INSTITUT ROUSSEAU

The European recovery plan: when the facade of a 'slowly but surely' approach results in a missed opportunity

22 July 2020, Gaël Giraud and Nicolas Dufrêne

In an editorial published on 12 April 2020, the Institut Rousseau warned of the illusions and delusions surrounding the idea – which was on everyone's lips at the time – of 'coronabonds' and a European funding mechanism. We wrote: "the main benefit of eurobonds ... would be to add a budgetary funding capacity exceeding that of all [EU] Member States taken individually. This means assuming that the whole is more than the sum of its parts, and that more investments would be allowed in Europe, in particular in southern Europe, because the countries in that region do not have the same level of budgetary reserves as their northern European counterparts." Is this assumption that the whole is more than the sum of its parts borne out in the European recovery plan recently concluded on 21 July 2020? Not at all, and that is not its only deficiency.

I. Size matters

French President Emmanuel Macron himself admitted that the same day in his televised address to the nation. While France should receive €40 billion in subsidies under this plan, Macron said that this sum would cover 40% of the expenditure of the country's proposed €100 billion recovery plan over two years. In other words, the European recovery plan (€390 billion in subsidies and €310 billion in potential loans over three years) does not complement the French recovery plan but replaces part of it. So this is all about replacing the national plan, not adding to it. This is all the more unfortunate because the main point of receiving subsidies from a shared European funding mechanism is precisely not to increase the national public debt.

This 'additionality' issue also conceals the problem of volume. When it comes to recovery, size matters. It would take at least €40-50 billion a year just to implement a fully-fledged ecological reconstruction policy at national level. We are not even close to that level, as the amount involved here is €40 billion over three years. The same applies at European level: €390 billion of subsidies – i.e. €130 billion per year over three years – is not even 0.7% of European GDP. That's not much for a 'recovery' plan, especially given that, according to European Commission calculations, at least €260 billion more per year, in other words €2,600 billion over 10 years, would have to be invested to ensure a successful ecological transition. If we add to this pre-pandemic status the dramatic drop in public and private investment caused by the COVID-19 lockdown, which, according to estimates by the Commission itself, will amount to at least €850 billion for 2020 and 2021 alone, we can see how far away we are from what was – and still is – necessary. This is why the European Parliament as well as EU Commissioner Thierry Breton had called for a recovery plan totalling at least €2,000 billion.

But the scale of the support is not the only key factor – the borrowing rate and the speed of repayment will also play a vital role here. In this case we must invest as quickly as possible, borrowing at the lowest rates and we must make the repayment terms as long as possible. After all, €390 billion in subsidies being rolled out over three years is not very fast. As for the loans, we do not even know whether they will actually be used, given that the idea behind a shared debt is to allow the most fragile EU Member States to reduce their individual debts, which are exposed to interest-rate risk, and to rely on collective indebtedness. However, in reality the European Central Bank (ECB) is already helping to ward off the risk of a rise in interest rates on the sovereign debts of eurozone countries with its pandemic emergency purchase programme (PEPP), which has removed the previous restriction under which buying more than one third of a country's debt was not allowed. This makes it unclear whether in light of strong ECB action on rates, resorting to shared debt will technically be useful to obtain lower rates. Against this backdrop, the supposedly historic European recovery plan runs the risk of being no more than a symbolic operation. One thing it has done, though, is remove the taboo of shared debt.

II. Problematic timetable and resources

However, the most questionable aspect is the staggering of repayments. The devil is always in the detail. This is demonstrated again by a short sentence on the fourth page of the European Council's conclusions that has escaped the notice of almost all commentators. It reads: "The amounts due by the Union in a given year for the repayment of the principal shall not exceed 7.5% of the maximum amount of the sums borrowed for expenditures." This sentence answers a question raised when looking at the French-German recovery plan and the Commission's version, which provided for the staggered repayment of the shared debt between 2028 and 2057. Why have such latitude in the repayment dates? A public bond, that is to say a debt security issued by a national government or by an international organisation, is repaid at maturity and only interest is paid as time goes on (and again, not always). In other words, when the French State issues, for example, a 30-year Treasury bond worth €100 million (it was borrowing at a rate of 0.58% in July 2020), this means that it will pay a coupon of only 0.58% of the bond's value until it fully repays the bond's value (€100 million) in July 2050 (30 years later). The longer the term, the longer the repayment deadline.

If we assume positive growth of 1, 2 or 3% per year in this 30-year period, the value of the principal to be repaid (viewed from the perspective of today) will be reduced by a fraction of between a quarter and two thirds. Therefore, it is quite appealing to borrow over the longest possible period, especially in times of low and even negative rates – and the €750 billion from the recovery plan is no exception. Admittedly, 2% average annual growth over the next 30 years is a bold assumption because for many reasons the European economy has little chance of achieving it: the deflationary trap where budgetary austerity (e.g. in France) suppresses it, the growing scarcity of some critical natural resources (including copper and oil), environmental damage's worsening impact on the planet's infrastructure, and the fragility of a financial sector that is still on the verge of implosion, to name but a few. Given the very strong correlation between GDP growth and increased CO_2 emissions, it would certainly be preferable from an environmental perspective if Europe were not to experience such growth rates until it has completed its shift to a low-carbon economy. However, most of these considerations are excluded from the Commission's calculations and were not mentioned at all at the recent European Union negotiations: all EU Member States continue to expect annual growth rates of close to 2%. President Macron himself has repeatedly emphasised that he is planning to promote a "humanist ecology", which, in his eyes, means promoting GDP growth.

