THOUGHTS ON THE DESIGN OF A EUROPEAN RECOVERY FUND

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Abstract

The European Union (EU) requires swift, lasting and sufficient action to combat the health and economic crisis triggered by COVID-19. The ECB and EU Council's responses have been effective in mitigating the short-term impact of the crisis and reducing the risks of it becoming protracted by enabling the Member States (MSs) to mobilise a significant volume of funds. Nevertheless, the scale of the crisis has underlined the absence of key shared economic policy instruments.

This article analyses the conditions required for an effective European response to the crisis and its possible consequences in the future. First, the article outlines the basic features which should underpin a recovery strategy based on providing a joint response to common structural challenges (the fight against climate change, digitalisation, higher investment in public health and disease prevention, and a restructuring of broad areas of the productive system) with fresh funds and a renewed reform drive.

Second, a design proposal for a "Recovery Fund" is set out. Funds will be mobilised with the twofold objective of maintaining suitable financing conditions for MSs' sovereign debt (which requires giving the Fund the capacity to purchase government debt securities for an extended period of time) and boosting the financing of specific structural projects aligned with the strategic needs of the EU as a whole. This instrument must be efficient (governed by the principle of a suitable and proportionate use of public funds), show solidarity (by making its funds particularly available to those who most need them), be balanced (by eliminating permanent transfer risks resulting from the opportunistic behaviour of Member States) and have conditions attached to ensure that the funds are used to advance the objectives of the recovery strategy. Insofar as its creation is tied to a medium and long-term European strategy, the Fund's effectiveness should be geared to covering a very extensive time frame, potentially laying the foundations for a permanent structure. And it should be backed by the EU budget, duly strengthened by additional funds from the MSs and receipts from the future introduction of new EU-wide taxes.

Keywords: Recovery Fund, sovereign debt, European economic governance, European Union, fiscal policy.

JEL classification: E02, E62, F55.

Resumen

La Unión Europea (UE) requiere de una acción rápida, duradera y suficiente ante la crisis sanitaria y económica provocada por el Covid-19. Las respuestas dadas por el Banco Central Europeo (BCE) y el Consejo de la UE han sido efectivas para mitigar la incidencia de la crisis en el corto plazo y reducir los riesgos de su propagación, facilitando que los Estados miembros (EEMM) puedan movilizar un volumen significativo de recursos. No obstante, la dimensión de la crisis ha puesto en evidencia la falta de instrumentos clave de política económica comunes.

En este documento se analizan las condiciones necesarias para una respuesta europea eficaz ante la crisis y sus posibles consecuencias futuras. En primer lugar, se esbozan los elementos básicos sobre los que debería pivotar la estrategia de recuperación, basada en dar una respuesta conjunta a los retos estructurales comunes —como la lucha contra el cambio climático, la digitalización, el aumento del nivel de inversión en salud pública y prevención sanitaria o una reestructuración de amplias áreas del tejido productivo—, con nuevos recursos y con un renovado impulso reformista.

En segundo lugar, se detalla una propuesta para el diseño de un «Fondo de Recuperación» que permita movilizar recursos, con el doble objetivo de facilitar el mantenimiento de unas condiciones de financiación adecuadas para la deuda soberana de los EEMM —lo que exige dotar al Fondo de una capacidad de compra de títulos de deuda pública durante plazos dilatados— y de impulsar la financiación de proyectos específicos de naturaleza estructural afines a las necesidades estratégicas del conjunto de la UE. Este instrumento debe ser eficiente (regido por el principio de uso adecuado y proporcional de los recursos públicos), solidario (haciendo especialmente accesibles sus recursos a aquellos que más lo necesiten), equilibrado (eliminando riesgos de transferencias permanentes inducidos por comportamientos oportunistas de los miembros) y con una condicionalidad en el uso de sus recursos ligada a los propios objetivos de la estrategia de recuperación, con especial énfasis en potenciar las palancas de crecimiento. En la medida en que nace ligado a una estrategia europea de medio y largo plazo, el Fondo debería tener una vocación de vigencia durante un horizonte muy amplio, dando lugar posiblemente a una estructura permanente, y estar respaldado por el presupuesto de la UE, debidamente reforzado mediante recursos adicionales de los EEMM y por ingresos procedentes de la eventual implantación de nuevas figuras tributarias a escala de la UE.

Palabras clave: Fondo de Recuperación, deuda soberana, gobernanza económica europea, Unión Europea, política fiscal.

Códigos JEL: E02, E62, F55.

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1 The need for common action

The European Union (EU) requires swift, lasting and sufficient action at a time when some of its main aspirations in the area of economic prosperity and social cohesion are at risk. The health crisis triggered by COVID-19 has demonstrated the absence of key shared economic policy instruments.

In terms of economic subjects, the EU has a similar size and capacity to other global actors such as the United States and China; however, its institutional framework hampers the mobilisation of collective funds and limits its growth capacity and options for ensuring macro-financial stability within the Union. The possibilities of financing action today with a charge to future funds under the appropriate conditions, of harnessing positive spillovers between different national and European policies,[1] and of targeting action at where it is most needed are much more limited in the EU than in these other large economic areas of reference.[2] As a result of shoring up Europe's capacity to act in order to deploy shared policies and efforts across all its members, pooled resources, which are far higher than the sum of MSs' individual action, may be harnessed.

