

The background of the entire page is a close-up, slightly blurred image of the European Union flag, showing the blue field with yellow stars.

E^{uropean} ^YEconomy INSIGHTS

The day after NextGenerationEU: **What could the EU do?**

European Economy Insights, Paper I
June 13th, 2024

“European Economy Insights” aims to promote, from EY Insights Spain, transcendent debates for the promotion of the European Economy. This first paper has been prepared by **Judith Arnal**, Senior Research Fellow at the Center for European Policy Studies (CEPS) and Elcano Royal Institute, with the collaboration of **Juan Pablo Riesgo**, EY Insights Leading Partner, **Chus Escobar**, EY Public Sector Leading Partner, and **Ignacio Niño**, Co-director of the EY Insights - EsadeEcPol NextGenerationEU Observatory.



Abstract

Following the COVID-19 outbreak, the European Union launched the Next Generation EU (NGEU) initiative, significantly going beyond the 2021-2027 Multiannual Financial Framework primarily through the Recovery and Resilience Facility (RRF). This facility was revolutionary in promoting national ownership over reforms and investments, replacing stringent conditionality with collaborative planning and evaluation aligned with EU goals, in contrast with financial assistance programs during the euro area sovereign debt crisis. As geopolitical shifts and economic crises emerged, such as Russia's aggression against Ukraine, the EU adapted the instrument by introducing measures like the REPowerEU plan to address immediate challenges. This paper evaluates these responses and outlines a strategic framework for the EU post-2026, advocating for policies that adapt to a rapidly changing global context.

The proposals for next steps are based on a set of principles, namely: 1) embracing a narrative focused on current and future EU public needs such as defense and competitiveness, 2) building on previous work and agreements by EU institutions, 3) ensuring financial sustainability, 4) promoting political feasibility, 5) tackling EU's challenges, 6) streamlining EU's governance frameworks, 7) not delaying national fiscal consolidation efforts and 8) finding the appropriate mix of public support instruments, with more space for tax credits. These principles guide the suggested EU Security and Defense Facility, a Budgetary Instrument for Convergence and Competitiveness, and an EU Internal Market Facility for Industrial Policies, which aim to strengthen the EU's strategic autonomy, economic resilience, and market integrity.

To fund these initiatives, the paper recommends enhancing the EU's role as a permanent issuer in financial markets, optimizing the use of the European Stability Mechanism, reforming the European Investment Bank's policies to better support strategic sectors, reallocating NGEU funds not absorbed by 2026, and leveraging private investments through well-designed public facilities.

These funding mechanisms are designed to provide robust financial support while maintaining fiscal responsibility and promoting EU-wide benefits.

[1] Introduction

In March 2020, the unexpected happened: a major health crisis forced national governments to severely restrict movement and business activities, leading societies into uncharted waters. With traditional economic indicators coming with a delay of several months, alternative indicators had to be found to have a broad idea of how economies were being affected (Fezzi & Fanghella, 2020)¹. The European Union reacted relatively swiftly, putting in place a set of relevant measures in different waves (Temprano Arroyo, 2022)². Focusing exclusively on the fiscal side at EU level and thus leaving aside both national fiscal measures as well as the monetary response by the European Central Bank, the first wave of measures by the EU consisted of three short term instruments agreed by the Eurogroup in April 2020 (Eurogroup, 2020)³.

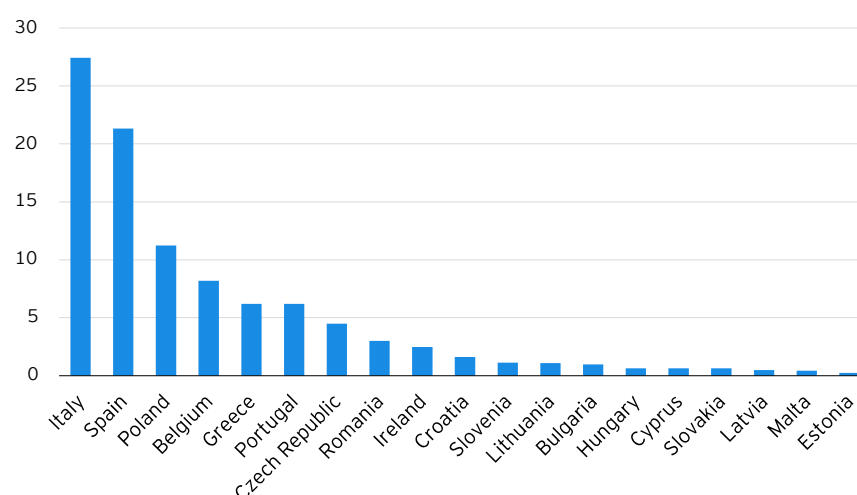
First, the SURE instrument, under which the Commission was allowed to borrow up to EUR 100 billion between 2020 and 2022 to help EU countries finance short-term work schemes by providing very low interest rate loans. Indebtedness under SURE took the form of social bonds, in line with the EU SURE Social Bond Framework adopted in October 2020. SURE bonds were guaranteed by the existing headroom⁴ in the EU budget, as well as by EUR 25 billion of direct and irrevocable guarantees provided by EU Member States.

Second, euro area Member States decided on the creation of a new facility under the European Stability Mechanism (ESM), the Pandemic Crisis Support instrument (PCS), which became operational on 15 May 2020 (ESM, nd)⁵. Under ESM's PCS, Member States could request up until 31 December 2022 very low interest rate loans to the ESM, amounting to 2% of country's GDP to finance health care costs related to the Covid-19 pandemic. Both SURE and ESM's PCS consisted of loans granted to Member States, though with different purposes, as stated above. In spite of both facilities, SURE and ESM's PCS, bearing a close resemblance in financial terms to each other, SURE was almost exhausted (almost EUR 98.4 billion were drawn, with the amount allocated per Member State shown in Figure 1), whereas no Member State applied to ESM's PCS. This difference is of utmost importance to decide on next steps for the Economic and Monetary Union, as will be explained in this paper.

-
- 1 Fezzi, C., & Fanghella, V. (2020, January 1). Tracking GDP in real-time using electricity market data: insights from the first wave of COVID-19 across Europe. <https://doi.org/10.48550/arxiv.2009.09222>
 - 2 Temprano Arroyo, H. (2022). The EU's Response to the COVID-19 Crisis: A Game Changer for the International Role of the Euro? European Commission, Directorate-General for Economic and Financial Affairs. https://economy-finance.ec.europa.eu/document/download/525da93f-92ac-4fcd-9f34-c339042b080a_en?filename=dp164_en_0.pdf
 - 3 Eurogroup. (2020, April 9). Report on the comprehensive economic policy response to the COVID-19 pandemic. <https://www.consilium.europa.eu/en/press/press-releases/2020/04/09/report-on-the-comprehensive-economic-policy-response-to-the-covid-19-pandemic/>
 - 4 The headroom is the difference between the maximum amount of revenue that the EU Budget can potentially call from EU Member States in a given year known as the Own Resources Ceiling and the maximum budgeted spending amounts.
 - 5 European Stability Mechanism. (n.d.). Europe's response to the corona crisis. Retrieved from <https://www.esm.europa.eu/content/europe-response-corona-crisis>

Third, the European Investment Bank (EIB) Group set up a EUR 24.4 bn Pan-European Guarantee Fund (EGF) made up of voluntary guarantees set aside by 22 EU Member States in proportion to their EIB capital shares, with the aim to mobilize EUR 200 bn in additional financing by allowing the EIB and the European Investment Fund to scale up their support, mostly for small and medium-sized enterprises. As with SURE and ESM's PCS, EIB's EGF was of a temporary nature. By the end of 2021, EGF had reached EUR 23.2 billion in approved investments, mobilising almost EUR 174.6 billion in total financing and investments (EIB, nd)⁶.

Figure 1. Disbursements under SURE (billion euros)



Source: Authors' elaboration based on European Commission data

But the real EU fiscal measure, with significant implications for the governance of the EU, came a few months later. The Next Generation EU (NGEU) instrument was agreed in principle by the European Council in July 2020⁷ and as will be explained under section 2, marked a U-turn in the design of EU policy responses to crises, which some even called *Hamiltonian moment* (Lionello, 2020)⁸. The Commission was empowered to borrow funds on the capital markets on behalf of the EU up to the amount of EUR 750 billion in 2018 prices (EUR 806.9 billion in current prices). To put these amounts in context, the Multiannual Financial Framework (MFF) 2021-2027 has a total amount of EUR 1,211 trillion in current prices, i.e. NGEU represents almost 70% of MFF 2021-2027. Almost 90% of NGEU funds are devoted to the Recovery and Resilience Facility (RRF), as shown in Table 1, the Regulation of which was adopted in February 2021 (European Union, 2021)⁹. Under the RRF, the Commission would provide beneficiary Member States with up to EUR 338 billion in grants and EUR 385.8 billion in loans, in current prices¹⁰, that Member States can draw until 2026. The loans provided under the NGEU instrument must be fully repaid by 2058. To protect its rating, the EU will use the so-called EU budget headroom as guarantee. Moreover, the Own Resources Ceiling has been increased temporarily, until 2058, by 0.6 percentage points of the EU's Gross National Income (GNI) and new own resources have been introduced.

