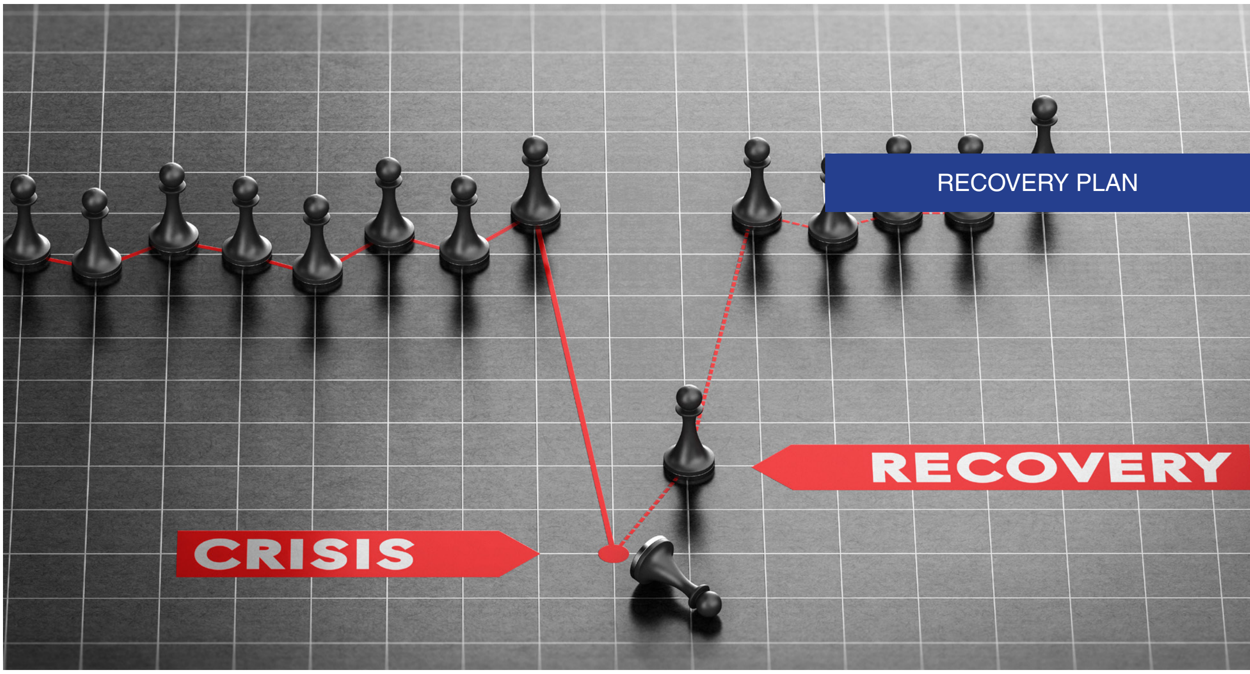


The NGEU recovery package in Spain: Structural challenges and proposal analysis

While the Next Generation EU (NGEU) recovery package was launched to counteract the economic ramifications of COVID-19, its success will depend on reversing the divergence between the economic performance of Spain and the EU, which pre-dates the crisis. Unfortunately, the biggest obstacle to achieving this will be the timing mismatch between the urgency of the situation and the long-term nature of any recovery initiatives.

Ramon Xifré

Abstract: In response to the economic damage wrought by COVID-19, on July 21st, 2020, the European Council agreed to an exceptional recovery package, the Next Generation EU (NGEU), sized at 750 billion euros. In examining the NGEU's potential effects on the Spanish economy, it is important to first note that despite much-needed progress on correcting imbalances and structural reforms post-financial crisis, Spain was already showing clear signs of reform fatigue before the onset of COVID-19. Indeed, convergence with the EU had, depending on the particular metric, either stalled or reversed. Thus, interrupting this trend must be a key goal of any recovery package for Spain. However, there are several obstacles that could undermine or minimise the effectiveness of the NGEU in Spain: (1) difficulty in reaching political and social consensus; (2) fund absorption deficits;

and, (3) managerial issues. In the best-case scenario, assuming all those obstacles can be overcome, the effects of the structural reform programmes will only materialise in the medium-to longer-term. For this reason, the biggest challenge policymakers must address is the timing mismatch between the urgency of the situation and the long-term nature of the recovery initiatives. The vital issue at present is to prop up as much of the productive business fabric as possible.

