IN-DEPTH ANALYSIS

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ECONOMIC GOVERNANCE

Recovery and Resilience Dialogue with the European Commission

BUDG-ECON Committee meeting on 10 July 2023

Executive Vice-President Dombrovskis and Commissioner Gentiloni are invited to the eleventh Recovery and Resilience Dialogue (RRD) under the Recovery and Resilience Facility (RRF) Regulation.

***Section 1** of this briefing covers recent developments relating to the implementation of RRF, in particular the European Semester assessment of the general RRF implementation progress, the status quo of new REPowerEU chapters, requests for additional loans, and the mid-term evaluation of the RRF.*

***Section 2** focuses on the Commissions' preliminary assessment for Romania's payment request, elaborating on an example that may be of interest from a scrutiny perspective; the Commission activated the 'payment suspension' procedure for two milestones that Romania has not yet fulfilled. This briefing also provides some information available in the public domain regarding Italy's upcoming payment request.*

***Section 3** finally focusses on funding aspects of the RRF, namely the effect of rising interest rates, the MFF revision, and the Commission's proposal for new own resources.*

1. Developments since the last dialogue

1.1 Latest procedural steps

All 27 EU Member States have RRPs in place that were assessed by the Commission and adopted by the Council. The current focus is hence on the implementation of the agreed reforms and investments, and on the introduction of REPowerEU chapters. Payment requests can be submitted once the milestones (qualitative achievements) and targets (quantitative achievements) for the respective tranche are achieved.

18 Member States have so far **submitted in total 28 payment requests** (Spain, Italy and Greece submitted each three, Portugal, Croatia, Slovakia and Romania each two, and France, Latvia, Cyprus, Bulgaria, Slovenia, Czechia, Lithuania, Denmark, Malta, Austria and Luxembourg each one). The Commission **published in total**

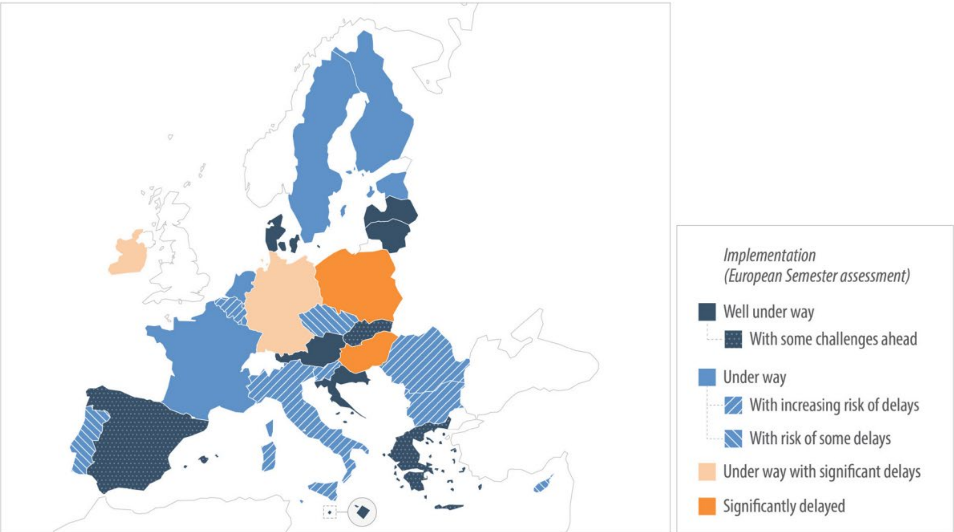
26 related preliminary assessments and made 25 disbursements to the 18 Member States, amounting to approximately EUR 153 billion in total (a separate EGOV document lists all related procedural steps).

There are **no preliminary assessments** yet publicly available for the latest payment request that **Greece** submitted on 17 May 2023, nor the one that **Italy** submitted on 3 January 2023.

1.2 European Semester assessment of the general RRF implementation progress

In the context of the 2023 European Semester spring package, the Commission **presented an assessment of the general implementation of the RRPs across Member States**, although it specifies that such an evaluation should in no way be related to formal approval of payment requests. Importantly, the Commission identifies four Member States (Hungary, Poland, Germany and Ireland) for which there are significant delays in the implementation of the plans (see Figure 1 below).

Figure 1: RRF implementation progress according to the European Semester assessment



Source: Recovery and resilience plans in the 2023 European Semester, EPRS

In the case of **Poland and Hungary**, this is related to the **late adoption of the plans** and to the **lack of implementation of "super milestones**" relating to the respect of "rule-of-law" principles, a precondition for any future payment. Hence, for both Member States, the Commission CSR pivots around the fulfilment of the super milestone as well as the finalisation of the REPowerEU chapters to allow for swift implementation (in this context, also see Box 1 that cites some findings from the 2023 Rule of Law Report).

- In **Poland**, while a number of reforms in other areas are being rolled out, the reform of the judicial disciplinary regime to strengthen the independence and the impartiality of the courts is still pending approval. No payment will be disbursed until this reform is passed.
- In **Hungary**, there are still 27 super milestones to be fulfilled to allow for future payments. These 27 super milestones are notably related to reforms in the area of the rule of law, including judicial independence, as well as protection of the financial interests of the Union.

In the case of **Germany and Ireland,** the deployment of the RRPs is underway, yet there are still significant delays due to the **limited resources** allocated to RRF implementation and to **insufficient prioritisation**. For both countries, the Commission in its CSR emphasise the need to speed up the implementation, ensure adequate resources and finalise the REPowerEU chapters.

- **Germany** is yet to sign operational arrangements and submit its first payment request covering 36 milestones and targets. It has already amended the plan once in February 2023, given the incapacity to fulfil two investments due to "objective circumstances". The Commission expects further changes, with a new REPowerEU chapter and an increase in the envelope of grants available to EUR 30.3 billion still being under negotiation.

- **Ireland** has also not yet submitted its first payment request. It has proposed to amend its plan in May 2023 due to *"unforeseen technical hurdles (...), delays (...) and other implementation issues"* (see here). It is currently still working on its REPowerEU plan.