6 European Investment Bank. (n.d.). European guarantee fund at a glance. Retrieved from https://www.eib.org/attachments/publications/european_guarantee_fund_at_a_glance_en.pdf

7 European Council. (2020, July 21). Conclusions - 17, 18, 19, 20 and 21 July 2020. Retrieved from <https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf>

8 Lionello, L. (2020). Next Generation EU: has the Hamiltonian moment come for Europe?. EUROJUS, 2020(4), 22-42. Available online: <https://hdl.handle.net/10807/161795>

9 European Union. (2021). Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility. Official Journal of the European Union. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R0241>

10 These are maximum amounts, which will only be released if all countries request the funds and comply with the associated reform and investment milestones and targets.

Table 1. Distribution of funds under NGEU (in current prices)

	Billion euros
Recovery and Resilience Facility (RRF)	723.8
RRF grants	338
RRF loans	385.8
NGEU contribution to other programmes	83.1
REACT-EU	50.6
Just Transition Fund	10.9
Rural Development	8.1
InvestEU	6.1
Horizon Europe	5.4
RESCEU	2
NGEU	806.9

Source: Authors' elaboration based on European Commission data

But once the pandemic appeared to be under control, the unjustified Russian aggression against Ukraine took place, sending EU's energy prices over the roof. This constituted a wake-up call for the EU, which became suddenly aware of the risk of critical dependencies especially towards unlike-minded countries. This prompted another fiscal reaction at EU level in the form of the REPowerEU Facility, with the main aim to reduce dependencies on Russian fossil fuels. The final agreement on REPowerEU led to an increase in the RRF financial envelope by EUR 20 billion in new grants and EUR 5.4 billion of funds from the Brexit Adjustment Reserve that Member States will be able to voluntarily transfer to the RRF to finance REPowerEU measures. The inflationary shock that the energy crisis led to seems to be progressively under control thanks mainly to the decrease in energy prices and the restrictive monetary policy measures.

But new challenges are emerging in a geopolitically complex world. This has prompted the presentation by the European Commission of several initiatives in the security and defense fields (e.g. the Strategic Compass in Security and Defense, the EU Space Strategy for Security and Defense, the European Defense Fund or the European Defense Industrial Strategy), as well as a Joint Communication on a European Economic Security Strategy (European Commission, 2023)¹¹, together with the High Representative.

One of the main requirements for the political approval of NGEU is that it would be a one-off extraordinary mechanism that would cease to exist after 2026. And this makes sense: NGEU was a reaction to the extreme health and economic situation the Covid-19 pandemic led to and if health conditions continue being normal in 2026, its existence is no longer warranted.

But the EU has learnt many important lessons from the past, from the sovereign debt crisis, from Brexit and from the health, energy and geopolitical crises. And it needs to build upon those lessons if it wants to face a brighter future. In this regard, though NGEU should not continue after 2026, other joint initiatives will be needed for the EU to face coming challenges.

In section 2 of this paper, we explore the main features of the RRF, as an instrument on which the EU can partially build for new endeavors as of 2026. In section 3, we list the principles next steps should be based on to be successful and potentially politically palatable for EU Member States. Under section 4, we put on the table three complementary proposals of EU instruments. And we end section 5 by making some suggestions as to how these new initiatives could be funded.

¹¹ European Commission (2023). European Economic Security Strategy. Official Journal of the European Union. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52023JC0020>

[2] The distinctive elements of the Recovery and Resilience Facility

Before the Covid-19 pandemic, the last time the EU was affected by a major crisis was with the sovereign debt crisis. This crisis led to major economic reforms, such as the introduction of the Banking Union, and the creation of so called safety nets, like the European Financial Stability Fund (EFSF) first and the ESM afterwards. These institutions provided Member States affected by serious financial stability problems with loans against strict conditionality, embedded in Memoranda of Understanding (Arnal, 2016)¹². These loans increased public debt to GDP ratios of beneficiary Member States, thus worsening their fiscal sustainability prospects. Moreover, conditionality was mainly imposed by staff of EU institutions, rather than suggested by the affected Member State.

This way of doing things came at a cost for the involved institutions and in particular for the ESM. As stated above, no Member State applied for the ESM's PCS. The dynamics of the sovereign debt crisis led to some sort of 'stigma effect' for Member States requesting a loan (Aerts & Pizarro, 2020)¹³, that ultimately spilled over to the ESM, deterring Member States from benefitting from any of its facilities, unless strictly necessary.

That is why one of the main revolutionary and distinctive elements of the RRF is the principle of national ownership. Strict conditionality imposed by staff in foreign institutions is replaced by an active participation by Member States in the design of their Recovery and Resilience Plans (RRPs), which must align with Country-Specific Recommendations (CSRs) and address challenges identified in the European Semester. Yet, national ownership does not mean there is no control by EU institutions: once Member States submit their RRPs, the European Commission needs to evaluate them, making afterwards a recommendation to the Council of the EU whether the plan should be approved. In case of approval by the Council of the EU, the implementation phase starts, with the Member State needing to fulfill predetermined milestones and targets for each disbursement.

The performance based nature of the instrument, with a clear focus not only on investments, but also on structural reforms, is another novelty of the RRF. Comparing the RRF with traditional EU funds, reforms under the RRF are linked to CSRs and have the potential to overhaul the governance of entire policy sectors hand-in-hand with major legislative modifications. If compared to cohesion policy, which is the one that bears a closer resemblance to the RRF, RRF-supported reforms are more far reaching than cohesion policy's enabling conditions, as they perform at very different levels (European Commission, 2024)¹⁴. According to the mid-term evaluation of the RRF (European Commission, 2024)¹⁵, compliance with CSRs has significantly increased: in the two years preceding the RRF, the share of 2016-2017 CSRs reaching at least 'some progress' increased by only six percentage points from 53% in 2018 to 59% in 2020. In comparison, the share of 2019-2020 CSRs reaching at least 'some progress' increased by 17 percentage points from 52% in 2021 before the implementation of the RRF to almost 69% in 2023.

12 Arnal, J (2016). Apoyo financiero a los Estados miembros de la zona euro ante la crisis de deuda soberana: El Mecanismo Europeo de Estabilidad. Boletín Económico de ICE, (3028). Retrieved from <https://revistasice.com/index.php/BICE/article/view/5528/5528>

13 Aerts, J., & Bizarro, P. (2020, February 27). The reform of the European Stability Mechanism. <https://academic.oup.com/cmli/article/15/2/159/5836061>

14 European Commission (2024). Case study on the functioning of the RRF and other EU funds. Retrieved from https://commission.europa.eu/document/download/c203ce47-c5d4-4fa1-abfc-50343d9ddcb6_en?filename=case-study-on-the-functioning-of-the-rrf-and-other-eu-funds.pdf

15 European Commission. (2024). COM(2024) 82. Retrieved from https://commission.europa.eu/document/download/f953f881-5a01-4040-804c-16be479ed3c4_en?filename=COM_2024_82_1_EN_ACT_part1_v5.pdf

Clear proof of the staggered approach and the need to fulfil milestones and targets to progressively receive funds is that at the time of writing this report (11 June 2024), according to European Commission data, only EUR 156.17 billion in grants (less than 46.2% of the total available) and EUR 84.15 billion in loans (less than 22% of the total available) have been disbursed under the RRF. Only Portugal and Italy (both on 28th December 2023) and Croatia (15th April 2024) have received a fourth disbursement of funds under the RRF. Three other countries, Spain (31th March 2023), Slovakia (28th December 2023) and France (5th June 2024) have received a third disbursement.

Another distinctive element of the RRF is that for the first time, Member States have empowered the European Commission to borrow in capital markets on behalf of the EU and disburse part of that lending in the form of grants to Member States. When the sovereign debt crisis struck the euro area, Member States had to come up with complex inter-governmental arrangements like the Greek Loan Facility, the EFSF and the ESM to avoid joint borrowing by the European Commission. As explained in section 1, SURE was also funded with joint borrowing, though the disbursements for Member States consisted in loans.

Moreover, whereas only five Member States benefitted from loans during the sovereign debt crisis, all EU Member States are RRF beneficiaries, though to different degrees, as can be seen in Table 2. And while sovereign support during the euro area debt crisis only took the form of loans, the RRF also has a sizeable grant component. In any case, RRF's support is concentrated on lower-income and more vulnerable Member States hit hardest by the pandemic. The RRF allocation key takes into account both the socio-economic context at the onset of the pandemic and how Member States recovered from the crisis up until June 2022.

