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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. 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.