

The merits of Spain's proposed recovery fund are irrefutable

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Priest Andres Conde is helped by his twin sister Inma to prepare to distribute food donations for families in Ronda, southern Spain, last week © Jon Nazca/Reuters

The phrase “moment of truth” is used more often than is warranted. But it applies with full force to the EU leaders’ summit on Thursday. What they agree — if anything — will definitively tell Europe’s citizens, as well as global markets, whether any crisis is big enough to forge a common European economic policy. A lack of agreement would amount to deciding against one. Once countries diverge towards different fortunes as the pandemic abates, it will be too late.

The dividing lines are well known, pitting high-debt southern countries on the side of large shared financial firepower against lower-debt northern ones resisting any further mutualisation of the public purse.

At the last minute, a new proposal from the Spanish government offers a way out of the old, interminable stand-off.

Spain proposes a European recovery fund of massive scale, at up to €1.5tn, funded through the same mechanism as the EU budget. It would finance grants — not loans — to member states commensurate with the damage inflicted by the pandemic. It would be

front-loaded, to start spending next January 1 and be expended over two to three years. To make this possible, it would be financed by the EU issuing perpetual (non-maturing) bonds.

This plan is, on the merits, the best of the many ideas that have surfaced. Above all, it takes seriously the scale of the challenge. It involves real resources, unlike the EU's usual financial conjuring tricks of leveraging private finance. At some 10 per cent of the EU's collective annual national income, its size is similar to the likely hit to the bloc's growth, and the likely worsening of public sector deficits. Anything less than this scale would be an inadequate fiscal response to the Covid-19 recession.

It also takes seriously what is at stake: a European mutualisation of spending, rather than old quarrels over whether to mutualise debt. By boldly calling for outright transfers and not rescue loans or cheaper credit, the Spanish proposal eliminates any trust-eroding suggestions of bad faith. Even the Dutch government, which has been adamantly opposed to common borrowing, has proposed outright transfers to the places worst hit by Covid-19 (albeit at a hundredfold or so smaller scale).

Spain's proposed design, too, should tick a lot of political boxes in the north. Because the recovery fund is linked to the EU budget, any country's liability for the money should roughly follow the current burden-sharing for budgetary contributions. These contributions are, of course, fought over tooth and nail. But the point is that they are well-defined and limited. Each country will only be on the hook for its share of the recovery fund — including any borrowing needed to front-load it — not the commitments of others (several but not joint liability). It is, above all, not a question of taking over the debts of other countries.

The use of perpetual bonds, too, serves to limit EU governments' liability. The principal need never be paid back, so only interest would have to be paid — and the rate could be locked in from the start. While not part of the Spanish proposal, there is no reason not to give each member state the right to redeem its share of the debt whenever it wants to put up the cash to "de-mutualise".

These factors may seem technical, but have the important function of addressing the concerns of sceptics such as the German constitutional lawyers who require well-defined limits on the European liabilities entered into by Berlin.

If there is going to be a common European fiscal response to the economic fallout from this pandemic, this is the form it should take. In that sense, the Spanish proposal is irrefutable: it strips down the debate to the essential question of whether there should be a common European fiscal response at all. That is the question technical discussions and worries about mission-creep and "undefined liabilities" for the mistakes of others can no longer be used to obfuscate.

There are strong arguments for a common response. There is a moral and political case for solidarity: what is a union for if not to help at the time of greatest need? Then there is a point underlined by both France and Spain: the extraordinary fiscal measures taken at national level undoes the single market's level playing field if not all member states can do the same.

The only real argument against it is the simplest one: some people just want each government to remain solely responsible for its own citizens' needs. But then they must be honest about the path they are advocating. Keeping the crisis response largely national will condemn Europe to greater economic divergence, perhaps permanently. If that happens, it will have been by choice, not accident.