In response to this situation, in April 2020 the European Council resolved to create a "Recovery Fund", whose details have not yet been specified by the European Commission. A succession of proposals have been made in this debate which include, most notably, the initiative agreed recently by the German and French governments[3] to create a €500 billion fund, within the European budget, to finance investments in keeping with European priorities.

This article analyses the conditions required for an effective European response to the crisis and its possible consequences in the future. First, the article outlines the basic features which should underpin a recovery strategy for Europe. It then describes a design proposal for the Recovery Fund.

1 On this point, see Banco de España (2017), Alloza, Burriel and Pérez (2019) and Alloza et al. (2020).

2 See, inter alia, Banco de España (2017) or Albrizio et al. (2018).

3 Information on this initiative is available at: https://www.diplomatie.gouv.fr/en/coming-to-france/coronavirus-advice-for-foreign-nationals-in-france/coronavirus-statements/article/european-union-french-german-initiative-for-the-european-recovery-from-the

2 A recovery strategy for Europe

The coronavirus crisis is prompting an unprecedented fall in economic activity due to its reach (it is affecting all EU countries), its speed (in a question of weeks millions of jobs have been destroyed) and its severity (all MSs are facing the biggest economic recession of many decades). According to the spring 2020 forecast of the European Commission (EC), GDP will fall by 7.7% in 2020 and unemployment will increase significantly (see Chart 1). Furthermore, the EC acknowledges downside risks to this scenario which, if they materialise, could question the pillars of the EU, including the potential fragmentation of the Single Market. For this reason, the epidemic has drastically changed the scenario and priorities of the Union's economic policies.

In the short term, given increased healthcare expenditure, government net borrowing will escalate most considerably in the next few months. This will be due to higher spending on various programmes implemented throughout the EU to contain the slump in income of broad swathes of the population and to provide liquidity and financing to businesses and the self-employed.[4] More immediately, therefore, it must be ensured that the MSs can mobilise sufficient funds to adopt the measures required to mitigate the economic fallout from the pandemic and avoid a protracted crisis. It is against this backdrop that the recent action of the European Central Bank (ECB) and the EU Council was taken.

The asset purchase programme (APP) was enlarged by a further €120 billion until end-2020 by the Governing Council of the ECB (as agreed at its meeting on 12 March 2020), and the Pandemic Emergency Purchase Programme (PEPP) was launched with an envelope of €750 billion and a similar time frame. The former and, in particular, the latter have given rise to the risk of spiralling increases in the risk premia of the economies which are most vulnerable to this crisis, as occurred during the period 2010-2012. This has meant that, despite the sudden deterioration of public finances and the steep recession facing the euro area as a whole, national governments, which have made highly considerable budgetary efforts to alleviate the impact of the crisis, can continue to finance themselves under relatively normal conditions.

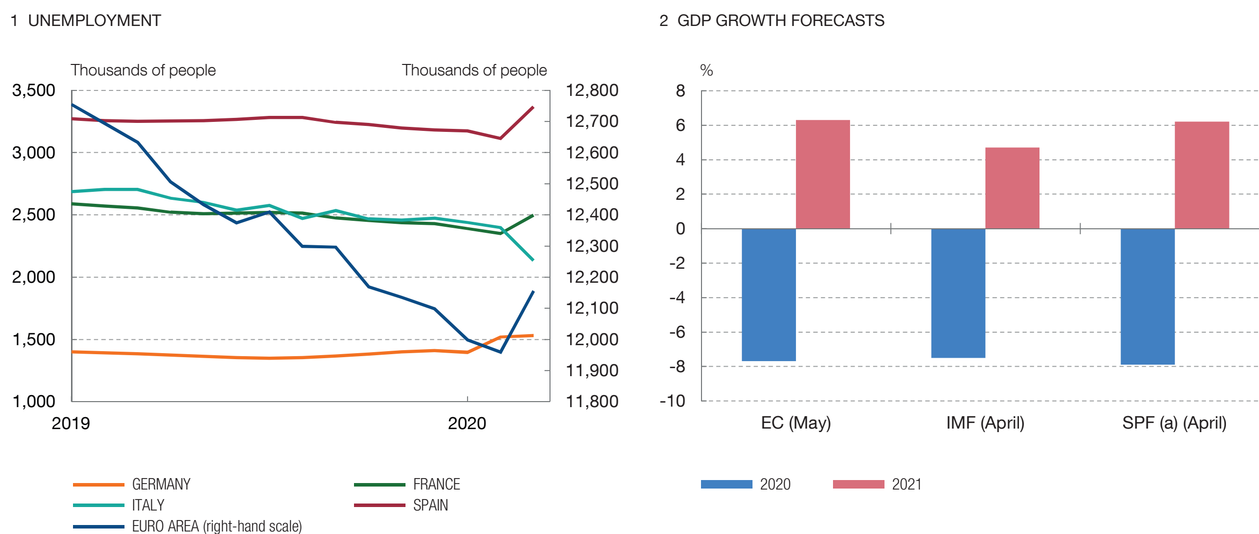
In April the European Council agreed a policy response package. This included the mobilisation of structural funds to finance pandemic-related expenses; the implementation of the temporary support instrument to mitigate unemployment risks in an emergency (SURE); the launch of financing facilities for the private sector by the European Investment Bank (EIB); and the agreement to provide a credit facility through the European Stability Mechanism (ESM) aimed at covering direct and indirect pandemic-related healthcare costs.

