VDMA Assessment

Basic economic policy issues

Decisions of the EU summit in July 2020: Cornerstones, evaluation and recommendations of VDMA

1. Summary of the decisions on the EU budget 2021-2027 and the Recovery Fund

- Agreement was reached simultaneously on two separate but closely related issues: The new "recovery" fund (Next Generation EU) of 750 billion euro and the EU budget for the next 7 years (Multiannual Financial Framework MFF) of 1,074 billion euro.

- **30% for climate protection in MFF and "Next Generation EU"**: All measures must support the climate targets for 2030 and the goal of being climate neutral by 2050. However, no independent "climate instrument" is envisaged. The summit document says little about how this quota is to be met and refers to sectoral targets and monitoring of the respective individual programmes.

- **Key points Recovery Fund (development instrument "NGEU"):**
  Volume of 750 bn Euro, most of which will go to the "Recovery and Resilience Facility" (672.5 billion, divided into 360 bn as loans and 312.5 bn as grants). “ReactEU” (47.5 billion) accounts for the second largest share. In addition, there are minor additions to the existing EU programmes InvestEU (5.6 bn), the research programme Horizon Europe (5 bn), rural development (7.5 bn), RescEU (1.9 bn) and the Just Transition Fund (10 bn).
    - The “Recovery and Resilience Facility” will be distributed on the basis of national " Recovery and resilience plans" for 2021-2023 and agreed ceilings per Member State. The plans must be consistent with the country-specific EU recommendations (growth potential, jobs, economic and social resilience). An effective contribution to the green and digital transition is also necessary. For example, plans must be coordinated with national energy and climate plans. If the plans are approved by the European Commission and the Council, Member States will receive the funding. 70% of the funding can be used in 2021 and 2022 and the final 30% by 2023. Overall, this means that there are certain criteria for the plans at EU level, but more detailed decisions on supported initiatives and priorities will be taken by the Member States.
    - “REACT-EU” (Recovery Assistance for Cohesion and the Territories of Europe) is an initiative focusing on crisis response. It is more aimed at providing short-term funding such as short-time working schemes and

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investment support for SMEs. Funds are channelled through existing institutions such as the European Regional Development Fund and the European Social Fund.
    - "InvestEU" is the programme to provide guarantees for loans to companies and governments, usually through the European Investment Bank. This programme receives an additional contribution of €5.6 bn through the Recovery Fund (compared to the Commission proposal of €30 billion). It seems that there will also be an extension of the scope, namely towards the strategic value chains and ecosystems preferred by the European Commission (note: VDMA is critical of such a vertical industrial policy).
- **Approval requirements and timeline recovery fund:**
  The national parliaments must give their consent, as the Recovery Fund goes beyond the EU budget and provides for the raising of common debts. Even an "accelerated ratification process" would usually take a year, according to Budget Commissioner Hahn. Approval could prove difficult in the Netherlands and Finland, both countries with minority governments and a strong right-wing populist presence in parliament. The ratification of the ESM Treaty during the sovereign debt crisis was completed two years after the basic political agreement was reached. The European Parliament must also approve important parts of the Recovery Fund (Regulation establishing the Recovery and Resilience Facility).
- **Financing the recovery fund:**
  Financing is provided by loans raised by the EU Commission on behalf of the EU on the capital markets. A new "own resources decision" must [1]raise the own resources limit and authorise the Commission (limited in time and amount) to borrow. The member states are each liable for Community borrowing in proportion to their share of the EU budget; for Germany this is approximately 27% (€ 202.5 bn). In order to repay these loans by 2058, new European taxes and levies are to be introduced (details have yet to be worked out). The following ideas for European taxes are on the table:
    - Plastic waste tax: From 1 January 2021, Member States are to pay a tax on non-recycled plastic packaging waste (EUR 0.80 per kg). This would result in costs of around 1.3 billion euros per year for German industry, and total EU-wide revenue is estimated at 5.7 billion euros (note: the VDMA has already written to oppose the proposed tax).
    - Carbon Border Adjustment: Proposal by mid 2021.
    - Digital tax: proposal by 1 January 2023.
    - Revised ETS proposal: Possible extension of the scope to aviation and shipping
    - Financial Transaction Tax: part of the next EU budget in 2027

[1] Maximum amount of funds that can be called up from Member States (currently 1,23 % of GDP, planned 2,0 % of GDP)

- **Key points EU budget 2021-2027**
  - Cohesion, Resilience and Values (430 bn remains the main item, followed by Natural Resources and Environment (around 400 bn, including agriculture).
  - New is the Brexit Adjustment Reserve of 5 billion euros to support the Member States and sectors most affected by Brexit. A proposal for this fund has yet to be drawn up.
  - Regions with above average GDP will have to invest 85% of their regional development funds in the digital and green transition.
  - Relevant budget items for Mechanical Engineering:
    - Horizon Europe research programme (note: VDMA already calls for more industrial research) (now planned: around 80 bn)
    - Connecting Europe: the programme aims to improve infrastructure (around 8 bn)
    - InvestEU (facilitation of loans through guarantees, about 32 bn)
    - Digital Europe programme: it will invest in strategic digital capacities such as EU high performance computing, artificial intelligence, data spaces and cyber-security (around 7 bn).
    - Major projects: Examples are the space programme (around 13 bn) and the International Thermonuclear Experimental Reactor (ITER, 5 bn).
- **EU Parliament criticism of the EU budget:**
  - Reductions in the new seven-year EU budget for investments in the future such as research, climate protection and health
  - Lack of clarity regarding the link between grants and respect for the rule of law
  - Uncertainty about the EU's future financial own resources (digital tax, CO2 border tax, expansion of the emissions trading system, etc.); German Council Presidency supports in principle the EU Parliament's call for financial own resources for the EU
- **Approval requirements and timeline EU budget:**
  The EU Parliament must approve the draft budget for the years 2021 to 2027. Despite vehement criticism (see previous point), the Parliament is expected to give its approval in September/October 2020. Until then, negotiations between the Parliament and the Council of the EU on changes to the budget will take place. MEPs from net recipient countries (Southern and Eastern Europe) will find themselves in a position of need of explanation if they delay or block the disbursement of funds.

