EU UNBLOCKS RECOVERY FUNDING FOR POLAND

Hungary remains only CEE market awaiting EU recovery funds approval

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Following a year-long debate over the situation of the rule of law in Poland, the European Commission on 1st June finally endorsed the country's National Recovery and Resilience Plan, unlocking €35.4 bn in grants and preferential loans aimed at supporting Poland's post-pandemic economic recovery. The new EU funds are conditional on Poland implementing reforms to ensure judicial independence and are expected to significantly impact Polish GDP and bring a number of investment opportunities, particularly in the green and digital sectors.

The endorsement from Brussels leaves Hungary as the only EU member state yet to secure a green light from the EU's top executive body. Hungary has also been locked in political disputes with EU institutions and is aiming for a similar compromise deal, although the immediate impact of ongoing talks remains uncertain.

Below, Aretera provides further insight into the political and economic impact of the Polish-EU deal, as well as to the state of the EU's post-pandemic recovery funding in the CEE region.

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A LONG-AWAITED GREEN LIGHT FROM BRUSSELS

On 1st June, the European Commission – the EU's top executive body – officially endorsed Poland's National Recovery and Resilience Plan (NRRP), unlocking €billions in post-pandemic recovery funding for the largest Central and Eastern European EU member state under the European Union's Recovery and Resilience Facility (RRF) within the Next Generation EU (NGEU) post-COVID-19 funding scheme.

Agreed in late 2020 and introduced in early 2021, the NGEU is a multi-annual EU recovery funding program worth a staggering €750 bn, distributed among EU member states in the form of preferential loans and grants for public and private investments. The landmark package, which marks an historic first in joint EU loans, came as the joint European response to the economic impact of the COVID-19 crisis and is aimed at ensuring the European bloc's economic recovery, primarily through investments to support the green and digital transitions.

Under the NGEU deal, all EU member states had to submit their own NRRP, a governmental plan on how to spend the recovery money efficiently and transparently. While the European Commission approved most NRRPs last year, the EU executive refused for over a year to rubber stamp the Polish plan due to concerns over the government's alleged breaches of the rule of law. While differences between the two sides remain significant, Russia's war against Ukraine has changed the political calculus, putting an enormous burden on neighbouring Poland, a strong supporter of Kyiv and now host to more Ukrainian refugees than any other country.

The war effectively pushed the two sides to search for a compromise deal, which they eventually reached on 1st June. Under the agreement signed by EU Commission President Ursula Von der Leyen and Polish PM Mateusz Morawiecki, the EU will release €35.4 bn in recovery funds, including €11.5 bn in preferential loans and €23.9 bn in non-refundable grants. Simultaneously, Poland has committed to make steps to strengthen the rule of law in the country. Prior to the agreement, the Polish parliament approved amendments to some of the controversial judicial changes, including the dismantling of a much-criticized disciplinary chamber for Polish judges.

POLITICAL & ECONOMIC IMPLICATIONS

The recovery funding is conditional on rule-of-law reforms. "The approval of this plan is linked to clear commitments by Poland on the independence of the judiciary," the EU Commission President said, pointing to the implementation of "milestones" in the proposed judicial reform. Poland's bicameral legislature – with a pro-government majority in the lower house (Sejm) and a pro-EU opposition majority in the upper house (Senate) – is still in the process of finalizing the legislative framework behind the reforms, suggesting that it will take months before the Polish government could actually apply for the first tranche of post-pandemic recovery funding.

EU-Poland ties could be decisive for the next Polish elections. While the Polish government was forced to make concessions under the current deal, the Commission notably avoided targeting Warsaw when the EU executive triggered its new rule-of-law sanctions tool for the first time (against Hungary in early April), an indirect recognition of the need to strengthen cooperation with Warsaw in the wake of the Russia-Ukraine war. Securing the funds following the implementation of reforms would be a major win for the ruling Law and Justice Party (PiS) and could support the party's chances for re-election in 2023. At the same time, a failure to normalize relations with the EU (as the war continues) could shift public opinion towards the pro-EU moderate opposition.

However, further compromise with Brussels might also lead to disputes within Poland's ruling coalition, given differences between the minor ruling United Poland party – led by Justice Minister Zbigniew Ziobro, the chief architect behind the controversial judicial reforms – and the rest of the coalition.

Poland continues to block the OECD's global corporate minimum tax. In April, Polish Finance Minister Magdalena Rzeczkowska notably vetoed an EU bill to implement the OECD's global corporate minimum tax rate, making Poland the only EU country standing in the way of the landmark reform in global taxation. The 15% global corporate minimum tax has been previously backed by all OECD countries (including Poland), leading to speculation that the veto is associated with the Polish government's aim of unlocking EU recovery funds. The Morawiecki Cabinet has continued to raise objections, demanding that the global minimum levy will be followed by tax changes for large companies in the digital sector.

The decision has caused a political earthquake in both Poland and the EU. Von der Leyen's decision to greenlight the funds has been subject to strong criticism not only in the European Parliament but also within the Commission. In addition to liberal MEPs considering a censure motion against the Commission President, five members of the Von der Leyen Commission, including three of her deputies, expressed disagreement with the compromise. Critics say that Poland must fully comply with previously scrutinized ECJ rulings and acknowledge the primacy of EU law. While it would be a first in EU history, such a censure motion against Von der Leyen is likely to fail, given her European People's Party's positions in the EU legislature. At the same time, the Commission President has vowed not to distribute any recovery funding for Poland if Warsaw does not deliver on judicial reforms.

