A European Recovery or Trickery Fund?

Brussels, 8 May 2020

Luis Garicano, Valérie Hayer and Guy Verhofstadt[1]

Members of the European Parliament

The recovery and reconstruction of the European economy after the COVID-19 pandemic will be a huge, challenging task for the European Union, a task that will require hard decisions and difficult choices. To avoid disappointment and to escape a new lost decade (as happened after the 2008 financial crisis), it will be crucial not to fall into the trap of easy and misleading solutions and recipes, such as to think that with a small amount of new public money it will be possible, though "leverage" and "frontloading", to mobilize a 2 trillion-euro plan to exit the crisis. To reconstruct the European economy, it will be necessary to raise between 7 and 10% of GDP in real money, an amount between 1 and 1.5 trillion euros. Only such an effort would be truly able to reactivate the European economy. We believe it is possible to do this without asking for any new contributions from Member States.

Deception: the Commission's 2 trillion-euro magic trick

Let's pull the curtain and look at the Commission's plan in detail. Headlines say the Commission's plan is a 2 trillion-euro plan. But internal documents reveal it's more about 320bn — 2% of the EU's GDP, that is, to cope with a 7 to 10% drop. Pressured by EU leaders to find a solution they have not been able to hammer out themselves, the Commission is shifting money around and dressing old spending as new. Besides, around half of the money will come in the form of loans to debt-choked countries who are the hardest-hit by the virus. The Commission's magic act doesn't deserve applause. Let's look at its main tricks.

First trick: the optical illusion, or how to shift old money around and pass it as new

Money that would have been spent anyway will now be dressed as "recovery money". We've been here before. This is the essence of Juncker's European Fund for Strategic investment (EFSI). Unlock 315bn euros with a 16bn EU budget guarantee for the EIB to fill the investment gap in Europe. Laudable. But here is what the European Court of Auditors had to say about it: *"the reported estimate of investment mobilised does not take account of the fact that some EFSI operations replaced other EIB operations and EU financial instruments or the fact that <u>a part of the EFSI support went to projects that could have been financed from other sources, albeit on different terms</u>"*. In other words, the Juncker plan was a massive repackaging of existing or about-to-happen investments. It's politically canny but economically irrelevant.

This time, it must be different. And yet, the Commission applies the same logic. For instance, here is how the Commission is coming up with its RecoverEU program. It takes the figure it proposed for InvestEU (heir of EFSI) in its 2018 MFF proposal (15bn). It then adds 15 fresh billions to it. With the same multiplier effect it uses with the Juncker plan (and InvestEU), it will turn 30bn into 1,300bn. What they won't tell you is that this includes the tranche of InvestEU it was already destined to the Just Transition Mechanism (2bn), along with all the projected

[1] This paper is written in a personal capacity, and not in the name of Renew Europe.

investments under the Sustainable Investment Plan (~280bn). The multiplier effect is not wrong, the EU budget does have a leverage effect. But InvestEU will face the same question the Juncker plan has: would investment have happened anyway? And are we simply trying to paint existing investments in blue and yellow money — now corona money?

In its resolution of April 17 the European Parliament called for a “massive recovery plan”, not a “massive repackaging plan”.

Second trick: the spoon bending, or how to twist the EU budget to make it look bigger

The Commission essentially intends to twist the EU budget by putting most of the money planned for the 7-years into the first half period — or “frontloading”, in EU parlance. Based on Charles’ Michel MFF figures, the Commission proposes to spend a massive part of the ~1,100bn in the first two or three years of the next MFF.

Details are scant in the Commission’s leaked documents, but this could entail as much as spending half of the money in the first two years of the 7-year budget. We do not yet know the extent of the frontloading, but the intention is clear: claim we will spend more now, when overall we are spending just the same. You may bend the spoon to impress the crowd, the spoon remains a spoon. A very small one. A teaspoon.

And once bent, you might no longer use it properly. If most of the budget's money is spent in the first years, the budget will be lowered for the period 2023-2027, leading to a drop in strategic investments after the tentative recovery. This may lead the EU to finance farmers’ and EU staff’s income and some infrastructures and not much else after 2023.

The Commission’s plan will accelerate the trend towards smaller and smaller budgets in the future. First, without any new EU-wide revenues, the 100-160bn in spending coming from the Commission’s recovery fund will have to be reimbursed in the future with money that would have gone to the EU’s programs. Second, in its grand Recovery program, the Commission proposes that our long-term budget require smaller national contributions than its original 2018 proposal, and even below Charles Michel’s proposal. When negotiating the next budget, MEPs will have to start from an even smaller existing EU budget. Once unbent your spoon will never come back to its initial shape.

