

## **Alert** | Health Emergency Preparedness Task Force: COVID-19 Economic Stimulus



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### **Next Generation EU: The Commission’s Proposal for the European Recovery**

On May 27, 2020, the European Commission (the “**Commission**”) put forward a proposal for the creation of a comprehensive recovery plan aimed at repairing the immediate economic and social damages caused by the Coronavirus Disease 2019 (COVID-19) pandemic and kickstarting the EU economy.

The proposed plan, limited in duration and use, has its legal basis in **Article 122 of the Treaty on the Functioning of the European Union (TFEU)**, which allows the Council of the EU, upon a proposal from the Commission, to grant financial assistance to Member States threatened with severe difficulties caused by exceptional occurrences beyond their control that call for a collective EU response in a spirit of solidarity.

The crucial terms, conditions, and objectives of the recovery plan were initially outlined in general terms by means of two Commission communications dated May 27, 2020, and then legally structured in a proposal for a Council Regulation issued May 28, 2020.

The proposed Regulation has a wide scope, designed to establish a thorough framework comprising measures to reactivate labor markets, social protection, and health care systems, to reinvigorate sustainable growth and employment, to provide support to those businesses most affected by the crisis, and restore trade and economic relations between certain Member States and the European Union (see Article 2 of the Regulation). For these purposes, the exceptional mechanism structured by the

Commission harnesses the potential of the EU budget to promote investment and ensure financial support during the crucial phases of the recovery by means of:

- an emergency **European Recovery Instrument** (the “**Recovery Instrument**”), significantly named “**Next Generation EU**”, equipped with €750 billion raised on financial markets, to be channeled through the EU budget to Member States in support of investment and reform priorities;
- a **reinforced multiannual financial framework for 2021-2027**, strengthened through Next Generation EU to bring the total financial power of the EU budget to €1.85 trillion in support of key EU programs.

The proposed plan constitutes an additional element of the complex recovery strategy promoted and constantly adjusted by the EU over the last few months. Indeed, its measures complement the existing framework of European support initiatives, comprising the €540 billion package – approved on April 23, 2020, by the European Council – consisting of the Temporary Support to mitigate Unemployment Risks in an Emergency (SURE), the Pan-European Guarantee Fund, and the Pandemic Crisis Support for Member States (for a more analytic overview on these programs, please refer to GT Newsletter “*EU at the Time of COVID-19*”, dated May 5, 2020). This comprehensive plan, integrated by the European Central Bank decision of June 4, 2020 (addressed only to the Member States of the euro zone), to increase the pandemic emergency purchase program (PEPP) by €600 billion, aims to generate a total EU investment of €3.1 trillion in front-loaded support tools for Europe’s recovery, in addition to the economic and financial support provided by each Member State under the State Aid Temporary Framework.

The recovery plan designed by the Commission is unprecedented, as is the extent of damages caused by the pandemic. The proposed plan would equip Member States with support tools for a sustainable recovery, while alleviating the increasing pressure on their (already suffering) budgets.

Nonetheless, this is an opportunity that all Member States must be able to seize.

Indeed, access to the bulk of Next Generation EU funding is subject to preliminary action by Member States, which are required to design tailored national recovery plans outlining an investment and reform agenda projected for the years ahead, as well as investment and reform packages to be financed under the Recovery Instrument. This means that, in case of approval of the Regulation establishing the Recovery Instrument, the funds of Next Generation EU will not be directly available to European businesses. As with State aid – *mutatis mutandis* since the funds distributed are originated by the EU – access to such financing will depend on the outcome of bilateral negotiations between the Member State and the Commission, which will first evaluate compliance between the national recovery plan and the long-term strategy of the EU.

Therefore, Member States must quickly become familiar with the new legislation, reduce administrative burdens, streamline bureaucracy, and develop efficient channels to submit to the Commission recovery plans in line with the Regulation within due time.