Table 2. Distribution of funds under the RRF (in current prices)

	Grants (EUR billion)	Loans (EUR billion)	RRF allocation as % of GDP
Greece	18.22	17.73	19.66%
Croatia	5.79	4.25	17.55%
Spain	79.85	83.16	13.51%
Romania	13.57	14.94	11.87%
Italy	71.78	122.6	10.95%
Portugal	16.33	5.89	10.51%
Poland	25.28	34.54	10.41%
Bulgaria	5.69	0	8.38%
Lithuania	2.3	1.55	6.95%
Hungary	6.51	3.92	6.77%
Slovakia	6.41	0	6.60%
Latvia	1.97	0	5.99%
Cyprus	1.02	0.2	5.21%
Slovenia	1.61	1.07	5.14%
Czechia	8.41	0.818	3.87%
Estonia	0.953	0	3.03%
Malta	0.328	0	2.24%
France	40.27	0	1.61%
Belgium	5.03	0.264	1.05%
Austria	3.96	0	0.98%
Germany	28.02	0	0.78%
Finland	1.95	0	0.78%
Netherlands	5.44	0	0.64%
Sweden	3.45	0	0.64%
Denmark	1.63	0	0.48%
Ireland	0.914	0	0.21%
Luxembourg	0.082	0	0.11%

Source: Authors' elaboration based on European Commission data

The size of the RRF is also noteworthy. At the worst moments of the sovereign debt crisis and when a message of credibility was crucial for financial markets, the ESM was put in place with a maximum firepower of EUR 500 billion on a permanent basis. The RRF exceeds EUR 700 billion at current prices to be committed before the end of 2026.

Also related to the size, the amount of funds the EU will have to raise in the coming years to fund the RRF turns it into a well-established supra-national issuer and the largest issuer of green bonds at global level. This is allowing the European Commission to build a full benchmark yield curve by issuing a diverse range of debt securities, with maturities ranging from three months to thirty years, laying the ground for an EU safe asset in the coming years (Christie et al, 2021)¹⁶. Table 3 below shows the volumes and issue forms of EU's issuances up until mid-May 2024.

Table 3. Volume issued and issue form by the European Commission

	Volume issued (in billion EUR)	Issue form
SURE social bonds	98.35	Syndication
NGEU green bonds	58.2	Auction (7) and syndication (7)
Bills	145.77	Auction
Bonds	302.94	Auction (42) and syndication (43)

Source: Authors' elaboration based on European Commission data

In spite of its merits, there is margin of maneuver to improve both the design and implementation of the RRF. Regarding performance based instruments, the European Court of Auditors (ECA, 2021)¹⁷ identifies four types of indicators: (1) input, consisting of the means to implement a project; (2) output, which is the achievement of a project, such as a training course; (3) result, consisting of the immediate effect of a project once it is completed, like the improvement in employability of the participants to the course; and (4) impact, which are the long term consequences of the completed project, i.e. the benefits for the whole population. As stated by the ECA (ECA, 2022)¹⁸, European Commission's guidance on the preparation of national RRFs called for input and output indicators, but did not call for any impact or results indicators. Moreover, regarding reforms, many milestones simply consist of legislation approval, without really going into details of its effects and implementation. Besides, the mid-term review of the RRF by the European Commission indicates that local, regional authorities and social partners pointed to their insufficient involvement in the design, implementation and monitoring of measures included in the RRFs and that going forward, the situation should be improved. The mid-term evaluation also called for a reinforcement of administrative capacities in order to facilitate the effective implementation of RRFs, as well as for better coordination with traditional MFF cohesion policy instruments. Finally, some criticism has also arisen regarding the ambition and direction of relevant reforms linked to the RRF (e.g. de la Fuente, 2024)¹⁹.

16 Christie, R., G. Claey's and P. Weil (2021) 'Next Generation EU borrowing: a first assessment' Policy Contribution 22/2021, Bruegel

17 ECA (2021) 'Performance-based financing in Cohesion policy: worthy ambitions, but obstacles remained in the 2014-2020 period', Special Report 24/2021, European Court of Auditors, available at <https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=%7bF0370F47-0A28-47A3-816D-6E908AC98FA1%7d>

18 ECA (2022) 'The Commission's assessment of national recovery and resilience plans - Overall appropriate but implementation risks remain', Special Report 21/2022, European Court of Auditors, available at <https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=61946>

19 De la Fuente, A. (2024). 'The reforms component of Spain's Recovery Plan'. Fedea. 'the balance of the reform program contained in the Spanish Recovery Plan has been spotty up to now, with some important reforms pointing in the wrong direction and some others lacking ambition'. Retrieved from <https://documentos.fedea.net/pubs/eee/2024/eee2024-08.pdf>

[3] Principles for next steps

Any new facility to be built as of 2026 should benefit from lessons learnt and be based on a number of principles. Indeed, as will be explained below, a new narrative will be needed, though previous work should be taken into account, with any new facility ensuring financial sustainability and political feasibility, tackling EU's challenges, streamlining EU's governance frameworks and avoiding delays in national fiscal consolidation efforts.

First, a new narrative is needed and (un)fortunately, it is not especially difficult to build one. The RRF was a reaction to the Covid-19 pandemic, but since the impact of the pandemic has been overcome, any new facility would need to fulfill different purposes and be adapted to face present and future challenges. Provision of EU public goods like security and defense, incentives for the adoption of structural reforms to increase EU's competitiveness as well as preservation and depth of the single market all seem to be aligned with the elements the EU will need to tackle in the coming years. Providing adequate answers to these elements is crucial in the current geopolitically challenging context, in which the EU is increasingly trying to derisk, as well as in light of the progressive loss of competitiveness of the EU vis-à-vis other major jurisdictions, like the US.

Second, it is necessary to leverage previous work by EU institutions. Although the RRF is a milestone in terms of European integration, it did not come out of nowhere, as it was built on previous technical work on the Budgetary Instrument for Convergence and Competitiveness, which was conceived as a permanent facility (Eurogroup, 2019²⁰ and European Commission, 2019²¹). When it comes to EU goods, there has already been common work, such as the European Defense Fund (EDF), which incentivizes cooperation on research and development between companies in the defense industry or the European Defense Industry Reinforcement through common Procurement Act (EDIRPA), which introduces a EUR 500 million instrument intended to encourage Member States to procure defense products jointly and which could be worth scaling up (European Parliament, 2023)²². Work by Enrico Letta on the Single Market (Letta, 2024)²³ and Mario Draghi on competitiveness should also be used as a source of inspiration for future proposals. The European Commission's proposal of 2017 on a European Monetary Fund is also worth taking into account.

Third, any new initiatives need to be financially sustainable and efficient. The EU budget is already under severe strain and negotiations on the MFF 2028-2034 promise to be particularly challenging. NGEU's debt will only completely expire in 2058, so if the EU were to issue more debt to fund new facilities, it would need to repay NGEU's principal and interests, while at the same time fund new facilities. Yet, from a financial perspective, it would be more efficient for the EU to become a permanent issuer in markets. Also, Member States should try to make the utmost of existing instruments which are no longer used, like the ESM.

20 Eurogroup (2019, June 14). Term sheet on the budgetary instrument for convergence and competitiveness. Retrieved from https://www.consilium.europa.eu/en/press/press-releases/2019/06/14/term-sheet-on-the-budgetary-instrument-for-convergence-and-competitiveness/?utm_source=dsms-auto&utm_medium=email&utm_campaign=Economic+and+Monetary+Union%3a+Eurogroup+agrees+term+sheet+on+euro-area+budgetary+instrument+and+revised+ESM+treaty

21 European Commission. (n.d.). Regulation governance framework: Budgetary instrument for convergence and competitiveness in the euro area. Retrieved from https://commission.europa.eu/document/download/5b5d4fc3-ed98-4690-983f-e31c4bd3bba0_en?filename=regulation-governance-framework-budgetary-instrument-convergence-and-competitiveness-euro-area_en.pdf&prefLang=es

22 European Parliament (2023). Briefing: European Defense Industry Reinforcement through common Procurement Act (EDIRPA). European Parliamentary Research Service. Retrieved from [https://www.europarl.europa.eu/RegData/etudes/BRIE/2023/739294/EPRS_BRI\(2023\)739294_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2023/739294/EPRS_BRI(2023)739294_EN.pdf)

23 Letta, E. (n.d.). Much more than a market. Retrieved from <https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf>

Fourth, political constraints should be carefully considered, with any new proposals being as politically realistic as possible. Coming up with new proposals that will be ultimately rejected by a number of Member States is counterproductive, as by doing so, the EU sends to the outside world a message of lack of cohesion, which can be especially harmful in times of geopolitical and financial turbulences. Up until now, RRF funds have especially focused on national issues, leaving aside elements of relevance to the whole EU. In this regard, **defense, competitiveness and preservation and deepening of the single market could be priorities that if financially tackled could also be in particular to the benefit of traditional net contributors, in addition to the EU as a whole.**

Fifth, EU's challenges should be tackled. Geopolitical tensions as well as the unjustified aggression of Russia against Ukraine turn security and defense into a major challenge for the EU. EU's competitiveness, as defined by the European Commission²⁴, is increasingly lagging behind other major jurisdictions like the United States, which suggests that structural reforms are needed. Moreover, the Single Market is one of the elements bringing greater wealth for the European project and measures should be introduced to protect it.

