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European funds and Spain's post-pandemic economic recovery*

III SANFI Alumni Meeting

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*English translation of the original speech in Spanish.

Good afternoon.

First of all, I would like to thank SANFI Alumni for their kind invitation to inaugurate this meeting, where we will have the pleasure of witnessing a debate between these highly respected participants in a few minutes. Naturally, I would like to take this opportunity to publicly congratulate, as I did in private several days ago, the facilitator of this debate, Alejandra Kindelán, on the announcement of her forthcoming appointment as Chairwoman of the AEB.

To begin with, let me point out that we are at present subject to the “quiet period” that precedes monetary policy meetings of the ECB Governing Council. This means that I cannot refer to subjects that may anticipate future monetary policy decisions. Therefore, my thoughts should not be interpreted as insight into the monetary or economic outlook that might shape expectations regarding these decisions. Accordingly, in my speech today I will not touch on certain topical issues that it would otherwise be important to address.

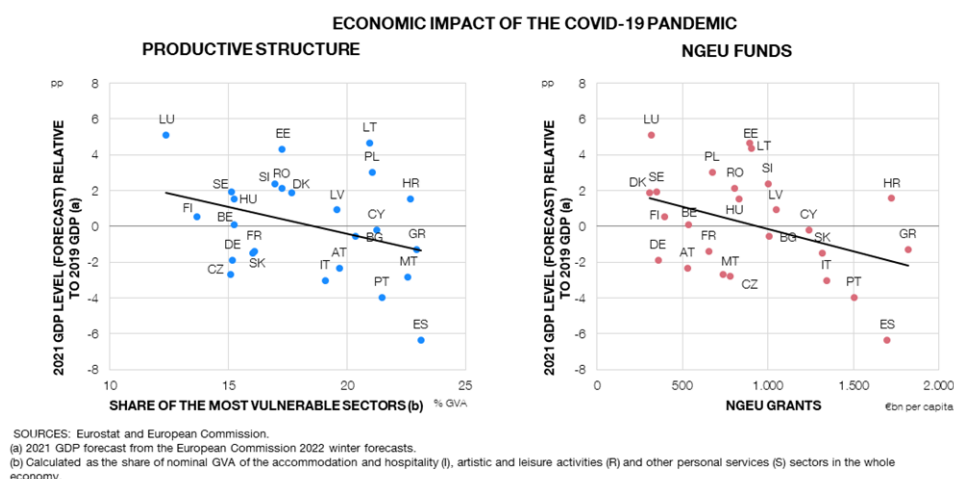
It is a pleasure and an honour to have the opportunity to participate for the second time in a row (although not the second consecutive year due to the pandemic) in the SANFI Alumni meeting. This meeting is an ideal forum to reflect on the economic future of Spain. Against this backdrop, I can think of no timelier subject than that which the organisers have chosen for discussion today.

This event takes place as Spain, after two long years, is finally emerging from this prolonged period which has been so painful in terms of loss of income, of economic activity and, above all, of human lives. With all the due caution that the unfolding of the pandemic has taught us to exercise, this may well be the beginning of the end of the health crisis.

We will always be confronted with new, and sometimes severe, shocks, as last week’s invasion of Ukraine by Russia reminded us. But, precisely because we will never be immune from such shocks, we must be as prepared as possible to respond to them.

This means we need to make the best possible use of the economic policy instruments at our disposal. This will allow us to strengthen the recovery in activity we are currently in the midst of, while promoting a structural transformation of the economy that will enable Spain to emerge from this crisis with higher levels of well-being for all.

To achieve these ambitious goals, we now have a new tool that was not available to us in previous crises: the Next Generation EU (NGEU) European funds. This programme has a major role to play not only in the post-pandemic economic recovery of Spain and the other European economies, but, above all, in the structural transformation of the Old Continent. That said, it is very important that we understand that all these benefits will not be obtained automatically, but as a consequence of the proper use of these funds.



The genesis of the programme lies in the acknowledgement of the fact that this crisis has been exogenous and has affected the different EU countries asymmetrically depending on their sectoral structure. Thus, economic developments have been more unfavourable in countries with a greater exposure to the productive sectors most affected by the pandemic containment measures, such as those related to tourism, food service activities, cultural activities and leisure in general.