Box 1: Findings in the 2023 Rule of Law Report

The 2023 Rule of Law report that the Commission published on 5 July 2023 examines, as in previous years, rule of law developments in Member States under four pillars: justice, anti-corruption, media freedom and pluralism, and broader institutional issues related to checks and balances. The report includes specific recommendations to Member States, and reports on progress in implementing the specific recommendations issued last year.

As regards the implementation of specific recommendations made in the 2022 Rule of Law Report, the Commission finds that **Poland** has (made):

- No progress on separating the function of the Minister of Justice from that of the Prosecutor-General and some progress on ensuring functional independence of the prosecution service from the Government.
- No progress on strengthening the existing integrity rules by introducing lobbying rules and a standardised online system for asset declarations of public officials and Members of Parliament.
- No progress on ensuring independent and effective investigations and prosecutions, address the broad scope of immunities for top executives and abstain from introducing impunity clauses in legislation in order to enable a robust track record of high-level corruption cases.
- No progress on ensuring that fair, transparent and non-discriminatory procedures are adhered to for the granting of operating licences to media outlets.
- No progress on strengthening the rules and mechanisms to enhance the independent governance and editorial independence of public service media taking into account European standards on public service media.
- No progress on ensuring a more systematic follow-up to findings by the Supreme Audit Office and ensure a swift appointment of the College Members of the Supreme Audit Office.
- Some progress on improving the framework in which the Ombudsperson operates, taking into account European standards on Ombudsinstitutions, and no progress on improving the framework in which civil society operates, taking into account European standards on civil society.

As regards the implementation of specific recommendations made in the 2022 Rule of Law Report, the Commission finds that **Hungary** has (made):

- Fully implemented the recommendation to strengthen the role of the National Judicial Council, while safeguarding its independence, to effectively counter-balance the powers of the President of the National Office for the Judiciary.
- Fully implemented the recommendation to adapt the rules related to the Kúria to remove judicial appointments outside the normal procedure, to strengthen eligibility criteria for the Kúria President, and to strengthen control by judicial bodies over the Kúria President, taking into account European standards, and to remove the possibility of reviewing the necessity of preliminary references, in line with EU law requirements.
- No progress on adopting comprehensive reforms on lobbying and revolving doors, and some progress on strengthening the system of asset declarations, providing for effective oversight and enforcement.
- No progress yet on establishing a robust track record of investigations, prosecutions and final judgments for high-level corruption cases.
- No progress on introducing mechanisms to enhance the functional independence of the media regulator taking into account European standards on the independence of media regulators.
- No progress on strengthening the rules and mechanisms to enhance the independent governance and editorial independence of public service media taking into account European standards on public service media.
- No progress on adopting legislation to ensure fair and transparent distribution of advertising expenditure by the state and state-owned companies.
- No progress on removing obstacles affecting civil society organisation.

1.3 Status quo of REPowerEU chapters in revised RRPs

In February 2023, the European Parliament and the Council agreed in February 2023 on the proposal to include REPowerEU chapters in the RRF, aiming to decrease the dependency on Russian fossil fuel imports and to increase the uptake of renewables, energy efficiency and energy storage capacity. In practical terms, Member States shall add **new REPowerEU chapters** to their national recovery and resilience plans; in the amended regulation, there is no compulsory deadline for the submission of REPowerEU chapters, but only a deadline for the access to additional funding in form of loans (31 August 2023).

The measures included in the new REPowerEU chapters will have to be implemented along the **same timeline** as all other measures set out in the initial recovery and resilience plans, meaning that Member States will have to **meet related milestones and targets by 31 August 2026 at the latest**. A careful selection of projects, whose implementation can be finalised within the remaining period, seems hence as important as the **timely submission** of the new REPowerEU chapters, which still need to be assessed by the Commission and endorsed by Council, a process that in total may take up to three months.

On substance, at the end of May 2023 the Commission's Directorate-General for Energy summarised the progress of the REPowerEU plan, one year after it was launched in May 2022, pointing out that the EU has for example successfully reduced its gas demand by 18% from August 2022 until March 2023, compared to the previous 5 years average consumption over the same period, and that Member States took significant actions to optimise the existing infrastructure to upgrade cross-border interconnections, to increase the import capacity of LNG with new terminals, and to speed up the installation of wind and solar power projects.

However, at present the **progress to update the national recovery and resilience plans is very limited**, so far **only seven Member States** submitted **REPowerEU chapters** (see table 1). See the Annex to the paper for an overview of the measures taken in the respective RePowerEU chapters.

Table 1: Submission of REPowerEU chapters, status quo at 5 July 2023 (amounts in € million)

Country	Submission	COM approval	Council approval	Grant amount	BAR transfer*	Loan amount	Total
Denmark	1 June 2023	pending	pending	€131m	€66m	0	€197m
Estonia	10 March 2023	12 May 2023	7 June 2023	€83m	€7m	0	€90m
France	20 April 2023	26 June 2023	pending	€2300m	€504m	0	€2804m
Malta	26 April 2023	26 June 2023	pending	€30m	€40m	0	€70m
Portugal	26 May 2023	pending	pending	€704m	€81m	€3200m	€3985m
Slovakia	27 April 2023	pending	pending	€367m	€36m	0	€403m
Spain	6 June 2023[1]	pending	pending	€2,586m	€58m	€1300m	€3,944m

* BAR transfer = Member States can submit a reasoned request to transfer the Brexit Adjustment Reserve to the RRF

[1] The Commission press release leaves some questions open on the exact allocation to the REPowerEU chapters, for further details please compare with breakdown in the Addendum to the Spanish RRP.

1.4 Additional loan requests

The amended RRF Regulation introduced a **notification requirement** for Member States to communicate to the Commission their intention to request additional loans, while formal request for loans can still be made until 31 August 2023. In April, the Commission provided an overview of the notifications received so far, not having published an update since.

The overview illustrates that at the time, ten Member States plan to request additional loan support under the RRF, amounting to approximately EUR 147.5 billion in total. At that stage, Spain has requested the whole EUR 84 billion in loan support originally allocated, and Italy and Greece indicated to ask for loan allocations in excess of 6.8% of their 2019 Gross National Income (GNI) – amounts exceeding the threshold can be made available in "exceptional circumstances". According to our calculation (see table 2), the **intention to request loans under the RRF strongly correlates with national refinancing conditions**.