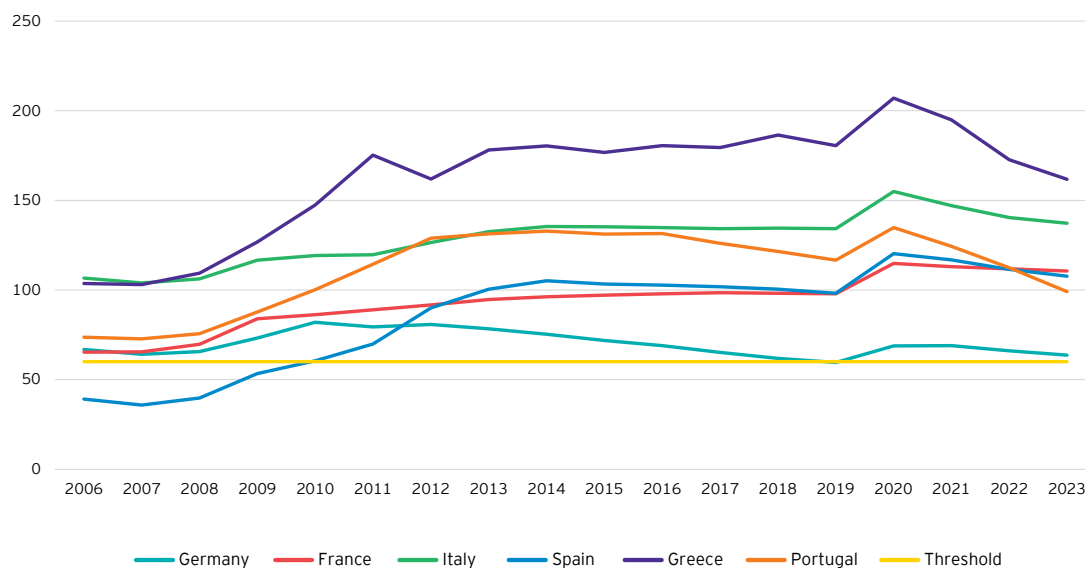
Sixth, EU's governance frameworks should be streamlined and the administrative capacity of national and regional administrations should be boosted. One of the main hurdles for national and regional administrations as well as for the private sector is the multiplicity of EU funds, accessible under different conditions, in a wide variety of governance frameworks. A case in point is the combination of performance-based instruments like the RRF with other more traditional EU funds based on expenditure accreditation. In this regard, it would be advisable to streamline EU's governance systems, by for instance promoting performance based instruments for the MFF 2028-2034. Furthermore, although funds were allocated for technical assistance under the RRF, these were not enough compared to the very sizeable amount of funds to be absorbed by some Member States. Hence, going forward, technical assistance should be reinforced to boost administrative capacities of national and regional administrations.

Seventh, any additional instrument to be introduced should not be seen as a way to escape national fiscal consolidation efforts. Once the general escape clause has been deactivated and with a new set of fiscal rules fully applicable as of 2025, Member States need to go back to fiscal discipline, especially in light of the high debt levels accumulated by a number of large Member States, as shown in Figure 2. The proposals contained in this paper should be financed by EU mutualized funding sources because they are of relevance to the whole EU and not as a means of offsetting lower spending in Member States.

Finally, efforts should be made to find the appropriate mix of public support instruments, with more space for tax credits. As a general rule, in the EU, support programmes are based on prolonged application procedures to which specific projects need to be presented with different levels of administrations (EU, national, regional and local) being involved depending on the specific area of competence. In contrast, in the US, public support is available upfront and is concentrated at the federal level. Thus, EU, national, regional and local authorities, learning from the most recent experience, should make an effort to cut red tape and use more straightforward instruments, such as tax credits.

24 European Commission. (2023). Communication on long-term competitiveness. Retrieved from https://commission.europa.eu/system/files/2023-03/Communication_Long-term-competitiveness.pdf

Figure 2. Public debt to GDP ratios between 2006 and 2023



Source: Authors' elaboration based on Eurostat data

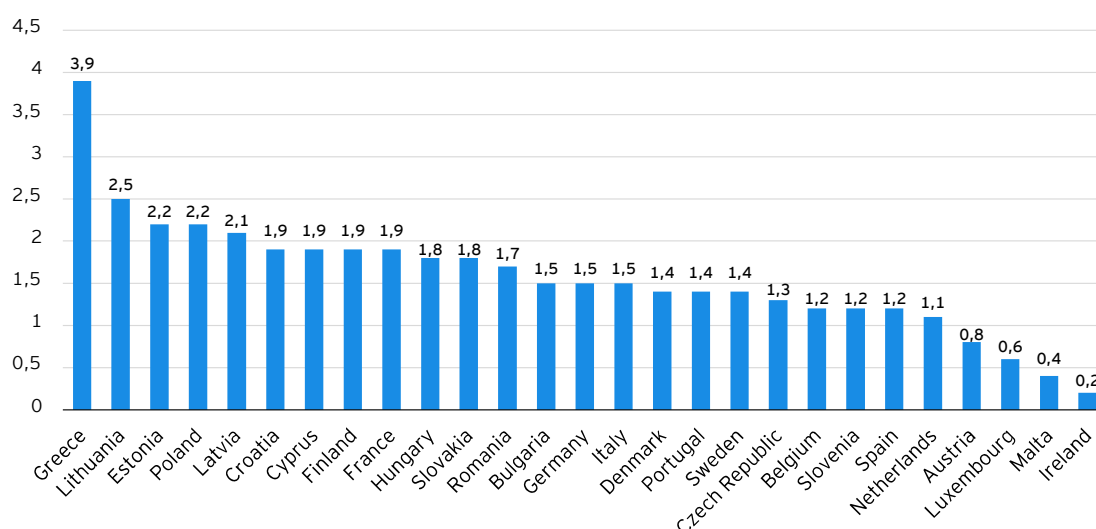
[4] Three (complementary) proposals

[4.1] An EU Security and Defense Facility

Economic literature states that pure public goods are featured by two main characteristics (Buchholz & Sandler, 2021)²⁵: non-rivalry, meaning that its utilization by an additional beneficiary has a marginal cost approaching zero; and non-exclusion, i.e. the exclusion of a potential beneficiary is either impossible or very inefficient. Market mechanisms tend to supply an insufficient amount of public goods, and hence the creation of an efficient amount of public goods requires a direct or indirect public intervention (Stiglitz, 1986)²⁶.

As per Buti et al. (2023)²⁷, the production and financing of an EU public good should take place optimally at the EU level. A clear example of this could be defense. EU Member States have for years severely under-invested in their defense, with most of them (22 out of 27 Member States in 2022) unable to reach the minimum 2 % GDP defense spending commitment under NATO that was formalized at the 2023 Vilnius Summit (NATO, 2023)²⁸, as can be seen in Figure 3. Russia's invasion of Ukraine, tensions in the Middle East as well as US's weariness to cater for Europe's security make it more urgent than ever for the EU to increase investment in defense and security. And this is reflected in the fact that according to NATO, in 2023, the number of member countries that have reached the minimum defense investment of 2% of GDP has more than tripled since 2014, increasing from 3 to 11 compliant countries.

