The hidden agenda behind the EU recovery fund

When the political leaders of Europe at 5.30am on July 21st, after four days and four nights of deliberation, made themselves available to the media, they found different reasons to present their achievement as a singular success. Many of them stressed that they had been able to trouser a substantial addition to the national treasury. A smaller group emphasized that they had not only been able to protect but increase the rebate on the membership fee. Angela Merkel and Emmanuel Macron didn´t really need to say much but did so anyway. Their original proposal for a 500 billion recovery fund had been trimmed at the edges but had otherwise been endorsed unscathed by the European Council. Most, but not all of the political leaders, ended their exhortation with a statement thar the deal was good for Europe.

But one should always be apprehensive when an agreement leaves enough wiggle room to allow all parties to claim victory. My ambition here is to scrutinize the advertised goals of the programme proposed by the Commission and, slightly altered, endorsed by the European Council[1] - a combination of the dedicated recovery fund (Next Generation EU, NGEU) and the long-term budget (Multiannual Financial Framework, MFF) – in relation to the probable outcome if implemented. A first observation then is that it does not target with credible precision countries hit particularly hard by the pandemic. A second is that the funds allocated are too puny to be a macroeconomically meaningful part of total efforts to rev up European economies. There is a clear risk that the programme establishes a de facto transfer union which would be a step towards a federal tax system. The most obvious consequence is that obscene amounts of cash will be transferred to the most corrupt member states which neither need nor deserve it.

Foreplay

This should have been an exciting tale about the second longest meeting of the European Council ever – missing the record set by the disaster in Nice in December 2000 by 25 minutes[2]. There must have been many tense moments before it dawned upon the participants that they were doomed to succeed in order "to save Europe." Unfortunately, it is going to be a pretty dull story. If we want to understand the outcome, we shall have to disregard the rhetorical flourish and trawl through shoals of facts and figures. However, it is a small price to pay since it will then be possible to take a critical look at the declared ambitions of our political leaders, the means they employed to realize their goals and the result they left behind.

[1] The European Council is a meeting of Heads of States and Governments. It does not have any legislative functions but shall provide guidelines for the development of the union (cf. TEU 15)

[2] It is still disputed which of the two meetings were the longest. I accept here the verdict of the German Presidency. My own calculations indicate that the Nice meeting was 2 – 3 hours longer. Admittedly, the sample is small but we are allowed to guess that as European summits come – the shorter the better.

The European Council agreed on 23 April to work towards the establishment of a Recovery Fund and asked the Commission to "analyse the exact needs and to come up with a proposal that is commensurate to the challenges we are facing" as a consequence of the unprecedented shock brought about by the corona pandemic. The fund should "be of sufficient magnitude, targeted towards the sectors and geographical parts of Europe most affected."

Thus, already from the beginning Europe´s political leaders had agreed that resources would be transferred from countries less impacted by Covid-19 to those "most affected."

Before the Commission had been able to get its act together, the governments in Berlin and Paris put forward a proposal of their own. At a press conference on 18 May Angela Merkel and Emmanuel Macron suggested that a 500 billion recovery fund should be set up to provide cash for countries impacted by the economic fallout of the corona virus in order to jump-start European economies and avoid distortion of the internal market. Merkel emphasized that the support would be provided as "budgetary expenditure – not loans but budgetary expenditure" as if to rub in that this was really a U-turn away from Germany´s adamant opposition to a transfer union.

The money would be borrowed by raising the EU´s Own Resources ceiling (the maximum amount that can be called upon from Member States) – and using it as a guarantee. After a grace period for the duration of the coming EU budget, amortizations would be stretched out over 30 years. In a joint statement the two governments wrote that the recovery fund should be embedded in the EU budget and disbursed "in line with European priorities." In order to strengthen Europe´s competitiveness it was essential to invest in digital and green transition.

Thus, the German-French initiative laid down "instructions" for how the money should be obtained; that it should be disbursed as grants and aligned with the EU budget. Even the conditions of the loans were prescribed in some detail.

