Luiss
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NEXT GENERATION EU: An interpretative guide

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1. Introduction: a breakthrough proposal

The proposal, which the European Commission made public on May 27, 2020, strengthens and articulates the framework launched by Macron and Merkel about ten days before (May 18). This proposal, which is called "Next Generation EU" (NG-EU), confirms the disbursement by the European Union of 500 billion euro in the form of transfers, including guarantees, and adds 250 billion euro in the form of long-term loans to European Union (EU) member states. These resources will be collected through the issue of bonds on the financial markets by the European Commission on behalf of the EU. These issues will depend on the increase in the margin between own resources and the disbursements of the EU budget. The associated European debt, which has a long-term duration (the first maturities are in 2028, the last in 2058), is guaranteed by the next MFFs and will have to be repaid (including interest) by means of increases in the revenues of these same MFFs, also through the introduction of new own resources and, for the component relating to the 250 billion euro in loans, by the payment of financial charges and reimbursement made by the beneficiary countries.

The few data mentioned show that, combining with the huge liquidity injection made by the European Central Bank (ECB) through the monetary transmission channel (almost 1,700 billion euro until mid-2021)[1] and the banking channel (a potential of 3,000 billion euro by the end of 2021) and with the substantial but more limited funding from the Eurogroup and other institutions of the euro area (EA) (around 540 billion euro by the summer), NG-EU presents the possibility for a strong economic recovery of the EU member states. In particular, thanks to the suspension of the adjustments required by the 'Stability and Growth Pact' and the strengthened purchases of public debt bonds of the EA countries made by the ECB on secondary financial markets, national economic policy initiatives have stemmed the pandemic's emergency phase. Eurogroup decisions and the further strengthening of the ECB's

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[1] The calculation has taken into account the strengthening of the PEPP program, decided by the Governing Board of the ECB at the meeting of June 4, 2020.

expansive monetary policy are accompanying the transition phase, which will last until the autumn of 2020. Starting from 2021, the NG-EU will offer adequate quantitative support to the recovery.

A qualitative feature of the Commission's proposal's makes it possible to add that NG-EU also provides the ingredients for a decisive qualitative leap in the European integration process. It is true that, similarly to the Macron and Merkel scheme, NG-EU acts as a one-off initiative, that is, it is an extraordinary intervention relating only to the flows of European expenditure or national public expenditure between 2021 and 2026 and not relating to pre-existing public debt stocks. However, NG-EU is also an initiative with significant redistributive effects, since the transfers of each EU member state to the MFF are, roughly, determined by the weight of the Gross Domestic Product (GDP) compared to the total Gross Product of the EU;[2] conversely, the 750 billion euro of transfers or loans are allocated among the EU member states on the basis of a distribution mainly dictated by their fragility and by the asymmetrical intensity and the timing with which the coronavirus has affected their economies.

Since it is inscribed in the adoption of the 2021-2027 MFF, the NG-EU proposal must be examined by the Council ECOFIN and must mainly obtain approval from the European Council and the European Parliament. Furthermore, by providing for the increase in the maximum threshold of the EU's own resources, the final approval requires not only member states' unanimity but also ratification by the national parliaments.