Figure 3. Total defense expenditure in 2022 (as % of GDP)



Source: Authors' elaboration based on European Defense Agency data

25 Buchholz, W., & Sandler, T. (2021). Global Public Goods and Sustainable Development in the Practice of International Organizations. In *Global Public Goods in Light of the New Paradigm of Sustainable Development under the Challenges Facing Today's World* (pp. 21-41). Brill. https://doi.org/10.1163/9789004687264_003

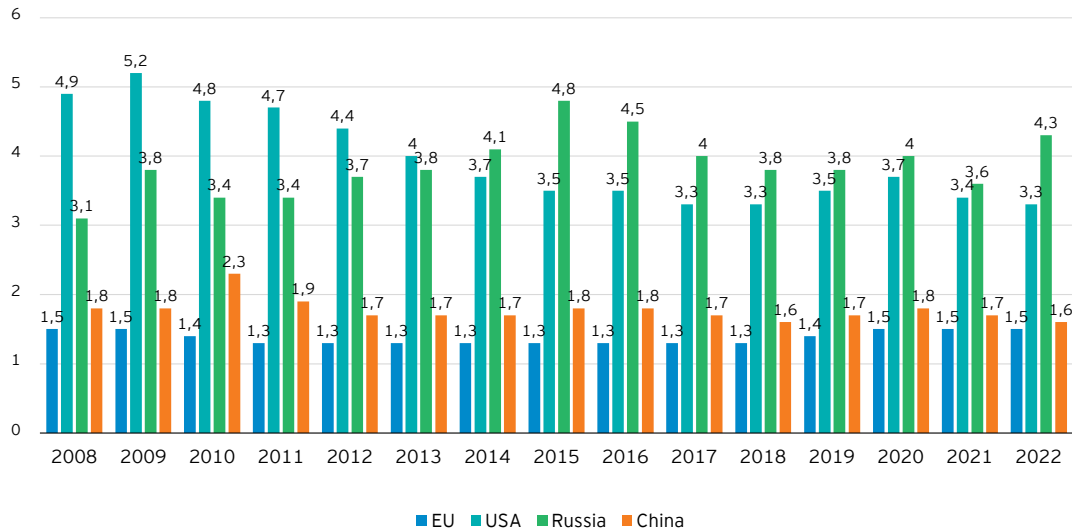
26 Stiglitz, J. E. (1986). The Theory of Public Goods: A Survey of Recent Issues. *Journal of Public Economics*, 29(1), 1-24. Available at: <https://www.jstor.org/stable/40750871>

27 Buti, M., Coloccia, A. & Messori, M. (2023). European public goods. Centre for Economic Policy Research. Retrieved from <https://cepr.org/voxeu/columns/european-public-goods>

28 North Atlantic Treaty Organization (2023). Vilnius Summit Communiqué. Retrieved from https://www.nato.int/cps/en/natohq/official_texts_217320.htm

Under-investment in defense puts the EU in a difficult position if compared to other major military powers like the US, Russia and China, as shown in Figure 4. In absolute figures, the US has consistently been by far the largest spender, allocating EUR 794 billion to defense expenditure in 2022. The US was followed by China, with EUR 273 billion, the EU with EUR 240 billion and Russia with EUR 92 billion.

Figure 4. Total defense expenditure in major jurisdictions (as % of GDP)



Source: Authors' elaboration based on European Defense Agency data

Due to the sensitive nature of defense products, defense industry has been subject to State control, slowing down or even hindering cross-border cooperation (Alvarez-Couceiro, 2023)²⁹. Even if the European industry has been consolidating since the 1990s, giving place to European defense giants such as Airbus, BAE Systems and Thales (Barbieux, 2023)³⁰ and the role of the State has declined (Bitzinger, 1994)³¹, there is still a clear lack of joint planning and procurement of defense capabilities among EU Member States. The structure of the EU defense industry still follows national borders, with demand only coming from national governments and supply covering exclusively national needs. As indicated by Olsson (2021)³², market fragmentation is also explained by large number of legacy systems. For example, whereas there are twelve different types of battle tanks in the EU, the US market is dominated by only one system, the Leopard 2.

This market fragmentation is not only a problem from a security perspective, but also from a financial point of view. As stated by Letta report, 'while supporting the Ukrainian resistance, Europeans spent substantial amounts, yet around 80% of these funds were spent on non-European materials. Conversely, the US sourced around 80% of the military equipment used to support the war in Ukraine directly from American suppliers, a stark difference that highlights the weakness of our approach'. And this is why this report calls for a 'Common Market for the Security and Defense Industry'.

The diagnosis presented above makes it clear that underinvestment and fragmentation are the main problems of EU defense industry. This situation prevents the realization of economies of scale that would arise from pooling defense equipment production across European companies.

29 Alvarez-Couceiro, P. (2023, April 18). Europe At a Strategic Disadvantage: a Fragmented Defense Industry. Texas National Security Review. <https://warontherocks.com/2023/04/europe-at-a-strategicdisadvantage-a-fragmented-defense-industry/>

30 Barbieux, F. (2023, September 1). Tackling the Issue of Fragmentation in the European Defense Industry. Finabel, European Army Interoperability Centre. <https://finabel.org/tackling-the-issue-offragmentation-in-the-european-defence-industry/>

31 Bitzinger, R. A. (1994). The Globalization of the Arms Industry: The Next Proliferation Challenge. International Security, 19(2), 170-198. <https://doi.org/10.2307/2539199>

32 Olsson, P. (2021). Defense Economics and Materiel Supply: The European Defense Market – Unevenly Fragmented. Swedish Defense Research Agency (SDRA). <https://www.foi.se/restapi/report/FOI%20Memo%207730>.

The EU should build on previous initiatives, like EDIRPA, and scale them up with additional mutualized funding. The EDIRPA is designed to encourage cooperation among EU Member States in defense procurement. It aims to enhance the European Defense Technological and Industrial Base by providing financial support for urgent defense needs, specifically for ammunition, air and missile defense, and replacing legacy systems. To access these funds, Member States must participate in common procurement activities, focusing on collaborative investments to address urgent and critical defense needs.

Another policy option to consider would be the creation of a Joint Undertaking focused on defense, following the models of EU Rail and the Single European Sky ATM Research (SESAR). This initiative could bring industry players together around a Research and Innovation (R&I) agenda, fostering alignment around common European standards and strategies.

As for the corporate world, Airbus has exemplified successful integration in the defense sector by merging various European aerospace and defense companies into a cohesive, efficient entity. This integration has not only streamlined production and innovation but also strengthened Europe's strategic autonomy in defense capabilities. As a result, Airbus stands as a model for the European Union, showcasing how collaborative efforts can enhance security and defense. Adopting similar integration strategies across the EU could foster greater cooperation, resource optimization, and a unified stance in addressing security challenges.

[4.2] Budgetary Instrument for Convergence and Competitiveness

Though the political agreement for the introduction of NGEU-RRF states that this facility should be one-off, its design was built on technical work and political agreements in 2019 for the design of a **Budgetary Instrument for Convergence and Competitiveness (BICC)**. Indeed, on 14 June 2019, the Eurogroup agreed on a Term Sheet with the main features of the BICC. Member States' intention was to turn the BICC into a permanent instrument to promote national structural reforms and investments as a means of reinforcing the competitiveness of the whole EU.

The main features of the BICC as agreed by the Eurogroup were the following:

- ▶ The Eurosummit and the Eurogroup will give strategic guidance on the key reform and investment priorities for the convergence and competitiveness of the euro area, which will be reflected in a strengthened Euro Area Recommendation. These priorities will be reviewed annually.
- ▶ Participating Member States will submit duly substantiated reform and investment proposals, reflecting the strategic guidance as above. The proposals will include, among other aspects, the timeline for implementation of the structural reforms and investments, with the relevant milestones and targets.
- ▶ With a view to ensuring ownership at the national level, a minimum national co-financing rate will be set as a percentage of the total cost of the investment and reforms.
- ▶ The support from the instrument will be delivered in the form of grants (i.e. direct financial contribution), the amount of which will be determined based on the cost estimate.
- ▶ The allocation of funds per country will be determined on the basis of a transparent methodology.
- ▶ Member States' access to financing will depend on the implementation of structural reforms and investments and will receive the financial support in instalments, subject to the fulfilment of agreed milestones. In case of unsatisfactory implementation of the reforms and investments, payments will be suspended, and cancelled in case this situation persists.
- ▶ The Commission will assess the Member States' proposals on the basis of transparent criteria. Member States will report on the implementation of reform and investment commitments regularly, in the context of the European Semester.
- ▶ The relevant preparatory committees of the Eurogroup will be involved in the discussion of the assessment of Member States' proposals and monitoring of progress, in full respect of the Commission's responsibilities for the implementation of the instrument and of the budget. The Eurogroup in the relevant format will also discuss the assessments and the progress reports.
- ▶ The instrument will be part of the EU budget. Its size will be determined in the context of the MFF.

The Eurogroup also considered that the arrangements for the governance framework for the euro area Member States had to be codified in an additional act, which led to the presentation by the European Commission of a proposal for a Regulation³³. This proposal was never approved by the legislators, as the pandemic started and EU leaders decided on the introduction of the RRF, building on many of the features of the BICC.

