Toward a European Reconstruction Fund

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The EU could finance the continent's trillion-euro economic reconstruction without asking for any money from national governments.

Context. This crisis is different. The coronavirus is no one's doing. It shouldn't be anyone's undoing. It is everybody's problem. Still, Europeans are stuck in old discussions between creditors, debtors, ants and grasshoppers. Both sides dig their heels in over the idea of mutualised debts and common bonds.

Let's put a few things straight. European debt exists — we have about €800bn of it. It takes the form of bonds issued by the Commission, the EIB and the ESM. What is peculiar about this debt, however, is that it is only used to make more debt. Governments are responsible for their own spending, the thinking goes, and therefore the EU must only help by lowering its interest rate. To have the European economy bounce back after the virus, we must put an end to that logic and have European borrowing for European spending. Here is how.

The proposal. The Commission has the power to borrow from the markets. It should use it to issue consolidated annuities (or "EU Consols") to finance a trillion-euro European economic reconstruction. The interests on these Consols would be paid up with the EU's own budget, and without using up any country's contributions.

The grand bargain. The EU long-term budget is mainly financed by Member States' direct contributions. Every seven years acrimonious talks are held to decide who pays how much and for what. Discussions are open at the moment. A set of Member States say they are paying too much. We offer them to keep the level of spending as it is for the next seven years. But in exchange we ask them to drop their reluctance to allow the creation of new, modern EU-wide streams of revenues, already designed by the Commission, that could bring in up to €26bn a year. These new resources (and not the direct contributions of national governments) would be used to pay the annuities of EU Consols. Assuming a conservative estimate that the annuities would have to pay a 2.5% interest rate, the EU could borrow over a trillion euros. **(See the figures in Annex I).**

Who would it benefit? All EU Member States. This is not a Euro area-only matter.

What are these new streams of revenue? The EU would raise the money so that big polluters and tax evaders finance the reconstruction. The digital tax is an obvious candidate. The OECD discussions on the matter should be concluded by 2021, so the structure of the tax would be clear. We would incorporate the proceeds of the ETS system, and set a contribution based on non-recycled plastic as proposed by the Commission. These new streams of revenue could bring in about €26bn a year.

[1] First draft 2 April 2020.
[2] This paper is written in a personal capacity, and not in the name of Renew Europe.

Would we be mutualising our debts? No. The EU Consol would operate purely at the EU level. It would not concern the debt or fiscal spending of any Member States. It would be a European annuity paying for a European plan, in favor of all European citizens' interests.

What would Member States have to pay? Nothing. The EU Consol would be issued just before the new MFF. The next 7-year budget is due to enter into force in 9-months time. In the next months, Member States could simply take up the new types of own resources proposed by the Commission alongside this new MFF. The Commission could speed up the work on an EU-wide digital tax. Only these new revenues would be assigned to pay EU Consols annuities. Again, national contributions to the EU budget would be frozen at current levels. No new money from national governments needed.

What to spend it on? Reconstruction of the European economy after the virus — the biggest economic shock since WW2. The fund would focus on European priorities such as:

- Supporting the most affected by the economic consequences of the crisis;
- Ensuring the competitiveness and growth of our industries and SMEs;
- A European infrastructure initiative to modernize our transport and technological infrastructure, relieving Member States' budgets;
- Decarbonizing the economy and ensuring no one is left behind in the transition;
- Investing in research and innovation to meet the digital needs that the virus has shed light on.

When would it be ready? The annuity issuance would happen right before the MFF begins in 2021. We have 9 months to act. It is doable. The European Financial Stabilisation Facility took seven months to be set up, between its creation and the issuance of its first bond.

How would it work? The Commission would set up and operate a European Reconstruction Fund. During the first part of the MFF, the spending of the fund would be aligned with the EU budget's priorities. The fund could potentially co-finance EU programmes in lieu of national authorities. In the second half of the MFF, the fund could be turned into a European Recovery Agency inside the EU budget on a permanent basis. **(See a legal analysis in Annex II).**

What would be the maturity? The initial issuance would be tied to the duration of the MFF. However, to maximize the amount of money raised, and take advantage of the low interest environment, a refinancing at the end of the period, or the issuance of a perpetual annuity, could be considered.

Who would buy the bonds? With the support of the ECB, the AAA rating of the Commission, and the high interest payments we assume, the annuities would surely attract market interest. It would constitute a safe investment in the future of the EU as a whole, which is exactly the signal we must send right now. With the EU Consols, we're betting on the future of the Union.

What democratic accountability? The fund would be operated by the Commission and accountable to the European Parliament. The Managing Director of the fund would be appointed by MEPs.

Annex I: The money we could raise — different scenarios.

Own Resource	Call rate	Potential annual revenue (bn)
EU ETS	based on EUCO	12
Plastic-based contribution	1€ per kilo	9
Digital tax	100%	5
CCCTB	3%	12
Total		**38**
Total Green Own Resources		21
Total Fiscal Own Resources		17
Total mix - CCCTB		**26**

Annuity structure		
Assumption for interest	**Interest rate**	**Total potential annuities (bn)**
EFSM funding rate	0.9%	2,965
1% estimate	1.0%	2,594
Conservative estimate	**2.6%**	**1,000**

- **ETS:**
  - European Court of Auditors (ECA) estimates €15bn in total ETS revenue, but that figure is the same as the 2018 revenues.
  - We can expect that the price of allowances will go up in Phase IV of the System, and consequently have taken the €20bn WFF estimates.
  - From here, the amount from total ETS revenues that correspond to the EU budget are estimated based on President 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."*
- **Plastic:**
  - ECA estimates €7bn a year from a €0.8 per kilo call rate. We apply the maximum call rate allowed for in the proposal regulation (€1.0 per kilo) to increase revenues by 25%.
- **Digital:**
  - Estimate taken directly from Commission 2017 Digital tax proposal, assuming a 100% call rate.
- **CCCTB:**
  - ECA estimates €12bn a year from a 3% call rate applied to the Commission's CCCTB proposal.

