The economy and coronavirus: Weekly Picks

Ahead of the Heads of State and Government meeting on 23 April, this Weekly Picks provides a selection of positions taken by EU institutions (or their representatives) on an EU recovery fund. It covers as well other recent proposals made in the public domain related to the COVID 19 crisis.

Focus: A European Recovery Fund in the wake of the European Council

European Council:

On 26 March the European Council agreed that a coordinated exit strategy, a comprehensive recovery plan and unprecedented investment are required. Leaders mandated the Presidents of the European Council and of the European Commission to work on a roadmap and an action plan to ensure the well-being of all Europeans and to bring the EU back to strong, sustainable and inclusive growth, based on a green and digital strategy. The Presidents should involve other European Institutions, namely, the European Central Bank, as required.

As part of the EU's response, Charles Michel, President of the European Council, outlined the following four priorities of the recovery strategy:

- Internal market
- Massive investment strategy
- External EU's actions and responsibility
- Resilience and governance.

EU leaders also tasked the Eurogroup to come up with the proposals to tackle socio-economic consequences of the crisis. On 9 April the Eurogroup presented a Report outlining a number of measures (see below).

European Commission:

Joint European Council and European Commission Roadmap towards lifting COVID-19 containment measures (15 April): Successfully coordinating the lifting of containment measures at EU level will also positively impact the EU's recovery. There is a need to strategically plan the recovery that is mindful of citizens' needs, in which the economy needs to pick up pace and get back on a path of sustainable growth, integrating the twin green and digital transition and drawing all lessons from the current crisis for the EU's preparedness and resilience.

Commission President Ursula von der Leyen (20 April):

I welcome the Eurogroup’s endorsement of the Commission proposals, in particular the creation of SURE which will help keep people in jobs and ensure we can make the full and quick use of Cohesion Funds. This will make a big difference but we know that more will be needed. This is why the Eurogroup also concluded that the next EU Budget will play a central role in the economic recovery.

This is natural: it is an instrument that is trusted by all, already in place and can deliver quickly. It can help target investment to our common objectives and is a tool for cohesion, convergence and investment. We will also have to realise that business as usual is no more. We will need to “bounce forward” not “bounce back”.

And we will need to build a resilient, green and digital Europe. At the heart of this will be our growth strategy, the European Green Deal, and the twin transition and opportunity of digitalisation and decarbonisation.

It’s true, Europe needs a Marshall Plan for its recovery and it needs to be put in place as soon as possible. For all the reasons I just mentioned, the EU budget must be right at the heart of this. And because this crisis is different from any other, so must our next seven-year budget be different from what we know. We will need to frontload it so we can power investment in those crucial first years of recovery. We will need innovative solutions and bigger headroom to unlock that huge public and private
investment needed to help Europe make that leap forward together. We will put forward our proposals for the MFF soon and we are not yet talking specific numbers. We will have an opportunity to discuss some key principles with Leaders at next week's European Council. Speed will be of the essence.

**Executive Vice President Valdis Dombrowskis** (14 April): Asked about the possibility of financing such a fund with bonds amounting to up to 1.5 trillion euros, Dombrowskis said in an interview with Handelsblatt published Tuesday (14 April): “I could imagine such a financial framework. But nothing has been decided yet.”

He said the recovery fund could be financed with bonds backed by a guarantee from member states. Asked if the Commission was going to raise money on the markets for the fund, he said that needed to be discussed now and he expected it to be on the agenda on an upcoming video conference for EU leaders. Dombrowskis said the Commission was open to all possibilities permitted by the EU Treaty of Lisbon, adding: “We’re not ruling out any option if the member states agree on it. As we all know, that doesn’t apply to eurobonds.”

**European commissioner for economic affairs, Paolo Gentiloni** (20 April): “Speaking to German magazine Der Spiegel, Gentiloni said the EU’s next long-term budget could be the fastest and most efficient way to make money available to kickstart the European economy, reiterating European Commission President Ursula von der Leyen’s call last week for a “huge” investment initiative within the budget.

“The Eurogroup has now put on the table proposals amounting to more than €500 billion to finance health care and short-time working and to help small and medium-sized enterprises,” the former Italian prime minister said. "That leaves at least €1 trillion. That is roughly the order of magnitude that we now have to deal with.”

Asked why he believed the proposal has potential, despite the fact that EU budget negotiations broke down without agreement in February, Gentiloni said he was "optimistic" because "we are living in extraordinary times and I hope that everyone understands that." "We can’t wait until the virus makes peace with us before we start rebuilding," he said. "Reconstruction has to start now, this spring, this summer."