Overall, these measures lend considerable support to crisis management to cover the most pressing needs. In other words, the measures adopted in recent weeks by the

4 See Delgado-Téllez et al. (2020).

Chart 1
UNEMPLOYMENT IN THE EURO AREA AND THE MAIN MEMBER STATES, AND EURO AREA GDP GROWTH FORECASTS

The forecasts point to a significant drop in GDP and a notable increase in unemployment as a result of the COVID-19 crisis.



SOURCES: ECB, European Commission and IMF.

a Survey of Professional Forecasters.

ECB and the European Council have gained time. However, the question is: time to what end? Basically, the purpose is to implement a European recovery and growth strategy which identifies medium and long-term strategic priorities, assigns clear responsibilities across European institutions and the governments of MSs, and sets up ahead of time fiscal and financial instruments to develop the strategy and mitigate the risk of macro-financial fragmentation within the Union, the latter being a prerequisite for undertaking everything else.

In addition to the structural challenges already facing the EU[5] in the medium term, such as digitalisation or the fight against climate change, there will be new needs arising from the current crisis. These include most notably higher investment in public health and preventive healthcare, and a restructuring of broad areas of the productive system. At industry level, adaptation must be made easier for those sectors which may be struggling in a world where there are greater restrictions on the movement of individuals, such as transportation or tourism. At the same time, the EU's industrial policy strategy needs rethinking in order to strengthen its capacity to supply goods which have proved essential for tackling the current crisis, such as pharmaceutical products and healthcare equipment. Lastly, other sectors need promoting, such as digital sectors or data processing activities, which will also be key in the strategy for economic recovery and overcoming the healthcare crisis[6].

5 See Arce et al. (2020).

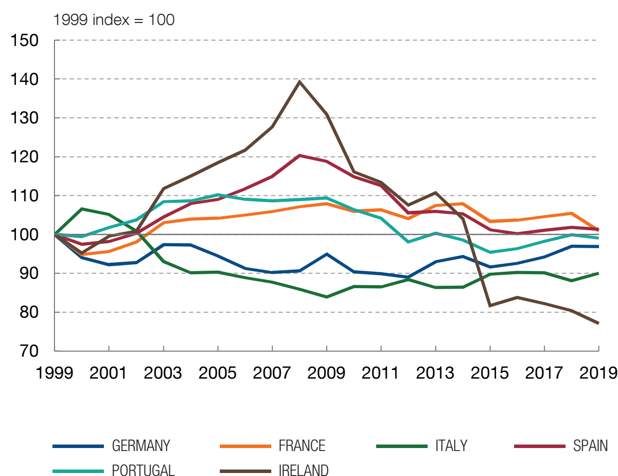
6 On these matters, see, inter alia, Pisany-Ferri (2020) or the European Commission (2019a, 2020).

Chart 2

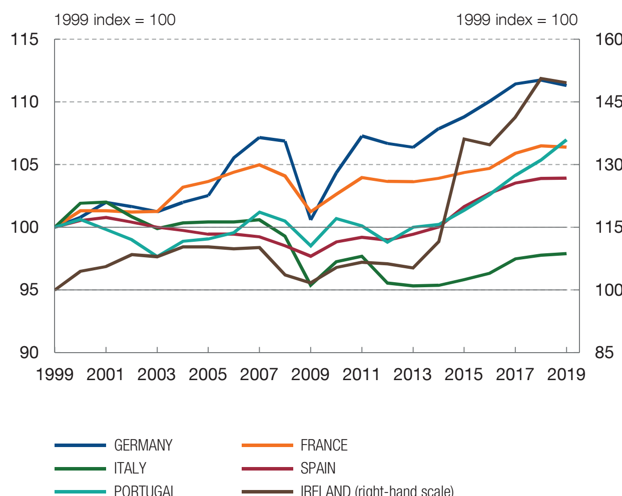
COMPETITIVENESS AND PRODUCTIVITY IN THE EU

The recovery of economies in the last decade is related to gains in competitiveness by those countries that undertook more ambitious structural reforms.

1 COMPETITIVENESS INDEX WITH UNIT LABOUR COSTS COMPARED WITH A SELECTED GROUP OF 37 COUNTRIES (a)



2 TOTAL FACTOR PRODUCTIVITY



SOURCE: European Commission.

a An increase in the index points to a loss of competitiveness.

