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Time for a Corona Fund

How a Coalition of Willing Member States Can Shore Up the EU Economy

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While the ECB has already taken bold steps, the EU member states need to support its efforts by committing to underwrite together some of the fiscal costs of the COVID-19 Pandemic. The best option would be to launch a Corona Fund with the power to mobilize 1 trillion EUR—support for such a fund need not be unanimous.

– Several options are currently on the table: the use of the European Stability Mechanism (ESM), strengthening the European Investment Banks and in particular its ability to extend guarantees, a backstop for national unemployment scheme with the support of the EU budget and borrowing capacity, or the creation of a Corona Fund with the issuance of coronabonds.

– The EU could use several of these instruments, but it should not limit itself to new instruments with unanimous support or existing instruments designed for other purposes.

– The most important tool would be a new Corona Fund, which could be launched by a limited number of member states and run by a new EU Agency. It should aim to deploy 1 trillion euros; the first funding would come from one-off contributions from the member states.

– Then the Corona Fund could receive own resources and be allowed to borrow with the backing of either the ESM or bilateral guarantees of participating member states. This issuance needs to be targeted, temporary, and timely. These resources would allow the Corona Fund to make grants to support both member states with especially vulnerable health systems or pressing economic needs and neighboring non-EU countries as required.

At the Eurogroup on March 24, 2020 and in the subsequent European Council videoconference on March 26, 2020, stark divisions over the need for European fiscal solidarity emerged. European heads of state and government could not agree a common position on the need for European fiscal solidarity or on the instruments to be mobilized—they have now kicked this discussion back to the Eurogroup.

President Macron of France and Prime Minister Conte of Italy spearheaded a group of nine countries (Belgium, Slovenia, Luxembourg, Ireland, Portugal, Italy, Spain, Greece and France) calling for the issuance of common debt in response to the coronavirus pandemic and its economic consequences. This proposal met with stark resistance, on the one hand from the Netherlands, which objected to any form of fiscal solidarity, and on the other from Germany, which wanted to limit any response to the use of existing instruments, in particular the European Stability Mechanism (ESM).

In the face of the COVID-19 pandemic, the European Union needs to display a much greater sense of solidarity both between its member states and towards its neighborhood and developing countries. It should prepare the policy instruments that are necessary in the short term for a common response and that will be required in the medium term to finance the economic recovery and avoid a crushing depression.

Indeed, the EU faces both immediate and medium needs that would be best addressed with common resources and expenditures. Many German political leaders agree in principle on the need for greater solidarity, as evidenced by a common letter by the Foreign Affairs Minister and Ministry of Finance,[1] but they disagree about which instruments should deliver it. While several groups of German economists have called for the creation of a common debt instrument[2], and lawyers have offered options to make it possible[3], there are still political disagreements preventing a consensus. The Eurogroup, meanwhile, does not seem intent on forcing through a compromise, suggesting this will remain a live discussion for a while.[4]

In the short term, EU member states need resources to respond to the health emergency, centralize the procurement of critical medical equipment and devices, and assist the economy as it goes into hibernation and workers are confined. But in the medium term, when the health crisis is under control, the EU will also need a common economic response in order to ensure the speediest and most coordinated recovery possible. These instruments need to be put in place now: by the end of the health crisis, national fiscal policy, having addressed the immediate fallout of the crisis, might be straining under the pressure and thus operating under more constraints.

The EU will likely require a common fiscal response along the lines of a boosted Juncker Plan/Green Deal. A coordinated economic recovery plan would also ensure a somewhat level playing field and avoid a race to the bottom combining increased state aid and cuts in social, regulatory and environmental standards. It is important that the economic recovery post-COVID-19 does not come at the expense of the climate transition and Europe's regulatory standards, but rather helps to support them further.

For the time being, the European Central Bank (ECB) has taken the boldest common action. It announced a Pandemic Emergency Purchase Programme (PEPP), which will buy some EUR 750bn of European Government bonds and commercial paper by the end of 2020. Importantly, this program will allow deviation from the ECB's capital key with regard to both the "issuer" limit and the "issue limit", which had prevented the ECB from buying more than 33 percent of a government's outstanding debt or of a particular bond issue or a particular country. The capital key was a constraint on the ECB's existing Quantitative Easing/Public Sector Purchase Programme (PSPP).

