

THE EUROPEAN RECOVERY FUND: A SOLUTION TO UNITE EUROPE

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BEYOND THE »COMPETITION UNION«?

The EU was caught unprepared by the disaster of the Covid-19 pandemic. Less because it was unexpected – everyone is in the same boat – than because the EU, and the Economic and Monetary Union (EMU) in particular, has never developed economic policy tools at Community and supranational level at a scale and in nature sufficient to cope with a systemic crisis. Quite the opposite, this has turned out to be one of the greatest sticking points of those defending the current framework: a area of free exchange reinforced by certain primarily regulatory supranational institutions within which sovereign(ist) states assert their economic policy prerogatives to the utmost and in mutual competition. The global changes that have emerged in the twenty-first century, and the threats linked to them, however, have made such a »competition union« fragile, unstable and unsustainable. The pandemic may further exacerbate these weaknesses.

Despite this, the inertia of the status quo has once again demonstrated its stubbornness. The emergency injection of 540 billion euros proposed by the European Commission and, for EMU countries, the suspension of public spending limitations and the strengthening of »unconventional« monetary tools set out by the ECB, are a welcome improvement on the errors of the 2009–2012 crisis. The scale of the EU budgetary response, however, has remained largely a matter of individual countries' spending capacity in deference to Bundesbank president Jens Weidman's conviction that »the priority is to give aid. But an extension of shared liability would modify the nature of monetary union« (interview with *la Repubblica – Affari & Finanza*, 20 April 2020).

FROM DISCORD TO A MORE AMBITIOUS APPROACH

It is clear that a more ambitious approach is needed, targeting two key objectives. The first – contingent – objective is to limit uncontrolled and uncoordinated growth in national

public debts as far as possible, and the second – prospective – goal is to deploy Community-level public finance instruments, without which it will be impossible to prevent the increasingly marked divergence between member states.

After some harsh, inconclusive and low profile disagreements this approach did find its way, however precariously, onto the agenda of the European Council meeting of 23 April. This endorsed both the EC emergency package, noted above, and a proposal presented by France (with the backing of Italy, Spain, Portugal, Ireland, Belgium and, in due course, others) to set up a European Recovery Fund (ERF), grafted onto a reinforced EC budget and comprising funds raised on the financial markets. The Commission was tasked with setting out a legal and operational framework for these measures, which may amount to as much as 1500 billion euros, and on which member states will be able to draw in order to shore up and relaunch their economies. It will be discussed again in May, although the fund is unlikely to be operational before 2021.

The political green light for the ERF dispels speculation concerning whether it will go ahead and shifts the focus to how. Many aspects remain to be worked out and there are still many hurdles to be cleared. Political constraints in many countries (including Italy) will frustrate any wild flights of fancy on the subject of European budgets and shared jurisdiction. Nevertheless, the ERF could herald, however feebly, a paradigm change. To bring this about it must be designed in such a way as to be able to neutralise potentially irreparable fractures between governments that favour the creation of a new Community instrument of this sort and those that oppose it. A recent proposal that two of us published under the auspices of the FES Italy¹ is along similar lines. It is also very similar to the non-paper presented by Spanish Prime Minister Sanchez. Its advantage over the Spanish government's proposal is that by keeping spending at the central level it would circumvent political objections to fiscal transfers. The idea is simple and, technical issues apart, resembles that of a cooperative fund.

1. Boitani, Andrea; Tamborini, Roberto; »Eurobonds and European Citizenship«; FES Italy, Briefing, April 2020, <http://library.fes.de/pdf-files/bueros/rom/16779.pdf>

