BLOG POST

CRISIS NOTEBOOK
EUROPEAN RECOVERY: HOW TO CONVERT THE TRY? SOMETHING IS HAPPENING IN EUROPE

This Note is the second in a series of reflections of members of the "Observatoire politique du Parlement européen" of the Jacques Delors Institute. These reflections have been inspired by the current crisis.

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The COVID-19 crisis has reshuffled the deck. It caught both the Member States and the European Union (EU) unawares; they were not prepared to face such a crisis, which stunned them. They began by closing the borders as if the crisis respected them, blocking the internal market linked to products required to fight the disease and showing a certain condescension towards Italy, the first country directly hit. They then reacted by adopting a scattered response to the health emergency.

From a series of emergency responses to a significant leap

After having bobbed along for three weeks, during which we witnessed masks being stolen on airport tarmacs or the export of breathing equipment being banned, the EU gradually took the European measure of this crisis and of what was at stake for the Union. Since then, there has been a succession of initiatives at a steady pace.

Today, faced with the immense economic and social impact of the crisis, which is affecting all economies albeit in an unequal manner, **the majority of European States seem ready to make a significant leap that could provide the EU with the means to demonstrate its effectiveness**, including in instances of populism, the seedbed of division, which is developing in different forms in the opposite camps.

The stakes are momentous. In the face of a symmetrical crisis whose impact is asymmetrical from one Member State to another, its systemic effect could have a lasting impact on European economies, destabilise the euro and the internal market and exacerbate social inequalities. To put it another way, the question being asked is that of determining how to rearrange the European port so as to ensure safe shelter for all whereas everyone faced the same storm but on different vessels.

To counter this storm, there was first of all the action by the European Central Bank, just like in 2007 during the global financial crisis, with the launch of the Pandemic Emergency Purchase Program (PEPP) of €750 billion on 18 March 2020, in addition to the €300 billion from the Public Sector Purchase Programme (PSPP), to which some €600 billion would be added on 4 June. Almost one month later, during the European Council of 23 April 2020, a three-part rescue package worth €540 billion was adopted. Part one was for the sovereign and health with the possibility of using the European Stability Mechanism's credit line facility for up to a total of €240 billion. The second element consisted of new lending capacity by the European Investment Bank for companies of up to €200 billion, and the third was the creation of a temporary instrument to help protect jobs and workers, SURE (Support to mitigate Unemployment Risks in an Emergency), worth €100 billion.

To complement this, on 20 March the Commission proposed the temporary suspension of the Stability and Growth Pact, an initiative subsequently validated by the Council, and adopted a temporary framework for State aid to allow national governments to fully exploit the flexibility granted by the regulations. Half of this aid, to be examined by the European Commission, will be authorized to Germany, who injected the equivalent of 17% of its GDP to support its industries, as opposed to 3% in Spain and Italy and 2.2% in France.

This package responds to the emergency but it lacks a fundamental element to ensure the recovery of European economies. This is the observation underlying the initiative of nine States (Belgium, France, Greece, Ireland, Italy, Luxembourg, Portugal, Slovenia and Spain) who, in a joint letter of 25 March to Charles Michel, President of the European Council, requested the mutualisation of the new debt being incurred, with the creation of "Corona bonds".

Before the European Council of 23 April, the Spanish government also presented a proposal for a €1.5 trillion fund financed by a perpetual debt entered in the EU budget.

While the Heads of State and Government agreed to put the question of this fund to the European Commission by asking it to integrate the fund into the next Multiannual Financial Framework (MFF 2021-2027), President Emmanuel Macron and Chancellor Angela Merkel did not wait to take a significant step. On 18 May they proposed a €500 billion recovery fund in grants, and not loans, with fairer taxation, the introduction of taxes on the digital economy and the implementation of a common tax base for corporation taxes. The plan comprises three other elements in favour of a health strategy, the acceleration of the ecological and digital transition and to "strengthening EU economic and industrial resilience and sovereignty of the EU, while generating new impetus for the single market".

