European Economic and Social Committee

ECO/548
NextGenerationEU funding strategy

OPINION

European Economic and Social Committee

Communication from the Commission to the European Parliament and the Council on a new funding strategy to finance NextGenerationEU

[COM(2021) 250 final]

Rapporteur: **Judith VORBACH**

Referral	European Commission, 31/05/2021
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Section responsible	Economic and Monetary Union and Economic and Social Cohesion
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Outcome of vote for/against/abstentions)	187/0/4

1. Conclusions and recommendations

1.1 The EESC welcomes the fact that all Member States have completed national ratification of the Own Resources Decision (ORD) and that, therefore, on 1 June 2021 the new ORD entered into force, enabling the Commission to start borrowing resources for the recovery instrument. The EESC calls on all stakeholders to go through the next steps swiftly in order to start the money flowing.

1.2 The NextGenerationEU (NGEU)'s confidence-boosting effect has already helped stabilise the Union and Member States' economies and borrowing costs. NGEU funding will step up the volume of EU safe assets and enhance the international role of the euro. The EESC notes that the NGEU's funding strategy relies on capital market borrowing and private investment.

1.3 Compared to the broad debate about NGEU spending, funding is perceived to be a technical matter. However, a well-functioning funding strategy is key for the smooth implementation of NGEU. Sound funding, solid risk management, low borrowing costs and sustainable financing are in the interests of civil society, which ultimately bears the market risks. Borrowing and debt management has to be based on democratic control, legitimacy and transparency.

1.4 The NGEU's funding needs require a sophisticated strategy to ensure that the EU can meet payment pledges in a timely manner and under favourable market conditions. The EESC stresses how important it is that the Commission manage the funding strategy directly and it welcomes the Commission's increase in its human resources in this domain. However, this should be done in a gender-balanced way. Additionally, an advisory board should be established, on which the Commission, the European Parliament, the Council, social partners and organised civil society are represented.

1.5 The EESC stresses the importance of preserving the EU's high creditworthiness and low borrowing costs in order to avoid redistributional effects from borrowers to lenders. Moreover, this will - together with rising economic growth rates - facilitate repayment. Creditworthiness will depend above all on the EU's economic, political and social strength and would be consolidated by the deepening of the EMU. In any event, crises should be anticipated, which may also include the ECB acting as a buyer of last resort.

1.6 Overall, a major part of the new funding strategy is dedicated to investor relations. The EESC welcomes the borrowing decision and the funding plans, which are primarily means of providing transparency for the financial markets. However, communication with the public and its representatives should never become a second priority. It is to be welcomed that one precondition for participation in the Primary Dealer Network (PDN) is, among other things, supervision by a competent authority of the Union. As compliance with the relevant rules is imperative, the EESC supports the possible involvement of OLAF in this supervision and welcomes the fact that other public authorities may also be appointed to verify the compliance of members of the PDN with the rules set up in the Decision.

1.7 The massive engagement on capital markets will be accompanied with a broad set of risks. The EESC supports the establishment of solid risk-management systems and the holding of the

'NGEU account' with the ECB. Due to the public interest in sound risk management, the Chief Risk Officer (CRO) should consult the European Parliament and the Council when drawing up the High-Level Risk and Compliance Policy. Finally, the EESC calls on the Commission to ensure accountability, transparency and sound financial management from the very beginning of NGEU borrowing and warns against excessive borrowing from investors outside the EU, while advocating the introduction of new own resources.

1.8 Overall, the EESC welcomes the NGEU's enhanced risk-sharing component, but also stresses the importance of risk reduction to ensure financial market stability and to properly protect the financial interests of the Union. In order to take due account of civil society interests, the EESC welcomes the planned 'NGEU Green Bond framework' and proposes that the issuance of NGEU social bonds be considered.

2. Background to the opinion

2.1 NextGenerationEU (NGEU) will inject up to EUR 806 billion – 5% of EU GDP – into the EU economy in the form of grants and loans. On behalf of the EU, the Commission will borrow these amounts through funding operations on international capital markets. The NGEU is designed to be a temporary instrument. The borrowing will take place between mid-2021 and 2026. Within this period, the Commission will execute financing operations of between EUR 150 and 200 billion per year. The financing raised by the EU is due to be repaid either directly by Member States (for loans) or through the EU budget (for non-repayable support) by December 2058 at the latest.