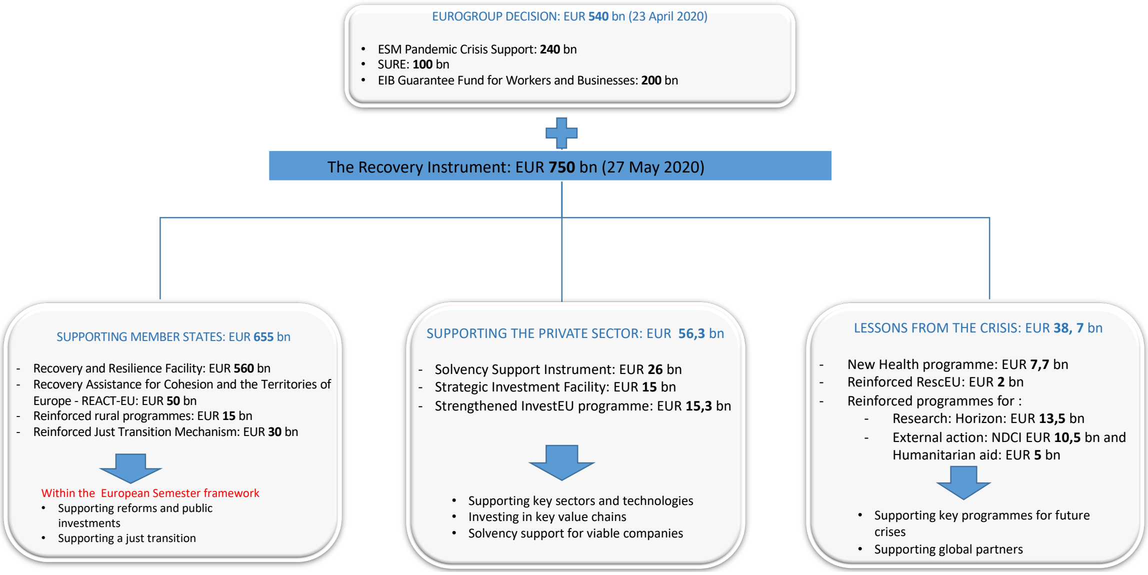
In what follows, first mention is made of the architecture of NG-EU (see section 2). It is then shown that, if combined with national fiscal policy decisions and other European initiatives, the NG-EU proposal has a quantitative dimension and an allocation of resources that is sufficient to support the recovery and convergence processes between the member states within the EU (see sections 3 and 4). The achievement of these results requires, however, that especially the member states that will most benefit from NG-EU develop and launch national projects suitable for the efficient use of the related European resources (see section 5). The *Conclusions* reiterate the fact that, if approved and properly implemented, NG-EU would mark important progress in the EU integration process.

2. The architecture of the proposal

NG-EU is divided into three pillars (see Fig. 1). The first pillar, called "Supporting Member States", represents the most substantial part of the initiative as it provides for the disbursement of 655 billion euro to EU member states (approximately 87% of the total of NG-EU) by the end of 2024. A part of this amount will be allocated in the form of transfers not to be repaid, which will be added to the transfer items traditionally included in the EU MFFs (cohesion funds, structural funds, and so on); the remainder will take the form of long-term loans at very low interest rates because they are guaranteed by the MFF.

[2] Here, it is not necessary to take into account the differences between GDP and Gross National Product.

Figure 1: The European Union response to the Covid-19 Crisis



Source: European Commission

The most important component of the first pillar is represented by the "Recovery and Resilience Facility" (RRF), which is endowed with resources of 560 billion euro, equivalent to over 85% of "Supporting Member States" and about 75% of the entire NG-EU initiative. The destination of these resources, which will take the form of both transfers (about 56%) and loans (for the remaining 44%), will be broad-based. The RRF aims, in fact, to protect employment, to strengthen education and the training of human resources, to support research and innovation, to improve the health system, to facilitate the evolution of the financial sector, to increase the efficiency of public administration and the social and economic environment. However, it is mainly intended to accompany the recovery phase of the member states by supporting those investments and those reforms that will be the basis of the national "Recovery and Resilience Plans" (NRRPs) to submit for approval to the European institutions within the European Semester. In its proposal, the European Commission underlines that this investment support aims to build a solid link between the economic recovery of the individual EU member states and the objectives of innovation in the digital field and of implementation of the Green Deal, with the progressive reduction of emissions. The RRF is therefore strictly connected to the original objectives set out by the President of the new European Commission (Ursula von der Leyen) when she was sworn in before the pandemic. In this sense, it represents an essential element for the implementation of sustainable and long-term EU development.

The second component of "Supporting Member States", the "React-EU" (REU), also aims to support green investments and digital innovations. However, the REU, which is expected to provide resources of around 50 billion euro, is primarily intended for the countries and sectors most affected by the pandemic shock. In addition to encouraging sustainable innovations, it must therefore allocate a large part of the resources available to small and medium-sized firms and their employees, as well as to activities relating to tourism and culture. Finally, the first pillar of NG-EU is completed by additional funds (equal to approximately 45 billion euro) for the mechanisms and reforms necessary to pass from the transition phase to the recovery phase. It is interesting to note that a portion of these funds will be used as leverage for EIB interventions.

The second ("Supporting the Private Sector": SPP) and third ("Lessons from the Crisis") pillars of NG-EU are intended to provide a more limited amount of resources (95 billion euro in total). They will, however, play significant roles.