Since the BICC was intended to be a permanent instrument to reinforce EU's competitiveness, a growingly crucial element for our economies, it would make sense to leverage on previous work and see what elements that were agreed upon in 2019 could be resuscitated going forward. More specifically, even if the RRF is conceived as a one-off instrument, it would be worth considering the introduction of a BICC-like instrument to promote structural reforms in EU Member States, incorporating all the corresponding improvements identified in the design and implementation of the RRF and taking into account the new governance derived from the fiscal rules, as a result of which, Member States have to present medium term fiscal adjustment plans also covering investments and reforms. Crucially, when agreeing on the governance of the BICC, specific provisions should be introduced to ensure that the proposed reforms count on broad support from national parliaments, regional and local authorities, as well as social partners. The BICC could also support the design and implementation of structural reforms in Member States through the Technical Support Instrument (TSI).

[4.3] EU Internal Market Facility for EU industrial policies

For decades, the EU implemented a horizontal approach to industrial policy, relying on competition and State Aid rules and in principle, not bringing any privilege or advantage to specific sectors or companies and promoting overall economic efficiency and consumer welfare. Yet, the increasing geopolitical fragmentation, lack of respect to World Trade Organization rules and economic weaponization of State Aid by other major jurisdictions such as the US and China has significantly altered EU's approach to industrial policies, which are of a growing vertical nature. Vertical industrial policies consist of direct support to key industries and tailored State Aid and subsidies to specific sectors, with the aim of strengthening their position in global markets. The debate about the need to switch the orientation of industrial policies has also been spurred by the European Commission's decision in 2019 to block the merger of Alstom and Siemens, leading some Member States to advocate for the subordination of competition policies to industrial objectives. Moreover, in academia, there is a growing number of voices, such as Mariana Mazzucato or Dani Rodrik, advocating for an active role of the State in industrial policy. But this new EU approach to industrial policy risks hurting the EU internal market (Arnal, 2024)³⁴.

EU's efforts in industrial policies do not end up here: the EU Chips Act, the Critical Raw Materials Act and the Net Zero Industry Act are also worth mentioning. And they all have something in common: a lack of substantial and mutualized budget to take forward their ambitious targets. For instance, while the EU Chips Act appears to be the European response to the US Chips Act, the truth is that their budgets are way different: up to EUR 42 billion of public and private investments against USD 54 billion of only public investments plus a 25% tax credit for capital investments in semiconductor manufacturing, respectively. Moreover, the design of semiconductor policies lies with individual Member States, creating overlaps, coordination problems and the risk for the EU as a block not to be able to double its production share of chips from 10% to 20% by 2030.

³³ European Commission (2019). Regulation on a governance framework for the budgetary instrument for convergence and competitiveness for the euro area. Retrieved from: Regulation on a governance framework for the budgetary instrument for convergence and competitiveness for the euro area | European Commission (europa.eu)

³⁴ Arnal, J. (2024). Is EU industrial policy hurting the internal market? EUobserver. Retrieved from <https://euobserver.com/eu-and-the-world/ara50b59c9>









Replacing horizontal by vertical industrial policies is probably the way forward for the EU given the current geopolitical stance. Nevertheless, it is important that the public sector is aware of its information limitations when implementing any vertical policy and that sufficient safeguards are in place to avoid that the private sector captures public authorities. There are clear cases of successful vertical policies, such as in South Korea, but also blatant failures, as in some Latin American countries (Asensio & Ganuza, 2024)³⁵.

Vertical industrial policies should not be conducted to the detriment of EU's internal market, one of the elements that has brought more prosperity to EU citizens. Vertical industrial policies are not always at odds with competition policy. Airbus is a clear example of this, having been the result of a vertical industrial policy that fostered greater competition in the sector of high capacity aircrafts.

In the current circumstances, any relaxation of State Aid rules should be done back-to-back with a mutualized budget. In this regard, the Letta report brings forward a very interesting measure: a State aid contribution mechanism, requiring Member States to allocate a portion of their national funding to financing pan-European initiatives and investments.

Important Projects of Common European Interest (IPCEIs) are one of the tools the EU can use to reach strategic autonomy in key industries and achieve a minimum degree of coordination in industrial policies. These projects represent a collective effort to build up entire European value chains. One of the positive elements of IPCEIs is the fact that their impact is not limited to a single national territory, but to a minimum of four Member States. Table 4 shows the main characteristics of approved IPCEIs.

Table 4. Main characteristics of approved IPCEIs

	Participating companies	Participating projects	Expected private investments (EUR billion)	Participating Member States
First IPCEI on Micro-electronics (2018)	29	43	6.5	
First IPCEI on Batteries (2019)	17	22	5	
Second IPCEI on Batteries - EuBatIn (2021)	42	46	9	
First hydrogen IPCEI - Hy2Tech (2022)	35	41	8.8	
Second hydrogen IPCEI - Hy2Use (2022)	29	35	7	
Second IPCEI on Micro-electronics and Communication Technologies (2023)	56	68	13.7	
IPCEI on Next Generation Cloud Infrastructure and Services (2023)	19	19	1.4	
Third hydrogen IPCEI - Hy2Infra (2024)	32	33	5.4	
Total	259	307	56.8	22 Member States, UK and Norway participated in at least one IPCEI

Source: Authors' elaboration based on European Commission data

In view of the lack of coordination among EU industrial policies, Member States granting public aid would have to contribute to a common fund for the financing of new IPCEIs. This fund could be supplemented with additional pooled funds, either from the MFF or from European Union debt issuances.

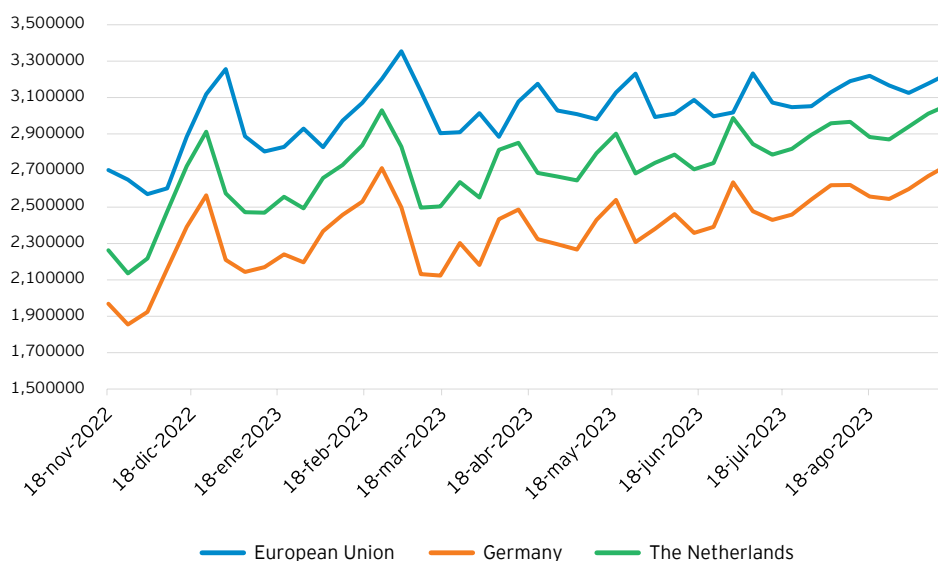
35 Asensio, J. & Ganuza, J.J. (2024). La complementariedad estratégica entre la competencia y política industrial. Retrieved from <https://www.funcas.es/articulos/la-complementariedad-estrategica-entre-la-competencia-y-politica-industrial/>

[5] How to fund all this?

[5.1] Turning the EU into a permanent issuer

Due to SURE and NGEU, the European Commission, on behalf of the EU, has become a major issuer in financial markets. Although it benefits from an AAA rating, its cost of funding is well above other AAA rated sovereign issuers in the euro area, such as Germany and the Netherlands (Arnal, 2023a)³⁶, as can be seen in Figure 6. This is due to a number of reasons such as lower liquidity, more penalizing treatment by financial institutions in internal risk models, exclusion from sovereign bond indices, lack of futures and massive reliance on syndications rather than auctions (Bruegel, 2023)³⁷. But many of these reasons seem to be linked to the fact that NGEU, which generates the bulk of the financing needs of the EU, is a temporary facility and thus markets discount that it will significantly decrease its issuance volumes at a certain point in time.

Figure 5. 10 year bond yields, December 2022-September 2023



Source: Authors' elaboration based on Eikon data

In light of this, Member States should consider the opportunity of creating a permanent issuer that could benefit from having a AAA rating. At the same time, the European Commission should do everything within its reach to revert some of the reasons for higher yields (e.g., relying more on auctions). By simply turning the EU into a permanent issuer and having an efficient issuance strategy, interest costs will decrease for the EU.