Yet there was a widespread expectation that European governments would do more than express the required political support for these measures, that they would rise to the moment themselves and deliver something heftier than a relaxation of fiscal and state aid rules. The European Council[5] failed on March 26

1 Heiko Maas and Olaf Scholz, "A response to the corona crisis in Europe based on solidarity," *German Federal Foreign Office*, April 3, 2020: https://www.auswaertiges-amt.de/en/newsroom/news/maas-scholz-corona/2330904 (accessed April 3, 2020).

2 Sebastian Grund, Lucas Guttenberg, Christian Odendahl, "Sharing the fiscal burden of the crisis: A Pandemic Solidarity Instrument for the EU," *VOX CEPR Policy Portal*, April 5, 2020: https://voxeu.org/article/pandemic-solidarity-instrument-eu (accessed April 6, 2020).

3 Matthias Goldman, "The Case for Corona Bonds," Verfassungsblog, April 3, 2020: https://verfassungsblog.de/the-case-for- corona-bonds/ (accessed April 3, 2020).

4 Mario Centeno, "Interview of Mário Centeno with Süddeutsche Zeitung, Le Figaro, La Repubblica, El Pais and Volkskrant", *European Council*, April 4, 2020: https://www.consilium.europa.eu/en/council-eu/eurogroup/president/news/2020-04-04-interview/ (accessed April 7, 2020).

5 "Joint statement of the members of the European Council from 26 March 2020," *European Council*, March 26th, 2020: https://www.consilium.europa.eu/en/press/press-releases/2020/03/26/joint-statement-of-the-members-of-the-european-council-26-march-2020/ (accessed April 3, 2020).

to agree on a common fiscal response, so it will be up to the Eurogroup to propose a set of options to European heads of state and government on April 7. There are essentially four options on the table:

CONDITIONAL SUPPORT WITH THE EUROPEAN STABILITY MECHANISM

Most governments will prefer to craft a response on the basis of the European Stability Mechanism. The problem is that the ESM was fundamentally designed to provide assistance in the case of an asymmetric crisis where one or several (but not all) member states are losing or are at risk of losing market access. By pooling borrowing, the ESM makes it possible to reduce borrowing costs for the affected member states, but it doesn't formally mutualize debt because the member state in need ends up borrowing from the ESM. There is thus a mutualization of the borrowing cost but no mutualization of debt.

In addition, the ESM can only operate under conditionality. The Precautionary Conditioned Credit Line (PCCL) and the Enhanced Conditions Credit Line (ECCL) both allow lighter conditionality than a standard ESM program, but they require conditionality[6] nonetheless. This conditionality could be staged, with only limited conditions at first so that member states can access funds now, but tighter conditions later to ensure a return to fiscal stability. In addition, some member states believe that the Debt Sustainability Assessment (DSA) should remain an important part of framing the conditionality over time and not only the immediate health challenges. A new facility could be created, but even this would hardly escape the broad logic of national veto on programs and conditionality, which remain the fundamental DNA of the ESM.

The German Government has insisted that the ESM remain the preferred instrument for intervention. It has indicated that its lending could be as large as EUR 100bn and that it could be specifically used to backstop national unemployment insurance schemes and to allow generous partial unemployment/Kurzarbeit programs (shorter working hours financed by government subsidy) to be undertaken.

These options are unlikely to find a consensus inside the Eurogroup, and if this is the only thing the Eurogroup can put on the table, the member states in need simply will not use it. Indeed, according to the provisions of the ESM Treaty, the Art. 136 in the TFEU on which it is based, and the rulings of the German Constitutional Court, the ESM cannot be used without conditionality. The initial conditionality could be very light indeed, but the use of an ongoing Debt Sustainability Assessment would allow conditionality to be imposed ex-post when the member state needs to start repaying its loan to the ESM.