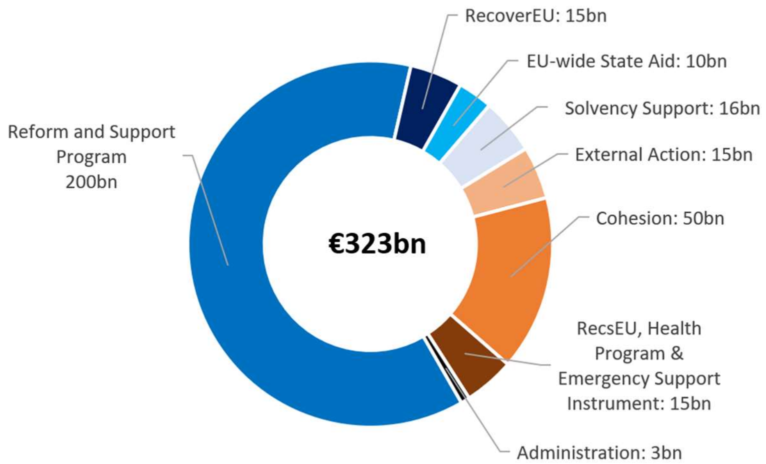
Third trick: the coin behind the ear, or how to make loans out of loans to avoid providing hard money.

Not providing hard cash is the trick Europeans do best. Take the recent Eurogroup €540bn package deal. All of this money will be used to generate new loans. Loans for companies who were forced to close (EIB). Loans for states who are broke (ESM). Loans for workers who’ve been laid off (SURE). Liquidity problem solved. Good.

But what about the looming solvency problem? What to do when people will not be able to repay their debts? How will states invest when their tax base is being consumed by the mountains of debt? The Commission’s answer seems to be: more loans. Of the 325bn billion, between 100bn and 160bn will be used to make further loans to Member States.

Looking into the hat: what does the rabbit look like?

Here is a breakdown of how the Commission intends to spend its European Trickery Fund:



Over half of the money (in both spending and lending) will go to the Reform Support program, a new EU program to incentivise reforms and investments according to guidelines issued by the Commission and adopted by Council. Here the European Parliament has no decisive role in setting up the guidelines. The European recovery will be dreamed by bureaucrats and approved by diplomats, no surprise it won't bring investments in our future. Elected representatives keep out. The Commission's magic trick should not please democrats.

Recovery and transformation: a real fund with real money

If our objective is to rebuild our economies after its biggest shock in decades and arm Europe for today's and tomorrow's challenges then we cannot merely tinker on the edges. Size matters. If the European economy takes a plunge of 10% of GDP the response cannot be a 2% "Initiative". Our response must be between 7%-10%, that is, between 1 and 1.5 trillion euros in real money. The programs also matter. Money cannot go to the programs of technocrats and diplomats; it has to go to the programs that will be ensure a socially inclusive and dynamic future. As elected representatives of the European people, four lines of action come to mind.

Clean bill for health. In an interconnected and pandemics-prone world we will need more hospital beds, more equipment as well as doctors and researchers working around the clock to find solutions to help us prepare for the worst. Europe could offer the world a vaccine for the next pandemics.

Digital, digital, digital. Most European spent the last weeks asking their colleagues on the screen: "can you hear me now?". Covid has forced us into the 21st century. We realize that we are not equipped. Investment is badly needed in communication infrastructures, in Artificial Intelligence, in supercomputers. Together, Europe should develop its own 5G technology and offer the world the next 6G.

