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European funds for economic recovery

Event held to commemorate the 3,000th issue of *Actualidad Económica*

Margarita Delgado

Deputy Governor

Good morning.

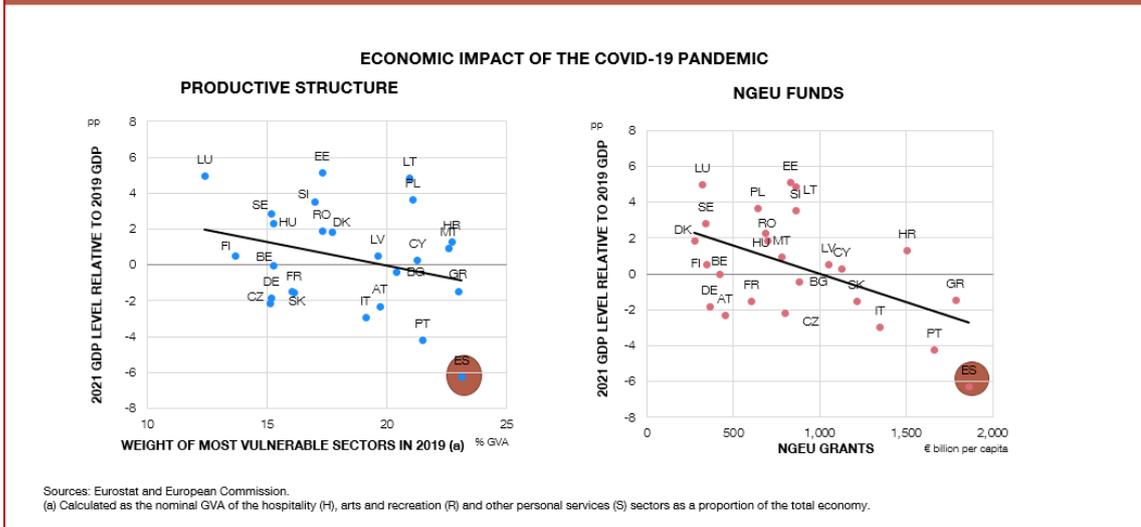
First of all, I should say that today we are subject to the “quiet period” that precedes the ECB Governing Council’s monetary policy meetings. This means I cannot refer to any matters that might anticipate future monetary policy decisions. Accordingly, my remarks today should not be interpreted as any indication on the monetary or economic outlook that might shape such decisions.

That said, I will begin by congratulating the team that has made it possible to reach the milestone of 3,000 issues of *Actualidad Económica*, a number that testifies to the work performed over so many years. The presence of top-quality economic journalism in Spain has always been vital for forming collective judgement on economic matters and on the policies needed to enhance the population’s well-being. But this top-quality economic journalism is even more necessary in a context such as the present one. The succession of severe shocks and the emergence of profound structural changes make it imperative that agents are able to base their decisions on a precise understanding of the economic reality. I am, therefore, honoured to take part in the closing proceedings, following on from the distinguished line-up of speakers who have preceded me.

Clearly, recent developments paint a complex picture. In the short term we can expect activity and prices to remain shrouded in high macroeconomic and financial uncertainty. As we have seen earlier today, in the medium and long term the challenges are multifold. Against this backdrop, we are almost duty bound to take a few minutes to reflect on how best to use the economic policy instruments we have available. Naturally, this requires a prior assessment of the goals that economic policies are designed to meet.

I wish to highlight two of those goals. First, economic policies need to help ease the negative impact that the recent shocks have had on activity. These shocks have been felt very unevenly across different groups of agents, so the steps taken must be designed to moderate their specific impact. Second, and perhaps even more importantly, economic policies need to pave the way for a far-reaching transformation of the Spanish economy, in keeping with the structural changes that are advancing at great speed.

Like its fellow EU member countries, Spain now has a new tool available to meet these two specific goals, namely the Next Generation EU (NGEU) funds. As you are well aware, NGEU has aroused great expectations, commensurate with the high volume of funds mobilised. But we need to bear in mind that, despite these ambitious expectations, its success hinges on the appropriate use of these funds.