2.2 The Communication on a new funding strategy to finance NGEU[1] is adopted under Article 5(3) of Council Decision 2020/2053[2], which requires the Commission to establish the necessary arrangements for the administration of the borrowing operations and to regularly inform the European Parliament and the Council about all aspects of its debt management strategy. Based on the approval of the Own Resources Decision (ORD) by all Member States, the Commission will implement a funding strategy, as outlined in the Communication and specified in three Decisions[3]. The instruments will include EU Bonds and EU Bills; the techniques involved will consist of syndications and auctions. An annual decision fixing the maximum amounts to be borrowed and semi-annual funding plans will be established. The Commission will boost its structures and will set up a pan-European Primary Dealer Network.

3. General comments

3.1 The EESC has supported NGEU from its very beginning and has repeatedly expressed its endorsement[4]. In its opinion[5] on the Annual Sustainable Growth Strategy 2021, the EESC

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1 COM(2021) 250 final.

2 OJ L 424, 15.12.2020, p.1

3 C(2021) 2500 final, C(2021) 2501 final, C(2021) 2502 final.

4 OJ C 364, 28.10.2020, p. 124.

5 OJ C 155, 30.4.2021, p.45.

confirms that "*the Next Generation EU initiative has been developed and adopted in the right form and at the right time*". Due to its confidence-boosting effect, NGEU is already having a positive impact on the EU's economy and has reduced the likelihood of a deep crisis in some countries. In the long run, NGEU is expected to considerably increase the EU's output, meaning that, ultimately, all Member States are likely to become net beneficiaries[6]. The EESC welcomes the fact that all Member States have completed national ratification of the ORD, allowing borrowing to begin, and calls on all stakeholders to go through the next steps swiftly to start the money flowing.

3.2 There is rightly a broad debate on the use of funds of NGEU and – to a lesser extent - about new own resources. Compared to that, little attention has been paid to NGEU funding, which is perceived as more of a technical matter than a political one. Yet, NGEU borrowing will decisively increase the financial obligations of the Union and has to be conducted with democratic control, legitimacy and transparency. The EESC stresses that sound and sustainable funding, solid risk management and low borrowing costs are in the public interest. European civil society will ultimately be liable for the debts occurred and enhanced borrowing costs would constitute redistributional effects from borrowers to lenders. A well-functioning funding strategy is also key for the smooth implementation of NGEU.

3.3 The EESC notes that the proposed strategy relies on funding via international capital markets. There are no capital buffers implemented, as they are in the European Stability Mechanism (ESM) and there are no plans to roll over debt beyond 2058. However, other approaches have also been publicly debated, such as perpetual bonds jointly guaranteed and issued by the ECB[7]. In the long run, and particularly in case of permanent common debt issuance, consideration should be given to entrusting the ECB with the role of lender of last resort.

3.4 Given the NGEU's high funding needs, its complex and potentially uncertain disbursement schedule and not precisely known budgetary envelopes, a sophisticated funding strategy is needed to carry out the borrowing on the markets. Financial market developments must be anticipated in order to ensure that the Union can meet payment pledges in a timely manner without being forced to raise capital in adverse market conditions. This requires market proficiency and flexibility to decide when to execute funding operations and which funding techniques to use in order to provide the lowest possible execution risk and funding costs. The EESC stresses how important it is that the Commission manage the funding strategy directly and not outsource this. The establishment of new operational capacities is needed and the Commission is, quite rightly, stepping up its respective human resources and competencies. The EESC calls on the Commission to implement a gender-balanced approach in doing so.

3.5 Moreover, the EESC notes that the NGEU funding strategy is accompanied by an extension of responsibility to the Commission and welcomes the obligation to keep the European Parliament and the Council regularly informed about all aspects of the debt management strategy along

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6 The nonsense of Next Generation EU net balance calculations | Bruegel.

7 Covid Perpetual Eurobonds: Jointly guaranteed and supported by the ECB.

with the provisions of the Interinstitutional Agreement[8]. The provision of annual updates will start from the third quarter of 2021. Given the strong public interest in solid NGEU funding, this appears to be a minimum level of involvement. The EESC proposes that a NGEU funding advisory board be established. Members of the NGEU Risk and Compliance Committee should meet on a semi-annual basis with selective representatives competent in financial market questions from the European Parliament, the Council, the social partners and organised civil society.

