The Road to Post-Pandemic Recovery

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Thus far, three recovery programs have been proposed in response to the economic crisis caused by the coronavirus pandemic. The first recovery program was presented by France and Germany who want the European Commission to issue bonds worth 500 billion euros to distribute as grants to member states. The Franco-German manifesto also includes protectionist proposals that would hurt the EU's economy, particularly the proposed changes to EU state aid rules.

A second program was proposed by the European Commission, who want a similar fund of 750 billion euros, out of which 250 billion would be given out as loans and 500 billion as grants. The Commission proposes this money could be paid back over a period of 30 years, starting after 2027. The Commission's fund has skewed redistributive effects that are not warranted by the pandemic alone. Some of the fund will also go to areas, such as agricultural support, which might not have a significant effect on recovery.

The third program was proposed by the "frugal four" **-** Sweden, Denmark, the Netherlands and Austria **-** who do not want any debt mutualisation or grants, and instead want a potential recovery fund to consist only of loans. The exact size of this recovery fund is not mentioned.

Introduction

The COVID-19 pandemic has crippled the global economy, and the European Union has been hit especially hard – particularly the Southern member states whose economies are dependent on tourism. Member states have created national recovery funds to support businesses and workers affected by the economic crisis. Because of this, the creation of a recovery fund at the European level has been suggested. In total, three recovery funds have been proposed: one by France and Germany, one by the European Commission and one by the frugal four: Sweden, Denmark, the Netherlands and Austria.

The debate about a coronavirus recovery fund has highlighted the ongoing divide over how the EU could spend its money. Unlike previous crises where Germany allied with the more frugal Northern countries, the Germans have now sided with France and most of the Eastern and Southern European countries – leaving the frugal four standing alone. Without the backing of Germany or the U.K., there is a greater risk that the four countries will not be able to withstand the pressure of French president Emmanuel Macron, who wants to increase the EU's fiscal integration and "strategic autonomy". Unlike the frugal four, who want the recovery fund to consist of only loans, both the Franco-German and European Commission proposals want all of or the majority of the money in the recovery fund to consist of grants. The European Council is scheduled to discuss this further on June 19th (Council of the European Union, 2020) (Government of the Netherlands, 2020).

Where will the money go, and who will pay for it?

It is understandable why the frugal four are against some of the proposals in the Commission's plan. They are all net payers to the fund and will on average contribute 3.7 percent of their current GDP. To compare, the Swedish contribution of 17 billion euros is more than twice as much than what they spent on defence in 2019 (Swedish Ministry of Finance, 2019).

Moreover, some of the money will go to areas that will not significantly contribute to a swift recovery. For example, agricultural support and cohesion are slated to receive 65 billion euros. Furthermore, only 70 billion out of the 750 billion euros will support innovations and strengthen the single market through programs such as Horizon Europe and InvestEU. The majority of the fund (560 billion euros) will go to what the Commission calls the "Recovery and Resilience Facility". This will be connected to the European Semester "and must contain measures that significantly contribute to addressing the green and the digital transitions to a large extent". During negotiations, it is important for the frugal four to put pressure on the Commission so that money in the fund doesn't go to areas that haven't been severely hit by the crisis or measures which won't contribute to recovery in a significant way (European Commission, 2020a), (European Commission, 2020c).

The countries that would receive the most money from the Commission's recovery fund (as percentage of GDP) are the ones that have not been most affected by the virus. For example, Bulgaria would receive 19.3 percent of its GDP from the fund compared to Italy's 3.2 percent, even though Bulgaria had one twenty-seventh the number of deaths from covid-19 per 1 million inhabitants compared to Italy. Moreover, Italy's economy is more dependent on sectors that were badly hit – such as tourism – than Bulgaria. This suggests that the recovery fund has skewed redistributive effects that are not warranted by the pandemic alone (Knoema, 2018), (European Commission, 2020b), (Worldmeter, 2020).

Finally, because of hurdles in designing, approving and implementing EU programmes, around three-quarters of the recovery fund payments won't be available until 2023. Thus, in the next two years when the need for stimulus is the greatest, few resources will be available. The policy challenge of frontloading pay-outs so that they are early enough to support recovery, regardless of the exact design of the recovery fund, remains unsolved (Darvas, 2020).