**Budget Commissioner, Johannes Hahn** (8 April): “What we in the Commission are exploring is to use the headroom in the upcoming MFF to allow the commission to raise extra money in the capital markets at attractive interest rates, on the back of our triple A rating, and then give this money to member states that are hard-hit by the coronavirus crisis.”.

**European commissioner for economic affairs, Paolo Gentiloni, and European commissioner for internal markets, Thierry Breton** (6 April): However, given the amounts involved, a fourth pillar of European funding will be necessary. Like the ECB in the monetary and financial sphere, EU member states must now show a common spirit of decision and innovation. This could for example take the form of a purpose-built European fund that could issue long-term bonds. One could also envisage allocating tax resources to such a non-conventional financing instrument. It could have a governance system that would avoid any moral hazard, particularly with regard to the objectives of the financing, which could be strictly limited to joint investments for economic recovery linked to the current crisis.

**European Parliament (resolution of 17 April 2020):**

Calls on the European Commission to propose a massive recovery and reconstruction package for investment to support the European economy after the crisis, beyond what the European Stability Mechanism, the European Investment Bank and the European Central Bank are already doing, that is part of the new multiannual financial framework (MFF); believes that such a package should be in place while the economic disruption caused by this crisis lasts; the necessary investment would be financed by an increased MFF, the existing EU funds and financial instruments, and recovery bonds guaranteed by the EU budget; this package should not involve the mutualisation of existing debt and should be oriented to future investment;

Stresses that this recovery and reconstruction package should have at its core the European Green Deal and the digital transformation in order to kick-start the economy, improve its resilience and create jobs while at the same time assist in the ecological transition, foster sustainable economic and social development – including the strategic autonomy of our continent – and assist in implementing an industrial strategy that preserves core EU industrial sectors; highlights the need to align our responses with the EU’s objective of climate neutrality;

Insists, therefore, on the adoption of an ambitious MFF that has an increased budget in line with the Union’s objectives, the projected impact on EU economies by the crisis and citizens’ expectations on European added value, has more flexibility and simplicity in the way we use the funds to respond to crises, and is equipped with the necessary flexibility; calls, furthermore, for a revision of the Commission’s proposal on the reform of the own resources system in order to gain sufficient fiscal room for manoeuvre and ensure better predictability, capacity to act and reduced exposure to national hazards; stresses that new own resources would be needed for the EU budget to guarantee the recovery and reconstruction package;

Calls on the euro area Member States to activate the EUR 410 billion of the European Stability Mechanism with a specific credit line; Recalls that this crisis is not the responsibility of any particular Member State and that the main objective there should be to fight the consequences of the outbreak; stresses that, as a short term measure the European Stability Mechanism
should immediately extend precautionary credit lines to countries that seek access to it in order to address short-term financing needs to tackle the immediate consequences of the COVID-19 and with long-term maturities, competitive pricing and repayment conditions linked to the recovery of Member States' economies;

**Eurogroup (report of 9 April):**

In this context, we also agreed to work on a Recovery Fund to prepare and support the recovery, providing funding through the EU budget to programmes designed to kick-start the economy in line with European priorities and ensuring EU solidarity with the most affected member states. Such a fund would be temporary, targeted and commensurate with the extraordinary costs of the current crisis and help spread them over time through appropriate financing. Subject to guidance from Leaders, discussions on the legal and practical aspects of such a fund, including its relation to the EU budget, its sources of financing and on innovative financial instruments, consistent with EU Treaties, will prepare the ground for a decision.

The next EU Multiannual Financial Framework (MFF) will play a central role in the economic recovery. It will have to reflect the impact of this crisis and the size of the challenges ahead, by setting the right priorities, to allow Member States to effectively address the fallout of the coronavirus crisis, to support the economic recovery, and ensure that cohesion within the Union is maintained through solidarity, fairness and responsibility. We welcome the Commission's intention to adapt its MFF proposal to reflect the new situation and outlook.

Work is ongoing on a broader Roadmap and an Action Plan to support the recovery of the European economy through high quality job creation and reforms to strengthen resilience and competitiveness, in line with a sustainable growth strategy. It should put in place the conditions to relaunch our economies whilst promoting economic convergence in the EU and reducing any fragmentation resulting from the crisis, including through the rapid restoration of the full functionality of the Single market. The President of the Commission and the President of the European Council, in consultation with other institutions, including the ECB, have started work to this end. The Eurogroup stands ready to contribute and support this endeavour.