In the meantime, the German Constitutional Court of Karlsruhe in its decision of 5 May 2020 concerning a previous ECB programme to support the euro, gave the European monetary institution three months to demonstrate the proportionality of the measures taken and called into question the decisions of the Court of Justice of the European Union. To a certain extent, through no will of its own, the Constitutional Court would play the role that Margaret Thatcher had for the creation of the euro, by making it obvious to others what they did not want and what they had to do. It is in this way that on 13 May, Chancellor Angela Merkel argued before the Bundestag for more economic and political integration of the euro area, by citing Jacques Delors. As a backdrop, the deterioration of economic prospects and the risk of collapse of the internal market will have done the rest.

It is **a real change of footing, representing an obvious success for arguments defended in France for a long time and made possible by a development in Berlin.** On 23 May, the response from four of the five tight-fisted or frugal States (Austria, Denmark, Netherlands and Sweden), two of which are not members of the euro area, no longer daring to refuse all solidarity as at the start of the crisis, was to propose a recovery plan funded uniquely by loans.

The leap was proposed on 27 May. Ursula von der Leyen, on behalf of the Commission, did the sums excluding the MFF: a €750 billion plan over four years, with a joint loan of €500 billion in grants and €250 billion in loans. The plan entitled "Next generation EU", is divided into three pillars, the first one will receive the majority of the funds to support Member States in terms of investment with due regard for the ongoing structural reforms and EU priorities (green, digital, health and social concerns) with the presentation of the "national recovery plans, based on the investment and reform priorities identified as part of the European Semester, in line with National Climate and Energy Plans, Just Transition Plans and Partnership Agreements and Operational Programmes under EU funds".

The second pillar is about "kick-starting the EU economy by incentivising private investment" and the creation of a new Solvency Support Instrument for companies, entrusted to the European Investment Bank (EIB) and the third pillar concerns learning the lessons of the crisis, in particular in terms of health.

The entire plan must be funded by a 30-year loan and an increase in own resources (CO2 emission rights, carbon border adjustment mechanism, own resources based on the operation of large companies, taxing the digital economy, taxes on single-use plastic).

In parallel, the Commission presented a revised MFF which decreased from €1.13 trillion in May 2018 to €1.1 trillion, closer to the February 2020 proposal of the European Council (€1.09 trillion) than that voted by the European Parliament amounting to €1.32 trillion.

The Commission also proposes to modify the current MFF in order to initiate further spending of €11.5 billion by the end of 2020. This requires a unanimous vote at the European Council, and the approval of the European Parliament. It also proposes to temporarily extend the ceiling of own resources from 1.2% to 2%, which will require a unanimous decision at the European Council and ratification by the national parliaments.

Avenues to consolidate and continue the current impetus

Beyond the mind-boggling array of initiatives and figures, we should venture to make nine observations so that the plan on the table keeps its word:

1) The figures may seem overwhelming but they have to respond to a significant decrease in the GNP of the European economy (in June, the ECB forecast a GDP drop of 8.7% in 2020; the European Commission, in its forecast of 6 May, indicated a 7.7% drop ; OECD forecast 9,1% drop), an increase in unemployment everywhere despite partial unemployment measures implemented by several Member States, and exacerbated poverty and divergences between the Member States. On this last point, certain elements of the scheme proposed should first of all help the countries worst affected by the crisis, beyond the classic allocation key of European aid. The crisis did not affect all economies in the same way, and they do not all have the same means to deal with it. There is no moral in this crisis hazard, this idea that helping such and such a country even though it has a significant budget deficit would support it in practices contrary to the Stability and Growth Pact. Economies based mainly on manufacturing activities or tourism were more severely hit than those whose national economy is based on the digital economy and platform activity. The ability of States to fund State aid to support their businesses is also correlated to their public finance situation before the crisis. The question therefore is raised of determining **how this recovery plan will contain or correct the divergences created or exacerbated, given the threats they pose to the euro area and the Single Market**. Certain observers have already warned of the limited nature of the strictly budgetary element of the plan, €310 billion, i.e. 0.6% of GNP over four years, and on the pace of its increase whereas in the negotiations about to get underway, the "frugal" countries, who first of all reason as "net contributors", could seek to increase their rebate which is nevertheless no longer justified after Brexit.

