EconPol Europe

The European Recovery Fund: An Effective Policy Measure to Deal with Covid-19 Consequences?

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Challenges for the euro area and actions taken so far

Challenges for the member states

Stabilising the economy:

- **Phase 1**: Help to survive the shutdown (employees, self-employed, companies...)
- **Phase 2**: Support for the economy after the end of the shutdown

Consequence: **massive expansion of public debt**

- **Limited scope for monetary policy action** (Short term financial aid, bond purchases, but not interest rates cuts)

- **High level of public debt before the crisis**, due to the current low interest rates there is less pressure on national budgets (some evidence that they will remain low)

Eurogroup decisions 9 April 2020 (€540 billion package)

- All countries have access to the **ESM**, credit line 2% of GDP (approx. €240bn)
- **EIB**: €25 billion funds, to provide €200bn in financing for SMEs
- **SURE:** Up to €100bn loans to member states
- Announcement '**European Recovery Fund'** and realignment of the MFF/the EU Budget to changed needs as a result of the Corona crisis.

Corona bonds

- **Idea**: European Institution (which one?) issues bonds, euro-area countries are **jointly and severally liable** (or they provide proportionate, limited guarantees without joint liability)

- Money is distributed to the Member States (according to which distribution key?)

- **Advantages**: Creation of a liquid asset, relief of highly indebted states from interest costs

- **Disadvantages**: Countries are **liable, but may have no control** over the **use of funds**; Institution for issuing coronabonds would have to be newly created

- EU-summit of 23th of april 2020: Corona bonds definitively rejected, instead a **European Recovery Fund** to be anchored in the EU budget (i.e. no instrument against the acute crisis)

SURE

- European instrument for temporary **S**upport to mitigate **U**nemployment **R**isks in an **E**mergency (SURE)

- **Idea**: EU takes on debt and lends the money to member states to finance short-time work during the crisis

- **Volume**: up to €100bn

- **Financial security**: Guarantees by the Member States, each Member States contributes at the level of the GNI (standard financing key in the EU budget)

- **Function**: Member States which have to meet a massive increase in expenditure through short-time working can apply for loans from the Fund

Art 122 (2) TFEU

“Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, **Union financial assistance to the Member State** concerned. The President of the Council shall inform the European Parliament of the decision taken.”

European Recovery Fund

- **Idea**: EU takes on debt and gives money to member states as transfer or loan or uses it for European programmes (to be clarified)
- **Volume**: claim: one-off up to €1500bn (10,8% of EU GDP)
- Council President Charles Michel on 23 April 2020: “This fund shall be of a **sufficient magnitude**, targeted towards the **sectors and geographical parts of Europe most affected**, and be dedicated to dealing with this unprecedented crisis.”
- **Financial backing**: Guarantees by the Member States, each member state contributes according to its GNI (standard financing key in the EU budget)
- **European Commission** is to develop the concept (Legal basis: Art 122 TFEU)

European Recovery Fund: What can it achieve and how is it financed?

What can the Fund achieve and how is it financed?

What can it achieve?

- **Insurance**: If the EU countries suffer different economic losses as a result of the crisis and this is not yet visible today, the fund could have the character of an insurance policy

- **Internalisation of spillovers in the fight against the epidemic?**The fund is probably too late for that

- **Solidarity/cohesion objective:** redistribution to poorer EU members or those hit most by the crisis

- Financing **New EU-Policies**? Crucial: **Added value** of European versus national provision

How is it financed?

- **One-off** guarentees from Member States according to the GNI scale. A repayment schedule, the next crisis is sure to come!