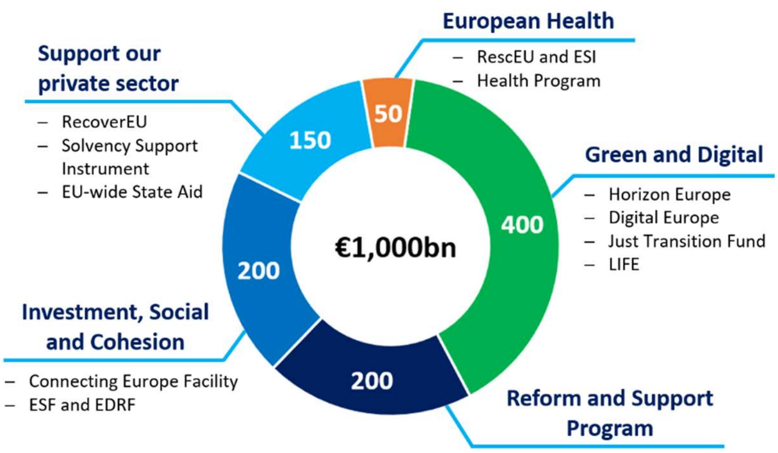
Making the planet great again. This was the promise of the Paris Agreement. We now must put our money where our mouth is. We already have the blueprint. It's called the European Green Deal. It will require massive investments in renovating our buildings, building clean cars, new batteries, and new mobility infrastructure (such as bullet trains and hyperloop connections). Green also means jobs. For everyone. Unless the recovery money is used to save the industries of the past.

European sovereignty. The outbreak has exposed how dependent we are on the global supply chains. Chinese and Indian products are part of our daily lives. It's all well and good. But for vital (literally vital) sectors such as health equipment or the production of medicines, Europe must take back control. Direct European strategic ownership — such as through equity and venture capital — must be the new normal in sectors and companies that we think are essential for our autonomy.

Strings attached. To get access to recovery money, the projects and countries will have to pass three tests:

- **The rule of law test**: that means, for instance, no money for autocrats and their cronies and no money to tech companies who do not care about privacy;
- **The climate test:** that means no money for projects that are not in line with the Paris Agreement and countries who do not commit to the climate neutrality objective;
- **The tax fairness test:** that means no money for companies and beneficiaries that have any link with tax havens or states who encourage dodgy tax practices.

What a true Recovery and Transformation Fund looks like



How to finance it with no tricks and no additional money from Member States?

The EU witnesses acrimonious talks over who should pay what and how much in all budgetary cycles. A group of countries think they pay too much already. Their complaints will only grow in the post-Brexit future; but the same countries happen to be opposed to new EU-wide taxes as they believe that the power to tax should be vested in national parliaments but not with the European parliament. We offer them a grand bargain. They can keep their contributions as they are today (we take Charles Michel's figures from February's last EU budget summit) but they give up their ideological reluctance to new, modern EU-wide streams of revenues, already designed by the Commission. Ideology is hard to give up on but it's free. Dropping it can also earn you big, especially if the new stream of revenues is used to service EU consols.

Then how? With European Consols or long-term debt: Consols are not new. They are short for "consolidated annuities". They are used in dramatic times. The Brits first used them to finance their war efforts in the Napoleonic wars. Then again in the First World War. If we take the pandemic to be a serious matter affecting us all and which should be dealt with at the continental level, European Consols, or alternatively bonds with a long maturity, must be part of the solution.

How do they work? Consols are bonds whose principal is never repaid. Instead, bond holders receive annuities or interest payments. Theoretically, they are equity, not debt. We suggest to issue consols and repay the interest with the batch of new EU taxes.

With the approval of long-proposed EU-wide taxes such as the ETS (12bn annually), Plastic-based contribution (9bn), Digital Tax (10bn), CCCTB (12bn), and a Financial Transactions Tax (4bn), there would be more than enough to sustain the issuance of 1.0 trillion in consols at a 2.5% interest rate. To emphasize, these are all resources that have long been proposed and studied, with even more revenues being available from the implementation of the popular Carbon Border Adjustment Mechanism.

This is 1 trillion of hard money, not some fanciful multiplier — if we spend it across our proposed priorities and apply the Commission's trickery, we would leverage them into 4.5 trillion of investments over the next three years.

We offer them an alternative issuance with a long-term maturity: 30 year bonds with gradual principal repayment. But freedom comes at a cost. The principal of the bonds has to be repaid. For this reason, the real consols could be issued with a smaller amount of new revenues — we could, for instance, leave out the CCCTB that gives some European countries the chill.

In both cases — 30 year or perpetual — we send the political message that the EU is here to stay. The guarantee that the EU consols' interests will be paid rests on the continued existence of the Union. Investors are ready to invest on Europe's future. So should we.

Different issuances	30 Year Bond	Perpetual Consol
Interest rate	**1.0%**	**2.5%**
Yearly payments	39 €	25 €
As % of GNI	*0.29%*	*0.19%*

How would it fit within the new long-term budget?