A responsive administration coupled with the Member State’s capacity to comply with commitments made through the recovery plan constitute the key prerequisites to be eligible for the financing and to continue to take advantage of the Recovery Instrument over time. Financing would be granted by the Commission through instalments related to the various stages of investment and reform set forth in the national recovery plan, which fulfillment would be subject to constant monitoring by the Commission.

To this end, reconciliation of the macroeconomic recommendations, annually reported by the Commission to each Member State, with the projected needs of national undertakings operating in sectors of strategic interest, is paramount.

## **1. The European Recovery Instrument: Repair and Prepare for the Next Generation EU**

The Recovery Instrument, which would provide the EU budget with additional liquidity necessary to respond to urgent challenges posed by the pandemic, consists in a one-off emergency mechanism, put in place for a temporary period and used exclusively for crisis response and recovery measures. It contains a massive reconstruction package, targeted towards those sectors and Member States most affected by the crisis and modeled on a number of EU programs, either new or already existing, based on three fundamental pillars:

- providing tools to support Member States' efforts to recover from the crisis;
- identifying measures to boost private investment and support ailing companies; and
- ensuring the reinforcement of key EU programs.

To finance the Recovery Instrument, the Commission proposes to temporarily lift its own resources ceiling to 2.00% of EU Gross National Income, in order to use its strong credit rating to borrow €750 billion on the financial markets. Given the nature of the measures to be funded, the Regulation provides that one portion of such amount (€500 billion) should be used to provide loans to Member States, and the remaining resources (€250 billion) should be used for non-repayable support, financial instruments, or provisioning for budgetary guarantees and related expenditure by the Union.

### **1.1 The Three Pillars of Next Generation EU**

#### *a) Supporting Tools for the Recovery of Member States*

According to the Commission's proposal, the bulk of the funding from Next Generation EU (more than 80%) should be used to fund investment and support reforms in all Member States – especially those most affected by the crisis – and in those sectors where resilience needs appear greatest (i.e., employment, education, research, innovation, health, environment, and finance). These are the purposes of the new **Recovery and Resilience Facility**, the centerpiece of the Recovery Instrument. The Recovery and Resilience Facility comes with a proposed budget of €560 billion, equipped with a grant facility worth up to €310 billion and able to make up to €250 billion in loans.

In order to have access to such facility, Member States should prepare **recovery and resilience plans** as part of their national reform programs. The plans should set out investment and reform priorities integrated with the related investment packages to be financed under the facility through installments depending on progress made and on the basis of pre-defined benchmarks; the regular fulfilment of these benchmarks would allow the State to benefit from the financing installment, which would be denied if the State failed to comply with the investment and/or reform objectives set forth by the national recovery plan. The national recovery plans should be submitted to the Commission in April 2021, unless Member States anticipate filing in October 2020, in conjunction with the presentation of their Draft Budgetary Plans. The recovery plans will first be assessed by a committee composed of Member States' representatives but will ultimately require Commission approval.

In addition to the Recovery and Resilience Facility, the Commission proposes to finance the adoption of key crisis repair measures in support of small- and medium-sized enterprises as well as of some economic fields – including the labor market, health care systems, and tourism sector – through the **REACT-EU initiative**, equipped with additional funding of €55 billion between 2020 and 2022.

Lastly, Next Generation EU would allocate €40 billion to the **Just Transition Fund** to support Member States in accelerating the transition towards climate neutrality, and €15 billion to reinforce the **European Agricultural Fund for Rural Development**.

*b) Incentives to private investments and support to undertakings in difficulty*

As far as the second pillar is concerned, the Commission proposes to upgrade Europe's flagship investment program, **InvestEU**, to a level of € 15.3 billion, with a view to mobilize private investment in strategic projects across the Union and provide crucial support to companies in the recovery phase.

A key feature of InvestEU should consist in the new facility, the **Strategic Investment Facility**, designed to generate investments of up to € 150 billion in strategic sectors, notably those linked to the green and digital transition, and key value chains in the internal market.