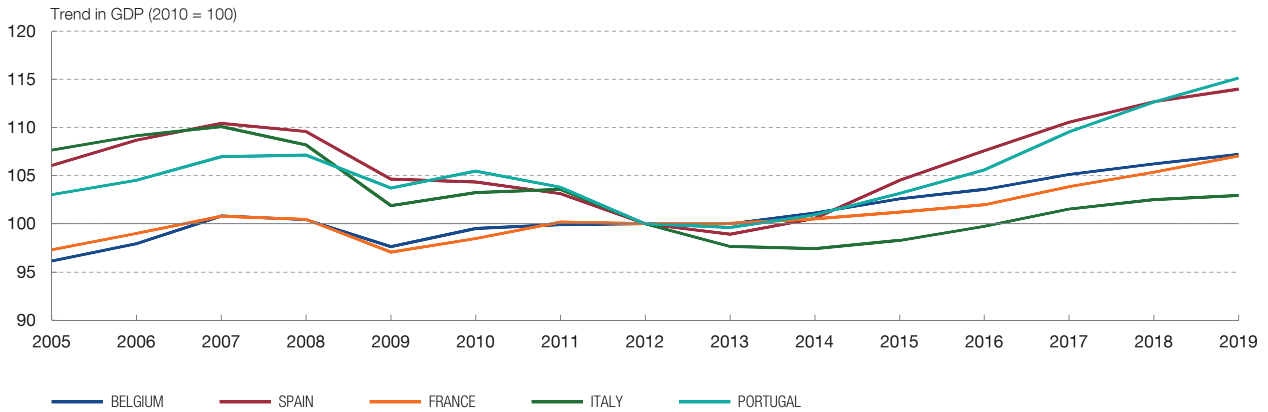
Subsequently, once the need to deploy and maintain pandemic containment measures has lessened, a clear course of action will be needed to drive the recovery of lost growth capacity as a result of the health crisis, which avoids the “actual fragmentation” of the EU, i.e. a situation where there is a pronounced divergence across countries in the pattern of their recovery from the crisis. This recovery strategy must focus fundamentally on investment and productive public spending, and the application of structural measures which promote increased productivity and competitiveness in an environmentally friendly and socially sustainable way.

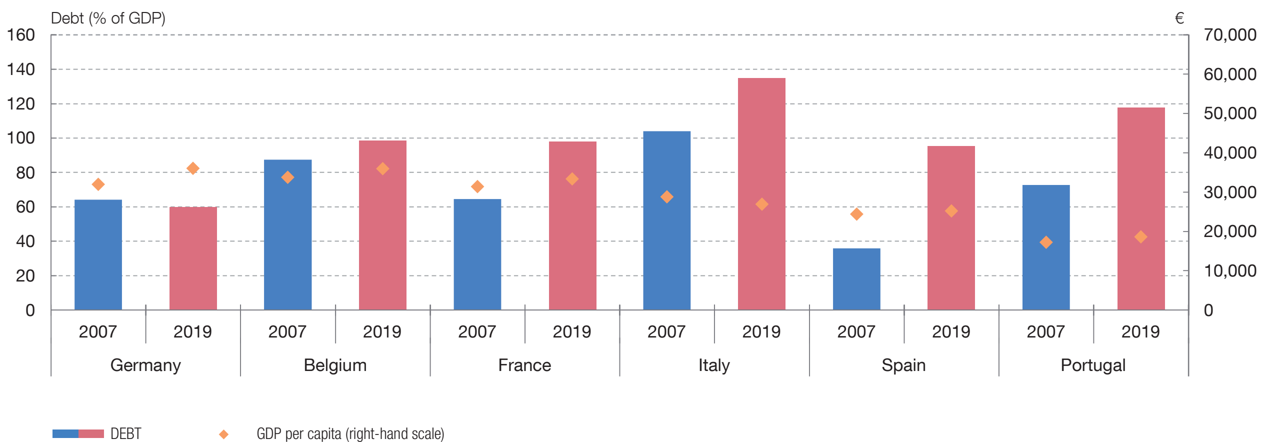
Aside from a lasting increase in growth potential and job creation, higher investment and productive spending generates a short-term stimulus through several demand channels. Once the confinement measures have been eased and agents’ behaviour returns to normal, these channels can be expected to be at their strongest. This will be so for three reasons: first, the amount of idle resources in European economies; second, the complementarity with private investment, which in turn must rapidly recover the resources that depreciated during the crisis and make the changes needed to operate in the new post-COVID 19 environment; and third, the positive synergies between the Union’s different policies. Furthermore, against a backdrop in which monetary policy will foreseeably remain markedly loose in the next few years, fiscal policy becomes more powerful, since its effects will not be offset by monetary policy.[7]

7 See Arce, Hurtado and Thomas (2016) and Banco de España (2017).

Chart 3
RECOVERY FROM THE SOVEREIGN DEBT CRISIS: A COMPARISON

Amid high levels of government debt, some countries were able to achieve sustained growth in their GDP per capita as a result of their reform drive.





SOURCES: Eurostat, FRED and World Bank.