Because of concerns about tight conditionality later, member states will seek to avoid borrowing from the ESM if they can avoid it. In addition, the amounts that would be made available are too small to really matter given the size of the expansion considered. We are facing not a shock to a single member state but a symmetric shock that has brought much of every member state's economy to a grinding halt. The concern is thus not about individual borrowing costs but about how to pay for a common response, a task for which the ESM seems wholly inappropriate.

The initial conditionality of the ESM could be very light

Indeed, the ESM would only serve the same objective as the current PSPP and PEPP programs, but in a less effective way because of its more limited firepower and unnecessary conditionality at a time when concerns about moral hazard do not warrant such conditions. More importantly, responding via the ESM could undermine the effectiveness of the ECB's instruments by signaling member states' preference to make assistance conditional and limited at a time when it needs to be potentially unlimited and unconditional.

6 Guideline on Precautionary Financial Assistance," *European Stability Mechanism,* April 3, 2020: https://www.esm.europa.eu/sites/default/files/esm_guideline_on_precautionary_financial_assistance.pdf (accessed April 3, 2020).

STRENGTHENING THE EIB

One alternative is to strengthen the European Investment Bank's ability to respond to the economic shock by providing guarantees, loans, and possibly direct investments and spending to the European corporate sector. This could play an important role in the recovery phase.

Strengthening the EIB would free up national fiscal resources and fully mobilize the EIB's ability to borrow and to extend guarantees. However, given the high level of economic uncertainty, it would be economically beneficial if the EIB agreed to meaningfully relax its investment guidelines on risk taking and to considerably expand its capacity to guarantee corporate borrowing. This might require an increase in in the capital of the EIB.

The EIB could play an important role, as its borrowing backed by EU member states effectively constitutes an important source of mutualization of the European response. However, it is important to note that the EIB cannot undertake direct fiscal spending and that its role would in fact be limited to financing public infrastructure or backing the private sector. While those are certainly important elements of an economic recovery package, they would probably not be suitable for the response to the immediate emergency.

A EUROPEAN UNEMPLOYMENT INSURANCE BACKSTOP BUILT ON THE EU BUDGET AND ITS ABILITY TO BORROW

The European Commission is working on loans from the EU budget to back national unemployment schemes.[7] This funding would allow each member state to expand its insurance scheme and encourage the use of Kurzarbeit and other partial unemployment schemes. While it would not allow any transfers or mutualization, this option would allow the EU to issue common debt. (This scheme would, however, be based on loans from the EU at a time where no member state is having trouble borrowing money.)

In fact, the EU already issues "Eurobonds" backed by the EU budget. Three facilities are used to issue common debt[8]: (i) the European Financial Stability Mechanism (EFSM), which can issue up to 60bn and lend it to EU member states, (ii) the Balance of Payment facility, which can borrow up to 50bn and lend it to non-Euro Area member states experiencing a balance-of-payments crisis (usually alongside the IMF) and finally (iii) the Macro Financial Assistance facility, which can be used alongside IMF programs for non-EU countries.

The total borrowing capacity of the EU is, however, constrained by the resources ceiling of the European Budget. There are several ways to increase the borrowing capacity of the EU budget, such as increasing the Own Resources Ceiling Directive, for example by including new potential resources (perhaps a carbon border adjustment tax, a tax on plastics, or an increase in Emission Trading Scheme revenues…), or by raising the size of the guarantee fund that allows the EU budget to borrow. These options need not necessarily lead to an increase in expenditure, but they would allow the EU to borrow more and create a new borrowing facility entirely controlled by the European Commission.

In principle, such an agreement would be superior to options one and two, both in terms of firepower as well as in the design of collective policies. However, this option requires unanimity by the Council and would have to be effectively reflected in the new Multi Annual Financial Framework. The German Government seems keener to design this unemployment insurance support through the ESM rather than through the EU budget. It will be important to see whether the Commission and others allow this process to take place through an intergovernmental rather than community approach.

7 "European Commission Proposal for a Council Regulation on the establishment of a European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) following the COVID-19 outbreak (leaked)," *Politico.EU*, April 1, 2020: https://www.politico.eu/wp-content/uploads/2020/04/SURE-Regulation-clean.pdf (accessed April 3, 2020).

