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FOREIGN AFFAIRS & TRADE
Manatū Aorere

# Europe's Ambitious Economic Recovery Plans

Market Report

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*Prepared by the New Zealand Embassy in Brussels*


## Rāpopoto – Summary

- The European Union has started implementation of its ambitious economic recovery plans. These plans will see €750 billion, in addition to an increased regular EU budget of €1.1 trillion, poured into stimulus and recovery plans. This is partly funded through Commission loans in an unprecedented move to respond to the EU's economic crisis post-pandemic.
- Beyond the spending, it is intended that the funds will provide European Union member states with a "once in a life-time" opportunity to reform their economies. Member state implementation plans are required to dedicate funding to green (37%) and digital (20%) transitions, in order to enable the EU achieve its vision for a modern European economy. Funding will also be provided to support communities reliant on fossil fuels to develop new industries. Reforming government bureaucracy, including through digitalisation, to increase the ease of doing business is also a priority for some member states.
- Whether this will meet the ambition of reshaping the European economy and paving the way for a green, digital and more modern and resilient Europe will take years to determine. However, in the medium term as funds begin to flow, the stimulus packages may bring opportunities for New Zealand business, particularly in the green, digital and consultancy sectors.


## Hohenga - Action

For information, including in contribution to the Economic Diplomacy programme.

## Pūrongo - Report


With thanks to EU MS posts who contributed to this message.


- Implementation of the EU's Covid-19 ambitious economic recovery plans have commenced, with the ratification by the 27 EU countries of a treaty enabling the European Commission to start borrowing financial resources for the recovery funds and the submission of national plans to the Commission, which describe the reforms and public investment projects each EU country plans to implement with EU funds. We report on the key themes of the EU and national plans and consider their potential to reset the European economy in the longer term, to support MFAT's economic diplomacy.
- The European Central Bank updated its growth forecast last week up .1% to 4.7% for the year, indicating that the Covid-recovery is on its way. However, the European architecture is conscious that the economy remains at a knife edge, particularly for some southern European economies. To recap previous reporting, the EU's response to this includes an unprecedented stimulus package of EUR 1.8 trillion consisting of two pots: the EU's regular 7 year Multiannual Financial Framework (MFF) of EUR 1,074 trillion (60% of total) and the temporary financial NextGenerationEU instrument to boost economic recovery of EUR 750 billion (40% of total).
- The 2020 political agreement to create the new NextGenerationEU financial instrument was a significant political step as it gives the Commission the power to borrow for the first time, a significant concession to European solidarity, particularly from northern 'frugal' member states. As a result, unlike in the 2008 financial crisis, EU

countries with poorer credit ratings will be able to finance their public expenditure under more favourable rates than if they borrowed directly from the markets.

**What's the money for?**

- Within the NextGenerationEU instrument is the Recovery and Resilience Facility, which will provide EUR 672.5 billion to support large-scale public investments and reforms undertaken by EU countries. The fund is designed to address the economic and social impact of the pandemic whilst ensuring that member states economies undertake the green and digital transitions the EU sees as necessary to maintain a modern economy.
- The European Commission will give national governments up to EUR 360 billion in cheap loans and up to EUR 312.5 billion in grants. The EU economies worst hit by the pandemic will become the main beneficiaries, with tourism-dependent Italy, Spain and France receiving the biggest share. The allocation of grants is determined according to population size, GDP per capita, average unemployment rate over the past 5 years (2015-2019) compared to the EU average, as well as the loss in real GDP in 2020 and the observed cumulative loss in real GDP over the period 2020-2021.
- The European Commission will use the remaining EUR 77.5 billion in NextGenerationEU to top up funds in the long-term EU budget, such as HorizonEurope - the research and innovation funding programme, InvestEU - the investment programme, and ReactEU - the fund to reduce regional development disparities.
- Funding will also be distributed through the Just Transition Fund, which is designed to support the economic diversification and conversion of EU countries and communities particularly dependent on fossil-fuels and high emission industries. This fund aims to alleviate the socio-economic costs triggered by climate transition, by promoting jobseeker programmes, up- and reskilling of workers, the creation of new companies, as well as environmental rehabilitation and transformation of existing carbon-intensive installations if they reduce emissions and protect jobs. Poland, Germany, Romania, the Czech Republic and Bulgaria will become the main beneficiaries of this fund.
- The Just Transition Fund is intended to contribute to EU efforts to achieve its climate neutrality and emissions reduction targets, both in terms of actually shifting emissions but also in terms developing the social licence for the green transition with certain communities, such as coal miners. The Polish coal industry is already lobbying hard against the Green Deal due to forecast job losses.

