crisis. Member states with high debt should take the opportunity of the RRF to begin to carry out structural reforms which will boost resilience and help repay the fiscal space, without reducing public investment. The

Commission should also address differentiated fiscal guidance to member states to encourage those with fiscal leeway to stimulate demand by supporting both public and private investment. This will help achieve a more balanced policy mix in the euro area in favour of sustainable growth.

4.3 Lasting very low interest rates favour liquidity assets or low-risk projects over productive investment

An official noted that at a certain point somebody has to think about how the ECB exits the unconventional measures. That will interlink with the question discussed before on how far has been reached with productivity and whether there has been success. If risk premia remain as compressed as they are, because of the unconventional monetary policy, investment will continue to be crowded out from productive, riskier projects. With the same risk premium in both the low-risk and the high-risk projects, it is the low-risk project that will be invested in. There may need to be investments in high-risk projects. It sounds counterintuitive, but this is exactly what is happening the longer these unconventional measures continue. This will, of course, interlink with the investments in NGEU and that is also something that needs to be done correctly. There also needs to be very good brinkmanship or very good steering at the top of the ECB.

The Chair emphasised that member states, the Parliament and the Commission should summon the political energy to drive the Capital Markets Union and Banking Union. Things are happening with the conclusion of the German presidency in December, but there is a need to go further. Fixing deadlines, as seen with the recovery plan, really focuses minds. That could be done for that triptych of issues, and then some spectacular changes in Europe might be seen, which would reinforce the impressive programmes proposed.