8 "Investor Presentation: January 2020," *European Commission*, January 2020: https://ec.europa.eu/info/sites/info/files/economy-finance/eu_investor_presentation_en.pdf (accessed April 3, 2020).

A TEMPORARY, AD-HOC INSTRUMENT ABLE TO MUTUALIZE RESOURCES AND ISSUE CORONA-BONDS: A CORONA FUND

All of these options have something going for them. But given the intractable divisions on this matter and the urgency of the economic crisis, it is important that the EU consider more flexible instruments. The goal should be to allow a coalition of the willing to move forward even in the absence of unanimous agreement now, but to keep the door open for all willing member states to participate later. By taking the following steps, the EU could bypass unanimity rules and empower a coalition of the willing to create a new form of common shared resources and common borrowing:

I. Create a Corona Trust Fund with all willing member states. Since 2013, the new Financial Regulation governing the EU budget has allowed the Commission to administer a fund to respond to major challenges and specific needs. In addition, the European Treaty foresees in its Article 222 a solidarity clause that offers options for member states to act jointly "to provide assistance to another EU country which is the victim of natural or man-made disaster" and allows them to resort to the use of an EU Solidarity Fund[9]. Trust Funds and the Solidarity Fund are voluntary vehicles, and member states can contribute financial resources to pursue a common policy objective. Article 187 of the 2012 Financial Regulation allows for the creation of a Trust Fund, although such funds were initially intended to support the EU's external actions. In this case, the fund would have both an external component (assistance to developing countries) as well as an internal solidarity component. This fund could be first endowed by voluntary, one-off contributions from the member states of EUR 10-20bn, but its resources would need to be able to expand over time.

II. Task the Commission with establishing a new EU Agency to coordinate the actions of the member states taking part in the Corona Trust Fund and transform the Trust Fund into a vehicle for delivering financial assistance. In order to use Article 352 as the legal basis for this, three conditions must be fulfilled: (i) there must be no other legal basis in the Treaties for the action, (ii) the action must be within the framework of Union policies, (iii) it must be necessary to attain a Treaty objective (in this case Article 4 (k) of the TFEU[10]). The Commission could on that basis extend financial assistance under Article 122(2) TFEU and implement it through Article 120 of Regulation 2018/1046). The EU agency created need not include all member states—think of the Single Resolution Board, which is an EU agency but only includes member states taking part in the Banking Union.

III. Establish, through an intergovernmental agreement[11], new own resources for the Corona Trust Fund, which would then become a Corona Fund and would no longer depend on exceptional contributions of member states. Its resources could be a small portion of VAT or a special tax on air travel (for the single resolution fund, it is a levy on banks).

IV. Authorize the Corona Fund to borrow on the basis of the own resources committed to it and with the additional backing of:

- A backstop from the ESM[12], very much along the lines of the SRF backstop from the ESM.
- A set of bilateral guarantees[13] from the participating member states to serve as credit enhancement on top of the stream of own resources along the lines of the EFSF.

V. Ensure that the funds issued by the Corona Fund, like national debt or supranational debt (EIB, ESM, EFSF), are eligible for ECB refinancing and asset purchases operations .

9 The EU Solidarity Fund was established in 2002. The Fund has been mobilized for more than 56 disasters covering a range of different catastrophic events including floods, forest fires, earthquakes, storms and drought.

10 The Union shall share competence with the Member States where the Treaties confer on it a competence which does not relate to the areas referred to in Articles 3 and 6 such as (k) common safety concerns in public health matters, for the aspects defined in this Treaty. See "Consolidated Version of TFEU", *Official Eu Journal*, September 5th, 2008: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12008E004&from=EN (accessed April 3, 2020).

11 Member States could use the precedent and drafting of the intergovernmental agreement establishing the Single Resolution Board and the transfer and mutualisation of contributions to the single resolution fund. See "Agreement on the transfer and mutualization of contributions to the Single Resolution Fund," *Council of the European Union*, May 14, 2014: http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%208457%202014%20INIT (accessed April 3, 2020).