**What's the process?**

- EU countries are submitting to the European Commission their national recovery plans, pledging to reform their economies and setting out their investment agendas until 2026, in order to unlock their allocated share of EU funding, which will be distributed from 2021 to 2023. As of 14 June 2021, the European Commission has received the recovery plans from at least 23 EU countries (out of the 27). The Commission has two months to assess the national plans against country-specific economic policy recommendations. This assessment is then provided to the European Council to approve plans on a case-by-case basis. The Commission will then have two months to pay 13% of the total support upfront in order to kick-start the national recoveries.
- The first payments are expected in July 2021, and Commission President Ursula von der Leyen announced on 8 June that the Commission will start approving national plans for Council adoption next week. The expectation is that "money will start flowing in the coming weeks". Media reports suggest that the national plans of Portugal, Spain, Greece and Denmark will be among the first to receive approval. EU countries will be able to request further disbursements up to twice a year, upon reaching agreed milestones and targets. This complex approval process reveals that national governments through the Council retain the core powers of defining and implementing their economic policies, despite the unusual involvement in the Commission in approving national plans.
- The European Parliament is only consulted during the process. Under pressure to ensure EU money acts as an incentive to ensure adherence to shared values, the Council will ultimately decide as well if the rule of law conditionality is met in order to access EU funds – this is particularly relevant for Hungary and Poland.

**What will it buy?**

- The European Commission is strongly encouraging EU countries to put forward reform and investment plans in the following areas: clean technologies and renewables, building renovations to improve energy efficiency, sustainable

transport and charging stations, rollout of rapid broadband services, digitalisation of public administration, data cloud and sustainable processors, education and training of digital skills.

- In addition, each national plan must include a minimum of 37% of expenditure for climate investments and reforms, and a minimum of 20% expenditure to promote digitalisation. Countries that will receive relatively smaller amounts from the EU recovery funds as a share of their GDP presented plans that concentrate on green and digital spending (Germany, Luxembourg and Denmark), while countries that receive larger amounts presented more diverse plans with higher 'other' (non-green and non-digital) shares of spending.

