RECOVERY FUND:
THE ENGINE BEHIND
THE EUROPEAN
TRANSFORMATION

The unprecedented Recovery and Resilience Facility, the main instrument of the EU’s €800 billion recovery fund, represents a unique opportunity to overcome the recession triggered by the COVID-19 pandemic and complete the twin green and digital transitions of the European economies.

But the European Commission, international institutions, and experts agree that for this to work, member states must put forward well-designed investment proposals, ambitious reforms and solid governance systems.
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A mid doubts around the implementation of the €800 billion recovery fund, European Commission and experts stress that the EU instrument is not a US-like emergency stimulus but an investment tool for the medium-term to transform the European economy.

Last July, every EU leader agreed on describing the recovery fund as a “historic deal”, built on the unprecedented joint issuance of €800 billion of EU bonds.

But the slow process of finalising all the details of the fund, preparing national recovery plans and green-lighting the massive borrowing in national parliaments sparked concerns among investors and criticism in national capitals.

“We have lost too much time. China has resumed its growth, the US is booming, the EU must remain in the race,” French finance minister, Bruno Le Maire said recently.

By Friday (6 May), only half of EU governments have submitted their investment and reform proposals to access their part of the funds, although they were expected by 30 April. Meanwhile, seven member states must still ratify the Own Resources Decision to make it possible to borrow the €800 billion in the markets.

In addition, the European stimulus has been dwarfed by the never-ending impetus of the Biden Administration, who have already put forward the fifth spending package for the US economy.

In recent weeks, EU institutions and finance ministers have rushed to point out that the comparison with the US efforts is unfair because EU governments had already approved national measures and European welfare programmes are more robust than on the other side of the Atlantic.

“Critically, a focus on scale understates the size and transformational nature of the support being provided, particularly for the EU economy,” Eurogroup president Paschal Donohoe wrote in
the Financial Times in March.

The Commissioner for Economy, Paolo Gentiloni, emphasised that the recovery fund, in particular its main pillar, the Recovery and Resilience Facility, is not “emergency money”, given that the first response given by member states was very strong and other EU instruments were approved before, including the SURE scheme to support workers.

Gentiloni explained that “this common money is for quality growth, it should be connected to green and digital transitions and reforms”.

Maria Demertzis, deputy director of Bruegel think tank, agreed that the recovery fund is not a stimulus comparable to the checks sent to citizens and authorities by the Biden Administration.

She argued that the European fund “is a medium-term investment instrument, not a fiscal stabilisation tool, and it is important to remember that because people talk about it as if it was an ordinary stimulus”.

**OPPORTUNITIES**

The unprecedented Recovery and Resilience Facility offers primarily three opportunities in the short, medium and long term.

In the near future, it could provide resources to impulse Europe’s leadership in the green transition and help the bloc catch up in the digital race.

Ángel Talavera, head of European Economics at Oxford Economics, however, warned that “there is a lot of uncertainty about the economic impact of a recovery plan of this kind. It will take many years to see what results it will bring”, for example in the digital transformation.

In the medium term, the Facility could represent the ‘carrot’ to implement long-delayed reforms in member states, for example, to transform the labour market in Spain or the justice system in Italy. The European Semester, the EU mechanism to coordinate national economies, did not provide enough incentives in past years because it lacked teeth, experts said.

In a recent paper, the Centre for the European Policy Studies highlighted that the RRF “has the potential to steer the implementation of structural reforms”.

“The disbursement of the RRF funds is linked to the completion of targets and milestones set in the National Recovery and Resilience Plans, which are defined in line with the structural reforms identified by the country-specific recommendations (CSRs),” the paper said.

But Demertzis was sceptical about the implementation of major reforms with high political costs and recommended “not to expect too much” from governments. She said that “emphasis” would be given to reforms linked to the green and digital agendas, although some “first steps” would be taken in labour, pensions and other difficult areas.

“This would be already a good thing because it is important to remain realistic,” she added.

In the long run, the RRF, which will be operative until 2026, could turn into the permanent fiscal instrument the EU is missing to deal with economic shocks, as the European Central Bank already requested in September at least for the euro area.

This step would require a potentially tricky change of EU treaties, and member states allergic to new fiscal transfers, including Germany and the Netherlands, have insisted on the temporary nature of the recovery fund. This will be one of the political battles to come, but only once the pandemic is over and member states prove they are making good use of the recovery funds.
Pressure mounts on member states to ensure successful roll-out of recovery fund

By Jorge Valero | EURACTIV.com

As the EU recovery fund slowly nears its implementation phase, member states’ absorption capacity and control mechanisms are considered among of the main challenges for its successful roll-out.