2) The second question to be asked is: Why a plan outside the MFF? The main reason is to mark its temporary and exceptional nature, and to carve nothing in stone. Some of these measures correspond to the highly specific nature of this crisis which is first all a health issue, but with serious economic and social consequences. But it is clear that this plan lifts taboos and that it should be the **opportunity to implement crisis or emergency management solutions and to rectify the shortcomings in European integration** which deserve to be made permanent, such as the increase of own resources and of the MFF, investment support, the joint loan, European unemployment insurance or the creation of a European Treasury. This is especially true because here the immediate and violent nature of the crisis has undoubtedly facilitated decision-making. It is not so sure that this would also be the case for more dormant situations.

3) The third question is institutional. In its resolution of 15 May 2020, the European Parliament had warned the Commission "against any attempt to design a European recovery strategy that is outside the community method and resorts to intergovernmental means" and had requested that it be fully involved in the recovery strategy on the basis of Article 324 of the TFEU[1]. The EU recovery instru-

1. "Regular meetings between the Presidents of the European Parliament, the Council and the Commission shall be convened, on the initiative of the Commission, under the budgetary procedures referred to in this Title. The Presidents shall take all the necessary steps to promote consultation and the reconciliation of the positions of the institutions over which they preside in order to facilitate the implementation of this Title."

ment that will spearhead the governance and allotment of the €750 billion loan is based on Article 122[2] of the TFEU, on the basis of which **the Parliament is simply informed**. This is more or less a replica of what happened with the European Stability Mechanism (ESM) implemented during the global financial crisis on an intergovernmental basis using tools from the Commission to provide assistance to Member States that no longer had access to markets to finance their debt. Except that in this case it is even less justified as the Commission will be directly involved and the loan will be guaranteed by own resources and not only by the Member States' budgets. Regarding own resources, the European Parliament is consulted concerning their creation and it must give its approval to implementing measures for the own resources system (Article 311 of the TFEU).

The legislative basis of the programmes that will be used to distribute the funds (Recovery and Resilience Facility, REACT-EU for cohesion policy, Just Transition Fund, InvestEU, etc.) will be co-decided between the European Parliament and the Council. But the concrete implementation of the programmes will essentially depend on the framework of the European Semester, the cycle of economic and budgetary policy coordination across Member States, where the European Parliament simply has the power of evocation. Concerning the part of the plan intended to support private investment, the Solvency Support Instrument, this will be implemented through the European Investment Bank (EIB) over which the European Parliament has limited supervisory control.

4) On the long-term strategy stemming from "Next Generation EU", the references are there to contribute to an ecological and digital transition by integrating a social dimension. But in substance, **it can be hoped that the Parliament, in its role as co-legislator, will have a better grip on these priorities**. This is all the more important as the European Semester, the framework for implementation of most of the "Next Generation EU" instrument, has not been amended. This remains badly implemented by the Member States and does not include enough social or environmental objectives or indicators. The same applies to private sector support, and nothing has been said about dividend distribution or the activity of companies assisted in this way in tax havens, or the obligation to present a country by country reporting. Many NGOs have warned of the absence of explicit condemnation of all support for fossil fuel activities. In the same way, although health and safety workers were in the front line of crisis management, it is to be hoped that this instrument will be accompanied by proposals in terms of working conditions on platforms and health and safety at work. The Commission should fully take up the concept of "social investment" introduced by László Andor when he was Commissioner.

It is not about pretending. Arbitrating between the priorities is complicated but they are in fact two sides of the same coin. After peak of the health crisis, the real urgency was the recovery of economic activity including in the name of the social emergency and the purchasing power of the most underprivileged. In systems with cumbersome management, combining several emergencies with difficulty, the European Green Deal the social objectives are mentioned but it can be feared that they will be pushed into the background. It must be remembered what happened after the global financial crisis of 2008: after the firefighters' work is over, that of mobilizing the architects is more difficult, and sometimes never happens. **Behind the allocation of budgetary appropriations, it is a social contract that is defined**. In this phase, the European Parliament should be at the heart of the action and for this it should be ready to use all the levers at its disposal. Just as it did in the past for the banking union, for example, when dealing with a package, only part of which depends on the Parliament's co-decision power, it can make its agreement conditional on its involvement with other parts of the package, based on the legislation in which it is an equal stakeholder with the Council.

