Teneo

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EU recovery: from political ambition to legal text

Summary

EU leaders took a landmark political decision at a summit in July, when they decided to create a loan-financed COVID-19 Recovery Plan and a framework for the EU's long-term budget for 2021-2027, the so-called "Multiannual Financial Framework" (MFF). The EU will now start the complicated process of **transforming political decisions into binding legal texts**. The greatest challenge will be to ensure that national parliaments ratify the funding (the new own resources decision) in time. We can expect major clashes between the Council and the European Parliament after EU leaders proposed **funding cuts for EU Parliament priorities**. The European Parliament is also pushing back on EU leaders' postponement of the introduction of a **'rule of law' clause** in expenditure programs. The European Council and the European Parliament have, however, made progress over the past year on finalizing more than 30 regulations on the use of EU funds. **Despite the political battles, there is little doubt that an agreement will be found before the end of the year, as the risk of failure is too great.**

Financing

Following the agreement reached by the European Council to change the EU's own resources, the next steps include consulting the European Parliament and national parliaments. Indeed, the entry into force of the own resources' decision requires the ratification of all national parliaments, which would take more than a year under normal circumstances. This time around, member states will need to convince their national parliaments to move forward much more rapidly since they are supposed to ratify the decision before 1 January 2021 for the European Commission to obtain the necessary loans on the markets. Despite EU leaders' confidence that the ratification process will be concluded in time, the EU also envisage a backstop measure in the form of temporary national guarantees to the EU budget, in case of failure.

As a reminder, the EUR 750 bn recovery package, dubbed "New Generation EU", will be financed through EU-issued bonds sourced from financial markets. To obtain low interests in the market and retain the EU's present triple-A credit rating, the EU must have the ability to pay back the loans, which is why its own-resources ceiling (i.e. claims on member states) needs to be increased. Indeed, the existing overall tax ceiling of the EU budget (presently 1.2 percent of member states' GDP) will be increased to 2 percent, until the loans are fully paid back. EU budget is financed through claims on member states, which presently consist of direct contributions by member states based on their Growth Domestic Income (GDI), 1 percent of VAT receipts and customs duties on imports.

EU leaders in July agreed to add new financial resources to the EU budget, starting with a non -recycled plastic waste tax of EUR 0.80 per kg of unrecycled plastic packaging waste, from January 2021. Over time, a new Carbon Border Adjustment mechanism and a digital tax (deadline 1 January 2023) could also be introduced. The EU also considers other revenues options such as extending the EU's Emission Trading Scheme (ETS) to Shipping and Air transport and a financial transaction tax (no deadline fixed). These new taxes will be collected by member states, which will transfer a percentage (yet to be fixed) to the EU.

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MFF and next year’s budget

The Multiannual Financial Framework and the 2021-budget must be agreed by the European Council and the European Parliament. While the European Parliament is fairly satisfied with the Recovery package (including the loan financing), it has expressed serious objections on the MFF.

More precisely, the European Council and European Parliament are divided on three major issues:

- The budget cuts made by the European Council on priority programs, such as research and health programs, Horizon Europe, ERASMUS, InvestEU and the Just Transition Fund. The European Parliament is also very much opposed to the generous rebates offered to some member states on their EU budget contributions.
- The lack of ambition and clarity on the introduction of new own resources.
- The absence of a human right clause in major spending programmes, that would enable the European Commission to stop funds going to countries that fail to respect the rule of law.

The European Parliament has already threatened to reject the MFF unless its demands are satisfied.

EU leaders are unlikely to change the financial allocations that were agreed with much difficulty in July. To ease the tensions, the Council could offer some flexibility to the European Commission in the use of the allocated budget figures. Indeed, only about 90 percent of the annual budget is traditionally spent because of delays or the cancellation of planned projects. Transferring the left-over money to other budget lines, such as those deemed important by the European Parliament, could provide more resources without changing the overall budget. The European Council could also commit to a more concrete timetable for the introduction of new own resources.

The ‘rule of law’ clause could prove to be a major stumbling block. Indeed, the European Council failed in July to agree on a clause linking payments under the Recovery Fund and major spending programs to the respect of the rule of law. This conditionality raises both legal and political difficulties. According to the European Council’s lawyers, making payments conditional on the respect of the rule of law could interfere with Article 7 of the EU Treaty, which is the main legal instrument for addressing shortcomings on rule of law. Specifically, lawyers are concerned that a parallel rule-of-law clause on access to funds would introduce different voting rules (unanimity under Article 7) and new sanctions (currently withdrawal of voting rights) than the ones envisaged in the EU’s constitutional text. According to the lawyers, a rule-of-law clause on access to funds could only work if the rule of law abuse threatens the EU’s financial interests, such as the proper functioning of national courts. One option could be to include a trigger for referral to the European Council.

Hungary, drawing on support from Poland, has already announced that its parliament will reject the ratification of the own resources’ decision if a such a clause is introduced.

For money to start flowing from 1 January 2021, the various institutions will need to agree on these issues by the end of October. The central European countries standing in the way of an agreement will be the main losers if the Recovery Fund and EU-budget are blocked, and face an even bigger risk if a deadlock sweeps them into an EU-level political and financial crisis at a time where economies of all member states are weakened by the pandemic.

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Spending plans – from ambition to legal text

The European Council and the European Parliament have successfully negotiated more than 30 regulations on the use of EU funds, many of which are in the final stages of talks. Both institutions might need to redraft some of the regulations to match political commitments at EU level to devote at least 30 percent of expenditure to climate action and the respect of the “do no harm” principle introduced by the European Green Deal to ensure EU funds are not invested in environmentally harmful activities. Some EU programs will be partially financed by the “New Generation EU” facility, which requires the frontloading of spending.

The draft regulation for the biggest program under Next Generation EU, the “Recovery and Resilience facility” (RRF), is currently under discussion, but a lot of the groundwork in terms of procedure was already agreed by EU leaders in July:

- Member states will need to submit national recovery and resilience plans, including appropriate milestones and targets for the execution of national programs, by the end of 2020. These should be consistent with the country-specific recommendations made in the EU’s regular recurring audit of national public budgets - a process known as the European Semester. The national plans should, among other things, support investments and reforms essential to a lasting recovery, improve the economic resilience, restore the labor market and support the green and digital transitions. Member states are expected to collaborate closely with the European Commission during the preparatory phase of their plans. This process has already started.
- The European Commission will then have two months to report to the Council on its assessment of the national plans. The latter will then have four weeks to approve the final national plans.
- The European Commission will then closely follow the execution of national programs. In this context, it will make payments only after seeking the opinion of the Economic and Financial Committee on the achievement of the planned milestones and targets. The system also allows a member state to directly ask the European Council to approve payments in emergency situations, in a three-month approval procedure. The European Commission has the final say on payouts if disputes emerge.

One pending decision for EU governments to agree is whether to allow pre-financing up to 10 percent, but the modalities still need to be worked out.

The RFF will differ from EU’s structural policy programs, as it will cover more global (macroeconomic) national programs that wouldn’t typically deal with single projects. In this sense, it will be more similar to past programs for macroeconomic support to member states.

The European Commission will establish an internal taskforce to oversee the roll-out of the RRF. It will comprise the European Commission President Ursula Von Der Leyen, the Executive Vice-Presidents Frans Timmermans, Margrethe Vestager and Valdis Dombrovskis and the Economy Commissioner Paolo Gentiloni. The European Commission will set up the taskforce, which is a branch of the Secretariat-General, with an initial mandate of 12 months, with Céline Gauer (currently Deputy Secretary-General in the European Commission) acting as head until a permanent head has been appointed.