3.6 Due to the EU's high credit rating and stable outlook, the Commission will be able to borrow on advantageous financial terms and to pass the benefit on to the Member States. The EESC stresses the importance of preserving low borrowing costs throughout the funding period. Together with the prospected enhanced economic growth rates, this will considerably facilitate repayment. Above all, the EU's creditworthiness will depend on its economic, political and social strength and will be consolidated by the deepening of the EMU. On the downside, centrifugal forces and tenacious conflicts between Member States are likely to weaken it, while the taking effect of guarantees[9] at the expense of some Member States could lead to severe political friction[10]. Moreover, crises of an economic nature or relating to the financial market, health or anything else should be anticipated. Hence, it is vital to establish the funding strategy on the most resilient and sustainable foundation possible, which may also include the ECB acting as the buyer of last resort.

3.7 While NGEU funding activities have already started, the timing of the introduction of new own resources is much less concrete. The Commission will provide proposals for new own resources based on a carbon border adjustment mechanism, the Emissions Trading System and a digital levy in mid-2021. Further proposals in 2024 could include a Financial Transaction Tax or a financial contribution linked to the corporate sector. Should new own resources be available before January 2028, these will be used to start repayment sooner. The EESC calls on the Commission to bring forward the proposals scheduled for 2024 and advocates the swift introduction of new own resources. Appropriately implemented, these would not only serve as compensation when taxes cannot be enforced effectively at national level due to tax competition, but would also contribute to a fair repayment scheme and help combat climate change. This would also help avoid the need to increase national contributions or to cut spending from the EU budget.

3.8 The NGEU borrowing of about EUR 800 billion will step up the volume of Euro denominated safe assets to about EUR 2 trillion, including SURE[11] and another EUR 800 billion in assets issued via ESM/ESFS and the EIB before the pandemic[12]. The boosting of European safe assets covering all maturities up to 30 years will provide new safe instruments for investment, help banks to diversify their sovereign bond holdings, increase the attractiveness of the Euro area and

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8 Interinstitutional Agreement of 16.12.2020 between the European Parliament, the Council and the Commission.

9 Due to the adoption of the ORD.

10 See Art 9 para 5, Council Decision 2020/2053.

11 The European instrument for temporary Support to mitigate Unemployment Risks in an Emergency.

12 Klaus Regling, Webinar - *Deepening EMU and the role of ESM*, 5.5.2021.

strengthen the international role of the euro. Moreover, the confidence-boosting effect of NGEU is also likely to reduce government and private-sector borrowing costs, particularly in euro-area countries with large spreads in relation to Germany. NGEU lending will also provide an option for Member States in case of market turbulences affecting national bond issuances. The EESC welcomes the enhancement of the risk-sharing component, but also stresses the importance of risk reduction by ensuring sound financial market regulation and supervisory convergence.

4. Specific comments

4.1 The EESC welcomes the fact that the annual framework borrowing decision will set maximum limits, for example, for long-term and short-term funding and that the borrowing will be organised on the basis of six-month funding plans based on information on upcoming payments. Apparently, these are meant to provide transparency to the markets by ensuring the predictability of issuances for investors and facilitating the coordination with other issuers, while also serving as a basis for information to the European Parliament and the Council. The EESC is fully aware of the importance of investor and issuer relations, but stresses that communication with the public and its representatives should never be of second priority and that the financial interests of the Union have to be carefully protected.

4.2 Ongoing liquidity planning will ensure that cash holdings are sufficient to avoid liquidity shortfalls while preventing unnecessary high cash balances. Given that the absorption capacity of capital markets is finite and that liquidity shortfalls would lead to a disruption of the NGEU implementation, the EESC pleas for prioritising solid risk buffers above excessive cost minimisation and explicitly supports prudential cash holdings being held in a dedicated account with the ECB in order to prevent these holdings from becoming subject to any counterparty risk.

4.3 Belonging to the Primary Dealer Network (PDN) entitles financial institutions to participate in auctions and includes the promotion of market liquidity and the provision of fair advice and market intelligence to the Commission, while it is connected to buying and reporting commitments. The EESC welcomes the fact that applicants already have to be an active member of an EU PDN and to be supervised by a competent Union authority. Primary dealers will play a key role within NGEU funding and any negligence or misconduct could lead to higher borrowing costs. Moreover, counterparty risks, as well as the market power and systemic relevance of primary dealers, must be considered.