In designing the NGEU, these asymmetrical effects have been rightly taken into account. The distribution of funds among the individual Member States has been determined according to the impact of the crisis on variables such as unemployment or income in each country, thus including an element of cross-country solidarity.

These funds will be implemented mainly through the Recovery and Resilience Facility (RRF), complemented by other additional instruments, including most notably the REACT-EU initiative. The RRF allocates €70 billion to Spain in grants, which the Spanish Government has requested through the Recovery, Transformation and Resilience Plan (RTRP), and another €70 billion approximately in loans (to which the authorities have not yet resorted for the time being).¹ It should be recalled that the NGEU is being developed in parallel to the usual programmes within the Multiannual Financial Framework, such as the cohesion or rural development funds.

As I already mentioned, given their envelope and the design of their main action lines, NGEU funds are to fulfil a dual purpose: to help repair in the short term the damage caused by the crisis and to bring about structural transformation. This is a unique opportunity for Spain, but significant challenges lie ahead.

¹ The REACT-EU amount is in addition to these amounts.

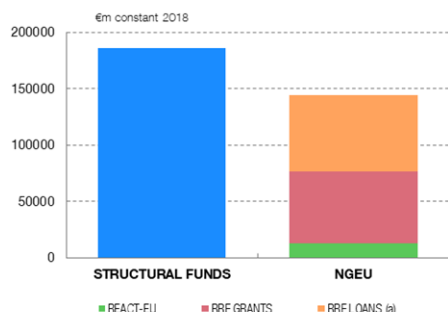
NGEU FUNDS

AN UNPRECEDENTED SCALE. ABSORPTION CAPACITY IS KEY TO THE ECONOMIC EFFECT

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- NGEU represents an unprecedented volume of funds, similar to the amount of structural funds Spain has received in the last three decades. The ability to absorb these funds in full is a key aspect to maximize their economic impact, particularly in the short term.

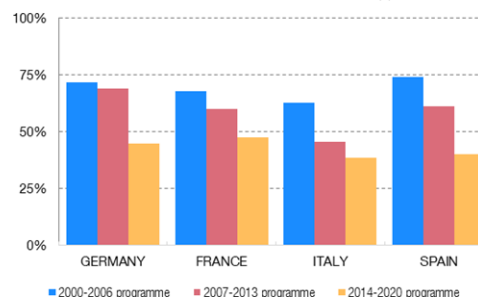
COMPARISON BETWEEN NGEU AND STRUCTURAL FUNDS IN SPAIN



SOURCE: European Commission.

(a) The absorption rate is the ratio of total payments to total cumulative spending commitments until year seven of each programme.

USE OF EU FUNDS FROM A HISTORICAL STANDPOINT
AT THE END OF THE BUDGET HORIZON (a)



As regards the first of these two objectives (the use of NGEU funds as a mechanism to cement the recovery), the main challenge is synchronising the implementation of these funds in the real economy and cyclical needs.

The ability to absorb and manage NGEU funds is a huge challenge due to three factors: (i) its sheer size; (ii) evidence on the use of other European funds in the past; and (iii) their simultaneity with the EU's regular programmes.

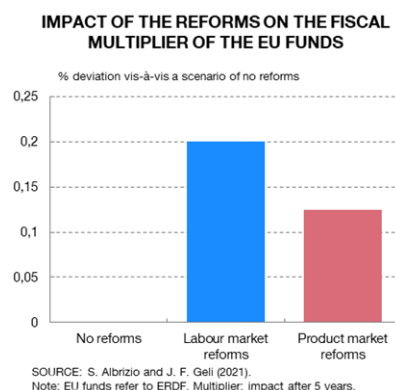
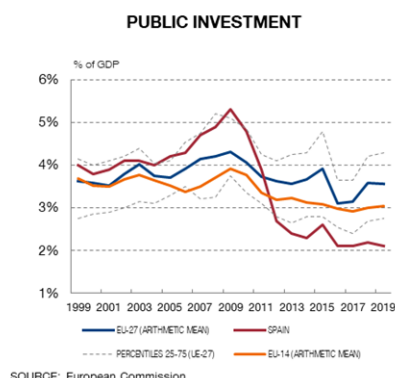
The volume of funds provided by NGEU is unprecedented. It is comparable to the total amount of structural funds that Spain has received in the past three decades (see left-hand chart). In the event that Spanish authorities decide to apply for the full amount available in the form of both grants and loans, we would be talking about a stimulus of close to 12% of GDP spread over six years.

