EU leaders have failed to resolve deep divisions over whether their proposed “recovery fund” will provide sufficient help to embattled member states as they debate the size of the proposed instrument and the amount of cash it will distribute.

Leaders agreed on Thursday night to task the European Commission with creating a “recovery fund” to fuel their economies once the lockdowns ease, but capitals including Paris warned that a programme that simply handed out additional loans, piling debts upon hard-hit member states, would fail to alleviate the deep challenges ahead.

Asked after the meeting about the size of the fund, Ursula von der Leyen, commission president, said “we are not talking about billion, we are talking about trillion”, but she declined to give specifics on the numbers involved.

Lucas Guttenberg of the Jacques Delors Centre said there was a temptation for the EU to come up with huge headline figures for the fund, but this needed to be backed with significant transfers of cash to the worst affected countries, not just guarantees for private investment projects and loans that added to their debts.

“The question is do we want to create an instrument that gives Italy and Spain
significantly more fiscal space?” he said. “That requires a lot more real money on the table.”

Guy Verhofstadt, a former Belgian prime minister who is now an MEP, said piling more loans on embattled countries risked causing a “new sovereign debt crisis”. “Grants are like water in a fire fight while loans are the fuel,” he said.

The leaders joined their fourth videoconference summit of this crisis with the aim of signing off a €540bn package of emergency measures and opening the door to an overhaul of draft plans for the EU’s upcoming multiannual financial framework (MFF).

The commission will now accelerate its work on rewriting the MFF, with proposals due early next month. Ms von der Leyen said there were huge differences between member states’ abilities to boost their economies and industries, given their varying fiscal situations, and said the EU would need to use the MFF to “counterbalance” that.

Agreeing a reconfiguration of the MFF that includes the recovery fund will be difficult given the significant political differences among member states. There were particularly acute divisions during the summit over the form any aid emerging from the fund should take.

France, Italy and Spain led demands for grants to stricken economies.

During the summit, French president Emmanuel Macron warned against coming up with a “fake MFF solution” or “window dressing” financial aid. Italy’s prime minister Giuseppe Conte, who is under pressure domestically to gain immediate aid from Brussels, called for grants by the “second half of the year”.

However, Ms Merkel insisted that any funding borrowed on the markets must ultimately be paid back. There were “limits” on what kind of aid could be offered, she told leaders, adding that grants “do not belong in the category of what I can agree”.

A four-page draft of the commission’s plans, seen by the Financial Times, does not provide figures for the overall size of the fund but says the recovery fund will allow Brussels to “trigger billions of additional investments”. The document also lays out plans to boost existing pots of money in the EU budget, including a €200bn reform support programme where “loans and grants would be made conditional on the implementation of reforms and investment measures to bolster potential growth”.

“The unpredictability and the fallout of the health crisis furthermore calls for an even more flexible and agile budget, which is only possible through the mobilisation of special instruments,” says the document.
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Ms von der Leyen confirmed that the commission wanted to amass firepower for the recovery fund by boosting the so-called headroom in the budget, which will allow the commission to raise extra funds by borrowing on the capital markets.

In a press conference after the summit, she said this would entail lifting the so-called own resources ceiling to 2 per cent of gross national income, a move that would provide extra scope for the commission to borrow while supporting its top-notch credit rating. The draft suggests the EU is aiming to raise just over €300bn on capital markets to seed the recovery fund, but figures are still under discussion in the commission and will depend on the final shape of the MFF agreed by member states.

The key question is how that money is deployed. Past commission schemes — including the so-called Juncker Plan after the sovereign debt crisis, and more recently the Green Deal Investment Plan unveiled early this year — have involved the EU providing guarantees to support investment initiatives. These type of instruments are supported by the Netherlands and the Nordic countries, which see investment loans as the best way to boost member states’ competitiveness and growth.

However, some economists worry that the EU ends up supporting projects that would have gone ahead anyway, or struggles to find viable schemes in the most economically disadvantaged economies. “We are at a moment where companies are not going to invest because there is a lot of uncertainty,” said Grégory Claeys, a research fellow at Bruegel, the think-tank. What economies needed was direct public spending, he added.

Ms von der Leyen, who has until mid-May to come up with a proposal, said Brussels would find a “sound balance” between grants and loans and make use of “innovative financial instruments”.

Additional reporting by Victor Mallet, Jim Brunsden and Guy Chazan