This latter effect is even greater where this spending is focused on productive investment and is boosted within a monetary union where cross-country spillovers are larger.[8]

In a setting such as that which will foreseeably prevail in the coming years, with high pressure on national fiscal authorities' budgetary resources and historically high public debt levels, structural reforms are a natural lever for stimulating economic growth, even in the short term[9]. The experience gained after the last great crisis clearly indicates

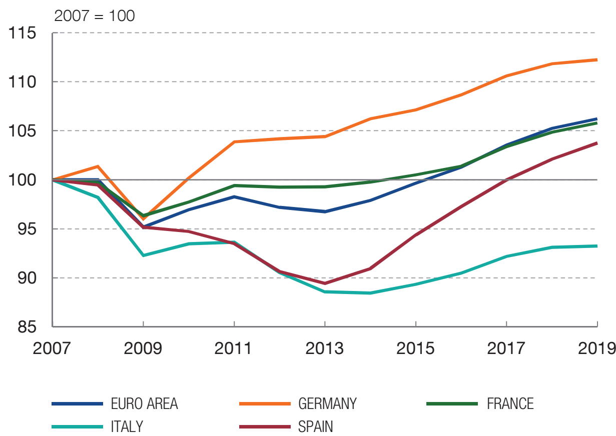
8 See Box 3.4 "The role of public investment in economic recovery" in the Annual Report (2020), and Delgado-Téllez, Gordo, Kataryniuk and Pérez (2020).

9 See Andrés, Arce and Thomas (2017) and Andrés, Arce, Fernández-Villaverde and Hurtado (2020).

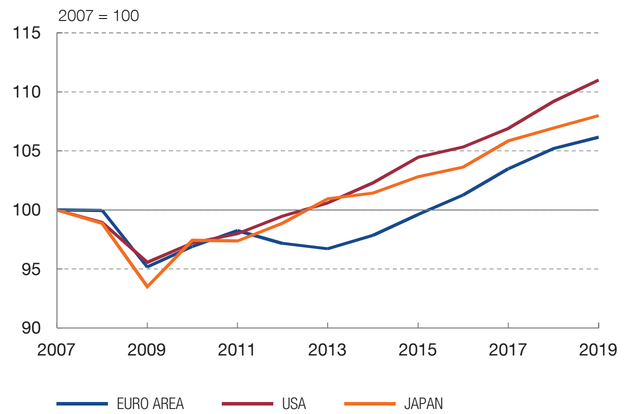
Chart 4
COMPARISON OF REAL GDP PER INHABITANT IN THE MAIN ADVANCED ECONOMIES

The divergence of growth in European countries means average living standards improve in a few countries only and generates a weaker overall trend in the euro area than other advanced economies.

1 REAL GDP PER INHABITANT IN THE EURO AREA



2 REAL GDP PER INHABITANT IN THE MAIN REGIONS OF THE WORLD



SOURCE: Datastream.

that the measures to bolster productivity, employment and balanced growth capacity are the best pillars for ensuring the sustainability of government and private debt[10]. For certain economies, the robust growth in recent years has been linked to the implementation of structural reform programmes that corrected economic imbalances and improved competitiveness (see Chart 2). This took place despite the strong initial rise in public debt which resulted in several EU countries, including Spain, turning to financing from the ESM. However, even in this difficult scenario, these countries managed to grow at a faster rate than other countries which also had high debt ratios but showed lower reform drive (see Chart 3).

The differing developments in the growth of European economies in recent years has also meant that a relatively small number of countries have achieved considerable gains in living standards between 2008 and 2019. This trend could probably worsen in the current crisis and, at the level of the euro area as a whole, contrasts with the trajectory of similar-sized economies with more buoyant growth, such as the United States (see Chart 4).

10 See Andrés, Arce, Thaler and Thomas (2020).

3 A European Recovery Fund

At present, not all the MSs and, therefore, not all European citizens, face the future with the same capacity and outlook for economic prosperity. Against this background, it is essential to ensure that all MSs can pursue a recovery drive in their economies that is commensurate with the scale of the shock and finance those efforts under conditions that their societies can accept and that are comparable with their Community peers. They share common rules, a single currency in many cases, and the same principles and values with these partners.

Faced with the risk of this crisis further – indeed permanently – exacerbating the disparity between welfare levels across the EU (the aforementioned "real fragmentation"), there is a pressing need to be able to resort to pooled resources to fund the reconstruction of all the MSs' economies. Also during this process, spells of destabilisation such as those experienced during the sovereign debt crisis that hit several euro area countries during the first half of the 2010s must be avoided. Put simply, it is time for the EU to implement the means necessary to activate the European Union's joint capacity to bring resources from the future to the present, when they are most needed. This must be done in an amount in keeping with the scale of the challenge of rebuilding the economy after the pandemic and at a cost that appropriately reflects the long-run natural interest rate's low levels which, in the case of the euro area, were estimated to stand at very low (including potentially negative) levels even before the current crisis.[11]

The pooling of the EU's borrowing capacity should be accompanied by a framework for putting that capacity to use. These would combine to form a "European Recovery Fund", a much-needed idea launched by the Council of the European Union in April, some of the broader aspects of which were developed in a recent speech by the President of the European Commission.[12]

This Fund must be efficient (governed by the principle of a suitable and proportionate use of public funds); show solidarity (by making its funds particularly available to those most in need of them); be balanced (by eliminating permanent transfer risks resulting from opportunistic behaviour by Member States); and ensure that the use of funds is tied to the objectives of the recovery strategy, placing particular emphasis on facilitating the funding of projects that enable the EU economies to regain strength and the ability to grow after the pandemic. As the origin of this instrument is attached to a medium- and long-term European strategy, it should remain in force over a very extensive time frame and should even remain in place permanently and be backed by the EU budget. In this connection, it is necessary to include new priorities in the EU budget in addition to those traditionally focused on cohesion and the common agricultural policy, and the aforementioned challenges of digitalisation and climate change.

