FOUR WINTERS IN BRUSSELS: THROUGH SEVERAL CRISES TOWARDS MUTUAL DEBT

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Introduction

The author worked on a diplomatic position in Brussels from 2017 to 2020 and was directly involved in the change the economic and financial policies of the European Union (EU), which was largely driven by the global financial crisis of 2008–2009 and the euro area debt crisis that followed in the first half of the second decade. The period of the Estonian Council Presidency was also part of this period of economic and financial diplomacy. In the middle of the decade, common financial instruments were created, which burden on the Community budget was expected to be and has been rather limited (facilitating access to capital through the guarantees of the EU). Since 2017 (after the French presidential elections), a subject of a common euro area budget appeared more visibly, yet, a decisive breakthrough in policies was made at the outbreak of the Covid-19 pandemic. It shall be noted that an idea of redistribution of debt (a so-called transfer union) has been a sensitive topic for several members of the Union. In the summer of 2020, the Member States agreed on a joint loan, which shall be partly disbursed to the Member States in a form of non-refundable support, the repayment of the Community loan being not linked to the share of the support. With this, the Union is being redistributing mutual debt.

Purpose and background of the article

The purpose of the article is to look at the paradigm change in the economic and monetary policy of the EU and the euro area in particular in previous decade, a time when the EU has had to adapt to several crises.
At a time when countries were dealing with recurrent waves of Covid-19 infection, a major military crisis erupted in Europe, with unpredictable effects on the world's leading economies. Economic policy steps related to the war in Ukraine, however, are not the subject of the article.

The EU is a large and complex system of institutions, in which changes take place slowly. Major changes are more likely introduced due to external pressure, which is particularly evident in the Covid-19 pandemic. An example here is the attempt to create a common budgetary instrument in the euro area, which would be used for the benefit

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of common policies. The Commission proposal was discussed in the Council for almost two years without any specific results, whereas decisions on the Recovery and Resilience Facility (RRF) thereafter were taken in the spring and summer of 2020, in three months following the outbreak of the pandemic. The essence of the RRF is the following: investors acquire bonds issued by the European Commission, the latter transfers money to the Member States in the form of loans or non-refundable support to perform structural reforms and investments. The common EU loan, which would be shared as a non-refundable subsidy to the Member States, was difficult to imagine before the Covid-19 crisis. The spring-summer decisions of 2020 will result in different long-term changes, the effects of which will be visible only after years and will become the subject of economic studies in the future.

The Council Presidency

The author's term of office in Brussels included the 6-month Presidency period of the Council. Compared to the 2020-2022, the second half of 2017 was very stable. However, Presidency is an intense task for each Member State. In the domain of economic and financial affairs, it includes preparing and chairing the Council formation consisting of finance ministers. Financial dossiers were high on the priorities of our Presidency, especially taxation, notably taxation in an increasingly globalised and digitalised world (so-called digital taxation). It is a politically and legally complex issue that goes beyond the borders of the EU whereas Member States' interests differ to a significant extent. Our portfolio legal dossiers included the EU budget implementation rulebook (the Financial Regulation) renewal and the increase and extension of the mandate of the European Fund for Strategic Investments (EFSI). In the latter case, we reached a political agreement with the European Parliament.

Search for stabilising elements of the Euro area since 2015

The low level of investment in the euro area has represented a problem since the 2008 financial crisis. This hinders long-term economic growth. The report by the five presidents of the EU institutions published in 2015 stresses that a system using a common currency must have mechanisms to stabilise the financial system, alongside the coordination of economic policies. After the 2008 financial system crisis, the Banking Union was established in the euro area with the Single Supervision Mechanism and Single Resolution Mechanism. A bank deposit insurance scheme has not been established yet. A European Stability Mechanism (ESM) had also been set up to help the government of a Member State facing trouble on the financial market.

The members of the common currency have no longer an independent monetary policy whilst stabilisation can be facilitated through the fiscal policy. However, these options differ due to the very different and at times very high levels of debt of euro area members. Thus, an idea of a central stabiliser of the single currency area has been sought. Since a central stabilizing instrument is likely constituting a transfer mechanism (transferring wealth from one member to another), guarantee instruments of the EU were extended at as first step.

Common budget for the single currency area or the Union as a whole?

A distinction must be made between the terms "EU budget" and "Eurozone budget". The first is known as multiannual financial framework (MFF). A new budget period (2021-2027) started in 2021, which was about to be prepared at least two years before the start of the new period. The preparation of the EU budget represents a difficult and long political process in which the final decisions fall rather at the last minute. No one was able to estimate the magnitude of increase of the budget (nearly 60 %) in the beginning of this process and how the previous dogmas could change (a common loan of the EU to be disbursed to the Member States in a form of the non-repayable support).