Introduction

The COVID-19 crisis has led to both human and economic losses, creating a level of instability that is unprecedented in recent times. Unfortunately, despite recent progress on the vaccine front, it is still too soon to estimate when the pandemic might end, its total impact or the nature of the subsequent economic recovery. The IMF's October 2020 *World Economic Outlook (WEO)* forecasts a contraction in Spanish GDP of 12.8% in 2020, the biggest in the EU, and a recovery of 7.2% in 2021. However, those forecasts were made before infection rates began to spike again during the second half of October, prompting the government to declare a second state of emergency on October 26th.

In general terms, the economic policy responses in the EU and eurozone to this formidable shock appear to be up to the task. The ECB has rolled out a new 1.35 billion-euro pandemic emergency purchase programme (PEPP) aimed at reducing borrowing costs and boosting credit flows in the eurozone. The purpose of this paper is to examine the other major instrument put together by the European institutions –The Next Generation EU recovery package.

To that end, we provide a brief overview of the programme, pointing out certain features that will be relevant to the more detailed analysis that follows. We then take a look back at the EU's record with structural reform programmes over the past two decades, focusing on the most recent one, the Europe 2020 Strategy. That programme provides a framework for measuring the Spanish economy's track record with such structural challenges over the past 20 years. We then briefly review some of the recent proposals published in Spain regarding the use of the NGEU funds. Lastly, we draw certain conclusions and provide some opinions.

The Next Generation EU recovery plan [1]

Building from the Commission's initial proposals in May, on July 21st, 2020, the European Council agreed to an exceptional recovery package, the Next Generation EU (NGEU), sized at 750 billion euros.

The agreement authorises the European Commission to issue up to 750 billion euros worth of debt on behalf of the European Union. The NGEU funds are in addition to the 1.07 trillion euros available under the Multi-Annual Financial Framework (MFF) for a combined support package of 1.82 trillion euros. The NGEU funds will be channelled via seven spending programmes and are articulated as both loans (360 billion euros) and grants (390 billion euros). The commitments must be made before the end of 2023 and the funds paid out before the end of 2026. The largest component of the NGEU is the Recovery and Resilience Facility (RRF), which accounts for nearly 90% of the total. In the case of the RRF grants, which amount to 312 billion euros, 70% of the commitments must be awarded in 2021 and 2022 on the basis of three criteria: the rate of unemployment between 2015 and 2019; GDP per capita; and the size of the population. The remaining 30%

" The IMF's October 2020 *World Economic Outlook (WEO)* forecasts a contraction in Spanish GDP of 12.8% in 2020, the biggest in the EU, and a recovery of 7.2% in 2021. "

> "The NGEU funds will be channelled via seven spending programmes and are articulated as both loans (360 billion euros) and grants (390 billion euros)."

of the RRF grants must be committed in full in 2023. [2]

The member states must draw up national recovery and resilience plans in which they must present their structural reform programmes and investment projects for 2021-2023. The Commission will then evaluate those plans on the basis of a series of criteria, including: (1) consistency with the country-specific recommendations set down in the European Semester; (2) reinforcement of the member state's growth potential, job creation and economic and social resilience; and, (3) the contribution to the country's green and digital transition.

The Spanish government presented its Recovery, Transformation and Resilience Plan (*España Puede,* Office of the Presidency, 2020a) in October 2020. That plan contained 10 guiding policies for structural reforms aligned with the general NGEU priorities.

