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the EU's recovery plan

Pozor!: This policy is much bigger than it appears in your newstream

In the early weeks of the coronavirus' public arrival in Europe, the casual observer could have wondered if the EU still existed. Alarmed by the mounting disaster in Italy, countries quickly constructed barriers to the movement of EU citizens over their national borders, and some, notably Germany, clamped down on the exit of essential medical supplies from European logistics located with their border. Despite the clear advantage of developing a coordinated response to a global pandemic, the member states initial instinct was to deal with it nationally.

This was second gut punch to the union in less than a year. The departure of the UK hurt the EU's standing on the world stage, and weakened its power to redistribute wealth within the Union– a primary source of its influence.

Therefore, the title of the Commission's new Recovery and Resilience Program could be applied to the state of the EU as it describes what it wants to achieve for the economies of the member states. But it is much, much more than a recovery. It is an advance. The program represents an attempt to transform the power relationship between the EU and its member states, and its influence over the economic development of the continent. This is more than an argument over which member state gets the best slice of the pie: this is an attempt to shift the power of economic policy making to the Commission and to introduce the power of the EU to collect tax revenue from EU citizens.

How the EU models the impact of the coronavirus.

The Commission's Spring 2020 forecast predicts "in Q2 2020 real GDP will be around 14 % below the level recorded in the same quarter of 2019. The second quarter marks the trough of a deep recession that will see GDP fall in 2020 by 7.4 % in the EU, with only a partial recovery in GDP expected in 2021 of 6.1 %. The large majority of Member States will have a lower level of output at the end of 2021 than when the CoVid-crisis erupted." The EU believes the variables that could alter this forecast are "strongly tilted to the downside, which is illustrated in the Spring Forecast's two alternative downside scenarios of a 'second wave' of infections and longer-lasting containment measures, which entail GDP contractions of 11 % and 16 % respectively in 2020."

This shock will not be the same for everyone. The hardest hit will be countries "with sizeable tourism sectors" and/or "economies with underdeveloped capital markets and those whose structure is mainly based on small and very small enterprises will also face more difficulties to their limited access to financing sources".

The Commission's model predicts most countries will see employment rebound in 2021, but seven economies– most in central and eastern Europe- employment levels are likely to remain more than 2% below 2019 levels.

As a result of the affliction in the private sector, government revenues will decrease as the demand for public spending to replace private spending increases. The consequence, according to the EU model, is that "the primary government balance (i.e. the difference between current revenues and expenditures) will worsen in 2020 by around 7½ percentage points of GDP on average for the EU27."

The general economic situation is heavily influenced by the willingness and ability of governments to spend money to make up the private sector shortfalls. According to the EU, the actions of member states appear to be exacerbating economic disparities: the big, economically strong countries have active government, while other governments are not doing as much. Germany, the biggest economy, has seen the most state aid (996 billion euros). This is "equivalent to around 29% of German GDP and 52% of all State Aid provided" in the EU. Germany's activity is followed by France (around €324bn, 13.4% of GDP), Italy (around €302bn, 17% of GDP) and Belgium (around €54bn, 11% of GDP). The aid granted by the vast majority of the other Member States ranges in the lower-single digits of GDP, including Spain with around €27bn (2.2% of GDP)."

Where the EU sees the needs in the economy.

The EU wants to create a program to help address 1) drops in public and private sector investment due to COVID19, 2) the general decline in public capital stock (often due to high public indebtedness) and 3) investment needs for its initiatives in the green economy, climate change, digital transformation and strategic economic autonomy.

EU-27 Investment Gaps following the crisis (current €bn, 2020-2021 cumulative)

	Public	Private	Total
Basic investment gap (relative to pre-crisis trend)	15	831	846
Avoid declining public capital stock	200	n/a	200
Total			**1,046**

Investment needs to meet targets of strategic twin transitions
(current €bn, 2020-2021 cumulative)

	Public	Private	Total
Green transition			940
Climate mitigation and energy 2030 targets*			680
Wider environmental objectives, beyond climate			260
Digital transformation			250
Strategic investment (for EU autonomy on critical value chains)			40
Total			**1,230**

Basic Investment Gap

The EU predicts severe solvency concerns for 180,000-260,000 companies across the EU. Total losses in the private sector are modelled to range from 720 billion euro to 1.2 trillion euro by the end of 2020.

> “The ability of the European economies to return to growth depends on the resilience and adaptability of the private sector. The Covid-19 crisis has a major impact on the liquidity and equity position of non-financial corporations (NFCs).4 Solvency concerns impinge strongly on both non-financial corporations and unincorporated businesses, the latter being the main income source of many households. In the most vulnerable sectors — and for viable firms that start from a weaker position — solvency support may be necessary to allow them to stay in business and resume investments and employment growth as the recovery takes hold.
>
> ...the baseline economic scenario from the Spring Forecast economic materialises total losses to be incurred by firms could exceed **€720bn** by the end of the year and would increase to above **€1.2trn** in the stress scenario.