However, under a rule laid down in the recovery plan, the EU will be prevented from repaying more than €29.25 billion per year (7.5% of €390 billion). This makes it impossible for the EU to repay €390 billion in one go over the next 30 years. The agreement requires repayment not at maturity but during the borrowing period, including over some periods that will have to be very short to meet the limit of €29.25 billion per year. As a result, a lot of the loans will be short-term, meaning that the first potential repayment deadline would be in 2028.

This rationale flies in the face of common sense, which would dictate that low rates should be used to issue the maximum possible debt immediately and repay this after the longest possible period. Otherwise, this will force the Commission to quickly seek the repayment of resources. This would reduce the time available to develop our own resources, for example in the form of an environmental tax on plastic or a carbon tax on cross-border trade, or a tax on Google, Apple, Facebook, Amazon and Microsoft (GAFAM) or on financial transactions. At this point, let's take another look at our editorial from 12 April 2020. Here is what we said: "In addition, the idea is that this debt, while shared, will be repaid. With what resources though? We can already imagine the impact: new taxes (which, however, could be beneficial if they were environmental taxes) or, more likely, an increase in Member States' contributions to the EU, or even austerity. If that turns out to be the case, what Member States spend on servicing the shared debt will no longer be spent at home. This would be almost a zero-sum game." That is where we are at the moment. The agreement secured in a high-pressure environment by the 27 EU Member States offers no guarantee that new domestic tax resources will be raised and, by shortening the timetable for the next negotiations, makes it even less likely that they will be. The most likely outcome is that most of the new shared debt will be repaid early, not through an environmental tax but by increasing Member States' contributions to the EU budget. Therefore, the Commission will probably ask Member States for a 0.6% increase in their contributions with a view to repayment of the recovery plan. And the shorter the term of the loans, the faster the Commission will have to dig into national contributions, at the risk of pushing Member States to continue to divest. All this will not manage to exceed the sum of its parts. Yet that was the entire point of the whole operation.

III. A losing game for many ...

In the case of France, we do not see the point of being forced to do this: we might as well have borrowed over a 30-year term (at an interest rate of 0.58% as at 22 July 2020!) so that we could make investments without risking an increase in our national contributions. Moreover, this could potentially end up being more than what the country will receive in subsidies since France's contributions account for 17% of the EU budget (€66 billion of the €390 billion total). In the absence of new domestic resources, if national contributions are the only way to fund the shared EU debt, we will lose more in repayments than what we get in subsidies. However, with a fall in national GDP of at least 10% in 2020 and with unemployment likely to double (or even triple), France could have done without giving up its meagre budgetary room for manoeuvre.

On the face of it, though, the plan is not that bad for everyone: with almost €140 billion in aid, including €72 billion in subsidies, a country like Spain will welcome the package in that it will receive more than it has to pay back eventually. The same goes for Italy (€82 billion in subsidies). But we could have done much better in other ways without penalising anyone, for instance through the conditional cancellation of public debts held by the ECB, in exchange for green investments.

We are also losing out in yet another area, namely the EU budget. It is surprising to say the least that the next multiannual financial framework (MFF), i.e. the European budget, envisages

€1,073 billion of expenditure for the period 2021-2027, while the previous MFF for the period 2014-2020 provided for €1,100 billion in those years, i.e. 0.96% of gross national income (GNI). Although the medium-term impact of the pandemic is still unclear, Europe is wealthier in 2020 than it was in 2014. However, leaving aside the 'recovery' plan, the EU budget is declining. Policies we were being told were absolutely essential a few weeks or months ago are either being mothballed or dramatically downsized.

Turning first of all to the European Green Deal, it is safe to say that this will simply fall apart in the new constellation of the Resilience Fund. Some aspects are already disappearing: the InvestEU campaign was to receive €30 billion under a Commission proposal, which was meant to lead to the mobilisation of at least €279 billion in private investments through a leverage effect. Only €5 billion of that now remains. It also affects the solvency instrument, which was due to have €26 billion at its disposal and was supposed to provide assistance to companies lacking equity. Yet the Commission tells us that the equity requirements of companies that would normally be solvent could reach €1.2 billion in 2021. The same is true for the Just Transition Fund, whose support drops from €40 billion to only €10 billion, making it difficult for it to provide the expected assistance to regions affected by the required shift in their economic activity towards a more ecological approach. Research is being hit hard too: the Horizon EU programme will have to make do with €81 billion rather than the initially anticipated €100 billion, while our digital divide for example continues to widen. Last but not least, the same fate faces the Neighbourhood, Development and International Cooperation Instrument (NDICI), which aimed to support EU action in the field of development, international cooperation and neighbourhood policies, and was held particularly dear by the International Trade Union Confederation (ITUC) and the European Trade Union Confederation (ETUC). In other words, short-term needs have taken precedence over future requirements. Here again, instead of making additions, the European Union is making reorientations and mothballing some initiatives. The EU is revelling in the fact it was able to reach a historic agreement which, in reality, is another small step towards sacrificing its future.

