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NGEU soon to be rolled out: the EU has (almost) done its part; now comes the member-states' turn

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Global Views

In leading the way to NGEU, the Covid crisis may have marked a crucial milestone in European construction. The amounts involved are high enough to play a decisive role, both in accelerating the cyclical recovery (especially in "peripheral" countries) and in providing a supply-side improvement. Member-states, however, will face a major challenge in absorbing them rapidly and productively.

The launch of the European recovery fund, called Next Generation EU (NGEU), is potentially a big step forward for at least three reasons:

1. From a cyclical point of view, NGEU is raising heavy amounts in order to support demand and accelerate the post-Covid recovery, in particular in "peripheral" countries, which have been hit harder by the crisis and are threatened with falling even further behind "core" countries.
2. From a structural point of view, it can be a powerful way to combine public investment and reforms to improve supply and, hence, potential growth.
3. It is also a significant step forward in terms of European fiscal solidarity, with the EU issuing debt in its own name (thereby also creating a European "risk-free asset" in large amounts) and distributing grants to member-states in amounts that are not proportional to their GDP.

The July 2020 agreement to create the fund helped calm the tensions that opposed Italy to other EU countries early in the Covid crisis. This political lull helped narrow sovereign spreads of peripheral member-states, both by itself and by facilitating the ECB's task. Hence, and before even being rolled out, NGEU has already indirectly helped those member-states fund their own fiscal response to the crisis.

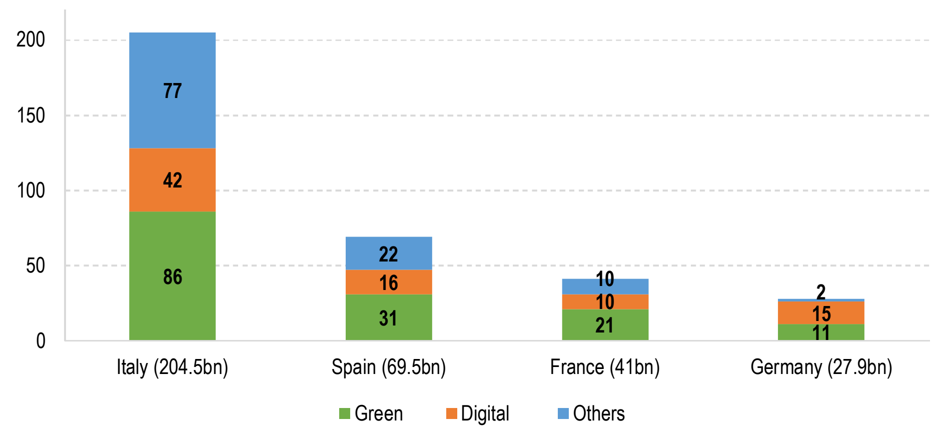
Before even being rolled out, NGEU has already helped calm political tensions and brought indirect fiscal support

Keep in mind, however, that NGEU is more comparable to the Biden administration's infrastructure plans (announced but not yet approved) than to the fiscal support measures already deployed in the US. The EU equivalent of the latter have been, basically, handled by member-states, which have tapped their budgets massively since Q1 2020 to maintain household income and guarantee companies' liquidity (however, in addition to ECB support, the EU did act by loosening regulatory constraints and rolling out some smaller programmes).

NGEU is now being rolled out. Some member-states have still not submitted their investment and reform plans, but the four main ones, as well as other peripheral countries, such as Portugal and Greece, did so by the (albeit non-binding) deadline of 30 April. Meanwhile, all countries have now approved the "own resources" principle (which allows debt-raising in the EU's name). Hence, a first release of funds could in theory happen as early as July (counting the c. 8 week delay from April 30 for Commission and Council approval of countries' plans) or, at the latest, in September.