Fiscal union

One new aspect of both the Franco-German manifesto and the Commission's proposal is that countries like Sweden and Denmark, which are not part of the eurozone, will share the risk of the loans. Because the European Commission – which includes all EU countries –will be indebted, it seems that non-eurozone countries like Sweden and Denmark are expected to participate (Steitz, 2020). Mario Centeno, the president of the Eurogroup, said this would be a great step towards a fiscal union.

One clear indication that we are moving towards a fiscal union is that both the Franco-German and the Commission proposals want the EU to be able to collect its own taxes as a way of financing the loans. This could have a significant impact on the dynamic between the EU and its member states. If the EU gets taxing powers, the Commission would no longer have to answer to the member states if it would like to increase its own resources, making it less accountable. It is worth noting that the overall error in expenditure in the EU budget is still above the EU's acceptable level of 2 percent, despite several years of criticism from the European Court of Auditors (European Court of Auditors, 2019).

If loans or grants are given with conditions of structural reforms, it is possible to avoid some of the above problems. The Commission and member states could also seize the opportunity to aid economic recovery by reforming and strengthening the single market. The Commission, Franco-German, and frugal four proposals all suggest some level of agreement on this. There is still a lot of regulation that obstructs intra-EU trade, especially in the service sector. If the trade barriers in the service sector alone were largely removed, the European Parliament Research Service suggests that the EU's GDP could increase by 2.4 percent. A full completion of the single market in all sectors could, according to the same study, result in a GDP increase of 7 percent (European Parliament, 2017). In an economic crisis as severe as this one, this could be the potential step to reach full recovery.

Changes in state aid rules

According to the Franco-German manifesto, "State-aid rules should be reviewed in light of more ambitious climate policy and carbon leakage" (Cabinet of Germany, 2020). In other words, France and Germany are not proposing a temporary change to save strategic companies during the crisis, but a permanent change of state aid rules. This would take the EU in a more protectionist direction.

A change in the state aid rules would set the EU on a more state-interventionist path, something that France and Germany have both shown interest in. The Commission has previously denied the merger of French Alstom and German Siemens, both active in the train and railway markets, on the basis that this merger would lead to lack of competition on the single market (European Commission, 2019). However, France and Germany claimed that it was necessary in order to create so-called European champions that could compete with Chinese state-owned enterprises.

This ignores why the EU has state aid rules and competition laws to begin with: they lead to a more competitive market and more productive companies that make our societies richer and consumers better off. Implementing measures such as relaxing merger control is no guarantee that European industry will become more competitive, and carries significant risk if it leads to more anti-competitive transactions. This is because there is a risk that governments, who also have non-economic interests, will support ineffective companies (Valero, 2019).

During the last 10 years, the European Commission have issued fines of 14 billion euros to countries who have broken state aid rules. If these rules were altered so there were no repercussions on state aid infringement, competition on the single market would worsen. Decreased competition on the single market could in turn decrease the EU's GDP by 2.1 percent (Veld, 2019).

Moreover, the purpose of the Franco-German proposal – to create European champions – can be achieved without altering the state aid rules. A European champion doesn't have to be a single company that dominates its market. It could just as easily be several companies who complement each other to reach a common goal. One such example occurred when Swedish companies Volvo, Telia and Ericsson combined their expertise to increase industry efficiency and sustainability through 5G testing (European Political Strategy Centre, 2019).

Conclusion

In conclusion, both the Franco-German manifesto and the Commission's plans include aspects that won't have a significant effect on recovery, or could worsen it. The proposed changes to state aid rules could worsen the functioning and effectiveness of the internal market. The Commission's fund has skewed redistributive effects and part of the fund will be allocated to areas like agricultural support, which won't have a significant effect on the economic recovery. Giving the Commission the power to raise taxes comes with the risk of “power grabs” in other areas.

It is important that the recovery packages shouldn't go to areas which won't contribute to recovery, and the money couldn't be given out without demands for possible reforms. One such reform will be the completion if the single market which could increase the EU's GDP by 7 percent. A step towards this would be to abolish all regulations of professions that only exist in one country.

Another potential reform is a push for further digitization of the EU member states’ economies and avoiding major pitfalls in the quest for “technological sovereignty” (Bauer & Erixon, 2020). In order to remain a competitive knowledge economy, the EU cannot close its borders to e.g. foreign cloud-computing companies and favour large, politically well-connected domestic ones. Europe’s recovery and future economic success depends, just as much now as it ever has, on remaining open and competitive rather than closed and interventionist.

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