IV. But is this a victory for dogmatic short-termism?

However, all is not lost for everyone because the countries that have been most instrumental in blocking an ambitious deal are also those that will get the biggest rebates on their contributions to the EU: in Denmark's case the rebate is increased by €377 million, for the Netherlands it goes up €2 billion (despite having the second highest trade surplus in the eurozone, behind Germany), for Austria it rises by €565 million, and for Sweden it is given a €1,069 million boost. A reward for selfishness and short-termism?

What is most striking about the end result is how threadbare it actually is, with so much diplomatic energy being expended with so little to show for it. While we are not saying that this is a zero-sum game, as it is clear that rather than falling completely into an austerity path as in 2008, this time EU Member States have at least understood the value of 'resilience' measures, to use the terminology of the framework document which – for reasons of modesty? – does not dare openly speak of 'recovery'. However, as we have shown, the amounts that will be invested are less than what would have been necessary, even before lockdown, to implement a real policy of ecological and social reconstruction. The COVID-19 crisis means that it is not even clear that they will make up for the losses and the decline in economic activity. Therefore, unfortunately there is nothing to celebrate here: Europe is now implementing on a small scale what it should have done in 2009. We are once again running behind where we should be and, again, a suicidal reluctance to invest in the future of Europe seems to be winning the day. A wall of public and in particular private debt is still facing us, which will continue to make it increasingly difficult to meet the challenge of environmental damage – one that is even more severe than the coronavirus pandemic. If 20% of currently populated land becomes uninhabitable by 2070, the geopolitical upheavals lying in store for us will be unlike anything humanity has experienced for 13,000 years. Cloaking ridiculous tricks regarding a debt-repayment timetable in the rhetoric of a 'last-chance summit' will not help prepare Europe's already severely tested social fabric to deal with this or enable the world to avoid such a fate.

Furthermore, in exchange for the paltry amounts invested as a result of the recently secured European agreement, a form of ideological surveillance has been reinforced, running counter to the democratic dialogue without which there is no European Union to speak of. Specifically, the European Council has said that national Recovery and Resilience Plans will be assessed by the Commission within two months of their submission. This will involve careful scrutiny of the criteria for consistency with the country-specific recommendations, as well as for strengthening the growth potential, job creation and economic and social resilience of the individual Member States, before a qualified majority vote is taken at the Commission's instigation. The case of Hungary has been widely commented on, with the country being criticised for stubbornly trying to ensure that it does not have to comply with the EU's principles and values (the 'rule of law') as a condition for receiving aid. However, this legitimate attachment to democratic values contrasts strongly with the dogmatism imposed in economic matters: once again, the EU's ideological recommendations in the economic arena will serve as an analytical framework for judging the legitimacy of the investments that Member States decide to make. Above all, a Member State can call on the Council if it considers another country guilty of a major discrepancy between what it presented in its plan and the actual use of the funds. Payments would then be frozen until a final decision is taken. This 'emergency brake' is a key concession to the Dutch demand for stricter control over the use of funds and is reminiscent of the mistakes made by the 'troika' in how it handled Greece. The European Parliament, the EU's only democratic body, is excluded from the negotiations, although it will have to give its approval at the end of the year. Let us hope that it forces the Council to increase its ambitions and manages to free it from the dogma of competition rules which prevent any sectoralised industrial policy.

However, there could be some good news for the future: the ECB already has the right to buy debt issued by the EU institutions, up to a limit of 50% of the overall volume of debt. Instead of or in addition to cancelling all or some of the debt of the Member States it holds, it could therefore also cancel the debt of EU institutions as and when this debt is acquired, to immediately finance reinvestments on the same scale. The ECB could start now with the €750 billion we will be borrowing on the markets.

Critics may respond that the cancellation of debts appears to be an obsession for the Rousseau Institute. However, the point is that cancellation or monetisation is plain common sense when it comes to debts that Europeans owe themselves and that they have already paid to the private markets (by authorising the European Central Bank to buy back these debt securities). Moreover, these are probably the only measures that can prevent us from the 'Japanisation' of a deflationary Europe.

The EU political project is currently trying to ensure its survival. The satisfaction that inevitably follows the long nights of EU negotiations will not conceal the truth for much longer, namely that (1) the economic and social disaster facing southern Europe is by no means resolved by this agreement, and (2) the environmental challenge will not be tackled if Europe continues to delude itself like this.

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