³⁶ Arnal, J. (2023a). Ten guiding principles to help cover the EU's investment needs. Real Instituto Elcano. Retrieved from <https://www.realinstitutoelcano.org/en/analyses/ten-guiding-principles-to-help-cover-the-eus-investment-needs/>

³⁷ Bruegel. (2023). The rising cost of European Union borrowing and what to do about it. Retrieved from <https://www.bruegel.org/policy-brief/rising-cost-european-union-borrowing-and-what-do-about-it/>

[5.2] Reforming and using ESM's firepower

The ESM played a crucial role during the sovereign debt crisis in the euro area. Nevertheless, at present, in spite of a highly qualified staff, its role is unfortunately marginal for the functioning of the EU and the euro area. As explained in the introduction, even during the pandemic, the especially designed PCS, was not touched upon by any Member State. This is in stark contrast with European Commission's SURE, which equally offered Member States concessional loans. A possible explanation for this different appetite by Member States for apparently similar facilities could be related to the perceived stigma of tapping on ESM funds, which to many bring back memories of the worst times of the euro area sovereign debt crisis.

Moreover, the ratification of the ESM Treaty is currently being blocked. Although there does not seem to be any good reason for blocking the ESM Treaty ratification (Arnal, 2023b)³⁸, the truth is that this makes the ESM de facto a blocked institution.

Still, the ESM has more than EUR 80 billion of paid-in capital by Member States and a remaining lending capacity above EUR 420 billion. While the ESM was originally conceived to safeguard the financial stability of the euro area by providing loans to Member States against conditionality, the stigma effect the institution seems to be suffering suggests a reform should be sought. Moreover, the experience of a more negotiated approach under NRPs of NGEU, where Member States themselves suggest the adequate reforms and investments to be later approved by the Commission and the EU Council, also testifies for a change in paradigm. Ownership is the new norm and has replaced Memoranda of Understanding. Finally, the intergovernmental nature of the ESM complicates unnecessarily decision-making processes and introduces an unwarranted layer of complexity in the institutional architecture of the EU.

The Letta report suggests to mirror the ESM's PCS and create a Defense Support Line that could provide loans of up to 2% of a member country's GDP at exceptionally favorable interest rates, specifically earmarked for defense and security expenditures. Letta argues that the sole criterion for accessing this credit facility would be a formal pledge by the requesting member state to allocate the funds exclusively towards national defense efforts. Nevertheless, under the current legal framework, for a Member State to have access to this facility, financial stability should be at risk. It is difficult to see any Member State arguing that its financial stability is at risk in order to have access to loans (not transfers) to fund defense investments. Moreover, non-euro area Member States would be excluded from such a facility, which is not warranted neither in economic nor in security terms, especially in a context in which accession talks for countries in the Western Balkans and Ukraine are making progress.

Therefore, a reform of the ESM is warranted, both to incorporate it into the EU institutional framework and to ensure an adequate use of its available firepower. In 2017, the European Commission presented a legislative proposal for a European Monetary Fund³⁹, which was never discussed at the Council of the EU. Though the current circumstances make an in-depth review of the 2017 proposal compulsory, there are some elements that are worth keeping, like the mechanisms to bring the ESM under EU law.

38 Arnal, J. (2023b). ESM Treaty ratification. Centre for European Policy Studies. Retrieved from https://cdn.ceps.eu/wp-content/uploads/2023/12/CEPS-Explainer-2023-17_ESM-Treaty-ratification-.pdf

39 European Commission (2018). Proposal for a regulation of the establishment of a European Monetary Fund. Retrieved from <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52017PC0827>

[5.3] European Investment Bank

The March 2024 European Council⁴⁰ invited the European Investment Bank *‘to adapt its policy for lending to the defense industry and its current definition of dual-use goods, while safeguarding its financing capacity’*. Following this political indication, the EIB Group Security and Defense Industry Action Plan was presented by President Nadia Calviño with the aim of strengthening EU funding tools for the defense industry. The plans aim at significantly empowering the EIB to support defense-related activities beyond the current scope of dual-use projects. Subsequently, on 8 May 2024, the Board of Directors of the EIB approved a revised definition of dual use projects, enhancing support for Europe’s security and defense industry. This includes promoting innovation, business expansion and supporting SMEs and start-ups within the industry.

Such an evolution within EIB’s practices clearly shows the key role the EIB Group can play in financing the investments the EU needs to undertake to tackle its most pressing challenges.

[5.4] Reallocation of non-absorbed NGEU funds by 2026

Though the objective is to absorb as many NGEU funds as possible, it is highly likely that by the end of 2026, a non-negligible amount of funds will still be unused. This is confirmed by the fact that a number of Member States have decided not to request any loan. In this context, it would be regrettable not to make use of these funds going forward by reprogramming them to finance any of the aforementioned instruments to be implemented from 2026. In any case, even if simple at first sight, this option would also require substantial legal amendments and political will, as the Council Regulation (EU) 2020/2094 of 14 December 2020 (also known as EURI Decision) and the Own Resources decision would need to be amended, requiring unanimity and ratification by 24 national Parliaments

[5.5] Private funding

The EU and its citizens need to be very much aware that the staggering amount of investment needs will not only be covered by public funds. Indeed, it is of utmost importance to adequately design public facilities like the ones proposed in this paper to mobilize private funding.

The successful channeling in the US of public support measures through tax credits (e.g. Chips Act or Inflation Reduction Act) suggests there is room for improvement in the design of instruments to foster private funding in the EU. Moreover, since most public funds in the US are made available at Federal level, businesses have clarity around the financial facilities they can have access to. Still, in the case of the EU, different facilities are provided at EU, national, regional and local levels, making it difficult for companies and citizens to have a clear view about the opportunities.

Efforts should be made to streamline the governance of EU instruments, while in the very short run increasing transparency, by trying to bring together all the relevant information into a single web portal.

40 European Council. (2024, March 22). European Council conclusions, 21 and 22 March 2024. Retrieved from <https://www.consilium.europa.eu/en/press/press-releases/2024/03/22/european-council-conclusions-21-and-22-march-2024/>

[6]

Conclusions

The lessons drawn from the implementation of the Next Generation EU (NGEU), particularly the Recovery and Resilience Facility (RRF), have underscored the European Union's capacity for swift and substantial fiscal response in times of crisis. The proactive measures undertaken have not only mitigated the economic fallout from the COVID-19 pandemic but have also laid a foundation for addressing future crises. As the EU transitions from recovery to resilience, the initiatives proposed in this paper build upon the revolutionary principles of national ownership, performance-based evaluations, and strategic financial planning introduced by the RRF.

The suggested EU Security and Defense Facility, Budgetary Instrument for Convergence and Competitiveness, and the EU Internal Market Facility for Industrial Policies are designed to further enhance the EU's strategic autonomy, economic resilience, and market integrity. These instruments will leverage the successes of the RRF while adapting to the evolving geopolitical and economic landscape that the EU faces. Each is grounded in principles that ensure financial sustainability, political feasibility, and alignment with EU public needs, such as defense and competitiveness.

Funding these new initiatives will require innovative financial strategies. This includes transforming the EU into a permanent issuer in financial markets, optimizing existing mechanisms like the European Stability Mechanism, reforming the European Investment Bank's policies to better support strategic sectors and reallocating NGEU funds not absorbed by 2026. Moreover, the mobilization of private investments through well-designed public facilities will be crucial to complement public funding, ensuring a robust financial base for these ambitious initiatives.

“

By embracing a narrative that anticipates future challenges and adapts accordingly, the EU can secure not just economic stability, but a thriving, resilient future for its member states and citizens.

In conclusion, as the EU stands at a crossroads, the strategic use of lessons from past crises, coupled with a forward-looking approach to fiscal policy and institutional reforms, will be paramount. By embracing a narrative that anticipates future challenges and adapts accordingly, the EU can secure not just economic stability, but a thriving, resilient future for its member states and citizens.