11 See Fiorentini et al. (2018).

12 See von der Leyden (2020).

The contribution of resources and the design of the Fund should bear a relation to the needs to rebuild and increase the growth capacity of each EU MS and the EU as a whole after the pandemic, with the twofold objective of maintaining suitable financing conditions for MSs (which requires giving the Fund the capacity to purchase government debt securities) and to boost the financing of specific structural projects aligned with the strategic needs of the EU as a whole.

The main aim of the capacity to purchase MSs' government debt securities is to prevent a disproportionate increase in the immediate financial burden of those countries subject to greater fiscal stress and to enable them to finance the recovery and reconstruction of their economies without disruption. The Fund's role, therefore, in relation to this objective should be to provide a backstop that can be used in the event of the risk of scenarios materialising that entail excessive tightening in the financing conditions for one or more sovereign issuers within the EU.

Here, it may be useful to take as a reference certain key aspects of the ECB's asset purchase programmes (APP and PEPP), regarding the acquisition of public debt securities. Thus, as in the case of the ECB's programmes, the European Recovery Fund would purchase these assets under the conditions and prices set on capital markets. This would be subject to minimum credit quality requirements for the assets acquired and on the basis of pre-set transparent criteria regarding the composition of the purchasers. In turn, the Fund's operations in this area should be sufficiently flexible as to maximise the effectiveness of this instrument, especially in circumstances of marked tightening on government debt markets with possible fluctuations in the distribution of purchase flows over time and across different assets and issuers.[13] Indeed, the ECB has been operating this way in the implementation of its PEPP programme.

Unlike the ECB programmes, and given the different objectives pursued (i.e. price stability in the case of the ECB, and stability of the funding conditions for MSs in the long-term in the case of the Fund), the Fund could set the minimum conditions, in terms of the macroeconomic and fiscal stability of the economies of the MSs issuing securities to be purchased by the Fund, for calibrating their asset purchase volumes. Another notable difference is that relating to the nature of the debt in both cases. While the financial counterpart of the ECB's asset purchases is the issuance of bank reserves, the Fund's debt, under the conditions described below, would be an asset of high credit quality (i.e. a safe asset) which could be made available to any type of investor, whether a financial or non-financial company, a public entity or even a member of the general public.

In parallel, the European Recovery Fund would allocate some of its funding capacity to European projects aimed at strengthening integration and sustainable growth potential across the EU as a whole, including projects focusing on network technologies, interconnection,

13 See ECB (2020).

research and, as witnessed in recent years, on common security (borders, supplies, food and health). Looking ahead, as MSs' funding needs generated by the crisis ease, the Fund should allocate an increasing share of its funding capacity to such pan-European projects.

The size of the Fund should be sufficient to meet the above objectives. On one hand, the increase in the funding needs of MSs directly connected to the effects of the pandemic could account for more than 8 percentage points of EU GDP in 2020 and more than 2 percentage points in 2021[14]. These figures give an idea of the capacity the Fund needs to have if it is to serve as a backstop, credibly averting any possible threats to the regular funding needs of MSs. In the short term, the recovery of some capacity for productive spending and public investment, similar to that in place before the financial crisis and comparable to that of other advanced economies, could provide a useful benchmark and starting point[15]. Productive spending and public investment, as a percentage of GDP, have not only declined in economies such as Spain, which have recently undergone a fiscal consolidation process, but also reflect an overall historical trend of cutting back on public investment in advanced economies (see Chart 5)[16].

The volume of funds to be mobilised by the Fund to address these two types of needs (backstop and funding through productive spending and public investment in projects aligned with the EU's broad strategic lines) would require that this instrument be set up with an initial target capacity of around €1-1.5 trillion.

To finance these amounts, with sufficient support from MSs, the Fund should have a top-notch credit rating in order to be able to issue very long-term bonds, which, in the current low interest-rate environment, would entail minimal (even negative) costs, in terms of the interest on its debt. To that end, the European Commission should be given the capacity to claim additional funds from MSs to back new issues. Pursuant to current legislation, the EU's payment obligations (including, if any, the direct guarantees on potential debt repayments in terms of principal and interest) cannot exceed the ceiling set by the multi-annual budget (Multi-Annual Financial Framework, MFF). Under the current MFF, which concludes in 2020, this ceiling is 1.20% of EU GDP, while payment commitments already stand at 1% of GDP. Thus, there is a margin for payments of up to €31 million[17] until the end of the year. This

14 Estimates based on the EU's government deficit projections between 2019 and 2021, according to the Spring 2020 economic forecast of the European Commission (published in May), under a baseline scenario. The aggregate deficit forecast for the EU is 8.5% of GDP in 2020 (compared to the autumn 2019 forecast of 0.9%), while in 2021, the deficit is estimated to be 3.6% (instead of 1%, as forecast at end-2019).