The second pillar (with an allocation of just over 56 billion euro) will be dedicated to the reinforcement of that Invest-EU program which - in the Commission's approach - should ensure the strengthened continuation of the Juncker Plan, and to a new instrument of recapitalization of companies located in the countries most affected by the pandemic (the "Solvency Support Instrument"). The three main programs, which substantiate the SPP pillar, are in fact intended to provide the financial public basis for Invest-EU leverage (set at 10, that is, a multiple lower than the Juncker Plan to take into account the lower availability of private investors in the current economic phase), for incentives to mobilize private resources and for the selection of efficient companies but with capitalization problems. Therefore, at least in the Commission's expectations, the limited financial commitment of the second pillar of NG-EU should be able to activate, directly or indirectly, much greater financing and guarantees in favor of European firms.

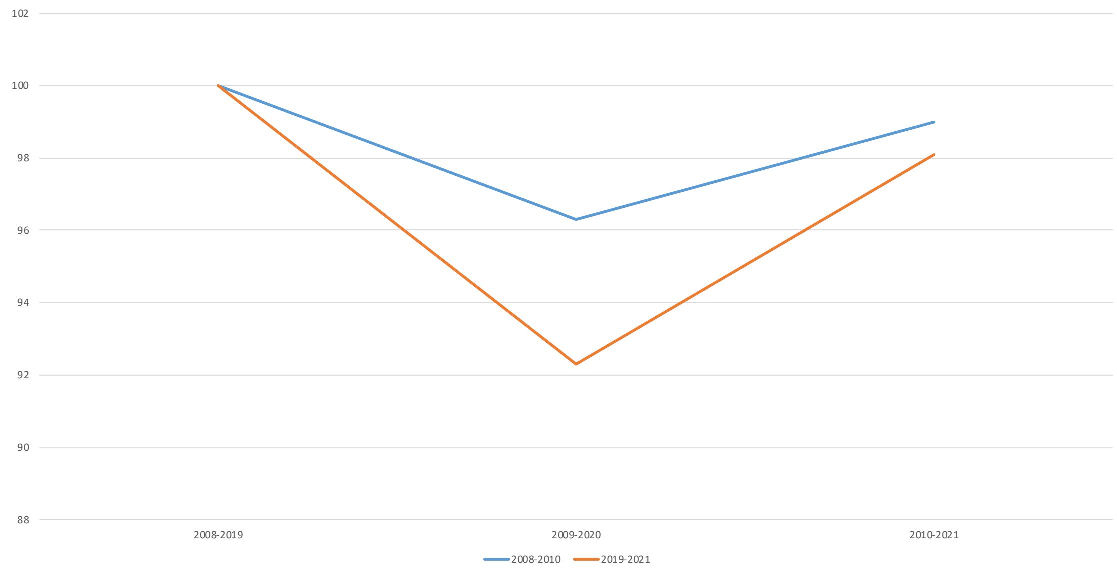
The third pillar (with an allocation of just under 39 billion euro) pursues the aim of financing European “public goods” that emerged as a priority during the crisis; in particular, it would have to launch a new health program at the European level. Moreover, this pillar safeguards relations between the EU and Europe’s economic partners in the new international setting, which will perhaps be characterized by more internal value chains in each of the large economic areas (China, the United States, India, parts of Central-South America, as well as the EU) and which - therefore - will request a partial re-internalization in the European single market of intermediate technology specializations and sectors. Finally, this same pillar will have to support and strengthen funding for research projects ('Horizon').

3. The economic phases to be financed

EU member states will have to bind 60% of resources mobilized by the most important NG-EU programs by 2022 and the remaining 40% by 2024; in addition, they will be called to account for the investments and reforms made thanks to these resources by 2026. This temporal sequence of NG-EU is important for various reasons. In this section, emphasis is made on the expected timing of the inflow of the first tranches of the financing. If we consider the crucial role played by the 2021-27 MFF and the architecture of the Commission’s proposal (see section 2), it becomes clear that the resources of NG-EU will begin to flow to the European countries affected by the pandemic shock only from 2021, except for a modest component obtained from the increase of resources in the 2014-2020 MFF. Various commentators have criticized this alleged delay, claiming that European economic systems are thus exposed to a high risk of falling into hysteresis during 2020.