According to the government's estimates (Office of the Presidency, 2020b), Spain will receive approximately 60 billion euros from the RRF in non-repayable transfers and may be eligible to access up to 80 billion euros of loans. With respect to the REACT EU fund, Spain will receive a little over 12 billion euros for deployment between 2021 and 2022.

The budget plan presented by the government to the European Commission on September 15th, 2020, and the general state budget for 2021 feature investments totalling 27 billion euros to be funded from these new schemes.

European structural reform plans

The structural challenges facing Spain in its quest to lock in an economically, socially and environmentally sustainable growth model have been the topic of debate and analysis for much time and are related with the plans the EU has devised to achieve similar objectives throughout the entire region.

The past 20 years have been marked by a succession of programmes designed to trigger reforms across the EU member states. The Lisbon Strategy was launched in March 2000 with the aim of turning Europe into the "the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion". That strategy was articulated around two pillars, the economic and social dimensions; a third dimension –environmental– was added later. A review of the progress in 2004 proved disappointing, prompting a revision of strategy. The new strategy was approved in 2006 with four primary initiatives: investing more in knowledge and innovation; unlocking business potential, especially for SMEs; increasing employment opportunities for priority categories; and, a new focus on climate change and energy policy in Europe.

The progress made on those general objectives was similarly deemed to fall short of the mark.

> "According to the government's estimates, Spain will receive approximately 60 billion euros from the Recovery and Resilience Facility (RRF) in non-repayable transfers and may be eligible to access up to 80 billion euros of loans."

> Employment has recovered since 2013 but continues to lag the EU average significantly, by around five percentage points in 2019 (68.5% in the EU-27 versus 63.3% in Spain).

In March 2010, the European Commission presented its proposed Europe 2020 Strategy which set similar targets in search of "smart, sustainable and inclusive" growth. An effort was made to translate the 2020 Strategy into more concrete lines of initiative and new mechanisms for coordinating economic policy among the member states were articulated. Seven "flagship initiatives" were defined to focus the effort and channel resources while the EU was to deliver on five "headline targets" by 2020:

- Rate of employment of 75% among men and women aged between 20 and 64;
- 3% of EU GDP invested in innovation;
- Delivery of the "20/20/20 targets" for climate change and energy (*i.e.*, cutting emissions by 20%; generating 20% of energy from renewable sources; and, boosting energy efficiency by 20%);
- Reduction in the school drop-out rate to below 10% and increase in the share of 30-34 year-olds having completed third-level or equivalent education to at least 40%;
- Lifting at least 20 million people out of the risk of poverty and exclusion.

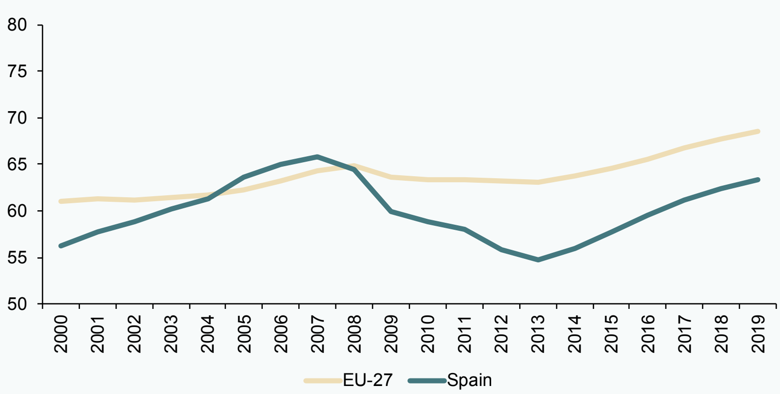
Beyond the validity of the above quantitative targets, that selection of priorities and goals provides a proxy for measuring Spain's progress in relation to the rest of the EU member states, the subject of the next section, which updates previous work in this field (Xifré 2014, 2017).