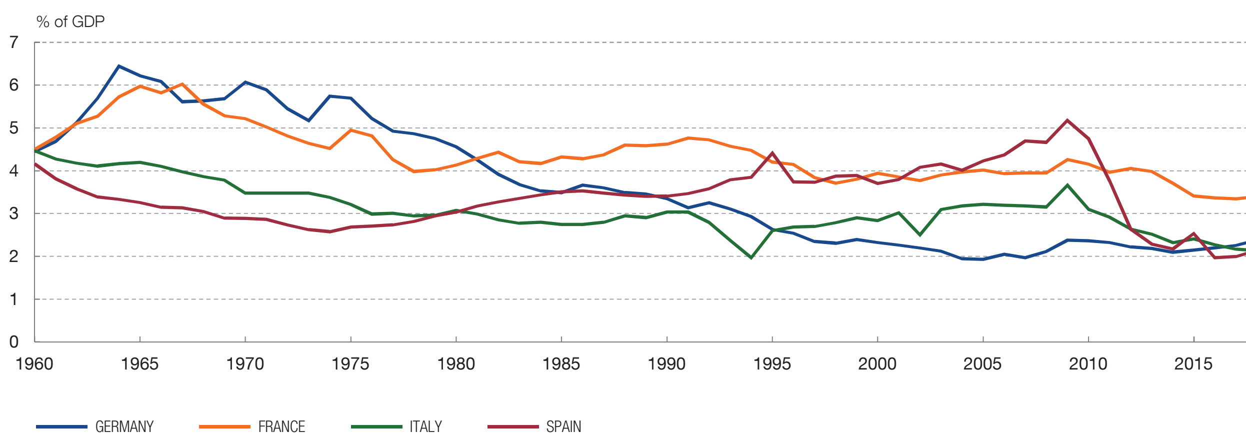
15 Productive public spending, from the standpoint of the Fund's objectives, would include items such as public investment in infrastructure, education, digitalisation, and R&D. For example, investment in the general government sector (which does not include the sizeable portion of investment channelled through State-owned enterprises) of the EU accounted for around 2.5% of GDP in 2019, compared with 3.6%, on average, in the 1980-2007 period. In that same period, the figure was 3.7% and 6.9% in the United States and Japan, respectively. It is difficult to quantify the overall (not only public) investment needs in these areas arising from the new post-COVID environment and the challenges mentioned in the text. The need for investment to adjust to and combat climate change must also be addressed. At the beginning of January 2020, the European Commission outlined a plan to mobilise up to €1 trillion over the coming decade as part of its "European Green Deal Investment Plan" (European Commission, 2020b).

16 See Delgado-Téllez et al (2020a).

17 See European Commission (2019b).

Chart 5
PUBLIC INVESTMENT FROM A LONG-TERM PERSPECTIVE

Public investment in Europe has followed a downward path in recent decades, compounded recently by fiscal consolidation.



SOURCE: European Commission.

amount should be increased substantially to ensure that the Fund has a top-notch credit rating and, if necessary, the MSs should issue guarantees to the Commission. It is therefore of crucial importance that there is sufficient support for the Fund in the new multi-annual budget framework to be adopted in 2020 to enable it to meet its objectives and to have sufficient credibility to issue highly rated debt.

The permanent increase in borrowing capacity at European level would considerably boost the amount of safe assets available in Europe. These could also be purchased, subject to broad limits, by the ECB under its different asset purchase programmes. The ECB currently purchases bonds issued by European supra-national institutions, but in small quantities, which prevents them from being a key tool for the transmission of monetary policy in the euro area as a whole (see Table 1)[18]. These jointly guaranteed bonds, given the current calibration of the ECB purchase programmes, are subject to a 50% limit per issuer (i.e. the ECB could purchase half of the bonds of a specific supra-national institution meeting the requirements of the monetary authority).

In addition to an increase in the EU's budget, the mobilisation of the necessary funds may require the EU to be given greater autonomy to generate revenues that include some of those obtained from the creation of new, stable, European taxes. Proposals already made in this connection in various fora include environmental taxes, "taxes on plastic", "digital tax" or the application of a rate to a future common corporate income tax base. Most of these taxes are levied on a tax base which can be transferred between jurisdictions, and

18 See also Delgado-Tellez et al (2020b).

Table 1
CHARACTERISTICS OF OUTSTANDING SUPRANATIONAL DEBT (a)

	Total amount (millions of euro)	Total amount (% of EU-27 GDP)	Current average term (years)	Rating (b)	Credit status	Capital structure
European Investment Bank	469,200	3.4	5.7	AAA/aa/AAA	Preferential creditor	€243 bn of capital
ESM	99,900	0.7	7.9	AAA/Aa1/-	Preferential creditor, after the IMF	€705 bn of subscribed capital
EFSF	217,400	1.6	8.4	AA/Aa1/AA	Pari passu	Backed by guarantees given by the Member States
European Union (EFSM, BOP, MFA)	51,300	0.4	8.00	AAA/Aaa/AA	De facto preferential creditor	Backed by guarantees given by the Member States

SOURCES: European Commission, Eurostat and ECB.

a Only long-term debt is deemed to be a safe asset.
b Fitch/Moody's/S&P.

it is therefore important that their implementation is coordinated by all European countries to prevent evasion to EU countries in which such taxes are not in force[19].

