An analysis of the European Commission's guidelines on the recovery fund

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As explained in a previous note (1), the European Commission's Next Generation EU recovery plan foresaw member states submitting national recovery and resilience plans by April 30 as annexes to their national reform plans, while allowing submission by October 15 alongside draft national budgets. However, in guidelines to member states accompanying the early publication of the Annual Sustainable Growth Strategy (ASGS), the Commission has altered the timeline of the 2021 European Semester and of the submission of recovery and resilience plans (2).

This guidance interprets the regulation giving legal form to the Recovery and Resilience Facility (RRF), which the Commission proposed in May (3). Integration with the European Semester ensured that recovery plans would need to be compatible with the ASGS. Early publication of the 2021 ASGS allows the Commission to update this major determinant of member states' plans.

The present note reviews this updated framework and looks at its consequences.

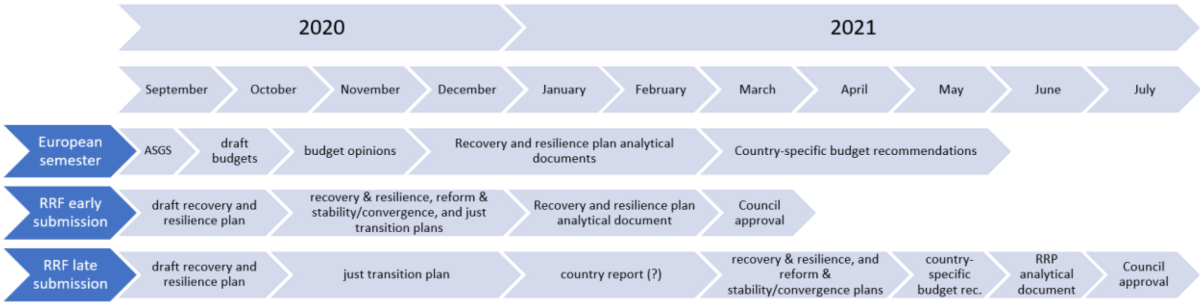
1. The modified 2021 European Semester

The ASGS is due in November alongside the Commission's opinions on member states' draft budgetary plans, but this year it came in September (4). This may be justified by member states aiming to submit their recovery and resilience plans by mid-October even though there is no legal basis to do so yet. As the recovery plan and the multiannual financial framework (EU budget) are bogged down by negotiations in the Council and Parliament, the Commission encourages member states to submit drafts now and finalised plans by January 1st (5). This aligns the timeline of the RRF with that of the Just Transition Fund (6).

The accompanying guidance on the recovery and resilience plans is also the first document by the Commission recognising that the relaxed fiscal rules framing member states' draft budgets next year (2). This would also justify issuing the guidelines in advance of the draft budget deadline.

Figure 1 below summarises the updated 2021 European Semester. Recovery and resilience plans were originally envisaged as annexes to national reform plans to be submitted by the end of April (7). Member states are now encouraged the two as a single document (5). This means national reform programmes will come early and the Commission's country reports, normally due in February, will become redundant. They and the economic part of the country-specific recommendations, due in May, will be replaced by the Commission's assessments of recovery and resilience plans.

Figure 1: updated timeline of the 2021 European Semester (see text)



The guidelines allow member states to delay recovery plans until April (4). It appears unlikely that any will, as that would delay disbursement of European funds.

2. The guidelines

2.1. Reasoned reform and investment plans

Recovery and resilience plans must justify funding requests with reforms and investments. They must be credible. Their substance must address the challenges facing each member state, as well as:

- promote the EU's cohesion,
- strengthen economic and social resilience,
- mitigate the impact of the Covid-19 crisis, and
- support the EU's green and digital transitions.

Resilience is defined as the ability to recover from shocks in a fair and sustainable manner.

Plans must contain an overarching narrative and illustrate with facts and figures the extent to which they address each of the above objectives. Support for the green and digital transitions includes a *"do no harm"* principle, as well as spending quotas of at least 37% on climate and 20% on digital. Member states must tag each spending item with its impact on green or digital transition objectives, and asses it accordingly: 100% for principal contribution, 40% for significant contribution, and 0% for no contribution. Training the workforce for the climate and digital transitions is also emphasised.

2.2. Internal coherence and external consistency

Coherence between reforms and investments is ensured by organising plans into thematic *"components"* consistent with any of the priorities set in the following policy frameworks.

- The 2019 National Energy and Climate Plans (8). These spell out how member states intend to achieve their own Paris climate targets and contribute to the EU's own 2030 climate and energy targets.
- The European Green Deal (9).
- The EU's "shaping Europe's digital future" strategy (10). This involves targets for 2025.
- The 2021 Annual Sustainable Growth Strategy (see section 3 below).
- The EU's country-specific recommendations (11). This refers to those issued under the 2019 and 2020 European Semester cycles and on which countries have not made at least substantial progress. These include, notably: anti-money-laundering, anti-fraud and anti-corruption drives; improving the business environment, the efficiency of the public administration, and the rule of law; and fighting aggressive tax planning.