References

1. Aerts J. & Bizarro P. (2020 February 27). The reform of the European Stability Mechanism. <https://academic.oup.com/cmli/article/15/2/159/5836061>
2. Alvarez-Couceiro P. (2023 April 18). Europe At a Strategic Disadvantage: a Fragmented Defense Industry. Texas National Security Review. <https://warontherocks.com/2023/04/europe-at-a-strategicdisadvantage-a-fragmented-defense-industry/>
3. Arnal J (2016). Apoyo financiero a los Estados miembros de la zona euro ante la crisis de deuda soberana: El Mecanismo Europeo de Estabilidad. Boletín Económico de ICE (3028). Retrieved from <https://revistasice.com/index.php/BICE/article/view/5528/5528>
4. Arnal J. (2023a). Ten guiding principles to help cover the EU's investment needs. Real Instituto Elcano. Retrieved from <https://www.realinstitutoelcano.org/en/analyses/ten-guiding-principles-to-help-cover-the-eus-investment-needs/>
5. Arnal J. (2023b). ESM Treaty ratification. Centre for European Policy Studies. Retrieved from https://cdn.ceps.eu/wp-content/uploads/2023/12/CEPS-Explainer-2023-17_ESM-Treaty-ratification-.pdf
6. Arnal J. (2024). Is EU industrial policy hurting the internal market? EUobserver. Retrieved from <https://euobserver.com/eu-and-the-world/ara50b59c9>
7. Asensio J. & Ganuza J.J. (2024). La complementariedad estratégica entre la competencia y política industrial. Retrieved from <https://www.funcas.es/articulos/la-complementariedad-estrategica-entre-la-competencia-y-politica-industrial/>
8. Barbieux F. (2023 September 1). Tackling the Issue of Fragmentation in the European Defense Industry. Finabel European Army Interoperability Centre. <https://finabel.org/tackling-the-issue-offragmentation-in-the-european-defence-industry/>
9. Bitzinger R. A. (1994). The Globalization of the Arms Industry: The Next Proliferation Challenge. International Security 19(2) 170-198. <https://doi.org/10.2307/2539199>
10. Bruegel. (2023). The rising cost of European Union borrowing and what to do about it. Retrieved from <https://www.bruegel.org/policy-brief/rising-cost-european-union-borrowing-and-what-do-about-it/>
11. Buchholz W. & Sandler T. (2021). Global Public Goods and Sustainable Development in the Practice of International Organizations. In Global Public Goods in Light of the New Paradigm of Sustainable Development under the Challenges Facing Today's World (pp. 21-41). Brill. https://doi.org/10.1163/9789004687264_003
12. Buti M. Coloccia A. & Messori M. (2023). European public goods. Centre for Economic Policy Research. Retrieved from <https://cepr.org/voxeu/columns/european-public-goods>
13. Christie R. G. Claeys and P. Weil (2021) 'Next Generation EU borrowing: a first assessment' Policy Contribution 22/2021 Bruegel
14. De la Fuente A. (2024). 'The reforms component of Spain's Recovery Plan'. Fedea. 'the balance of the reform program contained in the Spanish Recovery Plan has been spotty up to now with some important reforms pointing in the wrong direction and some others lacking ambition'. Retrieved from <https://documentos.fedea.net/pubs/eee/2024/eee2024-08.pdf>
15. ECA (2021) 'Performance-based financing in Cohesion policy: worthy ambitions but obstacles remained in the 2014-2020 period' Special Report 24/2021 European Court of Auditors available at <https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=%7bF0370F47-0A28-47A3-816D-6E908AC98FA1%7d>
16. ECA (2022) 'The Commission's assessment of national recovery and resilience plans - Overall appropriate but implementation risks remain' Special Report 21/2022 European Court of Auditors available at <https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=61946>
17. Eurogroup. (2020 April 9). Report on the comprehensive economic policy response to the COVID-19 pandemic. <https://www.consilium.europa.eu/en/press/press-releases/2020/04/09/report-on-the-comprehensive-economic-policy-response-to-the-covid-19-pandemic/>
18. Eurogroup (2019 June 14). Term sheet on the budgetary instrument for convergence and competitiveness. Retrieved from https://www.consilium.europa.eu/en/press/press-releases/2019/06/14/term-sheet-on-the-budgetary-instrument-for-convergence-and-competitiveness/?utm_source=dsms-auto&utm_medium=email&utm_campaign=Economic+and+Monetary+Union%3a+Eurogroup+agrees+term+sheet+on+euro-area+budgetary+instrument+and+revised+ESM+treaty

19. European Commission. (n.d.). Regulation governance framework: Budgetary instrument for convergence and competitiveness in the euro area. Retrieved from https://commission.europa.eu/document/download/5b5d4fc3-ed98-4690-983f-e31c4bd3bba0_en?filename=regulation-governance-framework-budgetary-instrument-convergence-and-competitiveness-euro-area_en.pdf&prefLang=es
20. European Commission (2019). Regulation on a governance framework for the budgetary instrument for convergence and competitiveness for the euro area. Retrieved from: Regulation on a governance framework for the budgetary instrument for convergence and competitiveness for the euro area | European Commission (europa.eu)
21. European Commission (2023). European Economic Security Strategy. Official Journal of the European Union. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52023JC0020>
22. European Commission. (2023). Communication on long-term competitiveness. Retrieved from https://commission.europa.eu/system/files/2023-03/Communication_Long-term-competitiveness.pdf
23. European Commission (2024). Case study on the functioning of the RRF and other EU funds. Retrieved from https://commission.europa.eu/document/download/c203ce47-c5d4-4fa1-abfc-50343d9ddcb6_en?filename=case-study-on-the-functioning-of-the-rrf-and-other-eu-funds.pdf
24. European Commission. (2024). COM(2024) 82. Retrieved from https://commission.europa.eu/document/download/f953f881-5a01-4040-804c-16be479ed3c4_en?filename=COM_2024_82_1_EN_ACT_part1_v5.pdf
25. European Council. (2020 July 21). Conclusions - 17 18 19 20 and 21 July 2020. Retrieved from <https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf>
26. European Investment Bank. (n.d.). European guarantee fund at a glance. Retrieved from https://www.eib.org/attachments/publications/european_guarantee_fund_at_a_glance_en.pdf
27. European Parliament (2023). Briefing: European Defense Industry Reinforcement through common Procurement Act (EDIRPA). European Parliamentary Research Service. Retrieved from [https://www.europarl.europa.eu/RegData/etudes/BRIE/2023/739294/EPRS_BRI\(2023\)739294_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2023/739294/EPRS_BRI(2023)739294_EN.pdf)
28. European Stability Mechanism. (n.d.). Europe's response to the corona crisis. Retrieved from <https://www.esm.europa.eu/content/europe-response-corona-crisis>
29. European Union. (2021). Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility. Official Journal of the European Union. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R0241>
30. Fezzi C. & Fanghella V. (2020 January 1). Tracking GDP in real-time using electricity market data: insights from the first wave of COVID-19 across Europe. <https://doi.org/10.48550/arxiv.2009.09222>
31. Letta E. (n.d.). Much more than a market. Retrieved from <https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf>
32. Lionello L. (2020). Next Generation EU: has the Hamiltonian moment come for Europe?. EUROJUS 2020(4) 22-42. Available online: <https://hdl.handle.net/10807/161795>
33. North Atlantic Treaty Organization (2023). Vilnius Summit Communiqué. Retrieved from https://www.nato.int/cps/en/natohq/official_texts_217320.htm
34. Olsson P. (2021). Defense Economics and Materiel Supply: The European Defense Market – Unevenly Fragmented. Swedish Defense Research Agency (SDRA). <https://www.foi.se/restapi/report/FOI%20Memo%207730>
35. Stiglitz J. E. (1986). The Theory of Public Goods: A Survey of Recent Issues. Journal of Public Economics 29(1) 1-24. Available at: <https://www.jstor.org/stable/40750871>
36. Temprano Arroyo H. (2022). The EU's Response to the COVID-19 Crisis: A Game Changer for the International Role of the Euro? European Commission Directorate-General for Economic and Financial Affairs. https://economy-finance.ec.europa.eu/document/download/525da93f-92ac-4fcd-9f34-c339042b080a_en?filename=dp164_en_0.pdf

EY | Building a better working world

En EY trabajamos para construir un mundo que funcione mejor, ayudando a crear valor a largo plazo para los clientes, las personas, la sociedad y generar confianza en los mercados de capital.

Gracias al conocimiento y la tecnología, los equipos de EY, en más de 150 países, generan confianza y ayudan a las compañías a crecer, transformarse y operar.

EY es líder mundial en servicios de auditoría, fiscalidad, estrategia, asesoramiento en transacciones y servicios de consultoría. Nuestros profesionales hacen las mejores preguntas para encontrar nuevas respuestas a los desafíos a los que nos enfrentamos en el entorno actual.

EY hace referencia a la organización internacional y podría referirse a una o varias de las empresas de Ernst & Young Global Limited y cada una de ellas es una persona jurídica independiente. Ernst & Young Global Limited es una sociedad británica de responsabilidad limitada por garantía (company limited by guarantee) y no presta servicios a clientes. La información sobre cómo EY recopila y utiliza datos personales y su correspondiente descripción sobre los derechos de las personas en virtud de la legislación vigente en materia de protección de datos, están disponibles en ey.com/es_es/legal-and-privacy. Las firmas miembros de EY no ejercen la abogacía donde lo prohíban las leyes locales. Para obtener más información sobre nuestra organización, visite ey.com/en_gl.

© 2024 Ernst & Young, S.L.
All Rights Reserved.

ED None

Este material se ha preparado únicamente con fines informativos generales y no debe considerarse como asesoramiento contable, fiscal o profesional. Consulte a sus asesores para obtener consejos específicos.

ey.com/es_es