At first glance, the criticism appears justified by the severity of the pandemic crisis. Compared to the recent international financial crisis (2007-09), which produced the "great recession" and then led to a European crisis (2010-13) that appeared at the time to be the longest and heaviest of the new millennium, the pandemic-induced depression is causing an even more drastic fall in the average GDP of the EA and envisages a delayed and partial recovery by all the member states (see Fig. 2). Yet, despite the dramatic intensity of the crisis we are experiencing, preliminary and aggregated empirical evidence is sufficient to instill doubts about the existence of a causal link between the delayed allocation of NG-EU resources and the increased risk of hysteresis in the EA and in the EU.

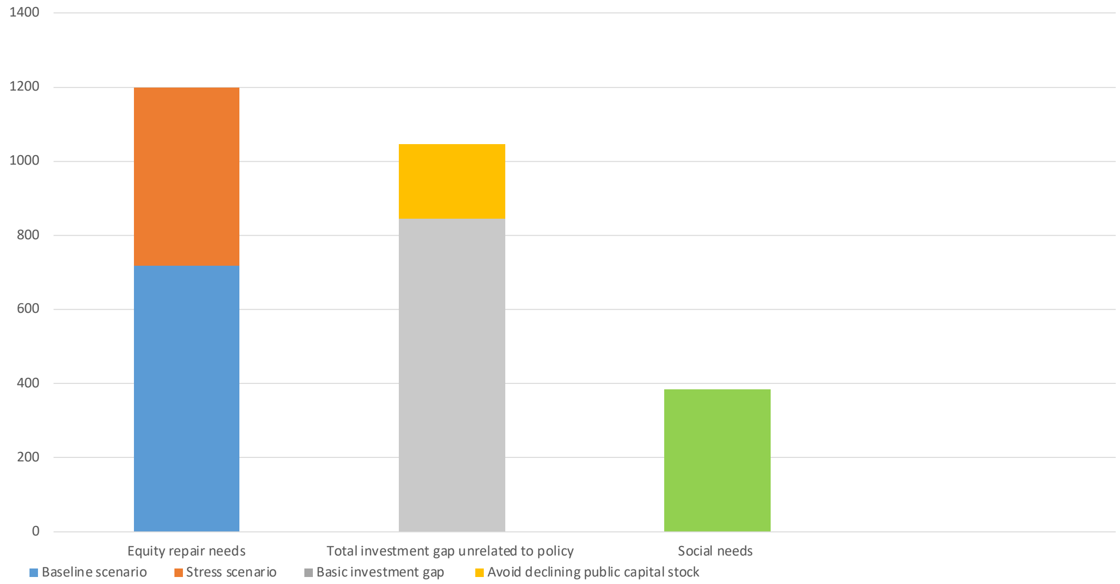
Figure 2 EA GDP level during GFC and Covid-19 (2008 and 2019=100)



Source: European Commission

Figure 3 shows that the additional financial needs of the EU in the 2020-21 period, attributable to the pandemic shock, are slightly below 2,000 billion euro in a baseline scenario and exceed 2,500 billion euro in an adverse scenario. It is not easy to allocate such enormous financial needs among the three phases of the crisis set out in the introduction (see above, section 1): (i) the phase of the pandemic emergency, (ii) the phase of the transition from the pandemic peaks to the recovery, (iii) the phase of a sustainable recovery. It is however reasonable to assume that social needs weigh above all in phase (i) and - in part - in phase (ii), that the need to bridge the investment gaps (public and private) occurs in the transition phase but becomes a problem to be solved only in phase (iii), that the need for production recapitalisations spreads out over phases (ii) and (iii) as it can concern both the survival and the strengthening and expansion of a part of the firms. These considerations should be refined with more specific data. However, they allow us to affirm that, even if the worst case scenario occurred, we would have - roughly - the following picture for the whole of the EU: the coronavirus emergency phase would determine financial needs for slightly less than 800 billion euro, the transition phase would determine financial needs for around 500 billion euro and the recovery phase would determine residual needs for around 1,200 billion euro.