**President of the Eurogroup:**

Letter to the European Council President (10 April): "Some Members were of the view that it should be based on common debt issuance, while others advocated alternative solutions, in particular in the context of the multi-annual financial framework. As with the remaining measures adopted, we are driven by a sense of urgency to set up the Recovery Fund in the context of a comprehensive recovery plan."

Interview with five European papers (14 April):

My role as president of the Eurogroup is to organise the debate, not to curtail it. Several countries have taken a position on this matter. Some are in favour of that solution and others prefer alternatives. There are many options: we can use the MFF [the pluriannual EU budget 2021-27], set up a fund, as proposed by France, or think of different solutions for common debt issuance. It is not up for me to judge these alternatives at this stage. The economic goal of any of them is spur the recovery and to spread the cost of the crisis over time through appropriate financing. Now, we must be innovative and get a right answer.

A few institutions have done computations. We need to think in terms of trillions. It could be 0.7 trillion euros, 1 trillion euros or 1.5 trillion euros... I cannot tell at this stage. But it will have to be a very sizeable package given the economic damage.

We don't need to close this figure in the coming weeks, because there is still a lot to learn from this crisis. We need first to define the way to wind down the lockdown measures in all our countries. The euro area is made up of a set of open economies. It does not make economic sense for one country to restart its economy without having other economies to trade with. This is especially true within Europe, but also globally.

We need coordination to set how we get out of the crisis. This will determine the final cost of the crisis. All these factors must be taken on board when deciding the size of the instrument, its scope as in the economic sectors to cover and dimensions it needs to tackle.

Note: the features of the proposal by France as referred to above, can be found [here](https://www.legifrance.gouv.fr/eli/lj/2020/2/19/20-f604-7/) and [here](https://www.legifrance.gouv.fr/eli/lj/2020/2/19/20-f605-7/) (in French).

**European Stability Mechanism:**

Interview with Managing Director Klaus Regling (19 April): I believe we will need new instruments and perhaps also new institutions to support the recovery phase, but I would like everyone to be aware that it takes some time. If you decide, for example, to issue coronabonds, in whatever form, there will be no money arriving before next year. I know this from my experience in building the ESM and the organism that preceded it, the EFSF. I would say that for the second phase we need at least another €500 billion euros from the European institutions, but it could be more. For that, we need to discuss new instruments with an open mind, but also use the existing institutions, because it is easier. Including in particular the Commission and the EU budget. Rethinking European funds can go a long way in keeping the European Union together.
Policy recommendations in the public domain: Some picks from last week

A. Bénassy-Quéré et al - Repair and reconstruct: A Recovery Initiative (20 April 2020):
Both the SURE and ESM new credit lines will help governments to borrow on favourable terms, but they will add to existing national debts. Hence it is crucial now to find ways to jointly finance priority actions – such as dedicated research on potential Covid treatments and vaccines, or resources to ensure the smooth circulation of goods despite lasting restrictions on the mobility of persons – and to provide support to countries worst affected by the crisis in order to restart their own economies. It should be remembered that while it is a common threat, the pandemic has hit member states very unevenly so far – registered deaths range from 1 per million inhabitants to 400 per million. Solidarity in responding is both part of the genetic code of the EU and called for by national self-interest. Externalities and spillovers are bound to be large during this phase, and the re-levelling of the playing field is a core common objective which can only be achieved by action at the European level. A funding vehicle consistent with these observations and aimed at the broad agenda for reconstruction would be based on direct borrowing by the EU backed by future budgetary contributions by member states.

G. Soros - The EU Should Issue Perpetual Bonds (20 April):
The disruption caused by the pandemic should be temporary, but only if Europe’s leaders take the extraordinary measures needed to avoid long-term damage to the EU. That is why the EU Recovery Fund is so desperately needed. Financing it with perpetual bonds is the easiest, fastest, and least costly way to establish it.

Y. Varoufakis - Solidarity Is Not What Europe Needs (20 April):
Dutch and German savers need to recognize that their savings would be much, much lower had indebted Italians, Greeks, and Spaniards not shared the euro with them. After all, it is southern deficits that keep the euro’s exchange rate low enough for Germany and the Netherlands to maintain their net exports. Eurobonds’ merit thus has nothing to do with solidarity. By shifting debt from deficit countries to a strong Union and, in the process, shrinking total eurozone debt (thanks to the lower long-term interest rates implied by the EU’s greater creditworthiness), Eurobonds would keep a country like Italy in the euro – thereby preventing Dutch and German savings from vanishing.