While Italy has not specified the amount of resources it would request from this second round of loan allocation, this overview indicates that the other Member States would not request the whole set of resources available (EUR 225 billion), leaving **approximately 77 billion euros untapped**. During the RRD held in April, Commissioner Gentiloni stated that this is "*not the end of the story*", as formal requests will only be made in August.

Table 2: National refinancing conditions and intentions to request additional RRF loans

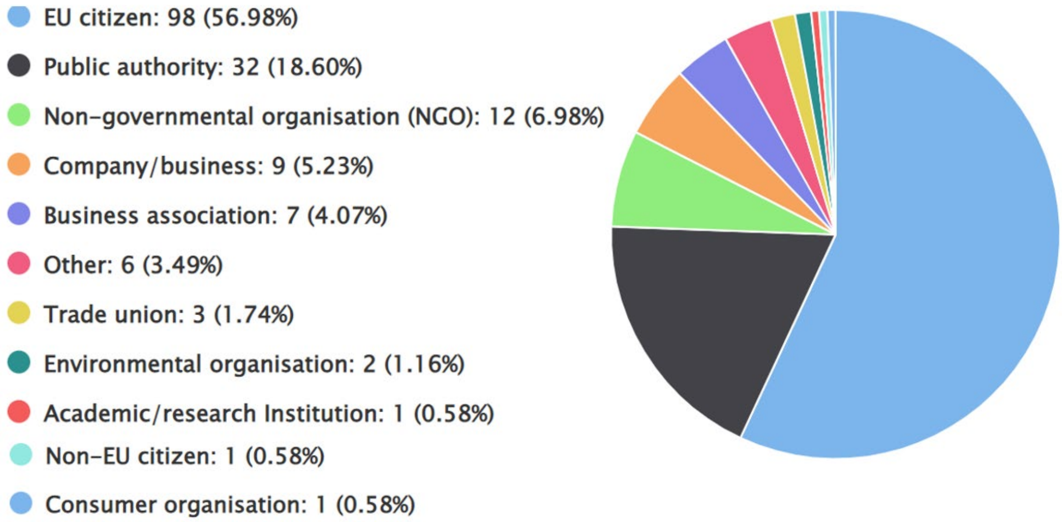
Country	Yield	Spread to EU	Loan request	Amount (EUR bn)
Germany	2,35	-64	No	n.a.
Denmark	2,66	-33	No	n.a.
Netherlands	2,69	-29	No	n.a.
Ireland	2,73	-26	No	n.a.
France	2,87	-12	No	n.a.
Finland	2,94	-5	No	n.a.
Austria	2,97	-2	No	n.a.
EU Next Gen	**2,99**	**0**		
Belgium	3,00	2	Yes	1
Portugal	3,17	18	Yes	11,5
Slovenia	3,28	29	No	n.a.
Spain	3,31	32	Yes	84
Italy	3,98	99	Yes	not specified
Slovakia	4,10	111	No	n.a.
Czech Republic	4,37	138	Yes	11
Hungary	7,30	431	Yes	6,6

Source: EGOV, based on MTS market data on spreads and yields of European bonds as per 26 June 2023 (no data by MTS for Croatia, Greece, Lithuania and Poland).

1.5 Mid-term evaluation of the RRF

According to Article 32 of the RRF legislation, the European Commission initiated its mid-term evaluation of the RRF in November 2022. The process commenced with a targeted consultation involving a select group of stakeholders in November 2022 that resulted in 53 responses (the majority thereof by EU citizen (39) and NGOs (8), while public authorities, business associations and individual companies each submitted 2 responses). The subsequent open public consultation (running from March to June 2023) finally resulted in 172 responses by a broader range of respondents (see figure 2).

Figure 2: Feedback to the open public consultation by category of respondent (absolute and relative numbers)



Source: European Commission

As stipulated in the RRF regulation, the "*Commission shall provide to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions with an* ***independent evaluation report*** *on the implementation of the Facility*" **by 20 February 2024.** That interim report shall comprehensively assess the effectiveness of the Facility in achieving its objectives, the efficiency of resource allocation, and its added value, and may include proposals for potential amendments to the regulation. (According to the RRF regulation, a full-fledged "independent ex post evaluation report" is only due by the **end of December 2028**).

With the aim of achieving this objective, the **Commission has assigned a consortium, co-led by CEPS**, the responsibility of conducting an evaluation study. This study intends to provide an impartial and autonomous assessment of the RRF, taking into consideration its effectiveness, efficiency, relevance, coherence, and the added value it brings to the EU. **The results of this study will play a significant role in shaping the Commission's mid-term evaluation report**. Moreover, they will provide substantial evidence and valuable insights to inform discussions **on future performance-based instruments** within the EU's post-2027 Multiannual Financial Framework.

Box 2: A recent study assessing governance of the RRF

In June, a study (part of the Recovery Watch series of publications) by Jonathan ZEITLIN, David BOKHORST and Edgars EIHMANIS assesses the effectiveness and legitimacy of the RRF's design, by analysing its practical functioning during the drafting, implementation and monitoring of the RRPs in eight member states. The study is based on documentary analysis and supporting interviews with key officials involved in drafting, implementing and monitoring the plans.

The authors make the following recommendations as regards any lessons to be learned from the RRF governance model:

1: Revise the RRF's performance-based financing system to allow greater flexibility in modifying investment and reform commitments, through a multi-tiered system of diagnostic monitoring.

2: Make effective inclusion of key domestic stakeholders in the drafting and implementation of the RRPs a binding assessment criterion for approval of plans and payment requests.

3: Establish explicit and transparent procedures for ensuring that RRPs address all or a significant subset of CSRs, including in MSs that receive low relative grant allocations.