Only six member states are still to give their blessing to the EU’s €800 billion recovery fund. National governments could receive the first funds by the end of July, once the European Commission approves their national recovery plans.

The EU stimulus programme represents a “unique opportunity” for Europeans to build back better after the COVID-19 pandemic, European Commission executive vice-president Valdis Dombrovskis, said recently. But its implementation is a “challenging task”, he added.

The first priority for the EU executive is to ensure the quality of the national recovery plans. To date, 18 national governments have submitted their investment and reform proposals. Most member states are expected to send their proposals by the end of May or early June, more than a month later than the initial end-of-April deadline.

Dombrovskis said that governments who already submitted their plans met the green and digital targets of the recovery facility and included a “good balance” of reforms and investments. The Commission now has two months to assess the national plans in detail, some of them more than 50,000 pages long. “We are under a lot of pressure to deliver swiftly”, admitted Economic Affairs Commissioner, Paolo Gentiloni.

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But the results of the six-year strategy to modernise Europe’s economies using EU cash will depend on the capacity of member states to handle the unprecedented amount of new funds coming from Brussels.

EU officials and diplomats agreed that the absorption of the recovery fund will be “challenging” in Italy and Spain, the two largest beneficiaries of the instrument.

To ensure a timely and efficient absorption of the funds, the European Central Bank recommended bolstering administrative capacity in member states and reducing bottlenecks.

“The quality and capacity of public administration are likely to be decisive factors in the successful use of Next Generation EU funds and could be a promising area for reform,” the ECB said in a note published in March.

**GOVERNANCE**

Another issue of concern is the governance of the mechanism. Member states will unlock the recovery funds twice per year, once the Commission and national officials validated the completion of agreed milestones.

Some have warned that the complexity of the process could hamper successful implementation of the fund.

Maria Demertzis, deputy director at Bruegel, said that there are still issues to be clarified, including how the governance and the conditionality will work in practice, the interaction between the Commission and the Council, and the role of the European Parliament.

Demertzis did not expect that approving funds would turn into a lengthy process such as the troika programmes. But “there will be discussions among member states, and there needs to be”, she added.

The European Court of Auditors issued a note of concern with the governance and recommended simplifying the procedures to the extent possible, to reduce the administrative burden and facilitate absorption.

The court also proposed last October reconsidering the frequency and timing of reporting and evaluation, and defining suitable indicators for the overall achievements of the fund.

**CONTROL**

The auditing and control mechanisms of the instrument, mostly left to national authorities, have been a major issue in the negotiations between the Commission and the capitals over the recovery plans.

As CEPS, a think-tank, explained in a study published in March, the cash-for-results “requires a strengthening of the ex post mechanisms for evaluation, control, and sanctions.”

The ECB also pointed out that “adequate national control and audit systems could also play a crucial role in ensuring an effective implementation of the recovery package”.

“Control systems could include precautionary measures to prevent corruption, fraud and conflicts of interest,” the Frankfurt-based institution added.

But according to the European Court of Auditors, the control mechanisms of the fund “need to be strengthened”, in particular against fraud and irregularities.

“We would like to stress the importance of effective measures against fraud and irregularities to counter the risks arising from significant additional resources to be spent in a short time,” the court explained.

For that reason, it proposed bolstering the European oversight by “clearly” defining the role of the European Parliament and the Court of Auditors in the instrument.

Having an adequate auditing and control framework is particularly important as the Commission has encouraged member states to crowd in private investment to multiply the impact of the fund.

Against this backdrop, experts said that providing legal certainty and guarantees to private investors would help to increase the impact of the European stimulus.

“An efficient process for checks, controls and an audit trail should be established” stressed Jorge Núñez, associate senior researcher at CEPS, “providing public and private operators with the necessary legal certainty while providing an efficient (one-stop shop) mechanism for the verification of investments and reforms”.

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National control mechanisms will be responsible for ensuring that the EU recovery funds are not affected by corruption or fraud, although the European Commission is also getting ready to use the new rule of law mechanism as soon as possible.

The first payments of the recovery funds are expected to reach member states in July. The long-awaited resources of the €672.5 billion Recovery and Resilience Facility will help to boost the European recovery.

As the funds start to finance member states’ investment and reform projects, a key element in the implementation of the recovery facility will be the auditing and control mechanisms in each member state.