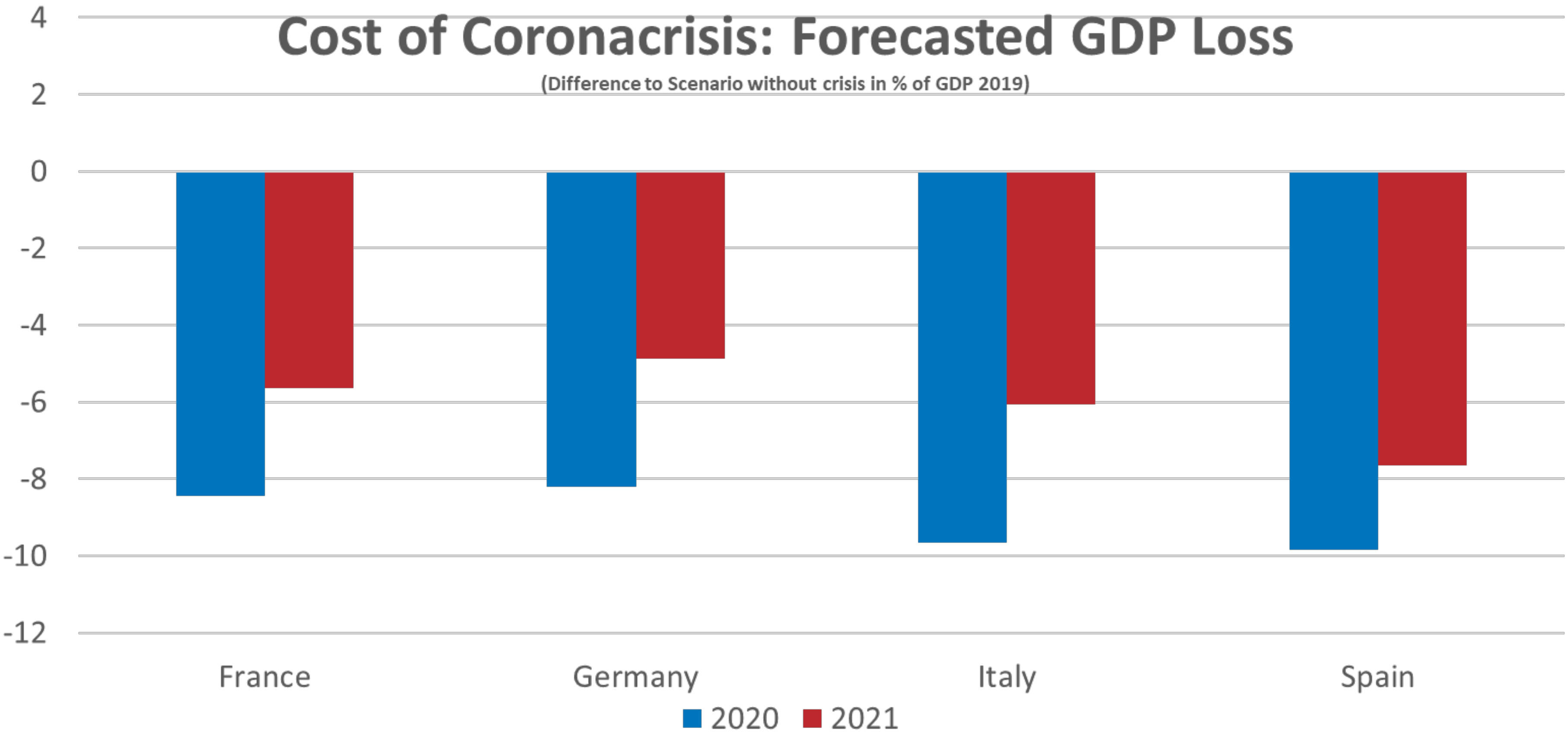
Example calculation for European Recovery Fund (ERF)

Calculations: Fuest (2020)

- **Financing:** Member states guarentee the debt according to the GNI scale and also finance the debt service, volume: 1500 billion euros.