2nd VDMA assessment:

The Recovery Fund is in essence not a fast-acting COVID stimulus package, but a pro-cyclical package to promote cohesion and structural change. Although the reason for this was the acute crisis situation, the money will only be paid out from 2021 to 2023. The aim must be for Europe to emerge from the crisis stronger.
The resources of the Recovery Fund will be allocated according to a distribution key which, in 2021 and 2022, will be based primarily on economic strength and the development of unemployment over the past five years until 2019. Only for 2023 will the unemployment indicator be replaced by the decline in GDP in 2020/2021. Compared to the Commission proposal, this will slightly increase the factor "reaction to COVID-19", but the "solidarity" aspect will be deferred, as economically strong countries will now benefit more.

Positive:

- The EU is capable of acting. The signal of solidarity and cohesion, which VDMA has called for, is being sent. Failure to reach agreement would have been a substantial damage to the common European project (which is of existential importance for the Mechanical Engineering sector). Between China and the USA, we need a strong, united EU which is capable to act.
- Europe is the home market for our industry, supply chains and customers. It is therefore in our very own interest that countries that were severely affected by Corona get back on a growth path.
- Linking the allocation of the Recovery Fund to national reform plans offers some opportunity to address overdue reforms: The lion's share of the funds will be allocated via national "plans for recovery and resilience", which in turn are to follow the economic recommendations of the EU Commission and Council. This type of recommendation is not new, but is already being made annually as part of the "European Semester". The recommendations are not always uncontroversial (for example, those on "macroeconomic equilibrium"), but often make sense (for example, the demands for reductions in taxes and levies and for investment in education, research and infrastructure). This theoretically offers an opportunity to use the Recovery Plan as a stimulus for reforms that have been necessary for a long time to increase competition and growth.

Negative:

- The Recovery Fund is the first step towards joint EU borrowing. Transfers are made without clear conditions. The EU Commission is authorized to raise its own debt on the capital markets - a decisive step towards further fiscal integration. This step must be democratically legitimised and institutionally secured retrospectively if it is not to result in future rifts. The planned debts will burden future generations.
- The legal basis for the granting of assistance through the recovery instrument is at least controversial and requires further clarification, especially the question of the extent to which structural change assistance such as the recovery plan is the "financial assistance in the event of a crisis" permitted under Art.122 (2). There is also the question of the extent to which a "secondary budget" circumvents the budgetary law of the EU Parliament. Complaints and thus uncertainty are foreseeable.
- Although there are requirements for the use of the Recovery Fund's resources (competition, growth, digitisation, sustainability, resilience), these remain rather vague in the summit document and, above all, a clear growth strategy is lacking. Much will depend on how seriously the Member States take the reform commitments. The disbursement of funds and the monitoring of projects will be decided by a qualified majority, so that the net receivers (Italy, Spain, France) will be able to decide even against the will of Germany and the other net contributors.
- Future burden for German taxpayers: Of the 390 bn grants from the Recovery Fund, 80 bn net are likely to come from Germany, while Germany's annual contribution to the EU budget will increase by around 10 bn euros to 45 bn euros.

- In the budget, investments in the future (e.g. for research and digitalisation) were cut by around 14 bn, but more money was allocated to agriculture and higher subsidies for coal-producing countries (explicitly Poland). There is a fundamental lack of sufficient elements that provide for the use of funds with European added value.
- It remains unclear how the debts for the recovery fund are to be refinanced. Through the back door and without public political discourse, the EU will be given the power to get into debt and levy its own taxes, e.g. the controversial Carbon Border Tax and/or a digital tax. A tax on non-recyclable plastic waste is to be introduced next year.

What's the bottom line?
In the recovery plan the are in total more negative points, but the positive points are to be weighted very high. The important goal of "Unity of the Union" is achieved. Counter-financing is proposed, but the taxes and duties proposed for this are rather unsuitable, the problem of financing is postponed.

The outcome on the EU budget, the multiannual financial framework, is rather disappointing. What is missing here is a clear signal for a modern and sustainable budget that focuses on technology and research.

3. Recommendations for improvements and implementation:

- No new additional taxes and charges at EU level; an alternative form of financing would be to increase the rate applied to each Member State's VAT base (currently 0.3%)
- EU budget: correct the reduction of the research budget, create more programmes and projects with European added value
- Use recovery funds for real reforms for competitiveness in the Member States (taxation, labour market, education, infrastructure, etc.). A clear EU strategy is missing here.
- When allocating funds by Member States, avoid distortion of competition and respect EU competition law.
- Efficient and targeted use of funds, freeriding effects are to be avoided
- The focus must be on strengthening competitiveness and creating appropriate structures in order to emerge from the crisis stronger together in Europe. Resources must not be wasted on covering national financial gaps. On the contrary: Member states must solve their structural problems, launch reforms and explicitly reduce public debt in the long term.
- When focusing on climate protection, care must be taken to ensure that this is done in a technology-neutral and low-bureaucratic manner. Labels or taxonomies that exclude technologies per se should be avoided.

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