BRIEFING

The economy and coronavirus: Weekly Picks

Following the Heads of State and Government meeting on 23 April, this Weekly Picks provides a snapshot of the current and recently proposed EU budgetary and financial support in view of the discussions on possible building blocks for a new European Recovery Fund. It covers as well other recent proposals made in the public domain related to the COVID 19 crisis.

Focus: An EU Recovery Fund: How to square the circle?

On 23 April, EU Leaders agreed to work "*towards establishing a recovery fund, which is needed and urgent. This fund shall be of a sufficient magnitude, targeted towards the sectors and geographical parts of Europe most affected, and be dedicated to dealing with this unprecedented crisis. We have therefore tasked the Commission to analyse the exact needs and to urgently come up with a proposal that is commensurate with the challenge we are facing. The Commission proposal should clarify the link with the MFF, which in any event will need to be adjusted to deal with the current crisis and its aftermath.*".

The Commission indicated that it aims at presenting its proposal by 6 May, clarifying its link to a revised and more ambitious MFF.

Some elements that need to be taken into account are presented below.

Within the MFF, there are two main constraints:

- In accordance with Art. 310 TFEU, the EU budget must be in balance. Therefore, all its EU budget expenditure must be matched by revenues (national contributions and EU traditional own resources; in other words, the EU budget cannot have deficits financed by borrowing on the market);
- The EU can borrow on the market only to provide loans to Member States, and therefore not to finance other expenditures. Loans are provided "back-to-back", i.e. exactly with the same conditions. Such borrowing is limited to the amount corresponding to the difference between the revenues and the planned expenditures of the EU budget ("margin").

Therefore, for the new Recovery Fund to be within the MFF, the EU revenue ceiling must be raised[*]. This would allow:

- to increase the amount of EU budget expenditures: new funds could be given as transfers (i.e. grants) to the beneficiaries, within the new limits;
- to increase the amount that can be borrowed and then lent to Member States (by increasing the "margin"), and/or;
- to increase the amount used to reinforce the EIB/EIF.

Once the general purpose of the Fund is agreed, at least three different dimensions of its design need to be considered, each of them with several options. These dimensions are: funding, spending, and governance.

Some options are presented below, together with the models that are currently applied (i.e. existing EU instruments). For each option, much more details could be specified, but they are not dealt with here.

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(1) In what concerns the **funding leg** of the Recovery Fund, one can note the following options based on current EU instruments:
- Increase the MFF budget earmarked for grants to beneficiaries;
- Issuing bonds, backed by the EU budget, up to the amount given by the margin, e.g. EFSM model;
- issuing bonds backed by the EU budget and with back-guarantees provided by Member States, e.g. SURE model;
- Possible additional funding provided by optional (or intergovernmental) Member States contributions (BICC planned model for euro area Member States).

(2) As to the **spending leg,** there are essentially the following current options, based on current EU instruments:
- Grants from the EU budget, including e.g. grants provided under the Common Agricultural Policy; the structural funds (grants for investments, to be matched by national/private contributions); financial contributions (grants to be matched by "variable" national contributions on the basis of progress in reforms implementation (the planned BICC model);
- Loans, as in the EFSM and SURE models, or EIB loans to companies, based on a EU budget guarantee (EFSI model);
- Equity financing by the European Investment Fund, which is co-owned by the EU.

(3) The **governance** of such Recovery Fund could be:
- Based on the "community method" (making use of the EU bodies and institutions as decision makers): that is the case for disbursements under the EU budget, where decisions are mostly taken by Council and Parliament and execution is left to the Commission; or disbursements under the SURE, EFSM or EIB;
- Based on an intergovernmental method such as the ESM and the EFSF.

There are currently no mixed models of governance. Nevertheless, the BICC model (as proposed) is an example of a mixed governance model, insofar the Euro Summit and the Eurogroup provide strategic guidance on the scope of the spending priorities, implemented by the Commission.

The Annex presents, in tabular format, an overview of the current EU budgetary and financial instruments.

* Increasing the revenue ceiling requires amending the own resources decision (involving a Council decision by unanimity, consultation to the European Parliament and ratification by national parliaments).

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Recent Economic Estimates by Fitch Ratings

On the 22 April, the credit-rating agency Fitch Ratings released an update of their Global Economic Outlook, the third in the space of a month, assessing a substantial revision of the previous estimates partly driven by the extension of lockdown measures. Fitch Ratings now expects world GDP to fall by 3.9% in 2020, a recession of unprecedented depth since WWII. This downturn is almost twice as large as the decline anticipated in their early-April forecasts released on the 2nd of April and would be twice as severe as the 2009 recession following the financial crisis.