How the Spanish economy has evolved structurally since 2000

Exhibit 1 shows the number people aged between 15 and 64 who are employed as a percentage of the total number of people

Exhibit 1 **Rate of employment among people aged 15 to 64**

Employees as percentage of total population in age group

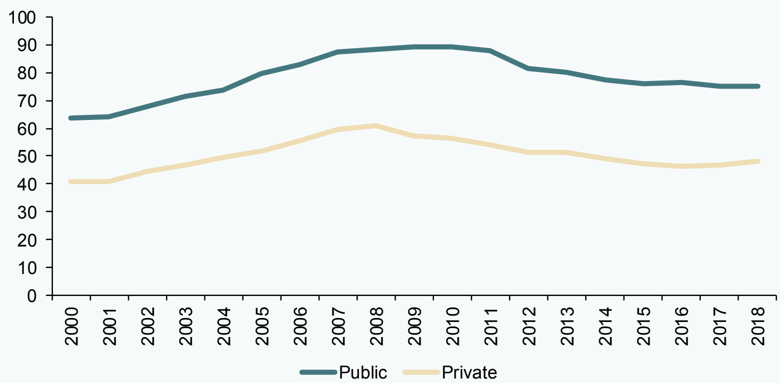


Source: Eurostat.

Exhibit 2

Expenditure on R&D in Spain with respect to the EU-27 in the public and private sectors

EU-27 average = 100



Source: Eurostat.

in that age bracket for Spain and the EU-27 between 2000 and 2019. In 2000, Spain's employment rate started out five points below the EU average. The ensuing process of convergence meant that the employment rate in Spain rose above the EU-27 average between 2005 and 2007. However, the crisis that began in 2008 reversed that trend, with Spain suffering far higher job losses than the rest of the EU; indeed Spain would lose jobs until 2013. Employment has recovered since 2013 but continues to lag the EU average significantly, by around five percentage points in 2019 (68.5% in the EU-27 *versus* 63.3% in Spain).

Exhibit 2 provides R&D intensity (proportion of gross domestic expenditure dedicated to research and development) in Spain in relation to average R&D intensity for the EU-27, broken out between the public sector (including universities) and the private sector. Public sector R&D intensity came close to the European average, reaching 89% in 2010, but has since lost dynamism, falling to 75% by 2018, which is similar to 2005 levels. The private sector never converged to the same degree; the nearest it got was in 2008 when R&D intensity stood at 61% of the EU average. Since then it has lost ground, with intensity standing at just 48% of the EU average in 2018, which is comparable to 2003 levels.

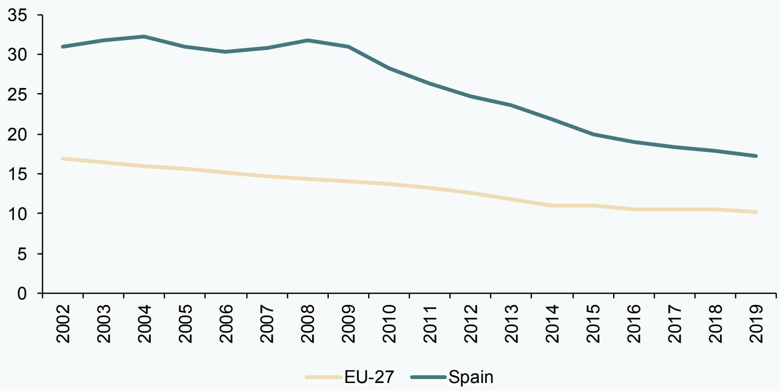
Exhibit 3 shows the rate of early school leavers, *i.e.,* the percentage of the population aged between 18 and 24 that had completed at most a lower secondary education and were not enrolled in further education or training. The analysis shows that although Spain has improved considerably on this indicator, reducing the drop-out rate from 30.9% in 2002 to 17.3% in 2019, the level of early school leavers in Spain remains significantly above the EU-27 average (2019: 10.2%).