...The estimates show that between 25% and 35% of companies would experience a financing shortfall by the end of the year after exhausting working capital and liquidity buffers, respectively. In the adverse scenario, these shares could increase to 35% and 50%, respectively. 180,000-260,000 of European companies employing around 25- 35 million employees could experience a financing shortfall should the adverse scenario materialise. The corresponding liquidity shortfall to be covered could range between €350bn and €500bn in the baseline scenario, and between €650bn and €900bn in the adverse scenario. The sectors showing the greatest share of firms facing liquidity and working capital shortfalls are wholesale and retail trade, accommodation and food services, and transport industries. These firms will face an acute risk of bankruptcy."

Green Economy and Climate Change

The Commission's proposed investment cover "current 2030 climate and energy targets (€240bn additional annual investment) but also investment needs to deliver on Europe's wider transport infrastructure (€100bn per year) and environmental objectives (€130bn per year)." These amounts are deemed conservative as the total needed investment is not yet quantified.

Digital Transformation

According to the report, "the EU suffers from low and fragmented investments in digital capacities and infrastructures and from a slow adoption of digital innovations in private and public sectors." The Commission's assessment identified an investment gap of 125 billion euros.

Investment gaps for digital transformation (EUR bn, per year)	
Communication networks	42
HPC, Graphene and Quantu 6 Cloud	11
AI and Blockchain	23
Digital green technologies	6
Cybersecurity	3
Digital Innovations/ Data and Next Generation Internet	5
Semiconductor/Photonics	17
Digital skills	9
Common European data spaces	3
Total	**125**

Strategic autonomy

The Commission believes that the virus exposed vulnerabilities of the EU due to “an excessive dependence on the import of critical goods and services”. Addressing this vulnerability would require of annual investments of 20 billion euro over the short-term. Four areas requiring strategic autonomy exist:

- Strategic digital infrastructures (5G, cybersecurity, quantum communication infrastructure)

- **Key enabling technologies:** robotics, microelectronics, high-performance computing & data cloud infrastructure, blockchain, quantum technologies, photonics, industrial biotechnology, biomedicine, nanotechnologies, pharmaceuticals, advanced materials.

- **Defence & Space**

- **Critical raw materials** crucial for e-mobility, batteries, renewable energies, pharmaceuticals, aerospace, defence and digital applications

- **Medical products & pharmaceuticals.**

Social and Health

In addition to the investment needed in purely economic areas, the Commission identified social and health needs.

The cost of employment support programs adopted by member states is estimated at 135 billion euros for 2020. The commission believes high unemployment will require a continuation of many of those policies through 2027 at the cost of 150 billion euros.

The pandemic has uncovered the need to re-orient “EU health systems towards increased use of hospitals for infectious diseases treatment, prevention and diagnostics, where care is falling short, as well as the need for a more substantive health programme to finance cross border issues related to health security and the resilience of health systems.” The Commission estimates the cost at 70 billion euros.

What the EU proposes to do.

To help member states with these daunting financing needs, the EU has strengthened or introduced seven programs.

European Recovery and Resilience Facility- €310 billion in grants and €250 billion in loans administered through member states according to their recovery and resilience plans.

REACT-EU- €55 billion of additional cohesion policy funding between 2020 and 2022. For municipalities, hospitals and companies. To be administered by member states. No member state co-financing required.

Next Generation EU support for green transition– up to 40 billion euro for Just Tranistion Fund to achieve climate neutrality. 15 billion euro for European Agricultural Fund for Rural Development to help transition to Green Deal.

Enhanced InvestEU Programme. 15.3 billion euro for guarantees for financing through EIB or national promotion banks.

Solvency Support Program. 31 billion euro in guarantees for private companies through EIB.

EU4Health. 9.4 billion euro to strengthen health security and prepare for future health crises.

Reinforcing rescEU. 3.1 billion euros to strengthen civil rescue systems.