Additionally, with a view to create a solvency lifeline for companies under pressure, the Commission proposes a new **Solvency Support Instrument** equipped with a budget of € 31 billion and aimed at mobilizing private resources to urgently support viable European companies and avoid massive capital shortfalls or possible defaults. It should be operational from 2020 and would allow to unlock € 300 billion in solvency support for such companies, from all economic sectors, operating in those Member States which are less able to intervene through state aid.

*c) Reinforcement of Europe's Strategic Programs*

Lastly, Next Generation EU is designed to provide targeted reinforcement for key programs related to health security, civil protection, and innovation, as well as to strengthen Europe's ability to withstand and overcome future crises.

As far as health security is concerned, the Commission proposes the new, standalone, **EU4Health** program with a budget of €9.4 billion to support health care systems, promote cross-border collaboration in health, and boost investments in critical health infrastructure, structures and processes for the forecast, prevention, and management of outbreaks. Furthermore, the Commission suggests reinforcing **RescEU**, the Union's Civil Protection Mechanism, for which financial allocation should be increased to €3.1 billion to strengthen the capacity and logistical infrastructure needed to respond to different types of emergency. 94.4 billion euros is additionally proposed by the Commission to reinforce **Horizon Europe** in support of health and climate-related research and innovation activities.

## **1.2 The Impact of the Recovery Instrument**

The scale and design of Next Generation EU reflect the magnitude of the extraordinary emergency mechanism proposed by the Commission, aimed at complementing national efforts, powering a fair socio-economic recovery, revitalizing the EU single market, and supporting urgent investments.

The measures provided by the Recovery Instrument constitute ad hoc supporting tools specifically designed to cover the financial needs of each ecosystem affected by the crisis; therefore, its effects should considerably differ between economic sectors and States to which it would be applied.

With respect to economic sectors, the Recovery Instrument allocates the highest financing to tourism, construction, and automotive industries, where equity losses are estimated at 26,4%, 17,4% and 14,1%, respectively, as well as to entertainment, hospitality, and transport, which may experience the largest losses in real gross value added in 2020, ranging from 20% to 40% compared to 2019 (see the Commission Staff Working Document, “*Identifying Europe’s recovery needs*,” dated May 27, 2020).

Similarly, the Recovery Instrument would have a different impact on Member States, depending on their GDP per capita and debt-to-GDP ratios. Indeed, the Commission proposes to address considerable funds to Member States with a below-average income per capita and high public indebtedness (so-called “S Member States”: Italy, Spain, Greece, Cyprus, and Portugal), while allocating medium amounts of financing to those Member States with a GDP per capita below-average with low debt (“E Member States”, including, among others, Bulgaria, Czechia, Estonia, Croatia, Hungary, Poland, Romania, and Slovakia) and lower amounts of financing to Member States with above-average GDP per capita and high incomes (“H Member States”, including, among others, Belgium, Denmark, Germany, Ireland, The Netherlands, France, and Luxembourg).

Notwithstanding this general allocation strategy has already been set, the exact amounts of financing that would be granted to each Member State under Next Generation EU have not officially been disclosed yet; indeed, the precise size of national contributions will only be known once Member States have agreed on the next long-term budget. Nonetheless, some preliminary information was provided by EU Commissioner Paolo Gentiloni, who announced that Italy would receive the highest amount of financing under the Recovery Instrument (€172.7 billion, of which €81.8 would be grants and €90.9 would be loans), followed by Spain (€140.4 billion, of which €77.3 billion would be grants and €63.1 billion would be loans) and Poland (€63.8 billion, of which €37.7 would be grants and €26.1 billion would be loans).