Having sound mechanisms in place to protect the Union’s financial interests against any maladministration has been one of the elements prioritised by the Commission in the negotiations with national governments to finalise the recovery plans.

A Commission spokesperson told EURACTIV that the Recovery and Resilience Facility requires “a control framework that is tailored and proportionate to its unique nature.”

For that reason, member states’ national control systems “will serve as the main instrument for safeguarding the financial interests of the Union,” the spokesperson added.

National governments will have to ensure compliance with EU and national laws, including the effective prevention, detection and correction...
of conflict of interests, corruption and fraud.

The national governments had to provide sufficient assurances in their recovery plans about how they are going to protect the Union’s budget.

Against this backdrop, national auditing authorities and national courts will play an important role in monitoring that the funds end up financing the green and digital transitions and structural reforms across the bloc.

The 2020 EU Justice Scoreboard showed “a continued improvement in the effectiveness of justice systems in a large majority of Member States,” Justice Commissioner Didier Reynders said last August.

But he noted that “challenges remain to ensure the full trust of citizens in the legal systems of member states where guarantees of status and position of judges might be at risk and subsequently their independence”.

Hungary and Poland are in everybody’s mind, as both are under an Article 7 procedure for putting at risk the rule of law and the independence of the judges in their territory.

But other member states also have outstanding issues with their judiciary systems.

Spain and Italy, the largest beneficiaries of recovery funds, face long-standing challenges with their courts.

In the case of Madrid, three associations representing the majority of judges sent a letter to the Commission in April warning about the “clear risk” of violating the rule of law in Spain. The reason was the reform of the governing body of judges put forward by the government, and seen as a threat to their independence by the judges.

Italy has been blamed for years for having a notoriously slow judiciary system. For that reason, one of the main reforms included in its recovery plan was a series of measures to improve the Justice, by including temporary hires to deal with the immense backlog of cases and increasing the role of mediation schemes to resolve disputes outside the courts.

A similar problem affects Portugal, which currently holds the EU’s rotating presidency.

Despite improvements, “the efficiency of the justice system continues to face challenges,” said the Commission in its first Rule of Law report about the country in 2020.

The EU executive addressed this issue in the country-specific recommendations, calling on Lisbon to improve the efficiency in tax and administrative courts.

The Commission said some “considerable gains” were made after Portugal took some measures, including the creation of rapid reaction teams to deal with case backlogs, although proceedings remained comparatively lengthy.

Some of the cases affected by the backlog are those put forward by a group of international investors, following the resolution of Banco Espírito Santo in 2015, who challenged the losses imposed on the €2.2 billion of bonds they held.

EU PROTECTION

As part of the recovery fund deal and the EU’s new seven-year budget, the bloc up a new rule of law mechanism to ensure countries receiving EU funds, including the recovery funds, respect these values, including the independence of the judiciary system.

This new tool is under review by the European Court of Justice, after being challenged by Hungary and Poland.

But Vera Jourova, Commission vice-president in charge of values, said she may not wait for the ECJ ruling before taking action.

Asked if the Commission was planning to trigger the sanctions procedure before the court delivers its decision, she told Bloomberg that “we will have to if the ECJ ruling comes too late.”

The new European Public Prosecutor’s Office, which started work on 1 June, will add an additional layer of protection at the EU level, as an EU authority will for the first time have powers to investigate and prosecute crimes committed against the EU budget.
The European Union is set to become the continent’s largest supranational bond issuer within the next five years as a result of its SURE and NextGeneration programmes aimed at helping the bloc’s economies recover from the damage caused by the COVID-19 pandemic.

With a total value of up to 5.5% of EU GDP, the €800 billion NextGeneration and €100 billion SURE programmes are likely to shake up the bond market. Last year, European social, sustainable, and green bond issuance already hit their highest ever volumes, a trend which is set to be accelerated by the new bond issuance.

Between mid-2021 and 2026, the total ‘NextGenerationEU’ bond issuance will amount to €800 billion, including 30%, equivalent to around €250bn, as green bonds. In 2021 alone, up to €65bn will be brought to the market from July onwards, after the EU has finalised its European green bond standards.

Deutsche Bank’s Natacha Hilger has estimated that over the remainder of 2021, under the NGEU programme, the EU is likely to issue €10 billion in new bonds every two weeks, putting it in the same rank as Spain and France, the eurozone’s second and fourth-largest economies, respectively.

Analysts have also noted that the size of the EU bond issuance could impact on the bond programmes of EU treasuries and improve sovereign credit ratings.

That, says EU Budget Commissioner Johannes Hahn, will also help bolster the international position of the euro.