Figure 3 Financing needs 2020-21, in EUR billion

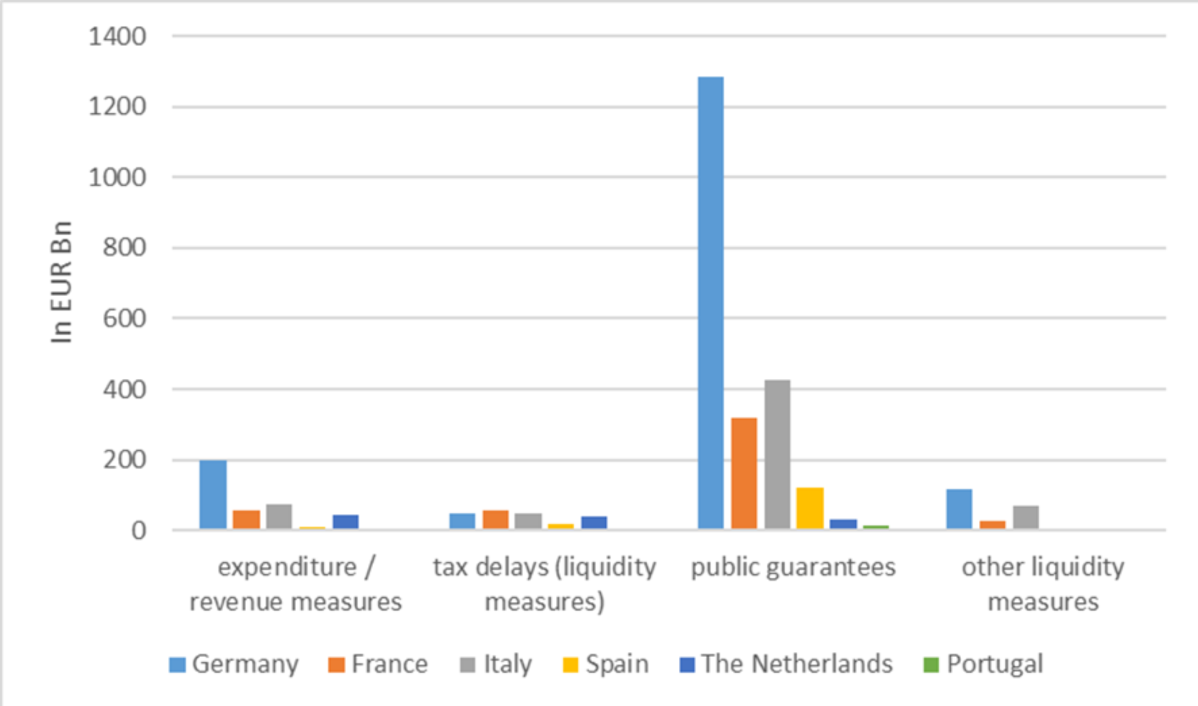


Source: European Commission

Figure 4 provides an estimate of a part of the public expenditure disbursed in the main EU member states in the period between mid-March and early June 2020. With some degree of approximation, it can be assumed that this period includes the peak period of the pandemic emergency in the various EU countries. It is easy to verify that the sum of expenses introduced by national government interventions to deal with the emergency more than compensates for the amount of the EU's financial needs in phase (i).[3] The same applies to phase (ii): as already mentioned (see Fig. 1), in the EA alone the Eurogroup and other European institutions have earmarked around 540 billion euro. In particular, SURE should provide funding to EA countries of approximately 100 billion euro to support the incomes of temporarily unemployed workers; the European Stability Mechanism (ESM) offers funding of approximately 240 billion euro for expenditure directly or indirectly related to the national health sector; the European Investment Bank (EIB) should guarantee or provide loans to European firms for around 200 billion euro. It follows that the huge resources of NG-EU are not necessary to finance the emergency and transition phases. Instead, they will be used to support the recovery phase which, in the coming years, will also have to ensure the convergence of the economies of the most fragile member states towards the heart of the EU. Taking into account the national initiatives for recovery undertaken by the 'stronger' countries (see also footnote 3) and the leverage effects of NG-EU, the latter's resources should be sufficient for the purpose.

[3] The sum of government interventions should remove a part of those implemented in the strongest EU countries that are already projected to support the recovery phase (see, for example, Germany's recent fiscal initiative). In this regard, a preliminary calculation leads to a subtraction of approximately 50 billion euro in absolute value. The residual amount is, however, sufficient to cover the needs of the emergency phase.

Figure 4



Source: European Commission

The example of Italy, that is, a 'fragile' country hit hard by the pandemic, is emblematic. Between March and May 2020, the Italian government issued three decrees which mobilized more than 80 billion euro of public resources and led to increases in public debt of around 130 billion euro. In addition, between March 2020 and June 2021, the ECB will purchase approximately 220 billion euro of Italian public debt bonds in secondary financial markets. Added to the additional public expenditure in support of households and businesses that will be disbursed in the second half of 2020, these liquidity inflows are quantitatively sufficient to stem the impacts of the pandemic emergency without making the management of the Italian government budget unsustainable in the short term.

