European Council finalizes Multiannual Financial Framework and Additional COVID-19 Response Measures

By Aidan Lawson

Original post here.

On July 21, the European Council unveiled its latest plans for the region's economic recovery from the ongoing COVID-19 crisis. The hotly debated package contains approximately €1.8 trillion in assistance for EU member states. Council members redesigned and reiterated the package multiple times since discussions began back in late April (see here).

Discussions about revamping the EU's long-term budget, called the Multiannual Financial Framework (MFF), and the creation of a COVID-19 recovery plan began on April 9. On that day the Council published a report that outlined the region's economic policy response to the COVID-19 pandemic thus far (see here).

In that report, the Council endorsed repurposing existing budgetary resources and augmenting the capacity of the European Investment Bank (EIB) to address the pandemic. It stated that it would discuss operationalizing a new recovery fund (see here). The Council also agreed on immediate relief through existing mechanisms totaling about €540 billion, to be deployed on June 1 (see here).

The MFF has two components: a multiannual financial framework regulation, which details how much the EU can spend, and an own-resources decision, which shows where the revenue comes from (see here). The European Council and Council of the EU negotiate the MFF in advance, and it typically covers a period between five to seven years. The recovery fund would be "temporary, targeted and commensurate with the extraordinary costs of the current crisis." There would be heated debate over the structure, amount, and type of aid that this fund would give.

On April 23, the Council had its first meeting to discuss the MFF and recovery fund. Member states had opportunities to bring forth their proposals, and France, Italy, and Portugal strongly endorsed a Spanish plan to provide up to €1.5 trillion in grants to distressed nations. However, other nations - the Netherlands, Germany, and Sweden - argued against financial transfers and stated that they would prefer loans instead. President of the European Commission Ursala von der Leyen said that the eventual recovery fund would likely contain a mixture of the two (see here).

On May 13, von der Leyen provided more details about the recovery fund in a proposal to the European Parliament (see here). The proposal stated that the money in the fund would be spent across three major pillars:

1. A new recovery and resilience tool for public investment in the hardest-hit member states.

2. A new solvency instrument that will revive private investment and "match the recapitalization needs of healthy companies who have been put at risk as a result of the lockdown"
3. A new dedicated health program, and efforts to strengthen existing programs

Von der Leyen went on to say that the recovery fund would be short-term, focused on areas that were most in need, and include grants, as well as the possibility to frontload some of the investment if needed. The proposal did not include specific amounts, however.

Two weeks later, von der Leyen announced the name of the €750 billion recovery fund: Next Generation EU (see here). The European Commission would fund this separate program by issuing bonds on behalf of the EU on financial markets, something that has never been done before.

The majority of this borrowing would take place from 2020-24 (see here). The EC would distribute €500 billion of the aid as grants, and the other €250 billion as loans. Additionally, the revamped MFF would total about €1.1 trillion from 202127.

Under this plan, a total of €2.4 trillion in assistance would be available via Next Generation EU, the MFF, and the aforementioned aid passed in April. Member states generally reacted positively to the proposal, although some (namely the "frugal four" group of Austria, Denmark, the Netherlands, and Sweden) professed the importance of budgetary discipline and advocated for a more even balance between grants and loans (see here, pp. 2)

The Council discussed the Next Generation EU and the MFF in a meeting on June 19. While difficulties remained, Council President Charles Michel stated that there was an "emerging consensus" and that the Council would further discuss the plan in July (see here). In a special session from July 17-21, the Council agreed to a proposal that was largely similar to the one in May (see here).

The final package of aid is broken up as follows:

1. A total of €750 billion for Next Generation EU. This would be funded through borrowing in financial markets by the European Commission on behalf of the EU. Up to €390 billion can be given in the form of grants, and up to €360 billion as loans (see here, pp. 3).
2. A revamped MMF totaling €1.074 trillion. Additional flexibility has been added to help the EU tackle exceptional circumstances created by the COVID-19 crisis. Annual GNI-based contributions of the frugal four and Germany have been reduced for the years 2021-2027 (see here, pp. 8).

For more details on the final package, see this YPFS blog post.

The nearly €1.1 trillion in the MFF will not go entirely towards COVID-19 economic relief. The primary goal of the MFF is to "allow the EU to fulfill its long-term objectives and preserve the

full capacity of [Next Generation EU]" (see here). To this end, the MFF also includes funds to tackle climate change, gender equality, digitization, and other key areas. However, the Council has increased health expenditures and introduced spending flexibility to "address new priorities in light of the rapidly changing situation following the COVID-19 pandemic" (see here, pp. 12). For more information on the EU's immediate response to COVID-19 see this YPFS blog post.

The passage of this plan represents a dramatic shift in the dynamics of EU funding and debt mutualization efforts. Large contributors such as Germany have recently and historically opposed burden sharing, even when the region was rocked by a sovereign debt crisis barely a decade ago.

However, bonds issued and guaranteed jointly by European states are in fact not a new instrument and have been used in extraordinary times since the 1970s. They were used first during the 1973 oil crisis as part of the Community Loan Mechanism, which issued its first bonds to Italy and Ireland in 1976 (see here). Much like today, the EU budget was used to guarantee repayment to private creditors, with a second set of quota-based guarantees from each European nation in case there weren't enough budgetary resources.

The European Central Bank (ECB) and European Stability Mechanism (ESM) have already provided relief to some of the most heavily indebted nations, such as Italy and Greece. Both the ECB and ESM have helped keep funding costs low for these nations by purchasing hundreds of billions of euros in sovereign debt or providing low-cost credit lines as an alternative to issuing expensive debt. While this isn't direct burden-sharing in the same way that issuing joint European debt is, the shareholders of the ECB - that is, euro-area members - would ultimately be liable for any losses.

It has taken several months, but a combination of Next Generation EU, the revamped MMF, and the efforts by the ECB and ESM may prove to be a potent enough mixture to provide substantial relief from the economic damage wrought by COVID-19.