Three Types of Expenditures

- **Insurance**: EU member states receive transfers depending on the economic losses due to the corona crisis (GDP decline in 2020)
- **Cohesion objective:** Redistribution in favour of the poorer EU member states (measured by GDP per capita)
- **New EU policies:** A share goes to new EU policies



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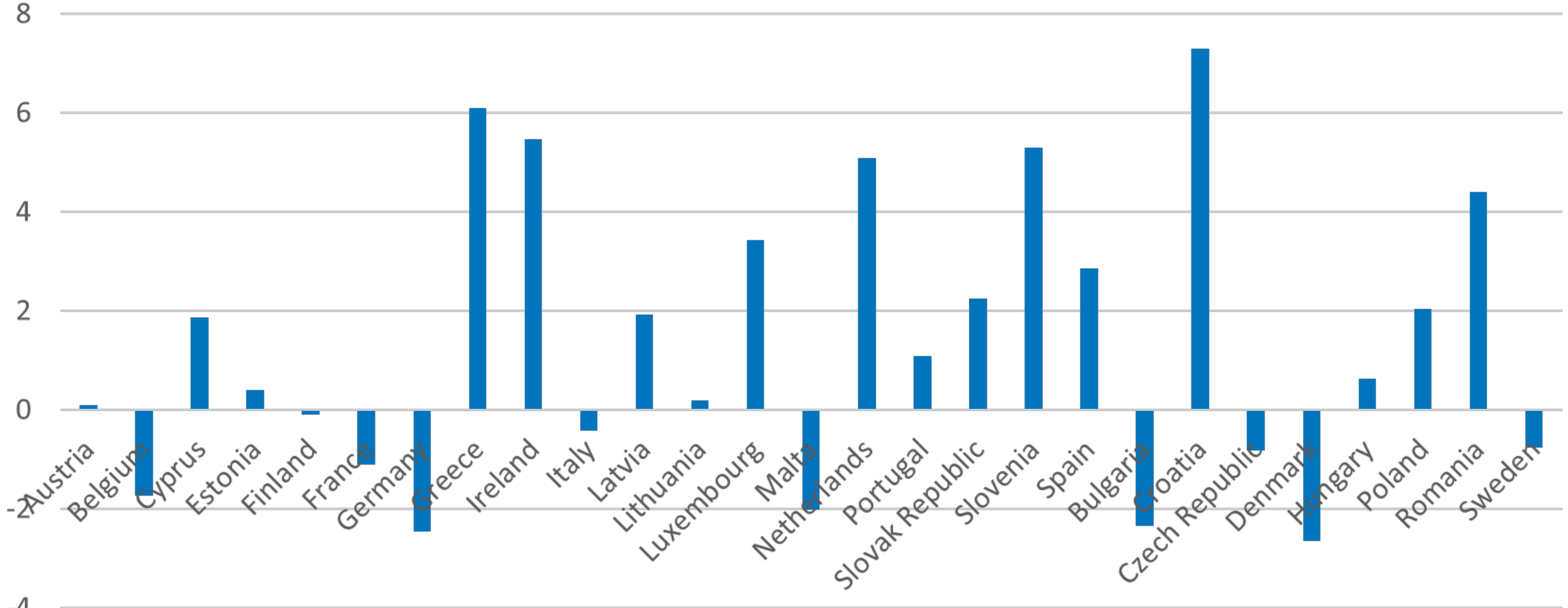
Net Balance ERF
(Pure insurance, % of GDP)



Source: Fuest (2020)

What new EU policies would the fund finance?

- **Crucial: Added value of European** versus **national** provision; insurance achieves that, solidarity as well (but needs to be explained)

- **European public goods**: defence, migration policy, development aid, climate protection, cyber security…

….problem: they all need **permanent funding**

Cohesion policy: is already in the EU budget

- **European Infrastructure? Useful** (see below)

- **European Industrial Policy?**

Conclusions

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- Corona crisis possibly more serious than financial crisis, high forecast uncertainty
- Eurozone has little room for manoeuvre in monetary policy and high national debt, but low interest rates, higher national debt therefore more sustainable
- Assistance in the area of public debt (run problem) covered by ESM/OMT programme
- European Recovery Fund: Can finance insurance function (allocations depending on GDP losses in the crisis), cohesion or other (one-off) expenditures - but until the money comes the acute crisis is probably over
- Italy's debt sustainability problem is not affected by this
- Crucial: Ensuring that added value is created by policy at European level:

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