From the political and legal point of view, the introduction of the euro area budget into the EU budget proved to be difficult, as Poland, Czechia, Hungary, Bulgaria, Romania, Croatia, Denmark and Sweden are not part of the common currency system. By allocating part of the Union budget to nineteen Member states, a corresponding part of the EU own resources mechanism must also be established. Even if technically and legally feasible, in this case, it would be to draw a dividing line into the EU, which is politically unthinkable. However, given that the economies of the common market are very closely intertwined with each other, irrespective of the currency used, it was only meaningful to keep all EU members at the table in the negotiations on a common euro area budget.

A sluggish search for a Eurozone budget before the Covid-19 crisis

The theory of the optimal currency area argues that central fiscal capacity is necessary in monetary union because Member States do not have the possibility to devalue their currency in order to restore its competitiveness in international trade. However, the term "central budgetary capacity" is not clearly defined which is why users tend to mean different things.

The financial crisis of 2008 and the European debt crisis that followed in 2013 gave rise to greater integration of the financial and fiscal system. Yet, it has not been completed. Greater fiscal integration has so far mainly meant stronger coordination of economic policies in the common rural area, organised by the Commission and endorsed by the Council. To this end, a recurring policy coordination process (European Semester) has been set up every year, starting with the preparation of country-specific reports and the adoption of country-specific recommendations to be endorsed by the Council.

Eleven German economists, policy scientists and lawyers stressed in 2013 that the currency union cannot be permanently stable without a controlled "transfer union". This has been the greatest fear of the so-called net payers (the wealthiest Member States that contribute more to the EU budget than they receive from it).

They suggested that a common security bolster could be considered in the common currency area to alleviate impacts of a steep economic decline, such as a common unemployment insurance mechanism, which would help to prevent state budget austerity measures from being triggered during the recession.

Economists have pointed out that there are basically two ways in the euro area of how central budgetary capacity could fulfil precisely the function of the stabiliser:

(i) supporting demand by increasing public investment during the recession, or
(ii) reinsurance of the national unemployment insurance systems by a central mechanism.

At the end of May 2018, the Commission came up with a proposal for a European Investment Stabilisation Instrument. It was proposed as a loan instrument by which a loan taken by the EU can be transferred to a Member State. Basically, the Union was meant to be the redistributor of the credit risk (and allowing Member states with lower credit ratings to benefit from low interest rates available for the Commission), otherwise there was no feature of a transfer union in the scheme. At the very same time, the Commission released a legislative proposal to support the structural reforms in the Member States.

These proposals went to lengthy political discussions involving lot of different political obstacles. Finally, it all went quite differently, driven by a large external shock.

An instant 100 billion loan instrument and hundreds of billions euros for a the RRF

At the outbreak of the Covid-19 crisis, Member States intervened in a coordinated way to support the economy. The firs instant measure was to support part-time work. As a matter of fact, governments promised to partly support payment of salaries to avoid sharp turbulence at the labor markets. In order to intervene with such a high financial impact, Member States needed joint lending from the markets. The Commission came up with a corresponding legal proposal (Unemployment to Mitigate Risk in an Emergency-SURE) on 26.02.2020. It was driven from the idea of backing the national unemployment systems and in amore wide terms, a central stabiliser within the common currency area. The size of the instrument was remarkable – up to 100 billion euros. It has to be stressed that at the outbreak of the Covid-19 crisis, a very rapid response was needed. Both the SURE and the RRF were built on prudent concepts of central budgetary capacity that had been prepared, proposed and negotiated over the previous two years.

Two years after the first and rather small-scale proposals for regulations testing central budgetary capacity, the Commission put on the table a proposal for a regulation on the RRF. The total volume of this facility is 672.5 billion euros, of which 312.5 billion in the form of non-refundable support. The amount of the RRF has been added to the EU budget, i.e. it shall be paid back by the Union from its future budget. At present, it is not clear from which own resources of the union this liability will be covered.. According to the regulation, repayments shall be made within 30 years starting from 2028.

By the end of 2021, the Council has endorsed most of the Member States' national recovery and resilience plans and first disbursements to the Member States are already been made.

Summary

Since the financial crisis of 2008 and the subsequent Euro area debt crisis, the European Union and the euro area have significantly improved the resilience of its financial system and more decisively coordinated its economic and fiscal policies. A banking union was set up with its main elements and a common market borrower, the European Stability Mechanism was set up. Intense discussions on central budget capability were held in Brussels between 2016 and 2020. The Commission put forward a number of proposals, which were slowly and in some way patently handled until the economic crisis caused by the Covid-19 pandemic put the ice in motion. Within few weeks Commission officials prepared the RRF proposal.

The RRF is rather a combination of a stabiliser and an instrument aiming at support of structural reforms. But it is certainly not just a stabiliser for the common currency area because it finances all 27 Member States. The heads of the Member States reached an unprecedented agreement in July 2020 by allowing to finance non-refundable support to the Member States with a common debt. Hence, a substantial addition to the EU's own resources will have to be found in years to come in order to return the mutual loan. It will be not problematic if the RRF and the national recovery plans contribute to economic growth through investments in innovation and human capital.

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