



Q&A : Next Generation EU - Legal Construction

Brussels, 9 June 2020

The proposed architecture of the exceptional financing is based on three pillars:

- The Own Resources Decision authorises the full amount of the borrowing, to be used for exceptional expenditure and for loans to Member States. Those amounts are not entered into the Union budget. It also organises the repayment of the amounts used for expenditure under the future MFF. The repayment will be entered into the Union budget in the year it takes place (as of 2028, until 2058).
- The Recovery Instrument based on Article 122 TFEU identifies recovery measures and allocates the borrowed funds to various Union programmes to that effect.
- The Union programmes receive the resources and lay down the rules for their implementation.

The major innovation, the borrowing for spending, is compliant with the Treaties.

1) Under the current circumstances, borrowing is a justified means to attain the Union's objectives

- The Union is allowed to provide itself with the means necessary to attain its objectives [*Article 311, first paragraph TFEU*]. A highly competitive social market economy, aiming at full employment, the promotion of economic, social and territorial cohesion and solidarity among Member States is an objective of the Union [*Article 3(3) TEU*].
- The financial means of the Union come predominantly, but not exclusively, from own resources [*Article 311, second paragraph TFEU*]. Therefore, the Union enjoys some discretion as to the choice of the means necessary, as long as it respects the financial rules of the Treaty.
- Borrowing constitutes such a means. Under the current circumstances, it is necessary. Tackling the exceptional consequences of the crisis requires large resources in short period of time, without increasing national debt in the short to medium term.
- Borrowing creates a financial liability for the Union. However, financial operations involving liability of the Union are not extraordinary. The Treaties do not prohibit the Union from taking liabilities. The Union is already now taking liabilities e.g. from **loans** for financial assistance to Member States and third countries or **budgetary guarantees**, inclusive for market operations (e.g. European Fund for Sustainable Investments). Borrowing used for crisis spending would simply be a **new type of a liability operation**.

2) Borrowing must respect the principle of budgetary discipline. For that reason, provisions are needed in the Own Resources Decision

- According to the principle of budgetary discipline [*Article 310(4) TFEU*], the Union's actions can be financed within the limits of the multiannual financial framework (MFF) and own resources. The Treaty also obliges the Union institutions to ensure that the Union can satisfy its financial obligations towards third parties [*Article 323 TFEU*].
- Therefore, liability from borrowing is only permissible if the Union **is able to repay the debt including interest**. This requires that the own resources ceiling be sufficiently high to ensure each year sufficient financial space for the **full coverage of the Union's liability**. It also requires a mechanism ensuring **availability of resources in all circumstances**.
- The proposed amendment to the proposal for the new Own Resources Decision makes sure that these pre-requisites of budgetary discipline are fulfilled:
 - o A dedicated and temporary increase of the Own resources ceilings will create sufficient budgetary space. That space is available (i) for the contingent liabilities from loans to Member States and (ii) for the repayment of the debt from borrowed funds used for spending programmes in the future (2028 to 2058);
 - o An additional rule will allow the Union to call on resources from the Member States where, on a given year, the authorised appropriations entered in the budget are not sufficient for the Union to comply with its obligations resulting from borrowing.

- The Own Resources Decision will go one-step further. It will determine the maximum amount that may be borrowed and will set the parameters for its repayment, in particular the start date for repayment (2028) and the end date for repayment (2058). This can be done under the Own Resources decision for the following reasons:

o Those provisions are a corollary of the dedicated increase of the own resources ceiling. The size and the modalities of the repayment delimit the maximum amounts of future own resources revenue, which will be needed for that purpose. They may, therefore, be considered as an integral part of the establishment of the system of own resources [Article 311, third paragraph TFEU].

o When defining the amounts of the needed revenue in the own resources decision, it is normal for the legislator to take into account related expenditure. E.g. the UK rebates were calculated in function of the total allocated expenditure in favour of the UK.

o Moreover, the Own Resources Decision is of *quasi-constitutional* nature. It only enters into force after approval by all Member States in accordance with their national constitutional requirements. The authorisation of the borrowing will need the approval of all Member States, and, depending on national procedures, of their national parliaments. This provides for the necessary democratic legitimacy of that innovative proposal necessary to fulfil the Union's objectives.

o At the same time, the approval by all Member States will constitute a clear commitment to bear the liability from the borrowing

3) Allocation of the funds to Union spending programmes, Article 122 TFEU

Article 122 TFEU allows for targeted derogations from standard rules in exceptional crisis situations. On that basis, the Recovery Instrument will provide for the financing, by reference to the authorisation to borrow provided by the own resources decision, and will assign those funds to the various spending programmes, as so-called "external assigned revenues", for the purposes of recovery and resilience. [Article 21(5), Financial Regulation]

The borrowed funds will remain additional to the annual budget. They will not be part of the MFF and of the annual budgetary procedure.