5) "Next Generation EU" should ensure greater consistency of Community instruments. After the Juncker Plan, in addition to the flexibility introduced, it would have been necessary to modify the Stability and Growth Pact to correct the bias that led to austerity policies and ignored the role of investment. Today, **the Pact is simply suspended, it needs to be revised to take into account investment needs and their control to serve the strategy of ecological transition and the specific need for real convergence** between economies of the euro area. Some will argue that while reform of the Pact needs to be undertaken, this should result in giving it "more bite". This can only occur if it is accepted and if its objectives are shared. For this to happen, it can no longer be considered simply as a tool to monitor the Member States of the euro area taken individually and it should fully integrate an aggregated view of

2. 1. "Without prejudice to any other procedures provided for in the Treaties, the Council, on a proposal from the Commission, may decide, in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products, notably in the area of energy."
2. "Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned. The President of the Council shall inform the European Parliament of the decision taken."

the area around the "European Green Deal" strategy and convergence objectives. Work on introducing a stabilisation function should also recommence. The SURE scheme, which will be available until 31 December 2022 and is renewable for six months, is a good candidate as an embryonic version of the automatic stabiliser, which was identified in particular by the IMF as the most effective: **European unemployment insurance.**

6) Concerning own resources, in the absence of legislative proposals the Commission's proposal remains blurry, in particular regarding the "own resources based the operation of large companies". The renewed proposal of own resources for the digital economy, including taking account of progress of OECD work, is welcome but it should not undermine that of consolidation of the corporation tax base. A portion of company gains should fund the EU own resources system. This is all the more important as before the crisis, a 'frugal' country such as the Netherlands, which hosts numerous platforms, continuously blocked any type of reform whether in terms of taxation of the digital economy or corporation tax. **It is time to reform corporation tax**. The European Parliament should make this the cornerstone of its participation in any agreement on the MFF. This should also be analysed with respect to those who paid a high price in this crisis both due to the impact of austerity measures imposed by the Troika on public spending on health before the crisis, and on the impact of this crisis given the economic model of the different Member States.

7) Given the amounts mentioned, **the issue of good governance is key**. To reconcile citizens who see the Union as 'austeritarian' and who have the impression that there is never money to increase their purchasing power, correct use of the amounts earmarked is essential. This is true both for projects and activities supported but it is also true for corruption. The Group of States against Corruption (GRECO) of the Council of Europe and the OECD have already warned of these risks given the significance of State aid pledged by the national executives. The same reasoning is valid on an EU scale.

8) On the vital issue of the **timeline**. The Commission already wishes to revise the current MFF in order to commit appropriations by the end of the year. But the gearing up of the various instruments may take longer than envisaged by the Commission, which is counting on finalisation of the package, including ratification by the national parliaments of decisions on own resources, by the end of the year. The European Parliament for its part has requested that the Commission define an emergency plan to allow the revised extension of the current MFF in the situation where the next one could not commence on 1 January 2021, to avoid interrupting the programmes. It has also requested an assessment of the recovery plan before it ends and before the MFF is modified accordingly during its mid-term review. For all these reasons, the MFF 2021-2027 should be divided in two.

9) In the wake of the health crisis, this "Next Generation EU" is an essential contribution. It does not erase the **need for the Conference on the Future of Europe** envisaged before the crisis, and advocated and supported by the European Parliament. Its mandate and its composition should reflect the new deal, but regarding its composition, the French model of what was done in the Citizens'Convention on Climate is a useful reference even if new terms and conditions, some of which virtual, should be proposed. Political leaders should commit to sharing the conclusions. The budgetary impact of the conclusions drawn from the Conference on the Future of Europe could be integrated during the revision of the MFF, which further justifies the aforementioned request to divide it in two.

In light of these avenues outlined, the recovery plan could not only transform European economies, by greatly supporting their transitions, but also through its means of funding, transform the very relationship that Europeans have with their Union.

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