Teneo

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EU Summit 19 June – Discussions on the Recovery Plan and Brexit

Summary

EU Heads of State will meet on 19 June to discuss the EU post-Coronavirus recovery plan. The meeting is not expected to yield final conclusions on the recovery plan, but hopefully leaders will agree on its main elements. Many important elements need more technical preparation before a decision is taken. One or two summits can be expected in July to reach an agreement on the whole expenditure program (EU long-term budget and recovery plan), with the necessary legal texts to be finalised and adopted after the summer. Once an agreement is reached, the European Commission will have the challenging task of ensuring it is implemented quickly. At the meeting on 19 June, EU leaders will also be briefed on the negotiations on a long-term agreement with the UK. No substantial negotiations are expected at this summit, but possibly in late September.

The Recovery Plan

Complex exercise but failure unlikely

For the past two weeks EU officials have been discussing the Commission's detailed proposals for a revised framework for the EUR 1.1trn ordinary EU budget for the period 2021-27 (Multiannual Financial Framework), and the additional EUR 750bn COVID-19 recovery plan, dubbed "Next Generation EU". The talks have exposed the political and financial complexity involved, but Germany, which holds the upcoming Presidency of the Council of the EU (six months starting 1 July 2020) is still determined to reach an agreement in July on the whole expenditure program (MFF and recovery plan).

The discussions by EU leaders during the Summit on 19 June will only be the first round. Two more summits are provisionally scheduled in July with leaders present in Brussels and will be needed to obtain a political agreement on the spending plans.

There is broad agreement on the overall architecture of the package, with the Recovery Plan financed through EU-issued debt. Five member states, the so-called "frugal" states (Netherlands, Sweden, Finland, Denmark, and Austria), continue to object to the overall size of the package and are seeking to reduce the amount of grants (as opposed to loans) in the rescue package. Their opposition is growing weaker, however, as they assess the political cost of blocking an agreement on the deal. Rather than blocking, they will seek concessions such as extending the current rebate on their EU budget contributions, which is set to expire.

EU states agree on the goals of the spending but are divided on the details. The package needs to be agreed by the European Parliament and the increase in the EU's financial resources (new EU taxes) must be approved by all national parliaments. Hundreds of pages of legal texts need to be adopted, which would take several months, or even years, to adopt under normal circumstances. However, for the money to start to flow before the end of the year, the legislative timetable needs to be speeded up. Agreement on the legal texts would also create confidence in the market that the EU spending plans are viable, which has been critical so far in stopping a new financial crisis from unfolding. This is a point European Central Bank President Christine Lagarde is expected to make at the summit.

The EU institutions, and European Commission in particular, will face an enormous task once the financial and legal framework is in place to ensure that an unprecedented amount of EU money is well spent and makes a substantial contribution to the economic recovery. For existing spending programmes where the Commission

has long experience, allocating additional funds will not be a major problem. Rather, the challenge will be to ensure that the maximum number of projects can be launched in the coming two to three years. To make the task easier, the commission can be expected to be exempt from requirements to match funding by national governments to projects and have more flexibility to decide what types of projects can be supported with EU funds.

The return of the troika?

The biggest program - the Recovery and Resilience Facility (RRF), where the Commission's proposals offer EUR 310bn in grants and EUR 250bn in loans – could prove more difficult to implement. The RRF provides support to member states for public sector investments and reform, including on green and digital transitions. More than half of the money is earmarked for the countries that have been hardest hit by the economic consequences of the Covid-19 crisis (Italy, Spain, Portugal, and Greece). The money is expected to boost public expenditure by the equivalent one percent of GDP over the next three years.

The RFF funds will be allocated according to the recommendations made in the EU's regular recurring audit of national public budgets - a process known as the European Semester. With money at stake, member states can be expected to be more committed to these recommendations than in the past. As it stands, member states will have a say on the allocation of funds in individual countries through secondary legislation known as comitology.

The Commission will have to be careful in its dialogue with the recipient countries. On the one hand, it wants to avoid the "Troika" label made (in)famous during the Greek debt crisis, where officials from the European Commission, European Central Bank and International Monetary Fund imposed strict conditions for continued financial support. On the other hand, the Commission wants to make sure that EU funds are used to ensure long-term transformation of the economy and not supporting failing sectors.

Safeguard against deficiencies in the rule of law

Most member states want to include a human right clause in the major spending programmes, which could be used to stop funds going to countries that fail to respect the rule of law. The formulation of such a clause has been a stumbling block throughout the negotiations of the MFF. Poland and Hungary have been leading the pushback with the support of other central European countries. The clause will now also cover the recovery package. It is unlikely that the Commission's original proposal will be accepted, which gave the Commission the power to cut financial support to countries failing to respect the rule of law, unless a qualified majority of member states object. In the latest proposal, funds would be cut if a qualified majority of member states support such a move and will only apply if rule of law deficiencies threaten implementation of the EU budget.

Brexit: Further agreement with the UK

The high-level meeting on 15 June between the British Prime Minister Boris Johnson, the Commission's President Ursula Von der Leyen and the European Council's President Charles Michel did not deliver progress on the substance of the Brexit negotiations. However, they agreed to accelerate the speed of the negotiations. The trio also confirmed that there will be no extension of the transition period, during which the UK remains in the EU Single Market, beyond 31 December 2020. At the 19 June summit of EU heads of state, leaders are likely to reconfirm their trust in chief negotiator Michel Barnier, but without providing him with much flexibility to deviate from his present mandate. The crunch time is likely to come at the end of September when hopefully the COVID-19 recovery package will be agreed. Michel Barnier has also indicated that October is the latest that a new deal can be agreed to allow time for ratification by the European Parliament.