NGEU: capacity for transformation and macroeconomic impact

The Recovery Plans and their capacity to transform the economy

As we write these lines, the European Commission is ratifying the Recovery and Resilience Plans (RRPs) of the EU Member States. This represents the starting pistol for the distribution of the funds from the Recovery and Resilience Mechanism (RRM), the main component of the Next Generation EU Recovery Fund (NGEU), which will provide 312.5 billion euros in grants and 360 billion in loans. But receiving the funds does not mean having access to a free money bar: from the first disbursement, the Commission will monitor the execution of the projects and the implementation of the reforms set out in the RRPs, and will determine whether or not the funding will continue to reach each country.

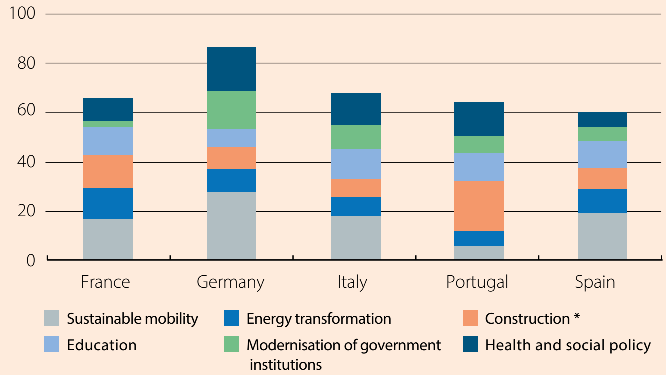
It is therefore key that the projects are executed in line with the measures and deadlines set out in the RRPs, the main characteristics of which are summarised in the first table for the four biggest economies and Portugal. The disparity in the figures reflects the unequal access to resources from the RRM, which is designed to ensure greater financial support for the countries hardest hit by the COVID-19 crisis. This explains why Italy, Spain and Portugal are the countries to benefit the most in the distribution. With regard to the application for loans and grants, Spain only discloses in its RRP the use of the latter, leaving open the possibility of applying for loans from 2022, unlike Germany and France, which have ruled out requesting them. Italy, meanwhile, foresees making full use of both the grants allocated to it and the loans, while Portugal's Plan incorporates the full amount of the grants but only 20% of the total loans it could access. As for how the funds will be spent, the Commission imposed a requirement that at least 37% must be allocated to projects for the green transition and 20% to digital transformation projects. While the various plans all meet these requirements, there are differences between them.

For instance, Germany will allocated 52% on digitalising its economy (more than twice as much as Brussels demands), followed by Spain (28%), while France will focus on the transition to a green economy (46%).

The investments proposed to achieve the various targets also differ from country to country, although some overarching trends are apparent, as reflected in the chart. Sustainable mobility projects will receive the largest share of funds (between 28% in Germany and 16% in France). The exception is Portugal, which will allocate almost 20% of the funds to construction (including new construction and programmes to support access to housing, as well as energy-related renovations of existing buildings). On the other hand, both Spain and Italy are the only countries contemplating investments to modernise and boost the competitiveness of the tourism sector (5.0% and 2.0% of the total, respectively), which has been one of the hardest hit and accounted for around 12-13% of GDP in both countries prior to the pandemic.

Main areas of investment of the national RRPs

(% of the total funds)



Note: ** Refers to expenditure on energy-related building renovations, except in Portugal, which also includes expenditure on new construction.*
Source: *CaixaBank Research, based on data set out in the RRPs and estimates by Bruegel.*

The RRPs also include reforms based on recommendations by the European Semester which seek to address major structural challenges and correct macroeconomic imbalances. The German Plan is the most scarce in terms of reforms, which include the modernisation and digitalisation of general government institutions and the removal of barriers to investment. In the other four countries, one of the priorities is to improve the state of the public finances: France proposes a spending rule; Spain plans to undertake a fiscal reform in 2023 which will increase revenues and reform the pension system (with the agreement of all the social stakeholders); Italy will focus on combating tax fraud, will review its public expenditure annually between 2023 and 2025 and will audit all general government institutions, while Portugal proposes measures to improve the performance of public corporations. Another common challenge involves combating unemployment through active policies in most cases. It should be noted, however, that France will also reform the unemployment benefit system in order to incentivise the unemployed to search for work, while Spain will convert its ERTE furlough schemes into a permanent internal adjustment mechanism for businesses.

National Recovery and Resilience plans

		Germany	France	Italy	Spain	Portugal
	Plan amount (EUR millions)	27.9	41.0	191.5	69.5	16.6
	(%) of 2019 GDP	0.8	1.7	10.7	5.6	7.8
Financing from the Recovery and Resilience Mechanism (EUR millions)	Grants	25.6	39.4	68.9	69.5	13.9
	Loans	No	No	122.6	Maybe	2.7
Main spheres of action (% of total Plan)*	Green transformation**	42	46	44	40	38
	Digital transformation***	52	21	25	28	22

Notes: ** The data correspond to the percentages published by the European Commission, after approving the RRPs in June. Therefore, in some cases there may be small differences relative to what was published in the national RRPs. ** Minimum required by Brussels: 37. *** Minimum required by Brussels: 20.*
Source: *CaixaBank Research, based on the national RRPs and the European Commission.*

What will the macroeconomic impact of NGEU be?