Annex II: The ways to set it up – within the legal framework.

1. Economic fundamentals of existing European debt:

European debt already exists. All of it is used to originate further loans but they are issued based on different economic fundamentals.

Issued by leveraging a capital base:

- The EIB and the ESM (albeit not a part of the EU) issue debt by leveraging a capital base that Member States contribute to.
- These institutions then leverage this capital and issue bonds.
- Without the need for Member States to directly guarantee the issued bonds, they secure an AAA rating due to the substantial amount of capital these institutions have, able to absorb any losses before the market creditors.

Issued leveraging guarantees and without a capital base:

- Without any capital, the EU budget guarantees all the loans the Commission issues, giving it an AAA rating.
- This is the debt issued under the following programs:
    - European Financial Stabilization Mechanism (EFSM).
    - Balance of Payments Facility and other smaller programs.
- If the total balance of the outstanding loans exceeds the margin available under the MFF Own Resources ceiling, the EU Budget is not enough to serve as collateral. For loans beyond this ceiling, Member States must provide guarantees directly:
    - This is the case with the Commission's proposed Support to mitigate Unemployment Risks in an Emergency (SURE).

2. The trillion-euro question: inside or outside the Union?

- It is imperative to act fast. Past experience proves intergovernmental agreements are not a speedy option.
    - This was the case of the European Financial Stability Facility (EFSF), set-up while the ESM was being negotiated.
- Economically, both SURE and the EFSF function in the same way: Member States directly provide guarantees on the Commission's loans.
- Their fundamental difference is institutional: While SURE is an EU instrument, the EFSF is a Special Purpose Vehicle (SPV) outside of the Union framework, with significant negative consequences:
    - For accounting purposes, lending and borrowing operations have to be consolidated into the national accounts. This entails that:
        - Financial assistance and loans granted by the SPV are included in the affected countries' national debt.
        - Guarantees put forth by all Member States are taken into account when drafting national accounts; as a result they correspondingly incur in an increase in their gross debt.
    - Legal certainty would be at risk:
        - The national law of the Member State in which the Fund is located would apply. Possibility of unilaterally changing it.
        - Possibility of withdrawal of shareholders under normal private-law conditions.
- The Reconstruction Fund should hence be established inside the EU framework (akin to SURE). Legal certainty would be preserved, and neither the Fund's spending nor Member State guarantees would be considered national debt for accounting purposes.

3. Potential EU legal basis

If the goal is to secure the necessary financing for a swift recovery of the Union's economy from the impact of COVID-19, two are its potential legal basis:

- **Article 122(1) TFEU:**
  - Allowing Member States to take, "in a spirit of solidarity", the "measures appropriate to the economic situation".
    - This would justify providing grants and not loans (unlike EFSM and SURE).
    - As long as the economic situation that motivated its creation lasts; a "temporality" safeguard that could be politically attractive.
- **Article 352 TFEU,** the flexibility clause:
  - Could serve to establish it on a permanent basis.
  - Broad compared to Art. 122 (1) TFEU.
  - Does not refer to an exceptional "economic situation" that would justify taking urgent extraordinary measures.
  - Subject to unanimity and cumbersome national procedures (i.e in Germany, where approval by both *Bundestag* and *Bundesrat* is required).

Following a two-stage implementation approach, **these two legal basis could be sequenced**:

1. During the first part of the MFF, a temporary Reconstruction Fund would be established based on Art. 122(1) TFEU.
2. In the second half of the MFF, the Fund would be turned into a European Reconstruction Agency based on Art. 352 TFEU.

4. Compatibility with no-bailout clause (Art. 125 TFEU).

- No moral hazard, no blame and therefore no conditionality is needed.
- The Article's own wording envisages an exception: "the joint execution of a specific project" i.e. the recovery from Covid-19.
- Budgetary discipline (as interpreted in *Pringle*) is maintained since:
  - Does not entail mutualization of existing debt.
  - It is proportional as it does not go beyond what is necessary to recover from the negative economic effects of the outbreak.
  - Spending is managed by the Commission (guardian of the Treaties) in accordance with EU priorities.

5. Compatibility with obligation of balanced EU budget (Art. 310 TFEU).

- Article 311 TFEU nuances the prior: "the Union shall provide itself with the means necessary to attain its objectives".
  - The Fund would help the Union attain its objective of guaranteeing financial stability.
    - Need for the EU Budget to step in given that Member States cannot provide additional national contributions.
- Interest payments by the Fund are financed by the EU Budget.
  - Revenues provided by new own resources (ETS, Plastic-based contribution, Digital tax, and CCCTB), allowing for maximum certainty and reliability, enabling the Commission to raise funds at minimal cost.
  - Interest payments qualify as normal expenditure and proceeds from annuity sales as normal revenue under EU Budget rules.
- Annuity's principal benefits from joint and *pro rata* guarantees by all Member States, beyond the MFF ceiling.
  - National parliaments to give consent, in full respect of Member State budgetary competence.