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A fiscal bazooka from Brussels?

The EU's recovery fund has finally seen the light of day. But this comes at a price: deep political rifts and painful budget cuts

Read this article in German.

After a marathon summit, the European heads of state and government have finally agreed on a recovery plan and the EU's financial framework for the next seven years. The deal has already been described as 'historic' – but does it deserve the label?

'Extraordinary events require extraordinary, new methods,' said Chancellor Angela Merkel at the summit's final press conference. We are undeniably experiencing an extraordinary situation with the Covid-19 pandemic and its direct and economic consequences triggered by its containment measures. All member states are affected by the pandemic, but to very different degrees and with different capacities to respond.

With an estimated reduction in the EU's Gross Domestic Product (GDP) of between 8 and 10 per cent in 2020, this crisis is particularly severe. It has an asymmetric effect and deepens existing economic and social divides between member states. That's why a special economic stimulus package on the European level is so important – the 'bazooka' from Brussels, so to speak.

Defending short-term national interests

It's coming now, but in a slimmed-down version. While the total volume of the Commission proposal remains the same, the €500bn in non-repayable grants to the countries most severely affected by the pandemic have been reduced to €390bn. They will be supplemented by €360bn in loans. The cuts were pushed for by the 'frugal four', a community of interests consisting of the Netherlands, Austria, Denmark and Sweden that stood out at the summit by defending short-term national interests.

Supported by Finland, they almost caused the summit to implode by

repeatedly attacking the negotiating boxes on the table: too much money overall, a lack of control mechanisms and lax conditions for corona aid were their central complaints. The summit in Brussels promotes the open – though unfortunately not public – exchange between the heads of state. But it's more a staging for domestic audiences. Apparently, the Hague, Vienna, Copenhagen, Stockholm and Helsinki have not yet realised how a sluggish recovery from the pandemic, because of the undersized economic aid for Italy, Spain and France, will backfire on exporting countries.

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The fact that the share of loans has now been significantly increased – at the expense of grants – will further increase the debt burden of the recipient countries. The next euro crisis could quickly follow; Italy already had a total debt of 135 per cent of GDP before Covid-19.

At least, the resources of the so-called 'Next Generation EU' recovery fund will be made available via the EU budget through the EU's own debt instruments and will only have to be repaid by 2058. That's a quantum leap and should not be underestimated. We will have to remain sceptical as to whether this will result in a 'Hamiltonian moment', as German Finance Minister Olaf Scholz called the fund. But with a €750bn economic stimulus package for the years 2021 to 2023, one that focuses on the economic situation of the recipient countries and not (as in the euro crisis) on the rigid budget rules of the monetary union, the European Union has come one step closer to a political union. This includes the introduction of a proper EU tax on plastic waste as early as 1 January 2021. Additional EU income resources are in the making.

Although the 'frugal four' have pushed through a multi-level system of economic policy control, it remains to be seen whether these decisions are not primarily on paper. If so, the European Commission still has considerable leeway in assessing the investment plans submitted. Qualified majorities for the decision will not be difficult to achieve in the Council. And it's questionable whether the Heads of Government Mark Rutte and Sebastian Kurz, whose populist intransigence has been in the limelight at the summit, will really interfere into suspected deviations from the programmes of individual country packages and force a debate on this in the European Council.

Financing transnational challenges

Then there's the new EU budget. The corona crisis was the final proof that the challenges facing the EU in the 21st century are truly transnational: Health protection and economic stimulation can only function in a well-coordinated manner, if one does not want to bury the single market. The first weeks of the pandemic, with unilateral border closures and export bans on medical goods, were a lesson in the lack of solidarity. We have seen a similar dominance of national interests in migration policy in 2015 and 2016.

The decision on the so-called 'Multiannual Financial Framework' (MFF) became complex when the temporary financial resources intended to boost the economy after the pandemic were incorporated into the EU budget. Any agreement on the MFF happens traditionally on difficult terrain, with each state trying to pay as little as possible and get as much as possible out of European programmes.

The question over EU finances from 2021 onwards was particularly complex not only because of the current crisis but also to the loss of Great Britain as a net contributor to the common budget (despite all the British rebates). At the same time, the EU faces more and more challenges in climate protection, migration, the digital transformation in the world of work and developing its own security and defence policy. The 'Green Deal' pursued by the Commission in particular, but also the understanding of the EU as a geopolitical decision-making power in a world that is undergoing a power-political transformation, entail corresponding costs.

The long shadow of Margaret Thatcher

The governing coalition in Germany has already committed itself to higher contributions to the EU budget in its 2018 coalition agreement. However, the 'frugal four' have also proved to be tough negotiating partners on the MFF. The agreement on the one-off and temporary economic stimulus package comes at the expense of a much smaller regular budget than originally planned. Of course, it's the largest sum ever agreed in the EU with just under two per cent of the EU's gross national income. However, almost all budget items have been cut in comparison to the Commission's proposal. It's already the case with the distribution of financial resources within the 'Next Generation EU Programme': expenditure on education, investment and ecology is particularly affected. Of all things, these cuts are not compatible with addressing the EU's future challenges.

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The extension of the rebate system for some net contributors is a hard blow. The 'frugal four' had their approval of the MFF bought at a high price: Austria, for example, can almost double its rebates on remittances to the EU to €565 million annually. But Germany, too, will retain its previous discount. The long shadow of Margaret Thatcher ('I want my money back') hovers over the result of the summit. With Brexit, there was a unique opportunity to completely abandon the complicated and unfair rebate system. This opportunity has been squandered.

As the conflict between donor and recipient countries was at the centre of attention, the dispute with Hungarian Prime Minister Victor Orbán over the rule of law mechanism, which makes the receipt of financial resources from the EU budget conditional on respect for the separation of powers, almost became irrelevant. In future, the Council will be able to decide on this by qualified majority; there will be no automatic retention of promised funds.

The Franco-German standing

Only naive observers would have assumed that there would be no fierce dispute between member states over the budget and the recovery plan. The question is, however, why EU Council President Charles Michel did not take better account of the different positions in advance.

And what's with the German government, which currently holds the Presidency of the Council? The alliance between Angela Merkel and Emmanuel Macron with their €500bn economic stimulus package presented in mid-May was right and important. Since the last financial and economic crisis, the Franco-German engine in European politics has not worked as well as it did now. It took Germany a long time, but in the end it renounced some of its ideological positions from the euro crisis and gave the French President a positive response to his ideas on Europe.

But what standing does the Franco-German duo still have when five small states can lead it by the nose through the European political arena? But perhaps Angela Merkel is just satisfied that others have acted as bogeymen, while also saving the German budget rebate and making the payments to Southern Europe more conditional. In that case, she would not be the honest broker for the European cause she claims to be vis-à-vis France.

The summit delivers a deal on the financial issues and, at the same time, shows the fragmentation among member states. Nothing has yet been decided. After the governments' backroom bickering, now the European Parliament comes into play. It will demand corrections to keep the package on track for the challenges ahead and, without detours, towards a political union.



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