Exhibit 4 depicts the percentage of the population at risk of poverty or social exclusion according to Eurostat. It illustrates how that percentage rose sharply during the years of crisis and the aftermath (between 2008 and 2014), since trending lower, to 25.3% in 2019, which is equivalent to the level seen a decade ago. The comparison with the EU-27 average

Exhibit 3

Early school leavers

Percentage



Source: Eurostat.

reveals that once again, despite the progress made, Spain is failing to keep up.

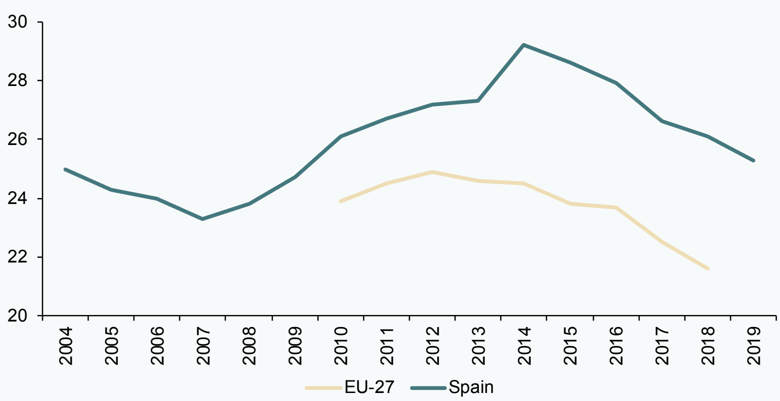
Analysing the recent performance on energy transition and climate change mitigation is particularly complex, as shown in Díaz, Marrero and Puch (2020).

It is worth analysing another two factors that are relevant to understanding the

Exhibit 4

Population at risk of poverty or exclusion

Percentage

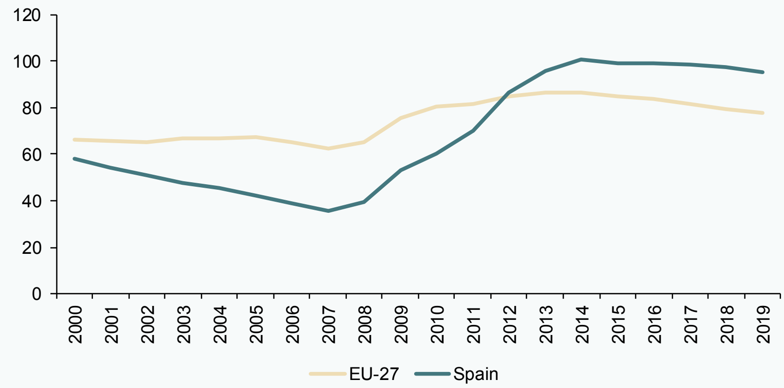


Source: Eurostat.

Exhibit 5

Public debt

As a percentage of GDP



Source: Eurostat.

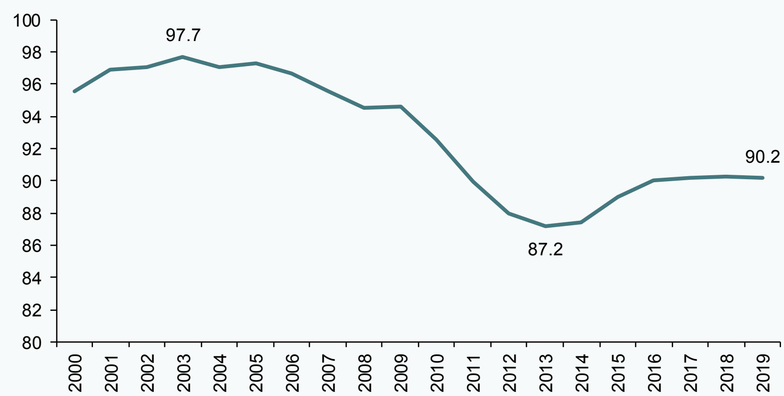
context in which the NGEU package will be implemented.