Managing these amounts, which includes project design, ex ante evaluation and an ex post evaluation mechanism to ensure accountability, is a challenge for the designated public organisations, which will probably even have to be adapted accordingly.

Additionally, one aspect that may help NGEU be used as a macroeconomic stabilisation tool is the fact that European fund revenues and disbursements are deficit-neutral in national accounts.

Therefore, the use of the programme is not affected by the foreseeable reinstatement next year of the fiscal rule framework under the Stability and Growth Pact, after appropriate modifications. This is another reason why the projects undertaken using the programme's funds should materialise in public investments that avoid as far as possible generating recurrent expenses in the future. Rather, they should broaden the economy's productive capacity and, therefore, the tax base.

- The government investment-to-GDP ratio has been in decline since the 2008 crisis. The NGEU programme can help to change that trend.
- This new investment could be positively affected by other factors: supply-side reforms increasing potential growth and enhancing the impact of fiscal spending.



These considerations highlight the even greater importance of the second objective of the programme: to drive the structural transformation of the Spanish economy in the medium and long term. The significance of this objective is underlined by the considerable challenges posed by the growing digitalisation of activity, the green transition and population ageing, among other dynamics.

These challenges are largely common to all of our European peers. However, their scale is greater in Spain given the composition of government expenditure in this country: as compared with our fellow European countries, we invest less in items that have a critical impact on the accumulation of physical and human capital in the economy and, therefore, on productivity. Specifically, in 2019 public expenditure on education and public investment stood at 4% and 2.1% of GDP, respectively, 0.9 pp and 1.5 pp less than in the EU.

The build-up of this negative gap over the years is generating a physical and human capital deficit that should be corrected, even if only partially, using the NGEU funds. This would help the Spanish economy to contend with the structural changes already under way from a position of greater resilience.

However, the main challenge that we face in this respect relates to the selection and specific design of those projects that will help to transform the economy's productive system and optimise potential output. In turn, this objective can only be met if that project selection and design process is transparent and grounded on ongoing assessment in real time. This would allow any deviations from the established goals to be corrected. In addition, the process should be completed with a rigorous ex post assessment, endorsed by independent bodies, to identify those initiatives that have come closest to meeting their goals.

In my view, there are three relevant factors that can help to maximise the benefits of the NGEU programme: (i) the need to accompany the budgetary stimuli with structural reforms; (ii) the importance of selecting projects that harness synergies between public and private investment; and (iii) capitalising on the opportunity that these funds offer to cover a portion of the substantial investment requirements aimed at mitigating the adverse impacts of climate change.

As regards the first of these three factors, I would like to emphasise the potential that a broad range of structural reforms would have in terms of optimising the transformative capacity of the NGEU funds. At present, aspects of our institutional framework may stymie the reallocation of resources between firms and sectors. A recent study by the Banco de España² pointed to very strong complementarity between (i) structural reforms geared towards reducing the rigidities in the labour market and the barriers to competition and (ii) NGEU-related spending programmes. In other words, the medium and long-term expansionary effect of the European funds will be substantially amplified if they come alongside policies that reduce the inefficiencies in those markets (see right-hand chart).

Turning to the second of the factors, the extent to which the use of the NGEU funds is successful in expanding the economy's productive capacity will largely depend on how effective it is in mobilising private investment. The economic literature provides theoretical arguments and empirical evidence that, depending on the circumstances and the specific implementation, private and public investment can act both as complementary and substitutive forces. That said, under the Recovery, Transformation and Resilience Plan a substantial portion of government investment must be tied to private investment, evidencing a conscious decision to ensure ex ante the complementarity of the two types of spending. The specific instruments used to this end are known as Strategic Projects for Economic Recovery and Transformation. They are selected based on the identification of spaces where public investment, far from crowding out private initiatives, provides the incentives for these to prosper. The evidence available internationally indicates that the most successful industrial policies are those that complement private investment by upskilling workers and fostering the improvement and modernisation of the physical capital stock.³

The third and final factor that, in my view, could allow us to make optimal use of the NGEU funds is gearing a substantial portion of the investments towards meeting Spain's ambitious medium and long-term climate targets, in line with those also adopted by the other EU members.