According to the Commission’s preliminary evaluation of the potential impact of the recovery package, the Commission evaluates the financial support granted to Member States in terms of the sum of grants and loans. In order to benefit from the supporting measures, each Member State is asked to proportionally contribute to the Recovery Instrument to receive funds adequate to sustain its financial needs. Based on the Commission’s preliminary estimation, certain Member States would obtain a higher net advantage from the Instrument, compared to the funds disbursed; this is the case of Spain and, secondly, Italy, while Germany, for example, would obtain the lowest net benefit. Moreover, the same estimations reveal that, in principle, a Member State could be asked to contribute to the recovery plan for an amount exceeding the grants it would receive under the same Recovery Instrument, provided that the total sum of grants and loans resulted in a supporting tool for the State, especially if such State had a below-average income per capita and high public indebtedness.

The funds raised will be repaid after 2027 and by 2058 at the latest. This will help to relieve pressure on Member State budgets when public finances are under severe strain, while ensuring that all obligations arising from this debt issuance will be honored from future EU budgets. The Commission additionally proposed using its further own resources at a later stage of the financial period to facilitate the repayment of the market finance raised and further help reduce the pressure on national budgets.

## **2. Reinforcements to the multiannual financial framework for 2021-2027**

In addition to the reinforcements financed under Next Generation EU, the Commission proposes to amend the Council Regulation setting forth the multiannual financial framework for 2021-2027, to strengthen other EU programs and align the future financial framework with recovery needs and strategic priorities.

In detail, the Commission amends, *inter alia*:

- the **Digital Europe Program**, which should be equipped with a total budget of €8.2 billion to boost the Union's cyber-defences and digital transitions;
- the **Connecting Europe Facility**, which should receive an additional €1.5 billion for investing in a high-performance transport infrastructure;
- the **Single Market Program**, as well as the programs supporting cooperation in the fields of taxation and customs, which budgets should be maintained at €3.7 billion, €239 million, and €843 million, respectively;
- the **Common Agricultural Policy** and the **European Maritime and Fisheries Fund**, which should be provided with an additional €4 billion and €500 million, respectively.

Lastly, beyond the individual programs, the Commission proposes to reinforce flexibility and emergency tools like the EU Solidarity Fund, the European Globalization Adjustment Fund, and the Solidarity and Emergency Aid Reserve. Together these instruments would provide for up to €21 billion in additional financing over 2021-2027.

### 3. First Steps of a Long Journey

As outlined by the European Commission President Ursula von der Leyen, *“the recovery plan turns the immense challenge we face into an opportunity, not only by supporting the recovery but also by investing in our future: the European Green Deal and digitalization will boost jobs and growth, the resilience of our societies and the health of our environment”*.

The plan is highly ambitious, and there is a long way to go.

The recovery plan designed by the Commission is still a proposal, which could be subject to adjustments or amendments during the approval process.

Moreover, the unprecedented nature of this operation and the exceptional amount of the aforesaid financing can be legitimated only through the amendment of the Own Resources Decision – the legal text which sets the conditions to fund the EU budget – by means of a unanimous decision of all Member States and approval according to national constitutional requirements, a process that will take time.

To bridge the transitional period until ratification of the amended Own Resources Decision and make much-needed funding available in 2020, the Commission has adjusted the current 2014-2020 long-term budget to allow for even higher spending in 2020.

Simultaneously, the Commission asked the European Council and the co-legislators to examine its proposals rapidly, to allow funds to be available immediately to address the most urgent areas. In response to such request, the European Council scheduled the discussion on the Recovery Instrument for June 18-19, 2020, with a goal of reaching political agreement on the matter by July.

The Commission will then work closely with the European Parliament and the Council to finalize an agreement on the long-term framework; the goal is to complete this work in early Autumn 2020, through the adoption of the new long-term budget that will drive Europe's recovery from January 1, 2021.

*\* This GT Alert is limited to non-U.S. matters and law.*

For more information and updates on the developing COVID-19 situation, visit [GT's Health Emergency Preparedness Task Force: Coronavirus Disease 2019](#).

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