In addition, it has already been said that the Eurogroup and other European institutions have implemented various programs to support the economic transition of EA countries in the post-pandemic phase. These programs will make more than 100 billion euro available to Italy as of summer 2020: SURE, for which Italy has made a request of 29 billion euro; the ESM, which would make available loans of approximately 37 billion euro if the Italian authorities requested them; the European Investment Bank (EIB), which should guarantee or provide loans to Italian firms for approximately 35 billion euro. Finally, the 2014-2020 MFF offered Italy, without co-financing, residual resources for more than 7 billion euro.

The result is that today Italy would already have over 230 billion euro to get out of the pandemic shock and to finance its transition phase. 230 billion euro would amount to around 13.5% of Italy's GDP. This confirms that it seems rational to allocate the new resources, which should come from NG-EU, to consolidate the recovery phase rather than the current emergency or transition phase.

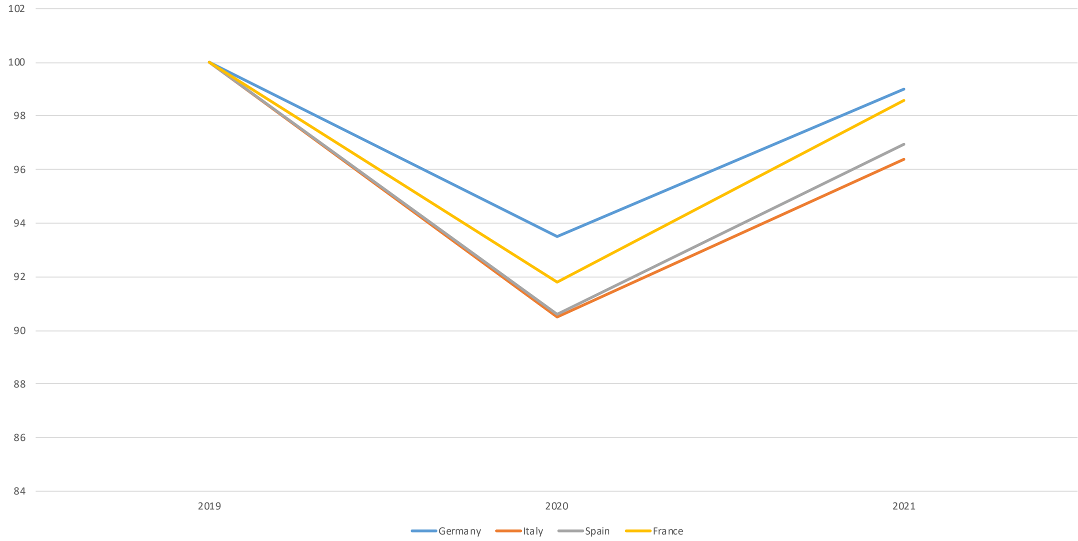
4. The redistributive effect to prevent the "Great Fragmentation"

The conclusions reached in the previous section are not only useful to underline one of the reasons that make a delayed (that is, starting from 2021) influx of NG-EU resources to European countries appropriate. They also explain why the EU's structural equilibria require that these resources be allocated according to the impact that the pandemic shock has had in countries with different fragilities. As it is now widely recognized, this unexpected event was a typical symmetric exogenous shock that produced asymmetrical consequences on individual EU member states due to their various industrial structures being founded on sectors differently exposed to the pandemic effects, as well as due to their previous macroeconomic imbalances and - in particular - their different fiscal capacities. Moreover, the pandemic shock has been temporally out of phase since it hit the various EU countries in different moments and with different intensity. This last element implied a kind of 'moral imperative' for countries affected to a relatively lesser extent to help countries hit earlier and with greater intensity. On the other hand, the redistributive policies became less controversial from a political point of view, since it was recognized that the refusal to help the more affected countries would put at risk the integrity of the single market and even the integrity of the European Union.