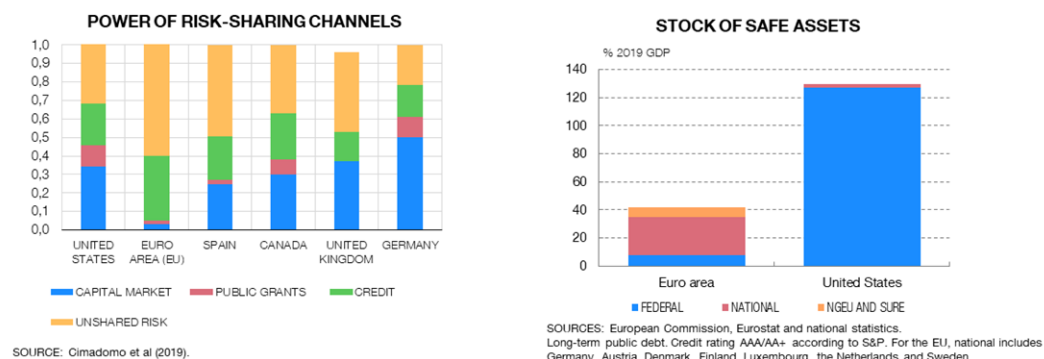
The Climate Change and Energy Transition Law passed this year intends to mobilise more than €200 billion in investment over the course of this decade. A significant portion of that investment will have to be implemented by general government. Against this backdrop, the NGEU funds will play a central role in meeting the objectives of that law.

However, it is important to acknowledge that government spending must be supplemented by fiscal measures. In 2019, environmental tax revenues (including taxes on energy, transportation, pollution and the extraction or use of natural resources) were appreciably lower in Spain than the EU average. This suggests that there is scope to gradually raise such taxes in the years ahead. Not only would this contribute to meeting the established climate goals, but, as a welcome side effect it would also further the necessary consolidation of public finances.

² S. Albrizio and 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.

³ A. Terzi, A. Singh and M. Sherwood (2022), [Industrial Policy for the 21st Century: Lessons from the Past](#), Discussion Paper 157, European Commission.

- Greater risk-sharing in the euro area, a common feature of more advanced monetary unions.
- Complements monetary policy by calibrating the aggregate fiscal stance.
- A permanent macro stabilisation mechanism should have its own taxation power, sufficient size and the ability to issue debt.
- The issuance of pan-European debt would help to alleviate the scarcity of euro-denominated safe assets.



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I should also mention a further aspect that underscores the importance of the NGEU programme, this time from a pan-European perspective rather than from a national standpoint. Beyond its contribution to shoring up the recovery in activity and to modernising the productive system of the various European economies, the launch of the NGEU programme could be the germ for a permanent macroeconomic stabiliser that goes a significant way towards cementing the European project.

The benefits of such a mechanism in the future would be manifold. First, a centralised fiscal capacity would allow for greater risk-sharing among the different euro area economies. This would help to attenuate the impact on countries of idiosyncratic shocks stemming from exogenous factors.

In addition, a macroeconomic stabiliser tool would help define the fiscal policy stance within the euro area, which would complement the monetary policy stance. Lastly, equipping this centralised fiscal capacity with the ability to issue debt would help to relieve the scarcity of euro-denominated safe assets. Financial institutions would thus have access to higher volumes of financial instruments eligible as collateral for monetary policy operations. All of which throws into sharper relief the importance of successfully implementing the projects under the NGEU programme, insofar as this can help to create the right environment in Europe for the eventual introduction of a permanent macroeconomic stabilising mechanism.

Allow me to conclude by touching on the recent sad and troubling events. Russia's invasion of Ukraine will affect the prices of energy and many other commodities. This, in turn, is bound to have repercussions for the income of firms and households alike, the extent of which remains to be seen. While we wait for confirmation of the specific effects on prices, wages, margins and economic growth, it appears more critical than ever to use the NGEU funds to maximum advantage. These funds will be critical to consolidating the economic recovery and, above all, to adapting our economy to the medium and long-term challenges, driving its competitiveness and smoothing the transition to more sustainable models. Sound use of the programme will ultimately further the overall and lasting well-being of our citizens.

Let us hope that the terrible conflict on Europe's eastern border is resolved soon, without endangering any more human lives.

Thank you.