

The EU's €750bn covid-19 plan is historic—but not quite Hamiltonian

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LIKE ALMOST everything else at this week's European Council, which concluded at 5.30am on July 21st after five days of deliberation, the question of whether it was the longest EU summit in history was hotly contested. Some said it beat the record-holder, a mammoth discussion over institutional arrangements in Nice in 2000. Others thought it fell half an hour short. Either way, the summit, which signed off on a multi-year spending package worth €1.8trn (\$2.1trn), will be one for the history books.

The deal struck by the EU's 27 national leaders has two elements: the regular EU budget, or multiannual financial framework (MFF), worth nearly €1.1trn over seven years; and a €750bn "Next Generation EU" (NGEU) fund to help countries recover from the covid-19 recession. Rows over the second of these explain the summit's length. A debate over whether to replace the word "decisively" with "exhaustively" in the communiqué took up several hours. But in the end each leader was able to return home bearing a bauble.

France and Germany laid the groundwork for the deal with their own agreement in May, and the final compromise was not too distant from their proposal. Hard-hit southern governments secured recovery funds worth several percentage points of GDP. The small countries of the self-styled "frugal" bloc—the Netherlands, Austria, Sweden and Denmark—won hard-fought concessions. Poland and Hungary managed to water

down efforts to attach rule-of-law conditions to budget payments. Most leaders emerged into the Brussels dawn claiming to have agreed on something historic, and to judge by the soaring euro, investors concurred.

The deal broke two historic taboos, says Silvia Merler, head of research at Algebris Policy Forum, the advisory branch of an asset-management firm. First, Europe's leaders agreed that the European Commission can incur debt at an unprecedented scale. Starting some time in 2021, the NGEU will be funded by borrowing over six years, with bonds at a range of maturities extending to 2058. Second, a total of €390bn will be distributed as grants, and hence will not increase recipient governments' debt burden. This is a lifeline for the likes of Italy, where government debt is already on course to reach 150% of GDP by the end of 2020. It breaches a former red line over substantial intra-EU fiscal transfers. Both developments would have been unimaginable just six months ago.

The EU has now marshalled a fiscal response to the covid crisis equal to or better than America's. The programme is equivalent to 4.7% of its GDP, a macroeconomically significant amount that comes on top of large stimulus spending by national governments. It has plugged the budgetary hole left by the departure of Britain, a net contributor before Brexit. It has answered the European Central Bank's repeated pleas to balance its monetary activism with a comparable fiscal effort. The EU may also have set a precedent for handling future crises, although any additional future collective borrowing will be stubbornly resisted by the frugals (as well as parts of Germany).

The recovery funds will be distributed to governments using an allocation key based on criteria such as unemployment and income per person. Governments will submit spending and investment plans to the commission, which will evaluate them on the basis of its annual "country-specific recommendations". These are reform checklists which Ursula von der Leyen, the commission's president, promises will pack "more punch". Governments' spending plans are also supposed to align with the commission's priorities on climate and digitisation.

But the commission will not have the final say over whether to approve disbursements of funds. Rather like Germany during the euro crisis, the frugals do not trust Brussels' technocrats to police the reform efforts of southern states. Instead Mark Rutte, the Dutch prime minister, secured an "emergency brake": any government can object to another's spending plans, delaying and complicating disbursements. That allows him to tell Dutch voters that they have not signed a blank cheque for feckless southerners. But Lucas Guttenberg of the Jacques Delors Institute fears the brake could entrench mistrust inside the EU if beneficiary governments believe others are objecting in bad faith.

The deal falls some way short of the "Hamiltonian moment" some had hoped for it. Unlike America's treasury secretary in 1790, no one has proposed mutualising EU countries' legacy debts; not even the new common debt will enjoy joint-and-several guarantees. And the question of how the EU will pay back the sums borrowed has been

left largely unanswered. Attempts to increase the EU's "own resources" (its revenues, in EU jargon) have traditionally been blocked by national parliaments, which jealously guard their powers of taxation. Yet from 2028 money must be found to repay the debt the EU will soon incur: if not from own resources, then from larger national contributions. Next year the commission will propose EU-wide taxes on digital firms and climate-unfriendly imports.

There are two areas of concern. The first is the price demanded by the frugals. To preserve the recovery fund's grants, cuts fell on so-called "future-oriented" areas like research, health-care and climate adjustment. These, critics grumble, are precisely the priorities the frugals claim should take precedence over agricultural and regional subsidies, which remain intact.

Moreover, the frugals won big increases to the rebates they get on their contributions to the EU budget. (Austria's doubled.) These small-country triumphs cost money, and will have to be fought over again when the next MFF comes around. Emmanuel Macron, France's president, has long wanted to eliminate the rebate system.

A second set of concerns centred on how to prevent handouts to countries that undermine the rule of law. The EU has long struggled to bring wayward governments like Hungary's and Poland's into line. Both are large net recipients from the MFF, and some hoped to pressure them by attaching rule-of-law conditions to disbursements. In the end the language agreed on is studiously ambiguous. It promises "a regime of conditionality to protect the budget" but is vague on how to obtain it. "Lots of people will want this to be made more precise," says Katarina Barley, a German social-democratic MEP.

Ms Barley and her colleagues in the European Parliament, which must sign off on the deal, will soon have their say. Many criticised the deal's cuts to favoured programmes and its lack of a provision for parliamentary oversight of the spending. Yet although the parliament may complain about the deal, on past form it is unlikely to squash it. A budget must be in place from the start of next year. The parliament will not want to spark a crisis by blocking it.

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