Consistency of each component of the recovery and resilience plan with the above priorities must be demonstrated both thematically and in terms of quantitative targets. The breakdown of the overall plan into components must be granular enough to demonstrate that each component is underpinned by at least one of these principles: addressing a country-specific recommendation; contributing to the green or digital transitions; or contributing to sustainable growth, job creation, resilience, Covid-19 crisis mitigation, and EU cohesion and convergence.

2.3. Funding of reforms

The Commission's guidelines presume that reforms may have a cost that the recovery fund can cover. Reforms may change the functioning of a market, policy, or institutional or administrative structures. They may also further policy objectives such as economic growth, job creation, resilience, or the energy or digital transitions.

Reforms and their timeline must be detailed, to allow the setting of milestones and targets as well as estimating their cost.

2.4. Eligibility of investment

Investment under the plan can accumulate fixed, human, or natural capital. This includes intangible assets such as intellectual property, research and development, or skills. Member states must consider the EU's sustainable investment taxonomy (12). This prioritises investment in the categories of climate change mitigation and adaptation, sustainable use and protection of water and marine resources, the circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems. In addition, member states must pay attention to avoiding investment that significantly harms environmental objectives.

The Recovery and Resilience Facility will generally not fund recurrent expenses as investment. Investments must be consistent with the timeline of the facility, which involves authorisation until 2023 and disbursements until 2026, as explained in (1). Investments that entail fiscal commitments beyond 2026 must be accompanied by an explanation of how the fiscal commitment will be sustained.

The guidelines encourage public investments that can be multiplied by additional private investment. This idea has become a mainstay of EU investment plans since at least the Juncker plan. Member states are asked to avoid crowding out private investment by focusing on areas of market failure.

The Commission also encourages plans to include cross-border and multi-country investments, particularly within existing EU multi-country initiatives such as industrial alliances, the Horizon Europe research funding programme, or research and innovation partnerships. However, cross-border and multi-country projects involve additional complexities in the allocation of funds, and in the setting and evaluation of milestones and targets.

2.5. Milestones and targets

Each reform or investment proposal must be accompanied by quantitative targets or qualitative milestones, relative to an established or readily-measurable baseline. Targets and milestones may refer to: inputs such as financial, human or monetary resources used; specific outputs of investment; other quantitative or qualitative results; or wider economic or social impacts. Milestones and targets should be associated to a clear timeline which will then influence the disbursement of funds.

3. The Annual Sustainable Growth Strategy

As indicated above, national recovery and resilience plans must address the goals contained in several framework documents. The Commission's latest Annual Sustainable Growth Strategy is the last update to this framework. It is organised into seven flagship initiatives, each with targets for 2025. Recovery and resilience plans must explicitly contribute to them.

1. Renewable *"power up"*: 2025 targets include 200 GW of additional renewable power generation, as well as 6 GW of electrolyser capacity for the production and distribution of 1 million tonnes of renewable hydrogen.
2. *"Renovate"* buildings, improving the energy and resource efficiency of both public and private buildings.
3. *"Recharge and refuel"* electric and hydrogen vehicles. 2025 targets include one million electric charging stations and 500 hydrogen stations.

4. *“Connect”* with digital networks including 5G. High-capacity network coverage of 44% is inadequate and must be improved to the greatest extent possible. Public investment is needed in rural areas where private initiative may not reach.
5. *“Modernise”* the public administration, by providing a European digital identity for use in public services including justice and health care.
6. *“Scale up”* hardware production and advanced data services. 2025 Targets include doubling the production of semiconductors in Europe, producing ten times more energy efficient processors, and doubling the share of EU companies using cloud services and big data. And
7. *“Reskill and upskill”* the workforce in digital areas. Targets include raising the share of adults with basic digital skills from 42% to 70%, reducing to below 15% the share of 13/14-year-old students who underperform in computer and communication literacy, and ensuring that at least 80% of vocational training graduates are employed and 60% benefit from on-the-job training.

4. Interpretation

The recovery fund is far from being a free-for-all. There is a sense that each of the individual goals (to contribute to the EU’s green and digital transitions, directly or through the national energy and climate plans; to further the ASGS’ flagship policies; and to address pending country-specific recommendations) must be addressed by some reform-and-investment “component” of the national recovery and transition plans.

This may be seen as policy conditionality, particularly since the July European Council agreed that member states may delay disbursements to others that miss “relevant” milestones and targets (13). An important open question is whether this ability to stop disbursements applies to the plan as a whole or to individual thematic components.

Because of the tight deadlines, we expect member states mostly to accelerate their existing national energy and climate plans, accompanied by reforms to address pending country-specific recommendations from the past two years. Any remaining gaps in the coverage of the ASGS would then be plugged. Finally, governments could include favourite projects so long as they agree with the four general principles of the EU’s recovery plan: cohesion, resilience, Covid-19 mitigation, and sustainable growth and job creation.

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