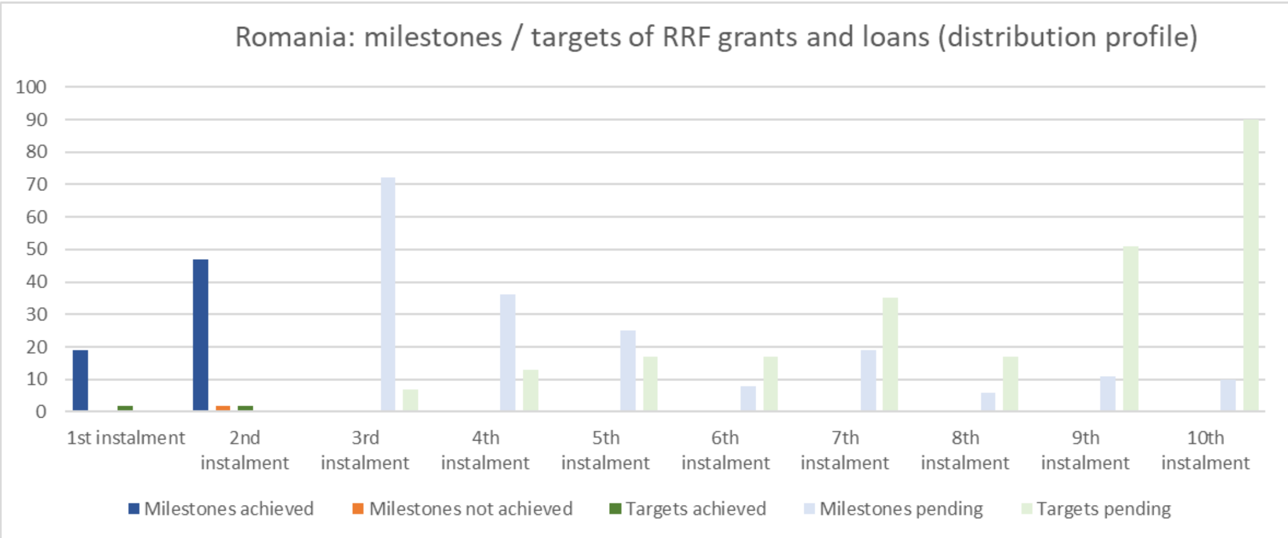
4: Revise the procedures for adoption of the CSRs, by reducing the voting threshold for amendments to the Commission's proposal and ensuring a greater role for multilateral peer review in assessing their implementation.

2. Latest Commission's preliminary assessment of milestones and targets

This section focuses on the preliminary assessment for Romania's payment request. Payment requests by Austria and Luxembourg were covered in a briefing published in May 2023 (here), those by Spain, Slovakia, Slovenia, Denmark, Czechia, and Lithuania in a briefing for the RRD in April 2023 (here), and those by Greece, Portugal and Malta in a briefing for the RRD in February 2023 (here).

Romania: Commission's preliminary assessment of the second payment request

Disbursement profile



On 16 December 2022, Romania submitted to the Commission a payment request based on the 49 milestones and 2 targets set out in the Council Implementing Decision for the second payment.

The Commission published its **(partially) positive assessment** on 27 June 2023.

After looking at the evidence, the Commission considered that 47 out of 49 milestones as well as 2 targets had been satisfactorily fulfilled. The Commission found that **two milestones related to energy investments** (milestone 129 and 133, which are part of the loan arrangements) **have not been satisfactorily fulfilled**. Even though first steps were already taken to fulfil those milestones, important work remains to be done. The Commission therefore activated the **'payment suspension' procedure**.

According to the Commission's preliminary assessment, the other milestones targets demonstrate that there is "*progress in the implementation of Romania's recovery and resilience plan*" (the Commission's recent **2023 Country Report** for Romania notably **adds a caveat**, saying that "*The implementation of Romania's recovery and resilience plan is underway, however with* ***increasing risk of delays***").

The milestones and targets envisaged by this payment request are related to several domains, including reforms and investments related to the green and digital transition, public policy delivery, water management, tourism and culture, the healthcare sector, tax administration, the pensions system, education infrastructure, road safety, and the fight against corruption.

Example for the fulfilment of targets and milestones in Romania's RRP that may be of interest from a **scrutiny perspective**:

Reform: **Reform of the National Agency for Fiscal Administration** through digitalisation; milestone (#195): Operationalization/approval of the **Joint Action Plan** between the National Agency for Fiscal Administration (ANAF) and Labour Inspection to prevent and **limit the phenomenon of grey/black work evasion**

Context: That milestone is part of a reform that aims at modernising and digitalising ANAF **to make tax collection more efficient**. According to the Council Implementing Decision, the reform aims at creating a framework for an **integrated risk management at tax administration level**, to adapt activities according to identified tax risks. The compulsory enrolment of corporate taxpayers in a certain registry, the definition of risk criteria, and the set-up of a centralised electronic risk register form part of that reform. The reform shall moreover strengthen the capacity and effectiveness of tax inspection bodies to prevent tax fraud and tax evasion, and strengthen the cooperation with labour inspectorates to prevent and limit the phenomenon of grey/black work tax evasion.

As regards the Joint Action Plan to limit the phenomenon of grey/black work, the Commission's preliminary assessment sets out the **evidence** based on which it concluded that the milestone was satisfactorily fulfilled, mentioning in particular the adopted Joint Action Plan agreed between ANAF and the Labour Inspection, as well as a related collaboration protocol (both documents are apparently **not publically available**, although ANAF usually publishes comparable documents; see ANAF webpage).

Articles in the **Romanian press** in any case suggest that the joint action plan was indeed the basis for a **new inspection program** that was **successful as a pilot project in the Bucharest area**, **but** that was **subsequently not rolled out** to the entire country, as announced by the president of ANAF.

In more detail, we noted that the joint action plan was used as a basis for a new inspection program called **Operation Cronos**, which was announced already at the end of March 2022 (see press article). According to that article, the joint action targeted companies that pay under-reported wages compared to the industry average, have a significant percentage of employees earning the minimum wage, or have a high turnover but a very low reported profit. Moreover, checks were carried out on companies that receive substantial loans from shareholders without justifying income for loans, or that show disproportions between the information declared on transactions carried out and those declared by business partners.