4.3.1 Due to the significant responsibilities of PDN members, their compliance with relevant rules is imperative. The supervision of compliance with the rules set up in the Decision[13] relies to a great extent on the reporting obligations of the primary dealers themselves. Furthermore, the EESC supports the possible involvement of OLAF in supervision and welcomes that in addition to the Commission also other public authorities may be appointed as third parties in order to conduct verifications to check the compliance of the members of the primary dealer network with the Decision.

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13 C(2021) 2500 final.

4.3.2 The Commission will also draw up a method for determining which primary dealers will be considered for participation in syndicated transactions, who will be appointed for the purpose of each borrowing transaction. Particularly active members should be eligible to serve as lead and co-lead managers in syndicated transactions and be remunerated. This group should engage in market-making activities, promote issuances with investors and provide further fair advice and market intelligence to the Commission. The EESC takes note of the pivotal role of financial institutions in funding activities and draws attention to possible conflicts of interest, particularly relating to the advisory role. In any event, it is highly welcome to ensure high-level financial market capability and intelligence within the public authorities.

4.4 The massive engagement on capital markets will be accompanied by a broad set of risks, which are ultimately borne by European civil society. The EESC fully agrees with the Commission's statement to the effect that "*In view of the unprecedented volumes of the operations and the sophistication of the funding strategy that is needed, it is of paramount importance that NGEU operations are subject to a robust and independent risk management and compliance framework*". Indeed, it has to be ensured that NGEU operations are conducted in a manner consistent with the highest standards of integrity, probity and sound financial management. The EESC supports the establishment of solid governance and risk management systems, including the establishment of principles and structures to ensure the robust and independent oversight of all NGEU financial operations.

4.4.1 A central pillar of this system will be the Chief Risk Officer (CRO), who will have complete autonomy when carrying out his/her tasks and will report, among others, to the Director-General of the Directorate-General for Budget and to the Member of the College responsible for the Budget. He/she will be responsible for developing a High-Level Risk and Compliance Policy and ensure that all NGEU operations comply with it, while being supported by a Compliance Officer and a Risk and Compliance Committee. Due to the importance of solid risk management and the associated public interest, consideration should be given to the CRO having to consult the European Parliament and the Council when drawing up the High-Level Risk and Compliance Policy.

4.4.2 Questions remain regarding the risk management at the beginning of the borrowing activities, particularly during the period prior to the appointment of the CRO and the three-month period planned for drawing up the High-Level Risk and Compliance Policy. In order to offset maturity mismatches between loans and underlying funding instruments, particularly in 2021, the Commission will apply a set of financial market instruments including swaps and possibly commercial papers, which are especially risky. The EESC calls on the Commission to ensure accountability, transparency and sound financial management from the very beginning of NGEU borrowing.

4.5 Apparently, an elaborate and comprehensive accounting system is needed to manage the diversified funding strategy in a proper way. The EESC welcomes the reinforcement of the Commission's back-office and accounting functions. Using tried and tested software should of course be standard. The EESC notes the important role of the Commission's Accounting Officer responsible to ensure the appropriate accounting for all NGEU operations and to open the "NGEU account" held with the ECB.

4.6 The EESC acknowledges that a major part of the new funding strategy is the development of an investor relations strategy and the accompanying tools. One element will be an EU funding newsletter allowing the Commission to communicate to the investor community in a regular and transparent manner. The Commission will also reach out actively to "investors across the globe" through a systematic programme of structured visits. However, the EESC warns against excessive borrowing from investors outside the EU, which could, particularly in times of crisis, go along with increasing risks such as, for example, a sudden stoppage of lending activities.

4.7 The Commission will seek to raise 30% of NGEU funds through the issuance of green bonds, which could total EUR 250 billion of green bond issuance¸ establishing the EU as one of the biggest green bond issuers globally and reinforcing the EU's policy and market leadership in sustainable finance. The EESC welcomes the planned "NGEU Green Bond framework", which builds on the obligation for Member States to ensure that 37% of the Recovery and Resilience Facility (RRF)-financed expenditures is dedicated to address the climate change. Moreover, also social bond issuance should be stepped up within NGEU and should complement the volume of EUR 100 billion dedicated to SURE. To receive support from the RRF, EU countries are also asked to draw up projects in, among others, the policy areas of inclusive growth and social cohesion – a basis for the development of a framework for the issuance of social bonds. In this way, civil society's interests could be taken fully into account in the funding strategy.

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