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Next Generation EU: A pillar of the recovery

More than a year after the outbreak of the COVID-19 pandemic in Europe the economic recovery is yet to gain ground. The breakthrough in vaccine development in the autumn and the start of mass vaccination campaigns are a game-changer that significantly brightens the economic outlook. But in the meantime, renewed waves of the pandemic have forced many Member States to reintroduce or tighten containment measures.

As a consequence, economic activity has remained subdued in the first months of the year. In its winter interim forecast, the European Commission projects only a mild uptick in economic activity before summer. Once the assumed, gradual relaxation of containment measures truly picks up pace in the second half of the year, the economy is expected to start recovering.

Yet, just as the pandemic's initial hit was very uneven across Europe, so will Member States' recovery paths be. More than half of Member States are forecast to close the distance to their pre-crisis output levels by the end of 2021. Others are expected to take longer. The economic structure — and the share of the tourism sector in particular — are among many factors contributing to such an outcome.

The longer the crisis lasts, the greater the risk of major cross-country divergences becoming entrenched, leading to a fragmentation that would disrupt the functioning of the internal market. A protracted crisis also risks inflicting deep scars on the fabric of the European economy and society, predominately through bankruptcies and higher unemployment. Given the disproportionate impact of the crisis on economically more vulnerable people, including youth and women, a deepening of pre-existing inequalities is also a real risk.

The Member States and the EU have reacted swiftly to the enormous economic impact of the COVID-19 crisis. Swift and determined policy action at all levels has helped to shield firms and workers from losing earnings and jobs in the acute phase of the crisis. The European Commission's €750bn-Recovery Instrument, 'Next Generation EU' (NGEU), complements the various emergency measures by supporting a swift recovery and building a more resilient European economy in the wake of the crisis.

Its centrepiece, the Recovery and Resilience Facility (RRF), will deliver financial support for investments and reforms in a fair manner. The allocation of financial support takes account of economic needs arising from the crisis while supporting the green and digital transitions of the European economy. If implemented swiftly, with a strong focus on high-quality public investment and additionality, the level of real GDP in the EU could be roughly 1.5 to 2 per cent higher than without NGEU, according to stylised simulations with DG ECFIN's QUEST model.[1],[2] This would help not only the sustainability of our economic model, but also that of public debt.

The common and coordinated European approach to tackling the pandemic's economic consequences is an expression of European solidarity, but it also makes good economic sense. Economic and financial spillovers spread fast through the Single Market and Monetary Union, supporting growth in all Member States. Moreover, high-quality investment and reforms address the challenges ahead – combatting climate change and supporting digitalisation. Our efforts are now fully geared towards the implementation of the RRF. Member States have been developing – in close cooperation with the Commission – Recovery and Resilience Plans that outline national reform and investment measures.

A lot of work lies ahead. However, there are good grounds to believe that Recovery and Resilience Plans can be finalised in months, allowing disbursements to commence around summer. Next Generation EU and the RRF should be seen as Europe's attempt ~~to 'build back better', an endeavour~~ that will require ambition to combine the investments in the right areas with the adoption of essential reforms.

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[1] European Commission (DG ECFIN) (2020), European Economic Forecast Autumn 2020, European Economy Institutional Paper 136, p.65-70.
[2] QUEST is a structural macro-model in the New-Keynesian tradition with rigorous microeconomic foundations and frictions in goods, labour and financial markets. See Burgert et al. (2020), 'A Global Economy Version of QUEST: Simulation Properties', European Economy Discussion Paper 126.