Such way to proceed for large amounts diverges from the standard practice for the establishment of the budget and financing of the Union [point 1, requirement of principal financing of Union policies from own resources]. It is justified as a temporary and exceptional solution in the context of the current crisis.

Q&A:

Is the mechanism compatible with the principle of budgetary balance?

The principle of budgetary balance [Article 310(1), 3rd sub-paragraph, TFEU] requires equilibrium between revenue and expenditure of the annual budget. The borrowed funds are exceptional and one-off amounts coming in addition to the annual budget as external assigned revenue (for the spending part), they do not form part neither of revenue nor of expenditure under the annual budget.

The borrowing does not mean that the Union engages in deficit spending in a manner comparable to a Member State. Budgetary deficit occurring in the Member States budgets relies on future income from revenue (taxes), which the Member State can impose as a sovereign.

The Union does not have that option. It has to rely on the own resources previously authorised in the own resources decision and can act only within such limits, in accordance with the principle of budgetary discipline. The borrowing will constitute an operation respecting those constraints because the Own Resources Decision will already guarantee the financial means needed for the repayment. In substance, the Member States agree to make financial resources available to the Union, but, having limited immediately available fiscal space, "defer" or "delay" the making available. The budgetary space thus created will allow the Union to engage into extraordinary and one-off borrowing operation, permitting the immediate adoption of the recovery measures.

Why do we need a Recovery Instrument based on Article 122 TFEU? Why could the resources not go directly from the own resources decision to the spending programmes?

- The Recovery Instrument is based on Article 122 TFEU, which allows for extraordinary measures in situations of crisis as an expression of solidarity among Member States.

- Recourse to that legal basis is necessary for derogating from standard Treaty rules, which would not allow the financing of such large amounts in addition to the Union's budget and outside of the annual budgetary procedure. This is justified only in the circumstances of the current crisis.

Can the borrowed funds be considered "external assigned revenue" provided for by the Recovery Instrument in accordance with Article 122 TFEU, while the empowerment to borrow and the repayment of the borrowing are embedded in the own resources decision?

- The borrowing and use of the funds involve three steps:
 - o Empowerment to borrow, including the determination of the maximum amount;
 - o Receipt of the borrowed funds and their assignment to particular items of expenditure;
 - o Repayment of the borrowing in the future, including the determination of the end date.
- The Own Resources Decision provides the legal basis for the first and third steps, whereas the Recovery Instrument constitutes the legal basis for the second step, in accordance with Article 21(5) of the Financial Regulation.
- This architecture is the result of a policy choice, while respecting legal constraints.
- It is legally possible to determine the maximum amount of liability in the Own Resources Decision. Article 311(3) TFEU has two functions, which are closely interlinked: it determines the revenue attributed to the Union and it contains the Member States' commitment to provide such revenue. The determination of the overall amount of funds that may be borrowed and of the modalities of repayment provides legal certainty concerning the revenue needed by the Union in the future and the obligations of the Member States to provide for it.
- However, the borrowed funds will not constitute own resources but a new category of 'other revenue'[Article 311(2) TFEU]. Such revenue comes in addition to the Union's budget and is intended to finance particular items of expenditure.
- Concerning the second step mentioned above, Article 122 TFEU constitutes the appropriate legal basis for receiving the borrowed funds and attributing them to particular items of expenditure. The choice of the legal basis for a Union act must be based on objective factors which are amenable to judicial review and which include, in particular, the aim and content of the measure. In the present case, the content is the provision of additional financing by derogation to certain rules; the objective is the recovery and resilience of the Union in an unprecedented crisis situation.
- To conclude, the three steps mentioned above are interlinked, but given the political and legal constraints, they may be regulated in two separate legal acts based on different legal bases.

The Own Resources Decision is an act establishing the revenue of the Union, the own resources. How can it constitute legal basis for expenditure (repayment of the borrowing)?

Article 310(3) TFEU provides that the "*implementation of expenditure shown in the budget shall require the prior adoption of a legally binding Union act providing a legal basis for its action and for the implementation of the corresponding expenditure in accordance with the [financial] regulation*". The Own Resources Decision is a "legally binding Union act" as defined by Article 2(4) of the Financial Regulation. As long as it can validly authorise the borrowing and its repayment (see previous question), the necessary consequence is that it will constitute a basic act for the expenditure intrinsically linked to the borrowing, i.e. the instalments of the borrowing. Therefore, this aspect belongs to the 'system of own resources of the Union' [Article 311(3) TFEU].

Do the borrowed amounts constitute own resources?

- No:
- The amounts are one-off additional reinforcement of Union's actions, as 'other revenue' expressly provided for by Article 311(2) TFEU. Own resources are regular income of the Union.
 - The amounts need to be repaid by the Union, while own resources are a final revenue that is not repaid.

The borrowing can be authorised based on the third paragraph of Article 311 TFEU. The determination of the maximum Union's liability and the modalities of repayment are intrinsically linked to the determination of the additional own resources ceilings.

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