Exhibit 5 shows public debt as a percentage of GDP for Spain and the EU-27 average. It depicts significant deleveraging between 2000 and 2007, driven by unsustainable growth, to leave public debt at 35.8% in 2007 (26 percentage points below the EU average). Public debt climbed sharply between 2008

Exhibit 6

GDP per capita in Spain relative to the EU-27

EU-27 average = 100



Source: Eurostat.

> Public debt climbed sharply between 2008 and 2013 as a result of the crisis and its ramifications, stabilising at close to 100% of GDP from 2014.

and 2013 as a result of the crisis and its ramifications, stabilising at close to 100% of GDP from 2014. This is more than 17 percentage points above the EU average, which has been trending slightly but steadily lower since 2008.

As a snapshot indicator, echoing the above observations, Exhibit 6 shows GDP per capita in Spain in relation to the EU-27 average between 2000 and 2019. The exhibit confirms that for much of that period Spain has been lagging the EU in terms of per-capita income. Following a period of brief and not very intense convergence in the early part of this century, the gap between Spain and the EU average widened between 2004 and 2013. 2014 marked the start of another short bout of convergence, which ended in 2016. Between 2016 and 2019, GDP per capita in Spain has been hovering at around 90% of the European average, which is seven percentage points below peak convergence at the start of the century.

Various proposals for using NGEU funds

In light of those structural gaps and the major opportunity posed by the NGEU recovery package, a number of proposals have been published recently to provide guidance on how to maximise the impact of the programme and support Spain's economic recovery. In this section we reference a few of these.

Spanish think tank FEDEA has published a number of proposals, most notably one whose title translates as "In favour of political and social consensus around an inclusive reactivation and growth strategy", in which 130 experts from different fields, coordinated by Ángel de la Fuente (De la Fuente, 2020) participated. The document identifies a significant number of measures for roll out in the short- and longer-term. Beyond the considerable battery of measures put forward, the common thread running through the document is an effort to defend "the need to reach broad political and social consensus around a strategy designed to emerge from the crisis as quickly as possible and lay the foundations for tackling the complicated economic and social challenges that lie in store in the medium- and longer-term."

Several of those same authors, together with others, have drawn up a complementary document focused around eight priority areas (Conde-Ruiz, 2020). That document makes explicit references to which instrument (NGEU, investment, reforms or a combination thereof) is needed to achieve each of the economic policy targets.

On the industrial policy front, Arrilucea *et al.* (2020) similarly flag the need for "national consensus for industry". Such an agreement needs to pave the way for an industrial policy that is targeted at clear objectives or missions. In addition to decarbonisation and digitalisation, those missions include goals such as increasing the number of years that Spain's elderly can live autonomous by five years, and turning Spain into a top-class scientific destination. The authors advocate for the adoption and adaptation of the

> A 'national consensus for industry' needs to pave the way for an industrial policy that is targeted at clear objectives or missions.

> "On the topic of absorption, recall that during the current budget period, 2014-2020, Spain has only spent 34% of its available Cohesion Funds."

necessary instruments, including long-term financing facilities and stable collaboration between the public and private sectors.

In the field of education, the paper by Gortázar (2020) proposes earmarking 10 billion euros of NGEU funds to the education system articulated around four key lines of action: (1) rescuing the students affected the most by the crisis; (2) infrastructure (physical and digital); (3) training and up-skilling for key players (students, parents, school teachers, school principals, vocational training teachers); and, (4) digitalisation of systems management.

