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The EU Recovery Fund: Negotiation and Contention among EU Members

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EU leaders have clearly learned the consequences of the fiscal austerity that characterised the multiple Eurozone crises of 2009–15.

This week's €750 billion ($A1.21 trillion) Recovery Fund, agreed by the European Council, injects considerable stimulus into the faltering EU economy in the form of grants and loans. Member countries that have been badly affected by Covid-19, such as Italy, Spain and Greece, will receive major financial aid for their economies to combat the impact of coronavirus. In addition, the European Council endorsed an EU General Budget in excess of €1 trillion through 2027.

Despite objections from the 'frugal four' – Austria, Denmark, the Netherland and Sweden – the EU will raise the capital through public 'corona bond' sales. What the 'frugal four' did accomplish was insisting on tying aid to reform.

The Four also demanded, and got, a reduction in the grants fund from €500 billion to €390 billion. More than half of the €750 billion fund will be distributed as grants, although these are 'tied' to Reform and Recovery Plans. Member countries will be compelled to undertake a number of reforms. As the EU seeks to implement its carbon neutrality targets, Green initiatives and digital economy dominate the plans. These will include recycling, a carbon border adjustment mechanism (cross-border carbon pricing) and duties to tax digital services. These will be implemented throughout 2021–23. The European Council will approve the plans via a qualified majority.

The European Central Bank (ECB) has undertaken a suite of stimulatory measures since 2019, including restarting quantitative easing (QE) last November. The ECB also introduced the Pandemic Emergency Purchase Program in 2020, in a bond-buying programme totalling €1.35 trillion through June 2021.

The Fund also serves to reinforce EU sovereign bonds and serves to strengthen the euro currency, which has fallen to 20% of global reserves. More importantly, as bond yields flatline and central banks retain near or below-zero interest rates, the Commission bonds delivers the AAA-rated debt that markets are looking for.

It is clear that the German and French governments, in close consultation with the Commission, have been developing plans since April to raise capital for the Recovery Fund; the difficulty lay in bringing on board the remaining EU-27 members. Moreover, to avoid confrontation with outliers, like Hungary and Poland, the Commission has softened its stance on dubious domestic measures both countries have introduced in recent years.

This was also an important summit for EU Commission President von der Leyen, given the turmoil of the Covid-19 crisis, that saw EU member governments requisition personal protective equipment (PPE) and order the cessation of exports of medical equipment. The Commission's pleas for cooperation fell on deaf ear. But now, Brussels has carriage of the 'corona bond' issues.

The Commission, backed by Berlin and Paris, has clearly acted as a policy entrepreneur throughout this process. It was Brussels that floated the plan for the Commission to issue bonds with maturities of between three and 30 years on financial markets. This is controversial; although the Commission has this power, it conflicts with the 'Own Resources' principle that has existed since de Gaulle's 'Empty Chair' crisis in 1965–66. However, the Commission will raise capital on 'behalf' of the EU.

The Commission's bond auction also solves a political problem for both the Merkel government and the ECB. As the Eurozone crises demonstrated, the strict Maastricht rule of 'no monetization' of EU members' debts remains a fundamental principal of the ECB's statute. This means the Bank cannot be a lender of last resort, a core element of national central banks, such as the US Fed and Reserve Bank of Australia. The ECB circumvented some of these strictures by buying EU government bonds on secondary markets (i.e., from private-sector banks). However, the ECB's measures have been stretched by the Covid crisis and the Bank cannot grant aid to member countries.

Consequently, the Recovery Fund avoids politically costly and complex renegotiation of the ECB's role. More importantly, it empowers the Commission (which will monitor Reform Plans) and transforms it into a significant actor in EU finance in its own right.

The Recovery Fund is simultaneously altruistic and self-interested. Export-geared German, Italian and French businesses have experienced a massive dislocation of their major markets in China and the US, forcing core EU countries to focus upon reflating EU economic demand. Moreover, the Fund reasserts the influence of the Berlin-Paris-Brussels consensus, marking the first real crisis decision taken by the European Council in the wake of Brexit.

Bio: Dr. Remy Davison was awarded the Jean Monnet Chair in Politics & Economics in 2012. He is the former Acting Director of the Monash European and EU Centre. His books include The Political Economy of Single Market Europe (2011). He lectures in international political economy and foreign policy at Monash University.