The uncertainty surrounding the potential impact of the NGEU programme is high. The economic literature does not provide a reliable benchmark on the effects of discretionary fiscal measures. Moreover, the situation in which it will be implemented is exceptional and we do not yet know all the details about the programmes it will finance or the reforms they will serve to strengthen. In spite of this, we shall analyse how powerful the Plan could become for the major European economies. In order to build impact scenarios, we will make assumptions about how much GDP will be generated for each euro invested – the so-called multiplier – as well as about countries' capacity to absorb the funds. Furthermore, we will focus on the grants, since some countries have not yet decided whether they will make use of the loans, others will not request them at all, and those who do use them will face a major challenge in terms their capacity to absorb them.

The multiplier remains an unresolved problem, despite enormous efforts dedicated to identifying it.[1] In the case of NGEU, there are specific reasons to expect high multipliers: i) it is primarily an investment Plan; ii) it will be supported by structural reforms, which provide opportunities to move towards more flexible regulatory regimes (e.g. in the labour market and the goods and services market) and to achieve lasting effects beyond the execution period;[2] iii) the timing is right to make the most of the funds, given the high idle productive capacity following the shock of COVID-19 and the environment of very low interest rates,[3] and iv) it represents a coordinated shock across Europe and an additional positive impact can be expected as a result of positive spillovers between countries.[4]

Conservative scenario: low multipliers and low persistence

(pp difference in GDP versus a scenario without NGEU funds)

	2021	2022	2023	2024	2025	2026
Euro area	0.41	0.54	0.60	0.66	0.30	0.20
Germany	0.11	0.14	0.16	0.18	0.08	0.05
Spain	0.92	1.22	1.36	1.49	0.66	0.44
France	0.26	0.35	0.39	0.43	0.19	0.13
Italy	0.62	0.82	0.91	1.00	0.45	0.30
Portugal	1.03	1.36	1.51	1.65	0.73	0.48

Note: *Absorption of grants in 4 years (25% per year, starting in 2021).*
Source: *CaixaBank Research.*

To assess the effects of NGEU, therefore, we have projected two scenarios: (i) a high-impact scenario with high multipliers and long-term persistence, assuming that the recovery plans are implemented effectively such that the impact per euro invested should be in the upper range of the usual estimates;[5] and (ii) a more conservative scenario with low multipliers and limited persistence.[6] In addition, since each economy can plan where to invest the funds, they will be efficiently channelled and a much higher absorption is to be expected than in the case of other European programmes (less than 50%, on average); in our scenarios we assume that it will reach 100%.[7] The results obtained are presented in the second and third tables. In our more conservative scenario, the NGEU Plan could lead to an annual increase in euro area GDP of between 0.4% to 0.7% up until 2024. This range rises to 0.9%-1.6% in Spain and Portugal, and to 0.6%-1.0% in Italy, while it would be limited to 0.3%-0.4% in France and to 0.1%-0.2% in Germany. In the high-impact scenario, the annual increase in euro area GDP could be between 0.5% and 1.2%, reaching a range of 1.4%-2.9% in Portugal and of 1.2%-2.6% in Spain. These calculations only take into account the part of NGEU associated with grants, although some countries have already applied for part of the loans as well (Italy and Portugal). Also, they do not include the potential effect of the associated reforms, which could have an even more significant long-term impact than that of the investments of the European funds and differentiated by country.

High-impact scenario: high multipliers and high persistence

(pp difference in GDP versus a scenario without NGEU funds)

	2021	2022	2023	2024	2025	2026
Euro area	0.54	0.87	1.07	1.19	0.78	0.55
Germany	0.14	0.23	0.28	0.32	0.21	0.15
Spain	1.23	1.98	2.39	2.62	1.70	1.19
France	0.35	0.56	0.69	0.77	0.51	0.36
Italy	0.82	1.33	1.61	1.78	1.17	0.82
Portugal	1.37	2.20	2.65	2.90	1.88	1.31

Note: *Absorption of grants in 4 years (25% per year, starting in 2021).*
Source: *CaixaBank Research.*

In any case, the estimates leave little doubt that NGEU is a powerful anti-cyclical policy, but many doubts about its potential scope and long-term legacy. If high-quality programmes are chosen, effectively developed and accompanied by useful reforms (the conditions attached to the disbursements could play an important role), a very high impact and potentially even permanent benefits could be achieved. If not, the boost to growth will be only fleeting. All in all, there is much at stake.

José Manuel Martínez Martínez and Rita Sánchez Soliva

1. For an in-depth review of the literature on multipliers, see A. Ramey (2019), «Macroeconomic Consequences of Infrastructure Investment».
2. See Albrizio and Geli (2021). «Scaling up NGEU, the role of institutions and investment Project selection». Bank of Spain Working Paper.
3. See ECB (2021). «The macroeconomic impact of the Next Generation EU instrument on the EMU». And Canova and Pappa (2021), «What are the likely macroeconomic effects of the EU Recovery plan?».
4. See Alloza, Burriel and Pérez (2018). «Fiscal Policies in the euro area: revisiting the size of spillovers».
5. We will place it slightly above 2 in the fifth year, in cumulative terms.
6. In cumulative terms, close to 1 in the third year and practically stable from then on (the positive effect is almost completed three years after the investment).
7. In both scenarios, with regard to the timing of the distribution of funds, we will assume that they are fully distributed during the period 2021-2024 at a rate of 25% each year.