Operation Cronos was considered a pilot program, centred around the region of the capital, Bucharest, and its surroundings. Following the initial pilot phase, Lucian Heiuş, the president of ANAF announced in September 2022 that the program **had been very successful** and that it would soon be extended to the entire country in the following months (see press article).

However, in May 2023 the press reported that **no more joint inspections have taken place since** (see press article).

Focus: Italy's latest payment request

On January 2023, Italy requested the payment of the third tranche of EUR 19 billion in grants and loans under the RRF. To date, the Commission has not yet issued its preliminary assessment of this third payment request. The Commission was expected to conclude a preliminary assessment by the end of the first quarter of 2023, yet discussions are still ongoing with Rome. In late June, the Commission also carried a mission in Italy with a view of agreeing the final details before issuing its preliminary assessment.

According to the Italian government[2] "*the assessment by the European Commission (...) is in its concluding phase*". It identifies among the reasons for the delay the complexity of the objectives as well as spot-checks of the investments undertaken. As of early June 20223, the government was still waiting for the results of some of these checks. Reportedly, these delays would be related to measures to foster the availability of student housing to align Italy to other EU peers.

In the meantime, the June deadline for the achievement of the milestones and targets of the fourth payment request has elapsed. Negotiations are already taking place with the goal of unfreezing the instalment amounting to EUR 16 billion. Key obstacles in the context of the fourth payment request relate to the risk of missing a number of milestones and targets, such as the deadline to award childcare facilities and delays in the roll-out of hydrogen base infrastructures.

Regarding the delays, the government has been adamant of the need to revise the RRP as Italy would not be able to achieve all the objectives of the current plan, as noted in its third report to the Italian Parliament on the state of implementation of the RRP (see part 1 and part 2). Here it clarifies that "*where changes to the relevant objectives are proposed as part of the overall revision of the Plan, [the fourth payment request] will be submitted in line with the timing of this process*". The report recognises the problems linked to this instalment, highlighting need for revisions. For instance, it floats the idea of revising down the target of hydrogen-based recharging stations from 40 to 35 given the lower attractiveness of the sector than previously foreseen.

On its side, the Italian Court of Auditors had already voiced concerns on the fulfilment of milestones for the fourth payment request, notably with a warning on the delays in the deployment of hydrogen-based recharging infrastructure and a second warning on challenges to the installation of at least 6,500 electric vehicle charging points[3]. EU affairs minister Raffaele Fitto had already on that occasion reportedly criticised the ex-ante warning of the Court on the fulfilment of the milestones, claiming that this would overlap with the competences of the Commission, the only body in charge of this assessment. The Italian Parliament has since then been working on a clarification of the competences of the Court to prevent it from exerting a "concomitant scrutiny" to focus only on ex-post audits. The Court has argued against this delineation of competences as a concomitant scrutiny could further accelerate the administration of the funds in its view.

The third report on implementation also provides a broader overview on revising the rest of the plan by identifying 118 measures that have been impacted by significant difficulties. It highlights key challenges encountered that would justify amending the RRP. Inflationary pressures and the energy crisis had a drag

2 Please refer to third report to the Italian Parliament on the state of implementation of the RRP (part 1).

3 For further details, please see EGOV briefing on the state of play on the implementation of the Recovery and Resilience Plans (RRPs) as of May 2023.

on the completion of projects by raising the cost of raw materials. This has been coupled by supply-side bottlenecks that delayed the procurement of intermediate goods. Labour shortages and skills mismatch have further contributed to hold back the implementation of the plan. All these challenges are particularly critical for the constructions sector, which remains the major element of the plan.

Among other challenges, the report notes the fragmentation of investments due to the involvement of a several implement actors as well as the heterogeneity in the size, administrative capacity and in the financing of the investments. Similarly, it notes that most of the administrations in charge have spent less than expected, suggesting potential delays in the launch of measures that could affect the achievement of the objective of the plans.

In terms of democratic accountability, the report commits the government to submit the revision to the Parliament before officially submitting it to the Commission.

While Italy has not yet submitted its REPowerEU chapter, the report outlines some of its future key components to "*focus on energy security, improvements to the network, increase in (energy) production from renewables, measures and incentives to decarbonise firms, as well as measures to support energy-related supply chains*". The chapter will thus seek to improve the need of security in gas procurement, re-orient demand towards renewables and strengthen the competitiveness of Italian value chains in the renewable space (possibly through the provision of State aid).

Finally, the report praises the updated to the governance of the RRP to better define competences of the Prime Minister's Office and the Ministry of the economy as it goes in the direction of the CSR which called for an effective governance framework.

3. Funding aspects of the Recovery and Resilience Facility[4]

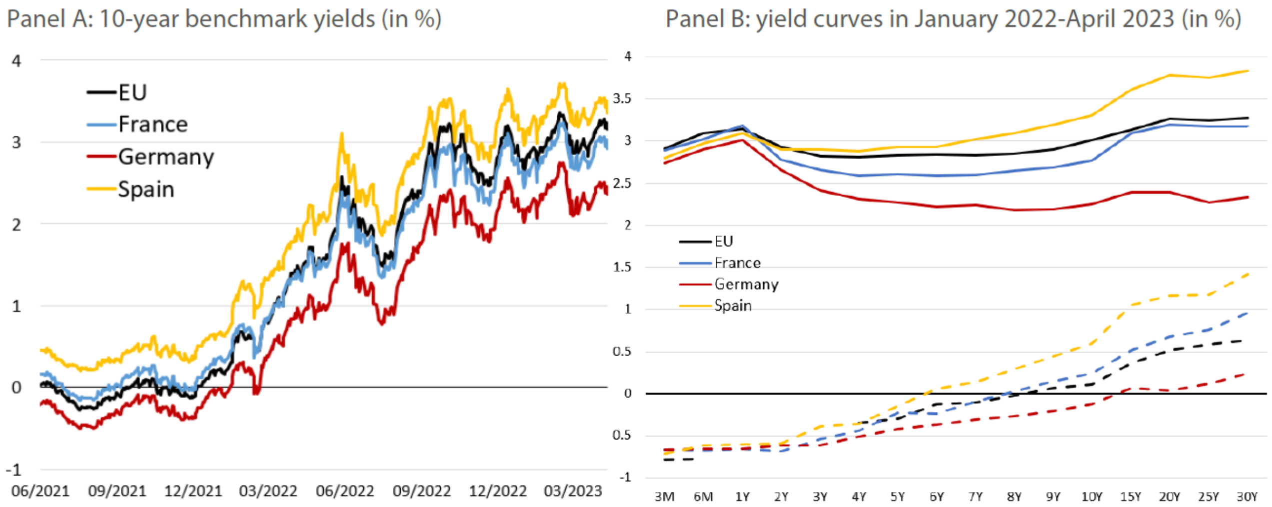
Sharp increase in NGEU funding costs due to higher than expected interest rates