The green and digital sectors are the largest beneficiaries of the Polish plan. As in all national recovery plans, the green economic and digital transitions are the largest beneficiaries of the Commission-approved Polish NRRP, with 42.7% of the funds supporting climate objectives and 21.3% dedicated to the digital transition. The latter includes investments to provide universal access to high-speed internet, digitalization of public services, IT equipment development in the education system, as well as cybersecurity measures. The plan also envisages the energy efficient renovation of buildings, railway and bus transport modernization and the development of green hydrogen technologies, opening up investment opportunities in public-private partnerships. The Polish government expects that the new EU funds will raise the level of investment in the economy by 0.4% in 2022 and 2% in the following years. As the EU, which recently introduced an oil embargo against Russia, takes steps to rid itself from dependence on Russian energy in the long run, Poland is simultaneously turning its focus to its energy sector, with the government having recently ruled out windfall taxes on state-owned energy firms[1].

The funds could make a significant contribution to Polish GDP growth. In 2020, the Polish economy contracted by 2.7% due to the COVID-19 crisis, followed by a 5.9% rebound in 2021. Russia's war on Ukraine has inevitably worsened Poland's short-term economic outlook[2], however, the CEE market is still on a growth trajectory. The spring economic forecast of the EU Commission expects the Polish GDP to grow by 3.7% this year and 3% in 2023, with the recovery funding likely to be a key contributor in strengthening economic resilience against external challenges. The Polish Finance Ministry believes the recovery funding will not only prevent a looming economic downturn, but will add 0.1% to GDP growth in 2022, 0.6% in 2023 and up to 1% in the following years. At the same time, the inflow of new funds may also boost Poland's record-high inflation, by 0.4% points in 2023.

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[1] See here for our overview of sectoral windfall taxes in Hungary introduced in May
[2] See here for our overview of Russia's war on Ukraine and its impact for the CEE region

RRF FUNDING PER CEE COUNTRY

EU Member State	Funding in Grants (€bn)	Funding in Loans (€bn)	In % of GDP (2019)
Bulgaria	6.3	-	10.2
Croatia	6.3	-	11.7
Czech Republic	7	-	3.3
Estonia	0.97	-	3.5
Hungary*	**7.2**	**9.6**	**12**
Latvia	1.8	-	6
Lithuania	2.2	-	4.6
Poland	23.9	11.5	12
Romania	14.3	14.9	13.1
Slovakia	6.3	-	6.7
Slovenia	1.8	0.7	5.2

*Hungary is the only EU member state in the CEE region still awaiting to receive RRF funding. Source: EU Council

ALL EYES ON HUNGARY

With the European Commission greenlighting the Polish recovery plan in June (and the Bulgarian NRRP in April), Hungary has remained the only EU state yet to secure approval for post-pandemic recovery funding. The Commission continues to block the Hungarian recovery plan over concerns of endemic corruption around the allocation of EU-funded contracts. Furthermore, shortly after Hungarian PM Viktor Orbán's ruling Fidesz party scored a landslide victory in Hungary's parliamentary elections on 3rd April[3], Hungary became the first EU country to be targeted with the Commission's new rule-of-law sanctions mechanism that links EU funds to upholding the rule of law.

While political differences between the two sides have the potential to cause further uproar, our baseline scenario assumes that the Orbán Government will reach a compromise deal with Brussels. Notably, Viktor Orbán's new Government[4], formed on 24th May, now includes former Fidesz-nominated EU Commissioner Tibor Navracsics as Territorial Development and EU Funds Minister, suggesting that Orbán is aiming for a compromise.

Minister Navracsics has pledged to negotiate the unblocking of the recovery funds by the end of the year, securing access not only to an estimated €7.2 bn in grants but an additional €9.6 bn in preferential loans that were previously rejected by the Hungarian PM. Furthermore, Orbán has hinted at a possible deal over endorsing the bloc's oil embargo against Russia if the Commission releases Hungary's recovery funding. While the latter has not yet happened, PM Orbán did endorse the EU's oil embargo during an EU Council Summit on 31st May, although after a month-long veto and with exemptions for Hungary.

[3] See here for our overview of the Hungarian parliamentary elections held on 3 April
[4] See here for our overview of the formation of Viktor Orbán's fifth government on 25 May

LOOKING AHEAD

The European Commission's unblocking of post-pandemic recovery funds for Poland comes as a major relief for the largest Central European market. The €35.4 bn funding scheme will make a significant contribution to the growth of the Polish economy in the coming years, opening up investment opportunities in a number of industries, with the green and digital sectors among the largest beneficiaries. Nevertheless, the new EU funding remains conditional on judicial reform, meaning differences within the ruling United Right coalition could theoretically disrupt its distribution and even – under a more extreme scenario – provoke coalition disputes or even a break-up.

With Brussels' greenlighting of the Polish recovery plan, Hungary remains the only Central and Eastern European country without approval for its recovery funding. Hungarian Prime Minister Viktor Orbán is aiming to secure close to €16.8 bn in grants and preferential loans by the end of the year, with a compromise deal looking likely. Political disputes between the two sides could yet prolong the procedure, however, particularly if Hungary's controversial stance on Russia continues.

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