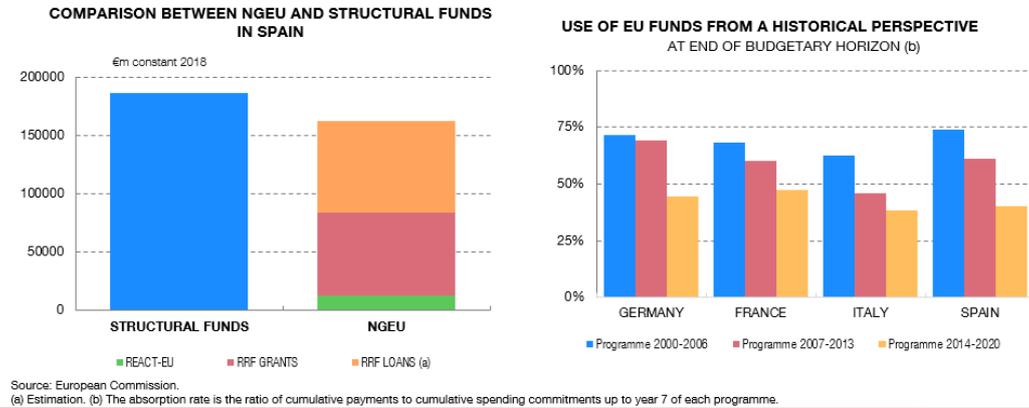
NGEU comprises a raft of programmes, the centrepiece being the Recovery and Resilience Facility (RRF). Another important factor to consider is that these extraordinary programmes established in the wake of the pandemic run parallel to other regular programmes included under the Multiannual Financial Framework.

The link between the NGEU funds and the pandemic has meant that the funds available have been distributed by country taking into account the relative size of the effects of the health crisis. One crucial determinant was the level of each economy's exposure to the sectors of activity hit hardest by the pandemic containment measures, such as tourism and hospitality. In consequence, the countries where these industries accounted for a higher share received a larger allocation of European funds. As the slide shows, Spain is the country with the largest share of the most vulnerable sectors (see left-hand chart) and, therefore, the country that will receive most funds in terms of billion euro per capita (see right-hand chart).

Specifically, the RRF makes €77 billion available to Spain in the form of non-repayable grants. Applications for these funds have been made through the Recovery, Transformation and Resilience Plan (RTRP). In addition, a further sum of almost €85 billion is available to supplement these grants, although in this case in the form of repayable loans.

The sheer size and correct design of these funds mean that, on paper, they are a powerful economic policy tool capable of fulfilling the most ambitious aspirations. Yet these two factors alone are not sufficient to guarantee their success. Moreover, important goals must be transformed into concrete actions, which in turn must be executed efficiently, to maximise the return on each euro spent. For this purpose, the design and selection of projects must be transparent and must be based on continuous assessment, to allow for correction of any deviations from the pre-established goals.

- **NGEU makes available an unprecedented volume of funds, comparable to all the structural funds received by Spain over the last three decades. Absorption is key to maximise the economic impact of the funds, especially in the short term.**

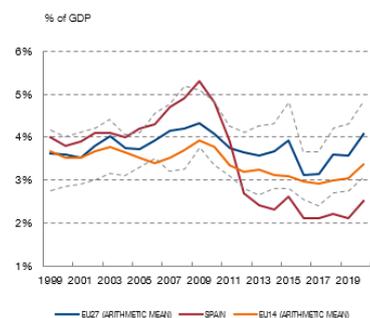


As I mentioned earlier, the first goal NGEU can meet is to help economic recovery take hold. One obstacle for the achievement of this goal is how to correctly time the delivery of these funds to the real economy. Now, when the effects of the health crisis on activity are still plain to see, may seem to be the right time to make all the expenditure. Yet such a high volume of funds calls for a gradual approach. Consider, in this respect, that the total funds allocated, if used in their entirety, may amount to almost 14% of GDP. Expenditure on such a scale would entail a stimulus for activity that would not be easily absorbed. Indeed, it would still be a very high stimulus even if it were distributed over the six years of the life of the programme, considering that, as the left-hand chart shows, it is a volume comparable to all the structural funds received by Spain over the last three decades.

Past evidence of the use of regular European funds received suggests that there are possible constraints on the absorption and management of these funds (see right-hand chart). The fact that these new funds overlap with other recurring programmes suggests that the public organisational structures entrusted with executing the funds will probably have to be reorganised and reinforced to match the size of the programme.

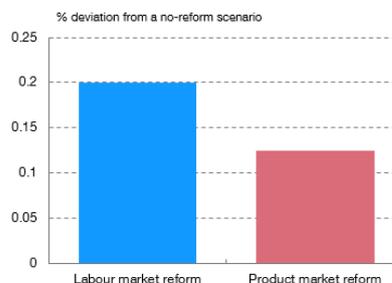
- **The public investment-to-GDP ratio has declined since the 2008 crisis; NGEU can help reverse this trend**
- **This new investment could be positively impacted by other factors: supply-side reforms boost growth potential and the impact of fiscal expenditure**

PUBLIC INVESTMENT



Source: European Commission.