A FISCALLY NEUTRAL COOPERATIVE SOLUTION

The first line of fracture concerns contributions to the fund, which should not raise the prospect of fiscal transfers between countries or endorse the distorted notion that it is an emergency operation of a humanitarian nature. The total sum of contributions, in financial equilibrium, is less in the case of a perpetual bond (consol) which guarantees creditors only *sine die* interest payments, and higher for bonds that require the capital to be repaid on expiry. There are pros and cons to both options, but the quantitative difference tends to diminish the longer the maturity (30 years or more) of the bond. More importantly, contributions can be fiscally neutral in form and may be framed as »citizens' contributions«, proportionate to each country's total adult citizenry. As an example, a 50 euros per adult contribution (equivalent to 19 billion euros across the EU, that is, 0.13 per cent of EU GDP in 2019) would ensure financial leverage worth 1500 billion euros (or more), as assumed by the Commission based on reasonable hypotheses about bond duration and interest rates. Individual governments would be free to collect the sums due as they prefer. A highly desirable alternative in terms of its symbolic implications would be to introduce a dedicated European tax. Fiscal neutrality could be achieved by capping individual countries' resort to the funds in accordance with their contributions. It might be asked whether such a proposal, which sidesteps potential lines of fracture rather than addressing them head on, may be just another compromise, perhaps more politically realistic, but one which does not resolve the contradictions at the heart of the European project. Perhaps that is true: a real change of direction is difficult to imagine while the diverse visions underlying the lines of fracture have not been reconciled. But a seed would in any case have been sown.

RISK REDUCTION AND SHARING

The second line of fracture concerns shared liability to creditors. Here, too, let us clear away some misunderstandings. The ERF designed in this way implies no direct exposure or liability to creditors on the part of individual states – that is, there is no country-specific risk. The fund's solvency is determined by total annual contributions. Thus member states' risk would consist of the probability of each of the others exiting the fund and the consequent need to cover the ensuing gaps, while creditors' risk would consist solely of the probability of sufficient countries exiting the fund to make covering their contributions impossible. The modest size of the contributions, the significant scale of the financial leverage and, perhaps, a large exit penalty, would make such eventualities remote. The risk would be further diminished by the issuing of perpetual bonds, as put forward by many economists of various orientations, so that joint liability would relate solely to the cost of the debt, not that of the stock. Contrary to what has appeared in the press, it would not be difficult to place such securities, perhaps with a small premium for duration, because they would be safe assets. Savers' appetite for safe assets today is such

as to allow the German state to resort to seigniorage (a tax on a par with the Bund's negative yield) in its dealings with its lenders (including the very Germans themselves who do not seem to appreciate this tax, as inferred from the complaints, even revolts, deceptively albeit wrongly directed against the ECB), who would presumably be happy to have an alternative higher yield option.

LOANS OR GRANTS?

The third line of fracture, which had already emerged prior to the European Council meeting, is the distribution of resources among the various member states: should it take the form of loans, with or without conditionalities, or grants with a license to spend? First of all, we must dispel certain persistent misunderstandings, such as the belief that, deep down, the only difference between grants and loans is that the former are necessarily non-repayable. But this is not the case: grants can fund agreed spending plans (existing example: the European Structural Funds' partnership agreements). The underlying difference between grants and loans (including on preferential terms) is that the latter are obviously new public debts for states deciding to access them, with the negotiating focus falling on the conditions to guarantee repayment. With grants for spending plans the focus is on the joint liability of the schemes themselves. With the spending plan mode, then, the ERF adopts the form of a cooperative goods or services supply body which, once again, members have the *right to receive*, not for charitable purposes but as, and to the extent that, they have paid their share (as occurs, in fact, in European Structural Funds). We believe that the latter is the best method, for two reasons: (i) because it accords with the objective of not driving national debts higher and (ii) because joint liability for spending dissipates the doubts of the Northern ants regarding the Southern grasshoppers and, at the same time, sidesteps the politically toxic subject of loan repayment conditions. It is, moreover, a way of demonstrating to the sovereignists that Europe is in everyone's interests and not simply a quarrelsome crew of small navel-gazing nations (whether north or south does not really matter).

In a January 2012 interview with the *Süddeutsche Zeitung*, Chancellor Angela Merkel declared that »in the course of a long process, the EU member states would transfer more competencies to the European Commission, which will then work like a European government. This requires a strong Parliament.« The Covid-19 pandemic now requires that this be accomplished sooner rather than later.

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