A. Duff - From lockdown to takeoff: The case for a federal eurobond (15 April 2020):
A federal eurobond will enhance the fiscal capacity of the Union without adding to national debt burdens, thus saving national treasuries money. The EU’s famous discipline of the balanced budget will be maintained. Maturities offered should be lengthy to emphasise the significance of the first federal eurobond as an act of political and commercial confidence in the stability of the euro and the durability of the Union. The target would be to raise more than €1.5 trillion. At a time of deep uncertainty, the launch of the EU’s first federal bonds should be an attractive investment opportunity for governments, institutional and private investors. In the long run, fully mutualised debt security as a permanent fixture of EU fiscal policy will need the legal certainty that can only be provided by a formal, upwards shift of competence from the national to European level. Ultimately, a ‘sovereign’ Union means treaty change. The EU’s constitutional courts, led by the European Court of Justice, will tolerate nothing less. In the meantime, however, the special purpose vehicle of the eurobond recovery fund is the simplest and quickest solution, achievable without treaty change as part of the imminent decision about new own resources.

H. Van Rompuy - COVID-19: A turning point for the EU? (16 April 2020):
Economically, the EU and the eurozone will have to be much more relevant, if only because 19 out of 27 countries have a single currency. All of them will be dragged into the post-corona depression, which will strike harder in some countries than in others. The ‘strong countries’ were not so strong before February 2020. Economic growth in Germany was the lowest in the eurozone, with the exception of Italy. The crisis response will not succeed without European coordination and solidarity. As in the years 2010-2013, we will achieve solidarity not for ethical reasons but because the enlightened national interests of a number of countries ultimately coincide with the European interest. It takes a while before this insight matures. But we cannot wait two and a half years to make that decision, as we did then. However, public debt in Italy and other countries should not spiral out of control, because then, not only one country would have a problem, but the eurozone as a whole. Lending more to that country via the European Stability Mechanism (ESM) or other funds is therefore not enough. The idea of forms of temporary solidarity derives from this observation. The Recovery Fund can play an important role.

T. Adrian, F. Natalucci (IMF blog) - COVID-19 Crisis Poses Threat to Financial Stability (14 April 2020):
Central banks will remain crucial to safeguarding the stability of global financial markets and maintaining the flow of credit to the economy. But this crisis is not simply about liquidity. It is primarily about solvency—at a time when large segments of the global economy have come to a complete stop. As a result, fiscal policy has a vital role to play. Together, monetary, fiscal, and financial policies should aim to cushion the impact of the COVID-19 shock and to ensure a steady, sustainable recovery once the pandemic is under control. Close, continuous international coordination will be essential to support vulnerable countries, to restore market confidence, and to contain financial stability risks. The IMF is ready to assert the full weight of its
resources—first, to help protect the world’s most vulnerable economies, and, for the long term, to strengthen the eventual recovery.

V. Gaspar, W. R. Lam, M. Raissi (IMF blog) - *Fiscal Policies to Contain the Damage from COVID-19* (15 April 2020): In times of pandemic, fiscal policy is key to save lives and protect people. Governments have to do whatever it takes. There are three guiding principles countries should follow: i) target support to households to ensure access to basic goods and services and to a decent standard of living; ii) deploy resources in a temporary and efficient way and reflect the costs in multi-year fiscal reports; iii) assess, monitor, and disclose the fiscal risks because not all measures will have an immediate effect on deficits and debts. As the pandemic abates and the Great Lockdown ends, a globally coordinated, broad-based fiscal stimulus may become an effective tool to foster the recovery. Coordination enhances the effectiveness of policy actions. But, at the same time, it has to respect relevant differences across countries, mainly in their financing capacity.

G. Goy, J. W. Van den End - *The impact of the COVID-19 crisis on the equilibrium interest rate* (20 April 2020): The lockdown of economies during the COVID-19 crisis creates conditions in which private sector demand may fall unboundedly while precautionary savings increase. The crisis will push down the equilibrium real interest rate further, which has been trending down since the 1980s. However, higher government spending to combat the crisis could counter this trend. If the increased supply of government bonds persists, there will be an upward effect on the equilibrium interest rate, to the extent that the bonds are safe and thereby provide a vehicle for the private sector to hold its increased savings. However, the crisis also has a downward effect on the equilibrium rate if potential growth falls and risk premia remain elevated due to increased risk aversion.

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- The economy and coronavirus - Weekly Picks - 15/04/2020
- The economy and coronavirus - Weekly Picks 6/04/2020
- The economy and coronavirus - Weekly Picks - 30/03/2020

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- The SURE: Main Features
- The European Stability Mechanism: Main Features, Instruments and Accountability
- The European Financial Stabilisation Mechanism: Main Features
- The ESM and the EIB: comparison of some features
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