Without ad hoc corrections, the post-pandemic phase would therefore be characterized by the strengthening of the divergences between EU countries: the stronger countries, which tend to coincide with those with wider room for fiscal capacity, would become even stronger in relation to the rest of the EU. Without a substantial intervention aimed at supporting the countries most affected by the crisis, the risk would be to move from the Great Recession following the 2008 financial crisis to the Great Fragmentation, which would be a consequence of the COVID-19 crisis and would be exacerbated by the different firepowers of the European countries. The spring macroeconomic forecasts drawn up by the European Commission and summarized in Figure 5 illustrate the phenomenon very well. Moreover, a lack of solidarity with the most affected countries would have negative ethical implications. Being allocated in proportion to the fragilities of the individual member states and to the impact of the pandemic, NG-EU resources are a potential tool for correcting the divergencies; and the instrument becomes even more effective in the recovery phase than in the emergency phase, which is characterized by scarcely selective public expenditure.

The redistributive effect is particularly important in the case of Italy. Suffice it to say that, at the end of 2019, Italy's GDP was about 11.3% of EU GDP; and, in the 2014-2020 period, Italian contributions to the MFF amounted to approximately 13.7% of the total of national contributions (which, in turn, roughly equalled 70% of the overall size of the aforementioned seven-year budget). Conversely, according to the proposals made by the European Commission, Italy could obtain over 170 billion euro (that is, slightly less than 10% of its GDP at the end of 2019) divided into approximately 90 billion of long-term loans and 80 billion of transfers, which would be 22.7% of NG-EU resources. The other fragile countries of the EA (Greece, Portugal, Spain) will be able to enjoy figures that will - roughly – be similar to those of Italy, if the different intensities and the different temporal sequences of the pandemic shock suffered and the size of their economies are taken into account.

Figure 5 GDP level EC Spring Forecasts (2019=100)



Source: European Commission

These considerations underline that the conclusions reached at the end of the previous section adapt above all to the case of the member states most affected by the crisis and to the redistributive component of the Commission's initiative: the NG-EU resources must be used to support the economic recovery that, starting in 2021, will have to ensure the convergence of the economies of the most fragile member states towards the heart of the EU.

5. NG-EU and national plans

The analysis carried out so far highlights an important aspect from the viewpoint of European economic governance: the redistributive effects between member states, induced by NG-EU, are activated by an initiative of the European Commission and are made possible by the use of the MFF. Thus, after the international financial crisis had focused EU governance on the decisions of the European Council and - consequently - on the intergovernmental method, the qualitative leap in the integration of the EU once again rests on two cornerstones of the EU community method.

This same analysis also reveals a further and fundamental reason which makes the criticisms of the postponement in the supply of NG-EU resources improper and which nurtures, if anything, an opposite concern. The actual transfers or loans to member states of the most substantial NG-EU components require the formulation of national strategies that are compatible with the priorities identified by the country-specific recommendations of the European Semester. In particular, the individual beneficiary states are called upon to formulate a strategy and to define the consequent specific investment and reform projects to be financed with those resources; and these specific national plans must obtain approval from the European Commission and other European institutions involved. The real problem that NG-EU will pose at the beginning of 2021 will therefore be not the delayed disbursement but rather whether or not the beneficiary countries have designed adequate strategies and are ready to specify the set of projects and their implementation steps between 2021 and 2024.

The description of the contents of "Supporting Member States" and, in particular, of RRF confirms what has just been said: the actual access to the most relevant component of NG-EU (that is, its first pillar) by potentially beneficiary countries requires the preliminary definition of a set of investments and strategic reforms, inscribed in a coherent high-profile planning and organizational framework. In particular, access to the wider program - that is, the RRF - should be substantiated with concrete projects that are able to meet the priorities assigned by the European Semester to each of the requesting countries and that, above all, mark national progress in terms of 'green' and digital transition. In other words, each member state of the EU and - a fortiori - of the euro area must justify its access to RRF resources by drawing up an appropriate "National Recovery and Resilience Plan" (NRRP). In addition, each of these NRRPs must be consistent with the corresponding National Energy and Climate Plan, with the Plan linked to the Green Deal and - therefore - developed in the context of the "Fund for a Just Transition", with the specific Partnership agreements and with the National Operational Programs concerning the use of other EU funds.

These considerations show that, for each of the EU member states, the NRRP plays a crucial role in the access to NG-EU resources. It is therefore worthwhile to elaborate on some further details. Each NRRP must at least provide an explanation of how the specific country intends to:

(a) address the challenges and priorities identified in the context of the European Semester;
(b) strengthen its growth potential, the creation of new jobs and its economic and social resilience;
(c) mitigate the impact of the crisis on the production system and on the access to resources, contribute to the economic, social and territorial cohesion of the European Union, implement internal convergence processes in the area;
(d) contribute to green and digital transitions, managing the consequent challenges.