On paper, the projects being proposed by the main member-states are in accordance with Commission expectations. The reforms that member-states have pledged to make comply with the Commission's recommendations, particularly those formulated in the framework of the "European Semester" process (especially as anti-Covid recommendations had in part replaced the usual requests for structural

1/ **NGEU: Ressource allocation, €bn 4 main euro countries**



Source: Bruegel Estimates, Amundi Research. Data as at May 2021

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reforms in 2020). Investment programmes also seem to comply on the whole with European recommendations (particularly the mandatory 37% and 20% earmarked for green and digital transformation), keeping in mind that country-by-country comparisons of amounts are hindered by the presence of national stimulus plans alongside NGEU (such plans are larger than NGEU in Germany and France, and smaller in Italy, while Spain does not currently announce a national top-up of NGEU). While the Commission will no doubt ask for some details (particularly concerning project follow-up mechanisms), its initial green-light is likely.

However, the main medium-term challenge is in member-states' ability to absorb the funds. Past experience of European investment plans (the Junker plan, for example) has shown that this is a real challenge. The Bruegel Institute, a think tank whose findings were taken up in a recent ECB[1] release, pointed out that several EU countries (notably Italy and Spain, the two largest NGEU beneficiaries) have had difficulty in recent years using the EU amounts made available to them, amounts that were far below those provided under NGEU. Generally speaking, public investment, which theoretically carries significant multiplier effects on GDP, tends to run into high bureaucratic barriers or even opposition from various vested interest groups.

The main challenge will be fund absorption against a backdrop of heavy country-level decision and implementation processes

The balance between NGEU's two main economic mandates (temporary demand-side support and structural supply-side improvement) could also evolve over time. As many services sectors are just now reopening in Europe after anti-Covid restrictions, it is still not clear how long it will take for the economy to return to normal (or at least to close the "output gap") and, hence, how much prolonged, on-demand fiscal support will be needed. Depending on the state of the economy in a few months, consideration may be given to shifting some expenditure in this direction or, on the contrary, to focusing on the supply side and long-term competitiveness, as the programmes that best meet both of these types of objectives are not necessarily the same. The usefulness of an additional EU fiscal plan (something that a number of economists have called for, and that has been mentioned by the French president), and its nature will also have to be reconsidered against this yardstick.

On the whole, NGEU, a potentially powerful mechanism that has been agreed and launched by the EU quite rapidly, is an adequate response to any shortage of fiscal resources that could hinder public investment capacities. The ball is now in the court of the member-countries to prove that investment is not being held up by their internal heavy decision-making and implementation processes. The success or failure of these investment programmes and of the reforms that must accompany them, will constitute an important precedent that will no doubt be cited by proponents and opponents of additional steps forward in EU fiscal solidarity.

Finalised on 24 May 2021

[1] *Will EU countries be able to absorb and spend well the bloc's recovery funding?, Zsolt Darvas, Bruegel, Sep 24, 2020. Mentioned in the ECB's Financial Stability Review, May 2021.*

Box: NGEU primer

- NGEU's amount is €806.9bn in current prices (€750bn in 2018 prices), equivalent to c. 5% of EU GDP, to be disbursed between 2021 and 2026. 70% of the amounts are expected to be committed (not necessarily disbursed) between 2021 and 2022, and the remaining 30% in 2023.
- The budget breaks down between €723.8bn for the Recovery and Resilience Facility for loans (€385.8bn) and subsidies (€338bn) to member-states. Another €83.1bn is being provided to support other European programmes.
- The two main beneficiaries are Italy (c.€200bn, or 11% of GDP) and Spain (c. €150bn, or 12% of GDP). For the moment, while Italy has officially requested all of these sums, Spain has asked only for the grants, while postponing its decision on loans.
- Based on approval times of the European Commission and Council, the first amounts could be disbursed no earlier than July (to countries that have submitted their reform and investment plans).
- Beneficiary countries should obtain prefinancing of 13% of their entire programmes as early as 2021.
- To fund the programme, the EU will take on debt in its own name, with repayments scheduled from 2028 to 2058.

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