The EU budget has limits. Plenty. It has annual ceilings on how much revenue it can raise, on how much it can spend, and of course on how long both of these limits should last. A genuine Recovery and Transformation Fund would not tear the EU budget down through frontloading. We have to build on top of the existing foundations, and ensure these foundations are changed according to the crisis.

Ceiling on revenues. Legally, there is so much the EU can raise. The current "own resources ceiling" is at 1.20% of the sum of all the Member States' gross national incomes. And the space between the budget’s spending ceiling and that of its own resources is called the “headroom”. When the first substantial program of European borrowing was created in 2010 (the EFSM) it was decided that the “headroom” of our budget be entirely consumed by the total loans being borrowed. The logic went: to ensure the repayment of all the loans guaranteed by the EU, the entirety of the loans must fit in the yearly budget headroom, and not just the ones that have be paid in any given year. The yearly headroom does not cover just the exposure to risk for one year, but for the entire duration of the loan.

We propose to stop this is financial madness. No country puts aside money for loans that have to be paid in decades. The only money that the budget of a particular year should guarantee is the one that has to be paid in that year. The rest is simply assumed by the Union, just like France assumes French debt or Austria assumes Austrian debt.

So. How do the EU consols and their massive fire power fit in? Only the interest and any gradual principal repayments must be guaranteed within the headroom of the budget. Only between 0.19% (perpetual consols) and 0.29% (long-term bonds) of GNI.

Ceilings on spending. There are legal limits to how much the EU can spend. But these limits can be circumvented through “assigned revenues” — outside money separated from normal EU budget revenues — which are allocated to specific spending items. This is an exception enshrined in the EU financial regulation. And this is not new, the EU used that when it had to set up a “facility” for refugees in Turkey. The proceeds of EU consols or the bonds would be considered “assigned revenues” and come on top of the annual ceilings. This would further avoid the frontloading of the EU budget and preserve a budget for the post-recovery years.

A 5-year foundation. The duration of the long-term budget has to be reduced to 5 years. Not only because everyone (including the Commission) already knows this is more democratic, but because the crisis requires it. The longer the budget, the larger the incentives to frontload it and to have a bent spoon by the end of it. The Recovery and Transformation Fund will be a temporary instrument, and its corresponding budget must be as temporary as the treaties allow.

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Appendix: The numbers.

Expenses	Interest rate	Yearly payments (bn)	Payments as % GNI
30 year bonds	1.0%	39	0.29%
Perpetual Consol	2.5%	25	0.19%

Revenues	Call rate	Potential annual revenue (bn)	Revenue as % GNI
EU ETS	based on EUCO proposal	12	0.09%
Plastic-based contribution	1€ per kilo	9	0.07%
Digital tax	100% (at a 5% tax rate)	10	0.07%
CCCTB	3%	12	0.09%
Financial Transactions Tax	Enhanced Coop	4	0.03%

Combinations	Surplus / Deficit to 30 year bond	Surplus / Deficit to perpetual Consol
ETS + Plastic + Digital	**-0.06%**	**0.04%**
ETS + Plastic + Digital + FTT	**-0.03%**	**0.07%**
ETS + Plastic + Digital + CCCTB	**0.03%**	**0.13%**

- **Issuance size:** Although we propose that the size of the fund be between 1 and 1.5 trillion euros, all our calculations are done with 1 trillion for simplicity. We believe a 1.5 trillion issuance would also be sustained with existing new EU budget revenues.
- **GNI:** all our calculations assume a GNI of 13.4tr, which assumes the departure of the UK along with a 7.1% drop in GDP (following the IMF's estimates for the EU)
- **EU ETS:** we follow Charles Michel's proposal: *"any revenue generated by the European Union Emissions Trading System exceeding the average annual revenue per Member State generated by allowances auctioned over the period 2016-18."* This is about 8bn, which we net out to the WFF estimates for Phase IV of the program.
- **Plastic-based contributions:** we follow the European Court of Auditor's revenue estimates, assuming an increase of €0.2 price per kilo (The maximum allowed for in the Commission's proposal).
- **Digital tax:** we follow the Commission's estimates for a 5% top-down revenue tax in their proposal's impact assessment (no correction for Brexit).
- **CCCTB:** we follow the European Court of Auditor's revenue estimates on the Commission's previous proposal for CCCTB
- **Financial Transactions Tax:** we follow the German government's estimate for a tax implemented through the enhanced cooperation of 10 countries.