The outbreak of the COVID-19 health crisis required extraordinary counter-measures from the governments to mitigate the effects and the consequences of the virus. Although some countries are starting to design possible "exit-strategies" from the social distancing policies, others have extended the lockdown, as of France, Italy, Spain, the UK and many of the largest US states. The additional month of lockdown has therefore affected the forecasts released on early-April, especially for the euro area, where the measures necessary to halt the spread of the coronavirus have already taken a very hefty toll on activity in the first quarter of 2020. Fitch now expects euro area GDP to shrink by 7% in 2020, which indicates a 3 percentage points cut over the previous estimates. Nevertheless, the euro area GDP growth for 2021 is upwardly revised and it is now expected to rise to 4.3 %, mainly due to the policies put in place to mitigate the crisis (see specific EGOV paper on this issue).

Focusing on the euro area, Fitch has cut Italy's 2020 GDP forecast to -8 %, accounting for the recent official estimates of the Parliamentary Budget Office, which indicates that GDP has already fallen 5% in 1Q20. In this respect, the impact in Italy is explained by the large proportion of small firms in the country and the limited scope for aggressive fiscal policy. Official estimates by the Banque du France and Banco de España also point to the situation in France and Spain that are expected to suffer respectively a 6 % and 4,7 % decline in GDP in the first quarter of 2020, with the Spanish economy hit particularly hard by the drop in tourism revenues. Finally, compared to previous estimates, Fitch now expects a faster recovery of the German economy, where GDP will increase by 4.8 percentage points in 2021, both due to a greater headroom for policy easing in the country and to the more direct benefits following the recovery in China.

Table: GDP growth estimates by Fitch, comparison between early-April and Late-April forecasts

Country	GDP 2018 %	GDP 2019 %	GDP 2020 %			GDP 2021 %		
			2 April forecast	22 April forecast	Revision	2 April forecast	22 April forecast	Revisio n
Italy	0.8	0.3	-4.7	-8.0	-3.3	2.3	3.7	1.4
Germany	1.5	0.6	-3.8	-6.2	-2.4	3.1	4.8	1.7
Spain	2.4	1.9	-3.9	-7.5	-3.6	3.4	3.9	0.5
France	1.7	1.3	-4.1	-7.0	-2.9	2.8	4.1	1.3
United Kingdom	1.3	1.4	-3.9	-6.3	-2.4	3.0	3.9	0.9
Eurozone	1.9	1.2	-4.2	-7.0	-2.8	2.9	4.3	1.4

Source: Fitch Global Economic Outlook early-April and Fitch Global Economic Outlook late-April

Furthermore, Fitch foresees that the bank sectors in the developed market will be resilient in the short period, in spite of temporarily falling below the 100% liquidity coverage ratio or applicable leverage ratio, as set in the Capital Requirements Regulation CRR. However, according to the Fitch report issued on the 24th of April, the main concern is related to the banks' profitability and assets quality, as corporates will take long to recover and repay loans. In this context, regulators and policy-makers are encouraging banks to provide liquidity to corporates and SMEs, whose business, as pointed out in the global economic outlook, is strongly affected by the coronavirus crisis.

Policy recommendations in the public domain: Some picks from last week

E. Bekkers, A. Keck, R. Koopman, C. Nee - ***Trade and COVID-19: The WTO's 2020 and 2021* trade** (24 April 2020):

Among its many regrettable effects, Covid-19 will also have a strong impact on international trade. Forecasting potential trade effects is important for policymaking. This column develops a range of scenarios in a dynamic CGE model to simulate possible trajectories for GDP. It then generates short-term forecasts of trade for various regions and the world using time-series analysis. The outlook for 2020 is bleak with trade possibly declining by between 13% and 32%. Some recovery is expected in 2021. The WTO expects a significant downturn in global trade in 2020 of between 13% and 32%, and some recovery in 2021, with the results being very sensitive to the length of time that the Covid-19 threat and related health measures remain in place.

A. Georgiou - ***The European Union failing the viability tests?*** (23 April 2020):

The 2020 constellation of challenges for the EU and its member states is a critical one and the dislocations that are already taking place, and will probably be intensified in the period ahead, are going to make more onerous the ongoing test for the European Union. The test has the potential to provide '20/20 clarity' on whether the European Union is a union, functions as a union, and should be called a union. In the end, unless there is a fundamental change of tack and the European Union starts behaving as a union, living up to its responsibilities and offering benefits to its entire population as a union should, the EU may not survive. And that would be a great pity.

G. B. Wolff - ***EU debt as insurance against catastrophic events in the euro area: the key questions and some answers*** (22 April 2020):

European Union debt can provide comprehensive insurance against the COVID-19 pandemic and can enable a macroeconomic response, even though EU debt is a liability for taxpayers in EU countries and therefore indirectly for national budgets. To establish it, countries will need to give up control over some spending and some revenues. To be politically sustainable, that control should not be intergovernmental but be grounded in EU institutions. The EU Treaty offers some possibilities, but treaty change might ultimately be necessary. Democratic legitimacy is at the core of the debate.