As highlighted in a previous RRD briefing, higher than expected interest rates have resulted in a sharp increase in the NGEU funding costs and have substantial implications on the EU budget. The interest repayments related to the EU Recovery Instrument (EURI) have therefore significantly increased across the maturity spectrum of EU debt issuances[5] and will have to be covered by annual EU budget appropriations within the current MFF going beyond the amounts programmed for the repayment of EURI borrowing costs. For the MFF 2021-2027**,** an amount of **EUR 14.9 billion** (in current prices) **had been planned to cover the interest payments for NGEU loans**. The amount programmed in the MFF for EURI related reimbursements was based on the assumption of (historically low) average interest rates gradually increasing from 0.55 % in 2021 to 1.15 % in 2027. As acknowledged by the Commission, **that amount will be exhausted by the summer 2023**, in other words **more than 4 years ahead of initial plans**.

[4] The Policy Department for Budgetary Affairs made the main contribution to this section.

[5] Issuances of EU debt instruments became increasingly expensive in the 2022 market environment faced with a sharply rising inflation. At the end of September 2022, the yield on the 10-year EU bond topped the 3% mark, up from around 0.2% in January 2022.

Figure 3: Evolution of the yields for the EU, France, Germany, and Spain (in %)



Source: Bruegel based on Bloomberg. Notes: dashed lines represent data as of 3 January 2022 while unbroken lines represent data as of 11 April 2023. For January 2022, the EU yield curve was incomplete so the values for the 1- and 3-year maturity yields are extrapolated.

Moreover, as pointed out in a Bruegel briefing commissioned by the BUDG committee, alongside the sharp rise in interest costs that is common for all sovereign issuers (see figure 3), **the EU has also faced a widening of spreads between its yields and those of major European issuers**, such as France and Germany and for some maturities even as regards Spain. A part of the extra costs borne by the EU are due to specific factors that could (at least to some extent) be reduced. The briefing finds that **this spread widening has been driven by a combination of markets features, circumstantial factors and institutional characteristics.**[6]

In a nutshell, EU debt issuances lack a certain number of **market features** of conventional sovereign issuances that imply that the liquidity of EU issuances is significantly lower than what is the case for large euro area issuers[7]. Despite the fact that EU issuances have the highest investment grade (AAA), in practice, EU bonds are traded at prices that correspond rather to AA or even A securities. More specifically, the briefing highlights that EU bonds are valued in comparison with swaps[8] whereas *European government bonds are generally priced in comparison with German bonds.* (...) *The convention of pricing EU bonds against swaps could evolve. It made sense for the EIB, ESM and other supranationals, subnationals or agencies (SSAs) that have a balance sheet and need to manage their balance sheet risks with swaps, but this is not the case for the EU, which does not have a balance sheet nor exactly a lending book, and is already more like a sovereign in that regard, with cash flows coming from indirect taxation.*

As for **circumstantial features**, the end of eurosystem net asset purchases by June 2022, as well as the flight to safety experienced during periods of high stress, caused for example by the war in Ukraine or by the

[6] Interest rates remained at historical lows during the first 18 months of NGEU related issuances. Both market and Commission expectations were that interest rates levels across maturities would increase in the coming years. Such dynamics raise the question of whether low interest rates could not have been lock-in such low rates by issuing larger amounts of bonds in such circumstances.

[7] As highlighted in detail in the Bruegel briefing, the volume of securities traded daily is significantly lower for EU issuances that for German, French or Spanish debt. Average bid-asks spreads (i.e. the difference between the highest price a buyer is willing to pay for an asset and the lowest price a seller is willing to accept, at a given point in time) are also significantly bigger. EU debt issuances, in contrasts with sovereign issuers, lack REPO markets allowing holders of EU bonds to use such bonds as collateral for borrowing liquidity. EU bonds are not currently part of the most widely used sovereign bond indices that facilitate trading. Furthermore, in contrast with main sovereign issuers, EU issuances are mainly made through syndications that give more bargaining power to investors instead of auctions.

[8] A swap is a financial contract in which two parties exchange an annual fixed payment for a specified period, in return for a floating short-term rate. The fixed rates for various maturities are used to construct the swap curve. The swap most often used in this case for euro denominated assets is the swap against the six-month Euribor.

failure of the Silicon Valley Bank in the US that temporarily had a spill-over effect on the European banking sector, caused a widening in spreads between German bunds and swaps (and thereby EU issuances).

Finally, due to **institutional factors**, notablty the temporary nature of NGEU and the lack of direct taxation powers at EU level, most investors still perceive the EU as an "in-betweener", i.e. a hybrid issuer between a supranational agency and a sovereign. The briefing concludes with specific policy recommendations to address such gaps and mitigate thereby the negative consequences of such factors for EU taxpayers. The Court of Auditors in their recent Special report 16/2023 calls on the Commission to better measure and report how it manages the EU's debt in order for the programme to be in line with international best practices.

Commission proposal for a targeted MFF revision

On 20 June, the Commission proposed a mid-term revision of the MFF 2021-2027 that establishes for the period 2024-2027 a new special 'EURI Instrument', that in line with the request of European Parliament[9] is placed over and above the MFF ceilings, to cover all funding costs for NGEU borrowing which exceed the amounts initially programmed. This will allow for a provision of additional budgetary appropriations to cover the additional cost of interest expenditure as well as coupon payments overdue within the ongoing MFF. It is worth noting, that although the new special EURI instrument, represents a meaningful increase of nominal costs borne by the EU budget, the real costs will not necessarily be higher than initially assumed as the increase of nominal rates experienced since 2022 onwards until end of 2027 may be partially or even fully compensated by the reduction of the real value of reimbursements due to much higher than expected inflation during the 2021 to 2024 period[10].