The paper by Hidalgo (2020) is an example of the contributions that are not structured around specific areas of policy initiative but rather tackle a complementary, procedural and highly important issue – the steps Spain needs to take to improve its ability to absorb the European funds. He highlights five levers or areas for improvement: (1) planning with administrative capabilities in mind; (2) planning as far ahead of time as possible; (3) creating teams of expert professionals with a track record in public contracting; (4) creating centralised tender management agencies and offices; (5) simplifying and eliminating overlap in fund management procedures. Some of those issues are also addressed by Darvas (2020b) and Alcidi, Gros and Corti (2020).

Lastly, it is important to point out the insistence with which one of the world's greatest experts in R&D support policy, Andreu Mas-Colell, has advocated for earmarking some of the new funds to cross-cutting projects with the power to attract, retain and win back people with talent. Mas-Colell has recommended adding 400 contracts a year to the 300 that are generated under the various programmes already in existence (Ramon y Cajal, ICREA, Ikerbasque, Emergia, *etc.*) with a view to being able to hire 700 highly trained scientists and researchers per year over the next 10 years. Such a process, according to this expert, "can change a country" (Mas-Colell, 2020).

Assessment and conclusions

Despite much-needed progress made post-crisis, it is important to underline that the Spanish economy was already showing clear signs of structural reform fatigue before the onset of COVID-19. That is evident in a lack of convergence towards the EU averages along some indicators (percentage of the population in employment; R&D intensity in the public and especially the private sector; and public debt as a percentage of GDP). In other cases, the weakness is manifest in slower progress (reduction in early school leavers and in the percentage of the population at risk of poverty and exclusion). The indicator that sums up that structural fatigue is the stagnation in per-capita GDP in Spain with respect to the EU average, which has been stuck at 90% since 2016, well below the peak of 98% of 2003. The crisis generated by COVID-19 is therefore ravaging an economy that was no longer converging with the EU-27. Implementation of the NGEU needs, ultimately, to help revive this convergence process of Spain towards the EU.

Additionally, there are a number of observations about the proposals published on the matter of how to use the NGEU funds in Spain. The proposals are ambitious and need solid social and political consensus to facilitate implementation as in many instances the investment ideas are tied to legislative reforms that have been in the pipeline for many years. Indeed, the call for broad consensus is one of the explicit objectives in the majority of those reformist manifestos. However, even if such a degree of consensus is achieved, there are still problems related with the absorption and public management of the funds. On the topic of absorption, recall that during the current budget period, 2014-2020, Spain has only spent 34% of its available Cohesion Funds (Torres and Fernández, 2020). In regard to management, the public administration is reasonably nimble at managing the programmes already in existence but it is unclear whether it could be similarly adept at handling new spending programmes which will probably also require collaboration with regional governments, as seen recently with the minimum income scheme.

Lastly, and in line with Bandrés *et al.* (2020), it is highly likely there will be a significant timing mismatch between the urgent need to prop up and revive the economy in the short-run and the raft of structural reforms whose full effects will take several years to materialise. Given the way the NGEU package has been designed and reviewing some of the main proposals for using it, what appears to be missing is an economic policy initiative that can provide direct stimulus from the end of 2020 and throughout 2021. Past experience, in less critical situations, suggests that the scars from the crisis could prove very long-lasting in terms of both unemployment and business failures. That is probably the biggest challenge facing the Spanish economy and society — propping up as much of the productive business fabric as is possible.

Notes

[1] For the most updated information, go to https://www.consilium.europa.eu/es/policies/eu-recovery-plan/ (consulted on October 15th, 2020).

[2] For more detailed information, refer to Carrión Álvarez (2020a, 2020b, 2020c) for a comprehensive explanation of the programme; Bandrés *et al*. (2020), Torres and Fernández (2020) and Doménech (2020) for analysis of the importance of the NGEU package for Spain and an estimation of its impact; Darvas (2020a) for an explanation of the changes between the proposal and the final agreement; Pisani-Ferry (2020) for an overview of the package from the broader European perspective; Fuest and Pisani-Ferry (2020) for an analysis of the new EU financing scheme; and Pazos-Vidal (2020) for a comparison between the MFF and NGEU.

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