G. Daniel - ***A corona financial solidarity levy*** (22 April 2020):

This column argues that a one-time EU-wide levy on financial assets could raise €300-400 billion, and thus finance a European Solidarity Fund. This levy would be non-distortionary, could be implemented quickly through financial intermediaries, and would avoid the need for controversial Coronabonds. The tax base would, of course, be unevenly distributed among member states. Most of the levy would come from investment certificates, which are often issued by companies domiciled in Luxembourg, thus making it more difficult to ascertain how much the citizens of each member state contribute to the overall sum. This, admittedly thin, veil of ignorance would differentiate the financial levy from the typical contributions to the EU budget which are based only on national income. Moreover, the levy could easily be made to fit into national tax systems.

A. Boot, E. Carletti et al. - ***Corona and Financial Stability 4.0: Implementing a European Pandemic Equity Fund*** (25 April 2020):

The involvement of the EU in fighting the detrimental consequences of the Covid crisis has to be increased. This column expands on an earlier proposal for a European Pandemic Equity Fund – a programme of government assistance for firms hurt by the crisis in the EU – and discusses the principles and conditions relevant for the operationalisation of such a fund The overall payoff profile of the proposed scheme is largely similar to an equity contract: a claim, contingent on the success of the project. The 'cash-against-surcharge contract' makes it performance dependent and renders the scheme equity-like, without being equity in a strictly legal sense of the term. Furthermore, the scheme allows the firm to end the tax surcharge obligation of its own volition, by buying out the EPEF at a pre-set price that appropriately compensates the EPEF. In that manner, the firm is not indefinitely tied to the EPEF, while the EPEF can be appropriately compensated.

ANNEX

Table: A simplified overview of current, proposed and discontinued EU financial and budgetary instruments providing loans and grants

Instrument	Legal basis	Funding	Disbursements	Decision-making /Implementation	Capacity	Addressees
EU programmes (based on the heading of the MFF)	Multiannual Financial Framework (MFF) based on Article 312 of TFEU	EU own resources and contributions from Member States (based on GNI and VAT)	Mostly grants (depending on the specific programme)	Adopted by the European Parliament and the Council, on a proposal from the Commission	Around EUR 148bn per year (2019 figure; EU 28 level of payments)	All EU Member States (a variety of final beneficiaries)
BICC + CRI (RSP + BICC governance (**proposals**)	RSP: Arts. 175/3 and 197/2 TFEU BICC governance: Arts. 136/1/b and 121/6 of TFUE	MFF spending programme based on the EU budget + possible inter-governmental agreement for BICC	Grants	Eurogroup and Council (qualified majority)	To be decided in MFF 2021-2027	BICC - Euro Area (EA) Member States CRI - non EA Member States
SURE (**proposal**)	Art. 122 TFEU	Borrowings by Commission, guaranteed by the EU budget and back-guaranteed by EU Member States	Loans	Council (qualified majority)	100bn	All Member States
EFSI (InvestEU)	Articles 172 and 173, the third paragraph of Article 175 and Article 182(1) of TFEU	Borrowing by EIB based on guarantees by the EU budget and EIB and EIF capital	Loans	EIB + Steering Board, an Investment Committee and a Managing Director	EUR 85.4bn financing approved (EUR 466bn investment mobilised) in 2019	All EU Member States (companies)

EIF	Statute signed by the shareholders Company owned by EIB, EU and national financial institutions	Borrowing on the markets based on EIF capital (including back-guarantees EU budget)	Equity investment	Board of Directors	EUR 10.1bn used in 2018 (€ 58.9bn leveraged for SMEs)	SMEs in all EU
MFA	Article 212 of TFEU and Joint Declaration by the EP and Council	Borrowings by Commission guaranteed by the EU budget	Loans and grants	Co-decision procedure	Depending on EU Budget limits	Third countries
BoP Facility	Art 143 TFEU; Council regulation 332/2002	Borrowings by Commission guaranteed by the EU budget	Loans	Council (qualified majority)	EUR 50bn	Non-euro area Member States
EFSM	Art 122 TFEU; Council regulation 407/2010	Borrowings by Commission guaranteed by the margin of EU budget	Loans	Council (qualified majority)	Depending on EU Budget limits (EUR 60bn in 2010)	Euro area Member States
ESM	Intergovernmental agreement based on Art 136 TFEU International financial institution	Borrowings in international capital markets guaranteed by ESM capital	Loans	ESM Board of Governors	Around EUR 704bn (704 798.7 million)	Euro Area Member States
EFSF (**discontinued**)	Intergovernmental agreement between EA MS Company by shares owned by EA MS	Borrowings guaranteed by EA MS on the basis of ECB capital key	Loans	Unanimity of EA Member States	EUR 440bn	Euro Area Member States
Greek Loan Facility (**discontinued**)	Intergovernmental agreement between EA MS	Each MS funding	Loans	Unanimity of participating EA Member States	EUR 80bn (minus EUR 2,7 bn)	Greece (created in 9 May 2010)

For an overview of some previous EGOV Weekly Picks:

- 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

And for some other recent or topical papers by EGOV:

- EU/EA measures to mitigate the economic, financial and social effects of coronavirus
- A recipe for a sustainable and legitimate new EU/EA fiscal instrument?
- The SURE: Main Features
- What do we know about the BICC today?
- 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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