Each of these Plans must also justify its internal consistency and specify which are:
(e) the final objectives and expected intermediate targets, also defining an indicative timetable for the implementation of both the reforms, within a maximum period of four years, and the investments, within a maximum period of seven years;
(f) the individual investment projects envisaged and the related investment period;
(g) the indicators to measure the stages of their implementation and full realization;
(h) the total costs, estimated on the basis of appropriate justifications, for the implementation of the reforms and investments included in the Plan itself;[4]
(i) the correspondence between these costs and the expected impacts on the economy and on employment;

[4] This is the so-called "estimated total cost" of the NRRP.

(j) if applicable, the EU funding that already exists or that is in the process of being disbursed;
(k) the necessary measures accompanying the various projects (reforms and investments);
(l) the different procedures followed for monitoring and implementing the Plan itself.

The complexity of the drafting, submission and desirable approval of the NRRP of each EU member state is an excellent example of the fact that even if the NG-EU is approved by the European Council and other EU institutions (primarily, the Parliament) in the form proposed by the Commission, access to the relevant resources by countries would be neither easy nor unconditional. In confirmation of what has already been said, such access would require at least three steps. First of all, a preventive and systematic effort to define a strategic destination of the resources made available by the European Commission to the individual member states through the specific programs included in the NG-EU that is in accordance with the European objectives. Secondly, the translation of this strategy into concrete projects to be submitted for approval by the European institutions and, subsequently, to be implemented in constrained time periods. Finally, the implementation of individual projects through the effective transfer of the different flows of resources to their final beneficiaries.

6. Conclusions

The analysis carried out in the previous sections has revealed three essential points that we would like to reiterate by way of a conclusion.

First: the proposal relating to NG-EU represents a turning point in the evolution of European economic governance, as it marks a qualitative leap in the coordination of EU policies by adding to the 'horizontal' surveillance of national fiscal policies a 'vertical' coordination between these policies and the European budget. While taking due account of the extraordinary nature of the intervention, the fact remains that NG-EU attributes a crucial and innovative function to the EU's multi-annual budgets. In fact, for the first time the MFFs will guarantee a substantial issuance of European debt bonds (750 billion euro, or almost 70% of the 2021-27 MFF) and will thus become the tool for the first redistribution of huge resources among member states with the aim of stabilizing the EU countries most affected by the profound crisis. In addition, to cover the financial charges and to repay the portion of the debt contracted to finance transfers to member states at maturity, future MFFs will have to strengthen the revenue side also through the introduction of new own resources; and it is well known that, sooner or later, greater tax centralization will require progress in the centralized forms of representation, which in turn will imply a step in the direction of political-institutional federalism.

Second: by combining with the ECB's increasingly expansive monetary policies and Eurogroup interventions, NG-EU offers a decisive contribution to overcoming the economic depression induced in the EU by the pandemic shock. In particular, if used properly, the various NG-EU programs are quantitatively and qualitatively adequate to allow the most fragile EU member states to carry out those recovery processes which - between 2021 and 2027 - should lead to convergence with the stronger countries. It is an opportunity that cannot be squandered. To avoid this risk, it is necessary that the huge

NG-EU resources be efficiently utilized, especially by the most fragile EU countries. This would improve the evolution in European economic governance mentioned above, would reduce the differences between member states, and would strengthen - as a consequence – the European single market, which becomes the trigger for European economic growth in the current phase of weakening globalization.

Third: precisely to improve these positive outcomes even more, NG-EU incentivizes EU member states to launch investment and reform projects that will lead to an effective use of the resources offered by the three pillars. As far as the most important NG-EU programs are concerned, the actual disbursement of the resources is conditioned by the individual countries' ability to develop NRRPs capable of passing the European Semester exam and to translate them into concrete projects.

It is obvious that the NG-EU's final approval by the European institutions and the efficient and effective national utilization of the resources deriving from this desirable approval require a strong political-institutional investment. The European institutions and the two most important European leaders have already committed themselves in that direction. We hope that their commitment will be emulated by those who are in charge of the policy tools and of the institutional decisions in the different EU countries. This would be the crucial condition to re-establish trust between EU member states and, finally, between the EU and its citizens.