Hahn recently said that the widespread investor interest in the EU bonds was because investors “consider the euro and the European Union as a safe asset, as a safe haven”, adding that this will result in “a very strong economic but also political impact.”

Nordic banking group Nordea has argued that a genuine EU-level safe asset has been needed for a long time.

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time, with investors hitherto seeing German Bunds as the main safe asset in the bloc. Nordea has also argued that "a true safe asset would also help in improving the functioning of the European financial markets".

Last October, the European Commission issued a two-tranche €17 billion inaugural social bond under the SURE instrument to help protect jobs and keep people in work – a €10 billion bond and €7 billion bond, due for repayment in October 2030 and 2040 respectively.

The EU executive reported that the bonds, which form part of a programme worth up to €100 billion in social bonds, were more than 13 times oversubscribed.

Commentators have also pointed out that since the bonds are jointly issued, and will be financed either by member states or via new EU taxes, they represent a major step in EU integration and towards a genuine transfer union between rich and poor states.

However, despite the political and economic benefits of the programme, and the indications that there will be major interest from the market as a whole, there are several storm clouds on the horizon.

The questions of how exactly the EU borrowing programme will be financed remains unclear, although member states would have to make increased direct contributions to the EU budget in the event that new EU levies cannot be agreed upon.

Meanwhile, a group of eight investors known as 'Recover Portugal', which has an unresolved €2 billion case related to its investment in bonds of the former Portuguese bank Banco Espírito Santo (BES), say they will boycott the EU funds unless the Commission takes action to ensure that their case, and others similar to it, is resolved.
A group of international institutional investors coordinated by the Attestor Capital fund, on the hook for €2 billion in the Banco Espírito Santo case, want the European Commission to settle the case, warning that otherwise they will not fund the post-pandemic economic recovery.

“It is essential that the law is respected in member states and that there is no political influence. We want information about what is happening and to be compensated for what we have lost,” the investors said in a statement, demanding “guarantees of redress and equitable treatment before considering partial funding of the EU recovery fund.

According to a source from the group of eight investors – called ‘Recover Portugal’ – “for now, the legal action is focused on the BdP [Bank of Portugal], but, “if the matter is not resolved, they will undoubtedly be forced to take legal action against the European Commission”.

In a video posted online, this group of institutionalists who invested in bonds of the former Banco Espírito Santo (BES) claims to have “good and bad news” to give to Europe.

“The good news is that the EU will distribute €750 billion to member states, through the European Recovery Fund, to help them recover from the crisis generated by COVID-19,” they said.

“The bad news is that before distributing this money, the European Union has to borrow it, and that could be a problem because international investors are quite unhappy with the
EU and Portugal,” they pointed out.

The group warns that if the EU wants to get this €750 billion from international investors, “it first has to show them that it will treat them fairly and equitably, by first resolving the issue” of BES.

At a time when the Portuguese are “under the gaze of the world” for occupying the presidency of the Council of the European Union, ‘Recover Portugal’ calls into question both the country’s ability to manage the EU funds that are coming and the capacity of its legal system for “not working in cases like this”, which has been dragging on for six years.

At issue is the decision taken at the end of 2015 by the Bank of Portugal, faced with the capital needs of Novo Banco (the “good bank” that resulted from the BES resolution process), to retransfer responsibility for five lines of senior bonds of BES – which, at the time of the resolution measure in August 2014, had passed to Novo Banco – back to the “bad bank”, which kept the toxic assets.

However, the institutional investors holding these bonds accuse the BdP of discrimination by nationality, claiming that the five lines chosen by the regulator were “held by foreign investors, not Portuguese” and “the only ones managed by Portuguese law and not by international law”.

“We want to recover the more than €2 billion that was taken from us. The interests of investors must be protected, and we must ask the Portuguese government to solve the Novo Banco problem as soon as possible. This is what many investors are waiting for,” ‘Recover Portugal’ said.

Reiterating their “continued concern about the situation in Portugal” and the “eventual suitability and capacity [of the country] to manage such large funding” as that coming from the European Recovery Fund, the group of aggrieved investors believes that “the BES case has put Portugal at the centre of a controversy”.

“Being a candidate for grants worth more than 4% of its Gross Domestic Product, €45 billion in the coming years from the Next Generation EU fund, it nevertheless raises dire questions about the seriousness of the country’s judicial system,” they said.

They pointed out that the European Commission had “identified lengthy cases and long delays in Portugal’s administrative and tax courts and called on the country to implement its recommendations to increase the efficiency of administrative and tax courts, namely by reducing the length of proceedings.”