IMPACT OF REFORMS ON THE FISCAL MULTIPLIER OF THE EU FUNDS



Source: S. Albrizio and J. F. Geli (2021).
 Note: EU funds refers to ERDF. Multiplier: impact after five years.

The NGEU funds' second goal is to drive the structural transformation of the Spanish economy in the medium and long term. This is all the more important, considering the challenges – such as digitalisation, the green transition and population ageing – facing our economy. Clearly, these challenges also affect other European economies, but they are probably greater in Spain, as shown in a recent study published by the Banco de España.¹

In addition, many of the medium and long-term economic challenges require public investment. Yet, as the left-hand chart shows, public expenditure in Spain is characterised by a relatively low level of investment. This is particularly noticeable in certain expenditure items that play a crucial role in the accumulation of physical and human capital in the economy and, therefore, in productivity. For example, public expenditure on education and public investment amounted to 4% and 2.1%, respectively, of GDP in Spain in 2019, that is, 0.9 and 1.5 percentage points (pp) below the rest of the EU. Against this backdrop, the funds available through the RRF should help boost physical and human capital in Spain, leaving us better placed to address the medium and long-term challenges.

I also wish to mention two factors which I believe could help maximise the possible benefits associated with the NGEU funds. The first is that the chosen projects are capable of harnessing synergies between public and private investment. Ensuring that public actions do not crowd out private initiatives is key to increasing productive capacity. Studies conducted by the Banco de España in this respect suggest that there is a historical and positive correlation between the two.² In addition, the creation under the RTRP of initiatives such as the Strategic Projects for Economic Recovery and Transformation (PERTEs by their Spanish acronym) underscores the decision to ensure ex ante the complementary nature of public and private investment. The eleven existing PERTEs require that a substantial portion of public investment be necessarily accompanied by private investment. This is important

¹ See A. Fernández Cerezo and J. M. Montero, "A sectoral analysis of the future challenges facing the Spanish economy", *Occasional Paper No 2133*, Banco de España.

² M. Alloza, D. Leiva-León and A. Urtasun (2022), "[The response of private investment to an increase in public investment](#)", Analytical Articles, *Economic Bulletin 2/2022*, Banco de España.

in cases where, owing to various market externalities, such as uncertainty associated with a new project or financial constraints on its implementation, the private sector is reluctant to undertake investments that could be beneficial for society as a whole.

POSSIBLE LONG-TERM INSTITUTIONAL IMPLICATIONS
 THE NEED FOR A PERMANENT FISCAL CAPACITY

BANCO DE ESPAÑA
 Eurosystem

- **Greater risk-sharing in the euro area, a common feature of more advanced monetary unions**
- **Definition of an aggregate fiscal stance**
- **A permanent macro stabilisation mechanism should have taxation power, sufficient size and the power to issue debt**
- **The issuance of pan-European debt helps alleviate the scarcity of euro-denominated safe assets**

STRENGTH OF RISK-SHARING CHANNELS

Legend: CAPITAL MARKET (blue), UNSHARED RISK (orange), PUBLIC TRANSFERS (red), CREDIT CHANNEL (green).
 Source: Cimadomo et al. (2019).

STOCK OF SAFE ASSETS

Legend: FEDERAL (blue), NATIONAL (red), NGEU & SURE (orange).
 Sources: European Commission, Eurostat and national statistics. Long-term public debt. S&P credit rating AAA/AA+. For the EU, national includes Austria, Denmark, Finland, Germany, Luxembourg, the Netherlands and Sweden.

So far, the Government has approved public investment of more than €30 billion through these strategic projects (more than 40% of the total funds available under the RRF). Some of these projects have now begun to take shape in public tenders. This is the case of the PERTE for electric and connected vehicles, which aims to provide the Spanish economy with the capacity for start-to-finish manufacturing of electric vehicles. Applications, currently being reviewed, have been received for more than 90% of the available funding. Other PERTEs for modernising initiatives that are also under tender relate to renewable energy, renewable (green) hydrogen generation and storage, and the food supply chain. Others are still fully or mostly at the design stage. For instance, the microelectronic and semiconductor project, which aims to inject more than €12 billion by 2027, to provide Spain with greater strategic autonomy for the design and production of microchips and semiconductors. Although these public-private partnerships have ambitious goals, and many are designed to modernise existing infrastructures, it is important that they be continuously assessed, since their success could shape the future of industrial policy in Spain.