Austria, Denmark, Sweden together with the Netherlands, as their *de facto* leader, objected to the generous German- French plan and stated, on 23 May, that they would only agree to long terms loans amounting to 250 billion euro. They immediately earned the moniker cheapskates or the frugal four in the media. Their recovery fund should be temporary and one-off, with a sunset clause after two years and should, therefore, not lead to a mutualisation of debt.

The frugal four emphasized that loans would provide "sound incentives" and limit the risk for all Member States. For good measure, the four governments added that their fund should not be part of the long-term budget but accompanied by a "modernized EU budget" that would make Member States "better prepared for the next crisis." To top it off, loan recipients were expected to carry out reforms to make their economies more resilient and competitive. Inadvertently, this compromise proposal made the total package 50 per cent larger.

The Commission picks on the gauntlet

When the Commission developed its own programme it studiously followed the German-French script and simply tacked on the frugal four´s loan component of 250 billion euro. The general presentation is contained in *Europe´s moment: Repair and Prepare for the Next Generation EU* [COM(2020)456final] but the details, calculations of macroeconomic affects, allocations of grants and loans, as well as burden sharing, are found in an accompanying staff working document [SWD(2020)98final).

When these documents were drafted it was uncertain how long the pandemic would last and the economic fallout – already of unprecedented magnitude – could only be estimated on a still shaking ground. The Commission´s best guess was that total output would fall by 7,4 per cent on average in 2020 – more in Greece, Italy, Spain and Croatia. It was already obvious that some parts of the economy would be hit particularly hard. The Commission singles out tourism, entertainment, hospitality and transport sectors but also automotive and textile industries. "Non-essential client-facing businesses or those involving a high density of workers or customers have generally seen the largest losses in turnover and profit." In addition to the recession, immediate healthcare costs had taken their toll on public finances.

The core objectives of the recovery plan (NGEU), is to lift the economies out of recession; prevent increased economic divergence; save the Single Market and support countries which have had "the misfortune of being hit harder by CoVid 19 than others." Unless Europe can master a swift and adequate response there is a risk that "some Member States get stuck in a situation of prolonged sluggish growth, high unemployment and a permanently weakened corporate sector, resulting in growing cross-country divergencies" - but the names of those in danger are not revealed in the document.

This discussion of the pandemic challenge to the recovery of European economies is summarised, with surprising results, in a table which shows the allocation keys for the distribution of the borrowed money among the 27 member states. For each Member State it shows how much it puts in and what it receives. The difference is the net result which is presented in both absolute terms and as a percentage of GDP (cf. Table 1)

Distribution and burden sharing

The Commission splits (without explanation) the Member States into three groups. The programme will be financed by ten countries with a GDP per capita above the EU average (Belgium, Denmark, Finland, France, Ireland, Luxembourg, the Netherlands, Sweden, Germany and Austria), with the Czech Republic making a modest net contribution. As a share of GDP Luxembourg and Ireland chip in somewhat more and France somewhat less. The others make a net contribution corresponding to 2,9 – 3,9 per cent of total production.

All the others are net recipients. Five of them are labelled “below average (high debt)” – Cyprus, Greece, Italy, Portugal and Spain. They are twice as rich as the members of the third group, which includes all the other countries with below average GDP but with low public indebtedness. In broad terms, the recovery plan developed by the Commission redistributes 300 billion euro from ten rich member states. Greece, Italy, Portugal and Spain receive a net contribution of 193 billion euro to finance efforts to get their economy in shape. The poorest ten member states get 107 billion net.[3]

Table 1. Allocation of NGEU (% and billion euro)[4]