"It is good that they want to invest money in digitising the judicial system to speed up the resolution of cases and improve technology, but we need to solve the cases that have been blocked for political reasons. Unfortunately, this does not suit the European Union,” said ‘Recover Portugal’.

Stressing that it is “important for the European Commission and all members to put pressure on these unresolved cases”, the group considers it “unacceptable that investors have been expropriated, without any solution so far”.

"Recover Portugal demands respect for the rule of law in the member states”, it concluded.
In 2017, a coalition of institutional investors, including Pimco and Blackrock, boycotted an issuance of Portuguese bonds to protest the risks associated with actively investing in Portuguese public or private debt “as the Banco de Portugal still has not addressed the unlawful and discriminatory retransfer of notes from Novo Banco to Banco Espírito Santo in 2015.”

Today, this still unresolved case gives reason for grave concerns among some international institutional investors about the risks of lending the EU €750b to finance its Recovery and Resilience Fund (RRF).

After the collapse of Banco Espírito Santo (BES), Portugal’s second largest bank in 2015, Banco de Portugal retransferred 5 notes totaling €2.2b of debt from the newly established “healthy” Novo Banco’s books and dumped them back into toxic BES, knowingly targeting international institutional investors over domestic depositors.

The move came after the incoming Single Resolution Board (SRB) Chairman and the European Central Bank (ECB) warned Banco de Portugal that if it failed to substantially reduce Novo Banco’s liabilities by
January 2016, it would immediately be placed into liquidation. All other recapitalization proposals were rejected, and the decision was made to only dump notes held by foreign institutional investors.

This move in itself gives reason for grave concerns among some international institutional investors about the risks of lending the EU €750b to finance its Recovery and Resilience Fund (RRF). As the saying goes, fool me once – shame on you; fool me twice – shame on me. For the EU to reassure international institutional investors, Commissioner Mairead McGuinness, along with DG FISMA and the SRB, must demonstrate to institutional investors that the EU will protect them from sovereign risk, and will treat them fairly and equitably.

However, being held by foreign investors was not the only criteria Banco de Portugal employed when selecting these five specific notes. The second criteria was that only notes governed by Portuguese law may be dumped into toxic BES, while the remaining 47 notes, governed by English law, were not to be touched. This second criteria knowingly relied on the complicity of Portuguese Administrative Courts to reject or defer repaying creditors – and indeed, the Portuguese Administrative Courts have stalled and frustrated litigation ever since.

Following the Banco de Portugal’s Retransfer Decision dated 29 December 2015, several institutional investors, separately, filed administrative claims before the Portuguese Administrative Courts. Since filing, none of the cases has yet to be moved to the preliminary hearing stage, and all proceedings regarding BES’ resolution were stayed.

This second factor raises a second issue the EU is required to take up before approving Portugal’s RRF – Rule of Law. While Rule of Law concerns were initially focused primarily on Poland and Hungary, the scope of the European Parliament’s Committee on Civil Liberties, Justice and Home Affairs (LIBE) has been expanded to cover all Member States, particularly Malta, Slovakia, Slovenia and Bulgaria. In particular, a European Parliament Resolution adopted 10 June 2021 recalls that “the RRF and each of the national recovery and resilience plans should fully respect the Rule of Law Regulation.”

These are not the only rule of law scandals to rock Portugal during its Presidency. It kicked off with an extremely contentious nomination by Lisbon for the position of the European Public Prosecutor’s Office (EPPO), with the trial of former PM Jose Socrates’ shadowing the duration of its Presidency (very much linked to Ricardo Salgado, the former president of BES) and is ending with a real threat by investors to boycott the RRF.

The European Commission has pinpointed the slow pace of administrative and fiscal justice in Portugal, and has demanded reforms that the Portuguese Government needs to take, in order to be eligible for financial assistance from the EU Recovery Funds. This has been underlined by the European Parliament and the European Court of Auditors. In Portugal’s case, there are serious rule of law issues related to the independence of the judicial system and the operation of the national courts.

As Portugal’s Presidency of the Council of the EU draws to a close, there is an opportunity for Portugal and the EU to reassure international institutional investors by expediting resolution of this case, as well as insisting Portugal implement the judicial reforms it has committed to in its Recovery and Resilience plan.
The truth behind BES and Novo Banco!

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Recover Portugal

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If the EU wishes to borrow in the financial markets, it must first demonstrate to international institutional investors that it will treat them fairly and equitably.