Given the high level of uncertainty reflected in market expectations and the volatility of interest rates experienced over the last couple of years, planning the financing costs over the long term is prone to large deviations. Based on market forecasts of 16 June 2023, the new, additional estimated amount for the EURI Instrument is EUR 18.9 billion. However, given the above-mentioned uncertainty, such amount is a preliminary baseline estimation that is subject to meaningful variations. According to the Commission, based on the **different assumptions for the evolution of the interest rates used by the largest European Debt Management Offices, this amount could range from EUR 17 billion to EUR 27 billion**[11].

Linked to promoting long-term competitiveness on critical technologies via a Strategic Technologies for Europe Platform (STEP): the Commission proposed also as part of the MFF revision an increase of the ceiling under the RRF to use resources for InvestEU products via its national compartments represents an additional flexibility for Member States of EUR 30 billion potentially available for such sovereignty investments.

[9] In the EP plenary resolution on 10 May on the impact on the 2024 EU budget of increasing EURI borrowing costs, MEPs stated that they are "*deeply concerned that, without the necessary action being taken, the increasing EURI borrowing costs are likely to limit severely the Union budget's ability to finance the Union's priorities and policies and to respond to emerging needs*". As emphasized in the same resolution, such situation "*would not only curtail the Union's ability to respond to emerging needs and crises, but would also make it all but impossible to finance important new initiatives, such as the proposed European chips act, without cutting essential existing programmes or funds*". The resolution also stresses that "*this would constitute a de facto breach of the three institutions' undertaking not to reduce Union programmes*". The resolution recalls therefore the Parliament's demand already expressed in the MFF negotiations that *"EURI repayment costs be placed over and above the ceilings to reduce pressure on the MFF, to safeguard funding for already agreed programmes and to ensure sufficient leeway under the ceilings to finance new initiatives"*.

[10] If nominal interest rates remain at levels in line with market expectations and inflations comes back to target, the real costs of reimbursements of both interest and principal may remain in line with initially projected real costs under the original assumptions of average nominal interest rates and assumptions of a long-term 2% inflation rate for the whole period going from 2020 to 2057.

[11] Such amounts are roughly in line with the estimations provided by the above-mentioned that foresees as a baseline an additional amount to cover interest rate of EUR 15 billion, although in an adverse scenario, such additional amounts, could be as high as EUR 34 billion. See figure 8 of page 12 of the above-mentioned Bruegel.

Commission proposal on new EU own resources

As committed during the negotiations on the long-term EU budget 2021-2027, the Commission also completed on 20 June its proposal on EU own resources.

During the negotiations on the 2021-2027 MFF, the EU institutions reached an agreement on the review of the system of own resources and introducing new ones, in order to cover the repayment of the NGEU borrowing without increasing the GNI contributions or reducing the financing of existing programmes. The agreement was codified in Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union (Own Resources Decision) and a new Annex to the IIA on budgetary matters, establishing a binding roadmap for the introduction of new own resources over the period of the 2021-27 MFF.[12]

It is clear that it is not anymore possible to follow the original schedule laid down in the IIA, foreseen to be operational as of 2023. However, the ETS and CBAM own resources proposals are held up in the Council, and the OECD Pillar I agreement has not yet been adopted and ratified. Therefore, the Commission decided to propose an adjustment and extension to the first package of proposals. Besides numerous technical adjustments to better correspond to the Fit For 55 package, the proposal includes the **introduction of a temporary statistical own resource on corporate profits and an increase of the call rate of the ETS own resource from 25% to 30%**.

The temporary statistical own resource would be a national contribution based on the gross operating surplus of financial and non-financial corporations recorded under the European system of accounts (ESA) and would apply a 0.5% call rate. It is a temporary solution until a genuine own resource based on corporate taxation (BEFIT) is introduced. The Commission stresses that this own resource would not be a tax, neither would it increase the compliance cost of companies, as it would be calculated based on statistics and paid in a form of national contributions (similarly to the VAT or plastic own resources).

Concerning the higher call rate ETS own resource, it is based in the political agreement on the Fit for 55 package, which seeks to ensure EU policies contribute to the climate neutrality of our continent. The market price of CO_2 increased from around EUR 75 per tonne on 20 December 2021 to EUR 90 on 20 June 2023[13], therefore the Commission based its calculations on a carbon price of EUR 80 per tonne, instead of the EUR 55 per tonne assumption in the original proposal of 2021. Thus, the Commission argues that due this increase in the past year and a half, the revenue generated surged, therefore the income for the Member States would be much greater even after a higher percentage going to the EU budget.

The expected annual revenue from the ETS own resource is EUR 7 billion per year from 2024 and EUR 19 billion from 2028. The forecast for the CBAM own resource is unchanged at EUR 1.5 billion from 2028. The statistical own resource based on company profits is forecasted to generate around EUR 16 billion per year, as of 2024. Put together, these own resources after the adjustment would be EUR 36 billion from 2028 onwards, which should be sufficient to cover the NGEU repayment.

[12] After the proposals of 14 July 2021 for the revision of the EU ETS and the introduction of a carbon border adjustment mechanism, a proposal for a next generation of EU own resources was published on 22 December 2021. The proposal specified that 25% of revenues from ETS allowances auctioned, 75% of the income generated by the carbon border adjustment mechanism and 15% of the share of the residual profits reallocated to EU Member States under the OECD/G20 agreement on international corporate taxation (pillar one) would be paid into the EU budget as own resources. On 23 November 2022, Parliament adopted its resolution on the proposal, which has been awaiting a Council decision ever since. On 10 May 2023 Parliament also adopted an own-initiative report suggesting additional new own resources, for example a statistics based own resource on the gender pay gap.