These grants and guarantees would be allocated according to an assessment of how the pandemic impacted the country and the country's prior financial and economic condition. The Commission's proposal is below:

Table A.1: Allocation key

Country	Allocation Key	Group	GDP bn	Share in EU 27 GDP	Recip in bn	Contr (bn)	Net (bn)	Net (% GDP)	GDP per cap
BE	**1.6**	**H**	474	3.4%	12.0	25.5	-13.5	**-2.9%**	35900
BG	**2.0**	**E**	61	0.4%	15.0	3.3	11.7	**19.3%**	6800
CZ	**1.5**	**E**	220	1.6%	11.3	11.9	-0.6	**-0.3%**	18000
DK	**0.6**	**H**	311	2.2%	4.5	16.7	-12.2	**-3.9%**	49190
DE	**6.9**	**H**	3436	24.7%	51.8	185.1	-133.3	**-3.9%**	35980
EE	**0.3**	**E**	28	0.2%	2.3	1.5	0.7	**2.6%**	15670
IE	**0.4**	**H**	347	2.5%	3.0	18.7	-15.7	**-4.5%**	60350
EL	**5.8**	**S**	187	1.3%	43.5	10.1	33.4	**17.8%**	18150
ES	**19.9**	**S**	1245	8.9%	149.3	67.1	82.2	**6.6%**	25170
FR	**10.4**	**H**	2419	17.4%	78.0	130.3	-52.3	**-2.2%**	33360
HR	**2.0**	**E**	54	0.4%	15.0	2.9	12.1	**22.4%**	11990
IT	**20.4**	**S**	1788	12.8%	153.0	96.3	56.7	**3.2%**	26860
CY	**0.3**	**S**	22	0.2%	2.3	1.2	1.1	**4.9%**	24250
LV	**0.7**	**E**	30	0.2%	5.3	1.6	3.6	**11.8%**	12490
LT	**0.9**	**E**	48	0.3%	6.8	2.6	4.1	**8.6%**	13880
LU	**0.0**	**H**	64	0.5%	0.0	3.4	-3.4	**-5.4%**	83640
HU	**2.0**	**E**	144	1.0%	15.0	7.7	7.3	**5.0%**	13180
MT	**0.1**	**E**	13	0.1%	0.8	0.7	0.0	**0.3%**	21890
NL	**1.7**	**H**	812	5.8%	12.8	43.7	-31.0	**-3.8%**	42020
AT	**1.0**	**H**	399	2.9%	7.5	21.5	-14.0	**-3.5%**	38240
PL	**8.6**	**E**	529	3.8%	64.5	28.5	36.0	**6.8%**	12980
PT	**4.2**	**S**	212	1.5%	31.5	11.4	20.1	**9.5%**	18550
RO	**4.4**	**E**	223	1.6%	33.0	12.0	21.0	**9.4%**	9130
SI	**0.5**	**E**	48	0.3%	3.8	2.6	1.2	**2.4%**	20490
SK	**2.0**	**E**	94	0.7%	15.0	5.1	9.9	**10.5%**	15890
FI	**0.7**	**H**	240	1.7%	5.3	12.9	-7.7	**-3.2%**	37170
SE	**1.2**	**H**	475	3.4%	9.0	25.6	-16.6	**-3.5%**	43900

Note: E, S, and H groups refer to EU below average GDP per capita (low debt), EU below average GDP per capita (high debt), and EU above average per capita income (high income), respectively.

Explanatory note: illustrative key for the sole purpose of the preliminary estimation of the potential impact of the recovery package using the Commission's QUEST model presented on p. 43

A new taxman cometh.

The introduction of the EU as a lender of last resort is an interesting enough development in European politics. How the EU proposes to pay off those debts could change the relation between Brussels and the member states.

Emissions Trading System generating 10 billion euro annually.

Carbon border adjustment generating 5 to 14 billion euro annually.

Digital Services Tax on companies with revenue over 750 million euro generating 1.3 billion annually.

Single Market Tax on companies which receive a "huge benefit" from the single market generating 10 billion euro annually.

The Commission explains that these "own resources" could help finance the repayment of and the interest on the market finance raised under Next Generation EU.

This part of the proposal is not meant for immediate action, but to be implemented between 2021-2027.

Will the recovery plan be approved?

The probability is yes– in some form.

The EU’s assessment of the state of the European economy is shared by most credible forecasters. This fall is going to be tough on liquidity, even without a second wave of the virus. It will be hard for national governments to look into the television camera and tell unemployed voters and insolvent entrepreneurs that the government said no to an infusion of cash, particularly in countries with elections.

On the other hand, only one government has to say no. The most likely candidates are those countrie who will have to contribute to the plan than they receive. That includes the Czech Republic.

The negotations will likely center on whittling the package down to those things that will bail businesses and employees out. Determining how much should be a grant that members states do not have to pay back, and how much should be a loan which they must will also be highly contentious?

What happens if the proposal fails? That outcome could cripple the EU, especially after the failure of Brexit. And France and Germany, which are backing the proposal, could use failure as a reason to revive a “two-speed” Europe.

This proposal is a big deal. No matter what happens. Businesses– and citizens– should be weighing its opportunities and threats and expressing their views to their elected representatives.