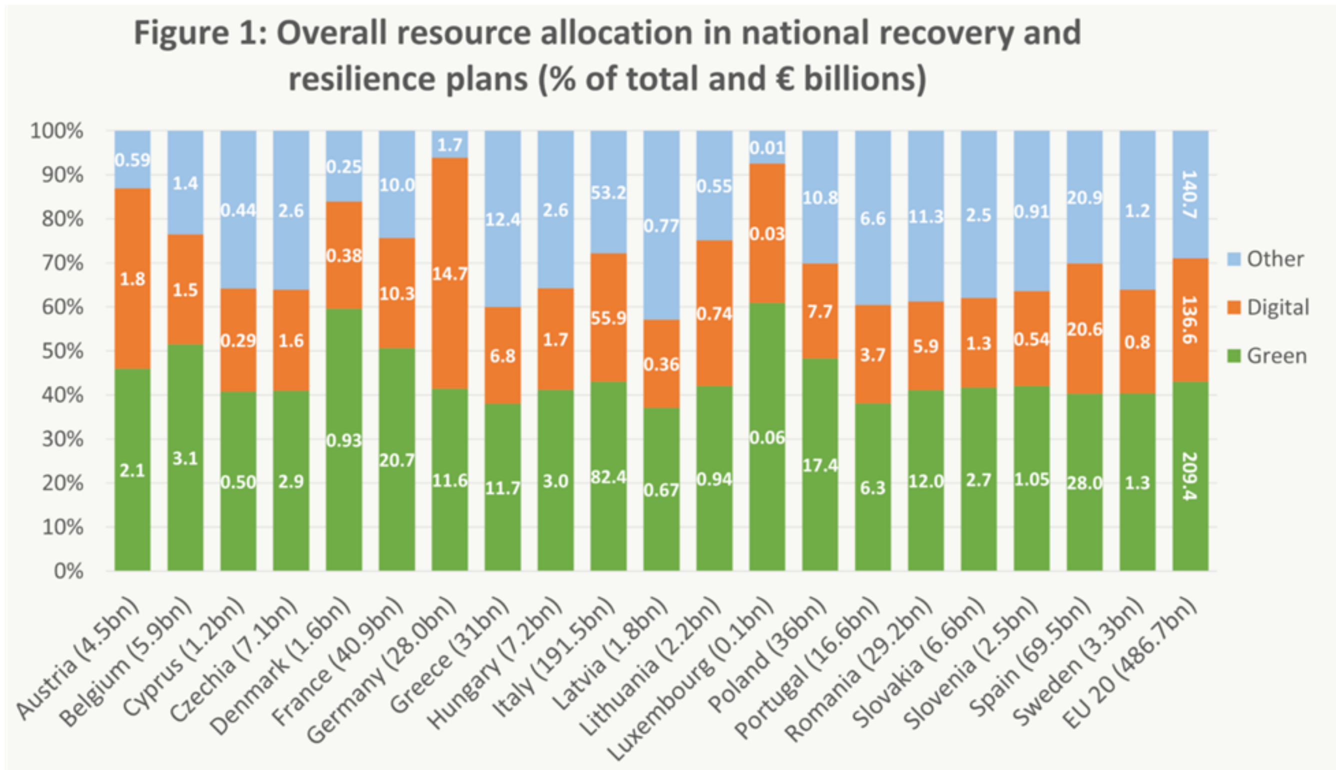


**Figure 1: Overall resource allocation in national recovery and resilience plans (% of total and € billions)**

*Source: Bruegel think tank dataset*

- Analysis by Bruegel, a Brussels-based think tank, of the recovery plans submitted by the four biggest EU countries (Germany, France, Italy and Spain) reveals "rather different national priorities", even if they all meet the minimum green and digital spending targets. Germany plans to spend more than half of the EU money it will receive on digitalisation (i.e. 5G rollout, investment in AI, quantum computers, digital government), while the other three countries will spend a quarter or less. France plans to spend half of its share of the EU money on green priorities, while the other three countries will spend around 40%. Italy's plan envisages making liberal use of the ability to borrow EU funds, while Spain's plan focuses on EU grants only, leaving the door open to applying for EU loans in the future. Common themes are electric mobility, modernisation of railway systems and investments in the energy efficiency of buildings and green hydrogen.
- With the exceptions of Latvia and Sweden, all countries that have submitted their plans so far requested the estimated full amount of EU grants or more. Of the seven countries that have requested loans, Greece, Italy and Romania have requested the full amount of loans available to them, while Cyprus, Poland, Portugal and Slovenia have requested between 16% and 37% of the loans available to them.

**Where will the money come from?**

- The plan to pay back the EUR 750 billion (about 5% EU GDP) borrowed (albeit with very long-term maturities) is unclear. The European Commission has identified new sources of revenue through the ETS (Emissions Trading System), the carbon border adjustment mechanism (CBAM), on big companies that benefit most from the EU single market, on single use plastics and through a digital tax based on the OECD's ongoing work. However, these potential sources of income might not be sufficient, some are yet to be in existence and have yet to be approved.

Some commentators drily suggest that NextGenerationEU means that the next generation of Europeans will be responsible for the cost of servicing this EU debt. Similar concerns exist around the level of debt some member states are taking on, especially Greece and Italy with public debt accounting for 207% and 156% of GDP respectively at the end of 2020.

**Is it actually transformational?**

- These plans are a central part of the political debate in many member states that see the grants, in particular, as a once-in-a-generation opportunity to modernise and transform their economies. European Commission President Ursula von der Leyen believes "this is the opportunity of the century for Europe. A truly historic moment". While the funding is significant, as is the method for raising funds (Commission loans), the impetus for reform that this creates is garnering as much interest as the money itself. This is particularly the case for Italy where the government has pledged to undertake an ambitious set of reform, including tackling Italy's infamously slow and burdensome bureaucracy and judicial system, as well as a rationalisation of legislation and other measures to promote competition (Comment: more detailed reporting on Italy's plan from ROM will be sent shortly).
- Other commentators have noted that the investment, and ambition, is actually relatively small compared to the scale of the shock. Shahin Vallee, a former economic adviser to Macron, compared the level of the EU and US ambition, noting that the US policies will lead to generational change, while the EU fund created the opportunity for investment but given the competencies of the EU, it cannot direct the same level of policy ambition. Further, it is unclear whether the funds available are enough to direct the climate targets that the EU has already signed up to.
- Commentators have also criticised the format of the mechanism for not sufficiently providing the short-term stimulus required to spur growth back to 2019 levels quickly enough for many economies, because national plans focus instead on the long-term green and digital transformations of European economies and the EU mechanism to frontload public investment is complex. Given this, the EU economy is expected to return to 2019 levels only in the first quarter 2022, in comparison to China who has already achieved this and the US who will achieve it in the third quarter of 2021. This imbalance exists within the bloc as well, with Italy and Spain projected to take the longest to recover.
- Both of these criticisms suggest that crucial for the success of the economic recovery plans will be whether the EU decides to further extend the window during which the EU's fiscal rules are paused, to allow for member states to maintain national stimulus efforts and anti-austerity policies. Christine Lagarde has said that the European Central Bank will continue support until the recovery is confirmed: "You don't remove the crutches from a patient unless and until the muscles have started rebuilding sufficiently so that the patient can walk on his or her own two legs."

**Takapu - Comment**

- With the EU being New Zealand's third largest trading partner, the benefits of the investment and the associated reforms shoring up economic stability across the bloc are clear. Beyond that, the scale of the investment is such that it will create significant opportunities for New Zealand business, particularly those operating in the prioritised green, digital, and potentially consultancy, sectors.
- Ultimately, the measures can be seen as an important milestone in the EU's economic development, especially when contrasted with the EU's traumatic experiences during and after the Global Financial Crisis. The recovery plan is also a key element of the EU's aspirations for strategic autonomy. And while we will have to wait and see whether the reality matches the rhetoric, getting the plan this far should be seen as a significant collective achievement across the EU institutions and member states.

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