Opinion – The Good, the Bad and the Ugly of COVID-19 Recovery Financing in Europe

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For once, there is unanimity in the European Union (EU). Consensus exists that unprecedented amounts of money will have to be spent across Europe to stave off the inevitable post-COVID-19 economic crisis. Like other crises before, COVID-19 has exposed the weaknesses of both the EU and the eurozone and brought into question the survival of the bloc. Should countries like Italy – the EU's third-largest economy and one its six founding members – fail to revamp their economy and service its huge sovereign debt, the future of the Euro is unclear.

Reminiscent of the 2010 sovereign debt crisis, the large economies of the eurozone are determined to rescue the common currency at any cost and restore trust in the EU. Doing so, requires money and if the EU Commission gets its way, it will command up to €2.4 trillion in the coming years – equivalent to the GDP of France.

The Good

Initially, the EU had been slow in responding to the crisis. EU solidarity and the integrity of its rules were being questioned when member states ignored rules, standards and expectations in lieu of uncoordinated unilateral crisis management measures. The absence of pan-European solidarity and the comprehensive institutional failure in Brussels disillusioned many citizens and political elites particularly in Italy.

In that light, it is encouraging to see the EU slowly awakening from its COVID-19 paralysis. Brussels' lobbying efforts managed to break the negative policy spiral across membership and managed to coordinate member states' mutual medical support. Most importantly, the European Council agreed on a joint strategy to rectify earlier institutional and regulatory failures as well as on a loan package worth €540 billion to support the worst affected EU businesses and workers.

The Bad

The old cleavage of the sovereign debt crisis has re-emerged: Southerners seek common bonds to raise capital for unconditional grants to keep their economy and budget afloat. The more frugal and fiscally sound Northerners reject both grants and common EU debt, but favour loans via the European Stability Mechanism (ESM), possibly contingent on fiscal and economic reforms – a deal-breaker for Italy.

However, many in southern Europe are now optimistic that the COVID-19 crisis has the power to shock stubborn Northern countries into a volte-face, making previously unimaginable concessions. In 2010, highly indebted, mostly southern EU countries demanded "European solidarity" in form of universal common Eurozone debt by issuing joint "Eurobonds". Germany and other fiscally sound Northern Eurozone and EU net-contributor countries responded with a clear "Nein". Now, piggybacking on the COVID-19 crisis, a similar group of countries called once again for Eurobonds – only this time called "Coronabonds" – to help their ailing economies with post-crisis recovery. Once again, Northerners rejected this idea. After all, the fiscal difficulties countries such as Italy and Spain find themselves in are compounded, but not caused, by COVID-19. Decades of unsound fiscal policy are more to blame for their predicament.

However, the spectre of a eurozone break-up or a further EU-exit seems to have sufficiently shocked Germany in particular. Reversing Germany's traditionally steadfast opposition to common EU debt, Merkel joined French President Macron in putting forward a rescue fund proposal that includes €500 billion in grants to support economic recovery of the hardest-hit countries. The "frugal four" (Austria, Denmark, Sweden and the Netherlands) fiercely reject the idea of grants and proposed "Loans for Loans" to be repaid and contingent on domestic reforms. The EU Commission's own proposal was for a bailout of staggering €750 billion, of which one-third are loans and two-thirds grants – something of a typical EU move of satisfying everyone a bit while simultaneously raising the stakes and its own authority.

Remarkably, all the proposals short of Eurobonds agree that bailout money should be raised by the Commission on the market and channelled in the form of grants to needy governments. Unlike Eurobonds, however, this is a one-off debt serviced via the EU budget and therefore guaranteed by all member states according to their share of budget contributions. Agreement by Germany and the "frugal four" to such common debt, even if limited and temporary, is remarkable. Germany would have to shoulder an astonishing 27% of that debt, although receiving little to nothing of the fund itself.

All proposals will be on the table going forward, but the Commission's proposal mostly aligns with the Franco-German position and is therefore most likely to resemble the eventual compromise.

The Ugly

The eventual rescue package will substantially decrease the risks of a eurozone collapse. But it is curious that a bureaucratic agency with no independent tax-authority produces the most generous rescue package. Further, the same proposal, conveniently, raises once again the much older issue of independent EU taxation-authority – allegedly to alleviate pressure on the national budgets. In the end, it will once again depend on the net-contributors, mostly Germany, to foot the bill.

The root-problem is the euro itself, always a political rather than an economic project, and flawed from the get-go. In 1998, German Chancellor Helmut Kohl championed the euro and promised a sceptical German public that a common currency would not lead to German taxpayer liabilities for weaker economies' sovereign debt and fiscal escapades. This promise was evidently short-lived.

The eurozone is a monetary, without fiscal, union. Monetary policy for the eurozone is set by the European Central Bank (ECB), while economic, social and fiscal policy is determined by national governments. Thus, fiscal policy is exposed to both reckless populism and the comforting knowledge that one state's economy is buoyed by a currency that reflects the performance of a union of 19 eurozone members. Such diversity is not sustainable without endless redistribution of wealth from stronger to weaker economies, particularly if the difference in economic performance and fiscal discipline is as great as in the eurozone.

It may be true that export-oriented Germany has benefitted from a common currency. This may be reflected in German GDP, but certainly not in the personal wealth of the German taxpayer, who, on average, owns less household wealth than the Italian taxpayer. Worse still, with so-called private patriot-bonds, Italy's government guarantees substantially higher interest rates to its citizens than Germany does. In other words, no strings attached wealth transfers across the EU artificially prop-up poor fiscal practices and discipline at the expense of taxpayers from fiscally conservative members. In the long run, it may be untenable for the fiscally sound countries to convince their taxpayers to bail out highly indebted Southern governments that run substantial deficits even at the best of times. Italy's debt-to-GDP ratio is predicted to reach over 155% for 2020.

This is a dilemma for moderate Eurosceptics who want to see the EU succeed and reap the rewards of regional cooperation but are sceptical of ever-deeper EU integration. In order to escape eternal wealth redistribution, the eurozone will have to reform and become a true fiscal union with more equal taxation and social wealth creation and benefit schemes. These require a substantial expansion of Brussels' authority. Alternatively, it will have to abandon the common currency.

For now, the EU and the eurozone may once again dodge the bullet. But whatever form the eventual compromise takes, the EU will emerge weakened from COVID-19. Short of deep reform, disgruntlement will be either with the Southern countries or the Northern taxpayers.

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