[13] EU Carbon Permits, Trading Economics

ANNEX: Key features of REPowerEU chapters submitted so far

Country	Key features of the REPowerEU chapter
Denmark Revised plan COM press release	**Renewable energy**: establishing a National Energy Crisis Staff to simplify permitting procedures and invest in renewable energy, including a call for tender for 4 GW offshore wind, screening of Denmark's offshore wind capacity, and testing of wind turbines. **Green upskilling:** developing new skills and knowledge related to green technologies and sustainability to support the transition to renewable energy sources and sustainable practices. **Replacing oil burners and gas furnaces**: scaling up existing initiatives to replace fossil energy sources with green alternatives such as district heating and individual heat pumps. **Carbon Capture and Storage (CCS):** scaling up the existing feasibility study on possible storage sites for CO2 in depleted oil- and gas fields and creating a CCS-pool to incentivise investments in infrastructure that support achieving negative emissions by 2025 Denmark considers the measures foreseen to be overall compatible with the 'Do no significant harm' principle. The Danish government mentions, however, that as concerns the measures related to call for tender for 4 GW offshore wind, screening of Denmark's offshore wind capacity, and testing of wind turbines, the implementation may result in some 'minor negative impacts on marine resources'. However, the Danish government insists that these effects are not expected to be significant as Denmark has strict environmental requirements and an environmental impact assessment is always conducted before installing offshore wind turbines.
Estonia Council implementing decision	The dedicated REPowerEU chapter includes the following reform and investments: 1. The plan includes a reform to streamline planning and permitting for **wind energy projects**, establishment of wind priority development areas, and support for local authorities. 2. The plan also includes investments to increase the **capacity of the electricity distribution network** by 160 MW and to increase the production and use of sustainable biogas and biomethane. 3. The latter investment includes the commissioning of an **independent survey** to identify necessary regulatory, organizational, and financial interventions and an action plan for legislative changes **to increase the production and deployment of sustainable biogas and biomethane**. According to the Council implementing decision, it is expected that **no measure in this component does significant harm to environmental objectives** within the meaning of Article 17 of Regulation (EU) 2020/852, taking into account the description of the measures and the mitigating steps set out in the RRP in accordance with the 'Do no significant harm' Technical Guidance (2021/C58/01). However, the installation of wind parks is inevitably associated with some degree of deforestation, potentially increasing biodiversity issues.
France Proposal for a Council Implementing Decision (see also Annex and RRP update from April 2023)	The REPowerEU Chapter increases the total envelop of grants available to France to EUR 40.3 billion (including by transferring EUR 504 million available under the Brexit adjustment reserve). Overall, the REPowerEU chapter beefs up the focus on the green transition, as the new plan now devotes to it almost half of its resources (49.5% vs 42.4% of the original RRP). The digital and social dimensions of the plans have remain broadly unchanged according to the Commission's assessment. **The REPowerEU chapter comprises of 3 reforms and 3 new investments** as well as **a reinforced investment from the original plan** with a view of boosting energy efficiency of buildings, support hydrogen projects, decarbonise the industrial sector, accelerate the roll-out of renewable energy projects, and improve public policies in the field of the transition. Reforms: 1. The law on the **acceleration of renewables** should allow for a faster procedure to issue permits, also via "acceleration zones" for the deployment of renewables. 2. The **"energy sobriety plan" aims at reducing energy consumption by 10% by 2024** (vs winter of 2018-19). 3. **Set up of General Secretariat for Ecological Planning** to improve planning and coordination of national strategies in the field of ecological transition.

Country	Key features of the REPowerEU chapter
	Investments: 1. The firs new investment introduced is addressing the **decarbonisation of the industry** by supporting *"the production of heat-based biomass (...), energy efficiency and changing production process".* 2. A second investment is aimed at supporting four projects to boost the production and **uptake of renewables and hydrogen**, e.g. the production of hydrogen-based vehicles. 3. A third investment seeks to **support energy renovation of State's public buildings**. 4. The plan also strengthens a measure to **promote energy renovations in private housing**, particularly via the "MaPrimeRenov" service.
Malta Revised plan COM Press release COM Staff Working Document	The proposed REPowerEU chapter directly contribute to the REPowerEU Plan and that address the challenges specified in the Country Specific Recommendation (CSR) 1 and 4 of 2022. New initiatives will aim to contribute towards supporting energy security of supply, through the **strengthening and widening of the electricity grid and battery storage** as well as **reforming the permitting process**. Measures will contribute to the ambitions of Sustainable Development Goal 7 and initiatives foreseen under Components 1 and 2 of Malta's RRP and actions will also complement initiatives under other EU Funded Programmes for the 2021-2027 period, particularly actions related to RES initiatives, the decarbonising of the environment and the transport sector.
Portugal Revised Plan COM Press release	Portugal's proposed REPowerEU chapter includes, according to COM's press release, 6 reforms and 18 investments, focusing on energy efficiency in buildings, renewables and biogas, sustainable transport, the electricity grid and green industry, i.e., supporting the production of climate technologies such as wind turbines, photovoltaic panels and heat pumps.
Slovakia Revised Plan COM Press release	Slovakia's proposed modification of the plan foresees, according to COM's press release, six new reforms and eight new investments to deliver on the REPowerEU objectives. These include considerable reforms in support of renewable energy sources, including geothermal energy and the hydrogen sector, transformative investments in the electricity grid and energy efficiency, as well as in support for transport sector and households at risk of energy poverty.
Spain Revised plan COM press release	The inclusion of a REPowerEU chapter allocates an **additional EUR 4 billion to the achievement of its objectives.** Spain outlined that it would use its funds to: 1. **Continue and deepen measures to promote the use of renewable energ**y, focusing on distributed energy sources, greater flexibility of the electrical system and hydrogen. 2. **Invest in the strengthening of the industrial value chain of renewable energy production** with a view of reducing dependencies and in line with the objectives of the net zero industry act. The **6 investments in the chapter** cover a number of areas such as **renewable self-consumption and energy communities, renewable hydrogen** (including by taking part to IPCEI), investing in **value chains of renewables** and storage, roll-out of **electric infrastructure** with a view of improving security and flexibility, support **industrial competitiveness and sustainability** through grants and loans.