12 This has not come into force, but the draft guidelines for the ESM to serve as backstop to the SRF could be used here. See "Draft Guideline on the Backstop Facility to the SRB for the SRF," *European Council*, December 4, 2019: https://www.consilium.europa.eu/media/41668/20191206-draft-backstop-guideline.pdf (accessed April 3, 2020).

13 The early agreement on the EFSF provides a template for the use of bilateral guarantees to ensure proper joint debt issuance with the highest possible rating. See "ETSF Framework Agreement," *ETSF*, November 10, 2019: https://www.esm.europa.eu/sites/default/files/20111019_efsf_framework_agreement_en.pdf (accessed April 3, 2020).

Not all of these steps can be secured at once and they will all be subject to challenges, but they are all legally and political possible provided there are enough member states willing to go ahead. Importantly, because such a Corona Fund would be entirely embedded in EU law, the European Institutions would have to side with those member states that support it, rather than its detractors.

How much could a Corona Fund raise? That largely depends on the length of the crisis and the depth of the shock, but a flexible instrument of this nature would enable the mobilization of around EUR 1 trillion without much difficulty. The more countries that decide to take part, the better and the more solid the financial construct, rating, and borrowing capacity would be. But even a small coalition of the willing could start.

European Fiscal Options to Respond to the Corona Pandemic

	PROPOSED BY	SUPPORTED BY	TYPE	AMOUNT IN EUR	LEGAL BASIS
Coronavirus Solidarity Fund	Shahin Vallée	-	Common Issuance of a coalition of willing Member States	1,000 bn	Art. 352 /222 TFEU
Pandemic Solidarity Instrument	Sebastian Grund et al.	-	Common Issuance	440 bn	Art. 12 TFEU
Corona Bonds		IT, FR, ES, SL, BE, LU, IR, GR, PT	Common Issuance	-	-
Corona Fund	FR	FR	Transfers/grants and Common issuance	-	-
European Stability Mechanism (ESM)				410 bn	Art. 136 TFEU
Enhanced Conditions Credit Line (ECCL)			Loans		
Ad-hoc Covid Credit Line	Agnes Bénassy et al.		Loans		
Unemployment Insurance Loans	German Federal Ministry of Finance (BMF)	DE	Loans	100 bn	
Unemployment Insurance (SURE)	European Commission	EC	Loans to national budgets	100 bn	Art. 122 TFEU
EU Budget/ multiannual financial framework (MFF)	European Commission	ALL	EU Budget	37 bn	
Corona Transfers via EU Budget	Daniel Gros	-	Recurrent Transfers from EU budget	-	
One-off-Transfer Fund	NL	NL	One off Transfers from National budget	10-20 bn	

Source: Author's own compilation

A Corona Fund would bypass the unanimity requirement, which is both a strength—because it permits fast action—and a weakness. Critics will argue that a fund without unanimous support could cause a potential fragmentation within the EU or the euro area and create a precedent that weakens the currency union. However, the risks of fragmentation are limited as long as it is clear that this vehicle is temporary, and that the associated transfers are limited to the coronavirus crisis. The ECB would have to commit to treat these bonds as it would treat national or European supranational bonds. In fact, rather than dividing the EU, the coalition of the willing could convince all member states to eventually participate over time.

Politically, going down this path could be an important departure from the current French strategy of systematically trying to negotiate a bilateral Franco-German agreement before pushing any European initiative. However, this approach has showed its limits. For the French, embracing transnational politics and coalition building could be a new way to force Germany to take a clear stand and limit its delaying and veto power. It would potentially erode Germany's own support among the EU's more fiscally hawkish countries, as is already visible with the weakening of the Hanseatic league.

But while it is a risky strategy and could lead to a more profound deadlock and divided Europe, it is a chance worth taking so long as the ECB is prepared to continue to backstop the member states that participate in it. The real dangers for the unity of the Euro Area are not so much associated with forming a coalition of the willing; they lie rather with inaction that erodes the affectio societatis that ties Europe together, or with ECB inaction that could be the real source of financial fragmentation. These are the two most important risks worth fighting against.

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