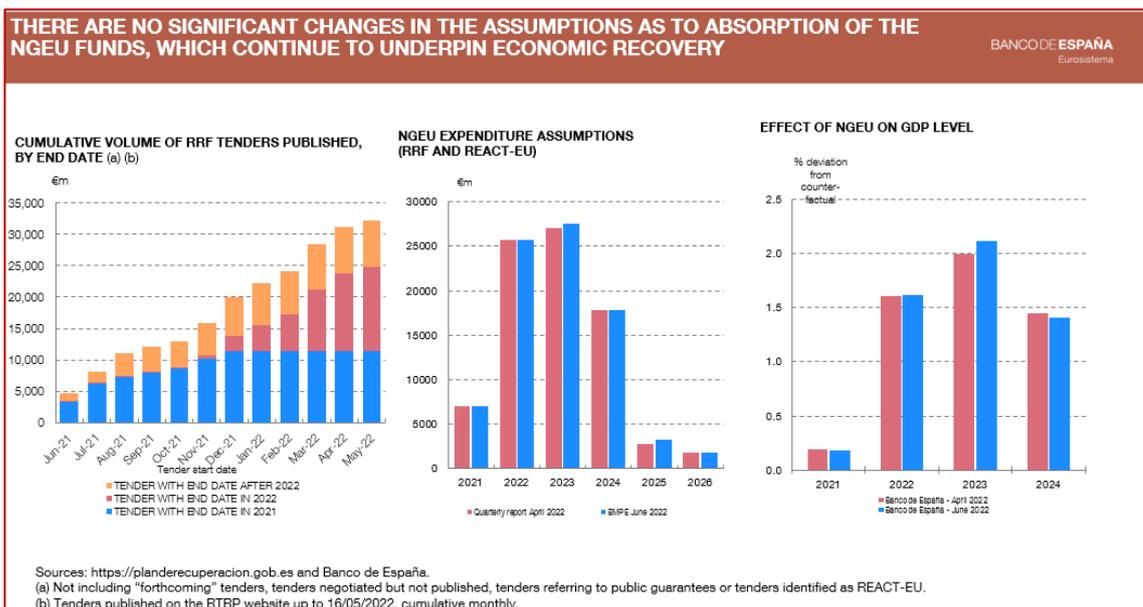
The second factor that could optimise the transformative capacity of NGEU is the adoption of a broad set of structural reforms. A recent study published by the Banco de España³ suggests that the medium and long-term expansionary effect of the European funds would be substantially greater if it were accompanied by policies that reduce labour market inefficiencies and barriers to competition. Moreover, according to the simulations made in

³ S. Albrizio and J. F. Geli (2021), “[An empirical analysis of the determinants that can boost Next Generation EU’s effectiveness](#)”, Analytical Articles, *Economic Bulletin* 4/2021, Banco de España.

a different study,⁴ the NGEU projects, if correctly selected and accompanied by structural reforms, could raise long-term productive capacity by some 0.8 pp.

As I mentioned earlier, the NGEU funds are expected to become a driver of economic growth in 2022 and following years. This year they could add up to 1.6 pp to GDP (see right-hand chart), depending on the level of absorption of the funds and subject, therefore, to continuous review. The left-hand chart shows the cumulative volume of RRF tenders published up to May 2022.

Lastly, from a pan-European standpoint, NGEU could be the precursor to a permanent macroeconomic stabilisation mechanism, which would give a substantial boost to the consolidation of the European project. Successful implementation of NGEU would help create a favourable climate for introduction of such a centralised and permanent mechanism.



Of the various positive effects of such a permanent mechanism, I wish to highlight three. First, a centralised fiscal capacity would enable greater sharing among the euro area economies of risks related to exogenous shocks that affect individual countries. Second, a macroeconomic stabilisation mechanism would enable an aggregate definition of the euro area fiscal policy stance, making for greater coherence with the monetary policy stance. Lastly, if equipped with the ability to issue public debt, such a centralised fiscal capacity could help ease the scarcity of euro-denominated safe assets, thus increasing the collateral available to financial institutions for monetary policy operations.

I wish to conclude my address today by highlighting the historic opportunity that NGEU provides, as it has the potential to make a significant contribution to the transformation the Spanish economy needs to adapt to the medium and long-term challenges it now faces. It

⁴ P. Cuadrado, M. Izquierdo, J. M. Montero, E. Moral-Benito and J. Quintana (2022), "[El crecimiento potencial de la economía española tras la pandemia](#)", *Documentos Ocasionales* No 2208, Banco de España.

is up to us to make the best possible use of the European funds, to enhance the well-being of our society both today and for future generations.

Thank you.