The allocation of funds should be accompanied by clear and transparent governance, which includes conditions that are in keeping with the Fund's objectives. Specifically, the release of funds should be subject to the duly justified needs of MSs, and their use should be related to the implementation of national policies and plans to rebuild growth capacity following the pandemic. The approval of projects could be based on the governance of the Budgetary Instrument for Convergence and Competitiveness (BICC). That would encompass investments centred on potential GDP growth, within the European Semester, using calculation criteria that would prevent the generation of unlimited transfers, allocating some funds on the basis of the economy's size, and others based on the specific needs of the countries hardest hit by the coronavirus crisis. To that end, the European Commission and the MSs must analyse the fiscal and long-term growth conditions so that burdens may be properly shared.

Once needs have been determined, and the budget framework for this Fund has been defined, the EU must agree on its financial structure. This could be done through capital subscribed by the European Commission (for example, as in the European Investment Fund, EIF), and secured by means of guarantees issued by MSs. A strong capital structure, together with a tax revenue commitment, would be necessary for the Fund to be financed on the markets at very low, even negative, interest rates, and therefore, to be able to issue debt that is a genuine European safe asset. In order to ensure such financing under advantageous conditions, the capital structure should amount to close to €150 million, which would allow for a maximum borrowing capacity of around €1.5 trillion, far higher than that of the ESM.

19 See European Parliament (2019), inter alia.

4 Final considerations

In short, given that even symmetrical shocks (such as that triggered by the coronavirus pandemic) have an asymmetrical impact on European economies' growth capacity, a European Fund such as that proposed in this article offers advantages which are expected ex ante for all countries. These advantages are provided through the diversification of the idiosyncratic risk arising for any MS when it loses access to markets or witnesses the cost of its borrowing increase during or after an adverse shock.

How does a fund of this nature benefit countries now facing the post-pandemic scenario from a position of greater vulnerability? The instrument ensures access to long-term finance (which can sometimes be constrained, as was the case in 2010-2012) at a lower cost than would be the case without the Fund.

And what about less vulnerable countries? As direct "shareholders" of the Fund, those countries facing the crisis from a more favourable position would receive a yield that would normally exceed the opportunity cost (the yield on ESM debt, for example, is slightly higher than that of the German Bund). Likewise, in the medium-long term, the Fund would concentrate on undertaking European investments that benefit all partners, due to the increase in potential growth and greater integration of the single market, while reducing the risk of economic and financial fragmentation within the EU.

Broadly speaking, an instrument such as the European Recovery Fund would mean significantly greater capacity to mobilise EU funds and would shore up confidence in the continuity of the European project. The likelihood of a State undergoing an episode of financial stress, with all the attendant adverse effects for the Union as a whole, has increased as a result of the pandemic, and not, therefore, as a direct result of poor policy or adverse strategic behaviour in the past. The EU must therefore accept that this greater risk, with potential adverse consequences for all MSs, naturally heightens the need for risk-sharing.

These objectives, which are shared by the European Union as a whole, are unlikely to be achieved under the existing institutional framework. The current ESM, which is based on an intergovernmental treaty and is therefore outside the EU framework, is an inappropriate mechanism for establishing common, sufficient and lasting capacity to provide large-scale financing that addresses the strategic needs of the EU as a whole. The institution was designed to manage crises, particularly those that exclusively affect certain countries of the euro area. Therefore, creating a common, long-term strategy for the EU lies beyond the scope of both its institutional design and the powers of its instruments.

The design of the Fund discussed in this paper draws on elements of several recent proposals. However, one substantial difference is the proposal that the Fund be able to buy up MSs' sovereign debt, ahead of the huge financing needs facing governments over the coming years resulting from their centralised efforts to combat the pandemic and its economic fallout. This is a novel aspect not featured in previous proposals for the future

"Recovery and Reconstruction Fund", including those put forward by the French and German governments. This objective justifies the larger scale of the proposed Fund. In addition, the opportunity should be grasped to gear the Fund towards the long term, serving to address the common challenges identified in the framework of a permanent European strategy.

A paradigm shift towards the greater pooling of fiscal resources in the EU would require stringent fiscal responsibility and commitment to macroeconomic stability at the national level. For the more vulnerable countries, this means pursuing an ambitious structural reform agenda, to set themselves back on the path to real convergence with the EU's strongest economies. Such convergence in the medium and long term is the only means of casting aside the damaging logic that identifies the EU as a fixed composition of blocs of countries. And it is also the only path towards an authentic and genuine economic and monetary union, as envisaged by prominent European leaders in two papers looking far ahead, the "Van Rompuy Report" of 2012 and the "Five Presidents' Report" of 2015.

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