	GDP (bn)	Share in EU GDP (%)	Contr. (bn)	Rec. (bn)	Net (bn)	Net (% of GDP)
Belgium	474	3,4	25,5	12,0	- 13,5	- 2,9
Bulgaria	61	0,4	3,3	15,0	+ 11,7	+ 19,3
Czech R.	220	1,6	11,9	11,3	- 0,6	- 0,3
Denmark	311	2,2	16,7	4,5	- 12,2	- 3,9
Germany	3436	24,7	185,1	51,8	- 133,3	- 3,9
Estonia	28	0,2	1,5	2,3	+ 0,7	+ 2,6
Ireland	347	2,5	18,7	3,0	- 15,7	- 4,5
Greece	187	1,3	10,1	43,5	+ 33,4	+ 17,8
Spain	1245	8,9	67,1	149,3	+82,2	+ 6,6
France	2419	17,4	130,3	78,0	- 52,3	- 2,2
Croatia	54	0,4	2,9	15,0	+ 12,1	+ 22,4
Italy	1788	12,8	96,3	153,0	+ 56,7	+ 3,2
Cyprus	22	0,2	1,2	2,3	+ 1,1	+ 4,9
Latvia	30	0.2	1,6	5,3	+3,6	+ 11,8
Lithuania	48	0,3	2,6	6,8	+ 4,1	+ 8,6
Luxembourg	64	0,5	3,4	0,0	- 3,4	- 5,4
Hungary	144	1,0	7,7	15,0	+ 7,3	+ 5,0
Malta	13	0,1	0,7	0,8	0,0	+ 0,3
Netherlands	812	5,8	43,7	12,8	- 31,0	- 3,8
Austria	399	2,9	21,5	7,5	- 14,0	- 3,5
Poland	529	3,8	28,5	64,5	+ 36,0	+ 6,8
Portugal	212	1,5	11,4	31,5	+ 20,1	+ 9,5
Romania	223	1,6	12,0	33,0	+ 21,0	+ 9,4
Slovenia	48	0,3	2,6	3,8	+ 1,2	+ 2,4
Slovakia	94	0,7	5,1	15,0	+ 9,9	+ 10,5
Finland	240	1,7	12,9	5,3	- 7,7	- 3,2
Sweden	475	3,4	25,6	9,0	- 16,6	- 3,5

The first observation is that money flows *from* countries severely impacted by the pandemic *to* Member States touched modestly or very lightly. The only exceptions are Italy and Spain. Their health care cost has risen dramatically but the same is true for Belgium, even worse, France, Sweden, the Netherlands and Ireland. If we use the mortality rate per 100 000 inhabitants as a proxy for direct pandemic costs, the gap is huge between the net contributors and the countries that receive the most as a percentage of GDP.[5] The death toll is around 10 in Denmark and Germany, 36 in Ireland and the Netherlands, and above 45 in Belgium (86), France and Sweden. The highest number of deaths caused by Covid 19 among

[3] Some countries are hardly affected at all. Malta breaks even. The Czech Republic is actually set back 600 million euro. Cyprus receives 1,1 billion which generously corresponds to 5 per cent of its GDP.
[4] This table is based on Table A.1: Allocation key in the Staff Working Document SWD(2020)98 final, p.51.
[5] The statistics are updated daily by Johns Hopkins University. The figures shown here are those that were available when document SWD(2020)98final was drafted. They have not changed significantly since then

the main recipients, as share of GDP, is 9 in Romania. All the others have less than a handful per 100 000 thousand inhabitants. Greece has two fatalities per 100 000 inhabitants and the Slovak Republic needs 200 000 inhabitants to reach a full round figure. This is apparently not a programme to help the countries that are most impacted by the pandemic.

As said, the Commission insists that some countries will be left in the doldrums unless given a golden handshake. If we look at how the money is set to be doled out we can see that the commissioners are particularly concerned about Croatia (net recipient of a sum corresponding to mor than 22 per cent of its GDP)[6], Bulgaria (19), Greece (18), Latvia (12), the Slovak Republic (11), Portugal and Romania (both 10), Lithuania (9), Poland (7) and Hungary (5). But again, the facts fight back. With one or two exceptions these countries have for a long time grown at a *much* faster clip than the eurozone as a whole (like the rest of the world); their level of unemployment and their public debt are lower than the EU average and the direct economic effects of the crisis are, so far, modest. Admittedly, they are still poorer than members of the Donors´Club but much less so today compared with when they joined the union. We have every reason to believe that they will be able to jump-start their economy ahead of others and no discernible reasons to think that they will do worse.

In fact, as Alice said in her Wonderland, it becomes curiouser and curiouser when you look beyond the words for a rational relationship between huge net contributions to some national treasuries and the extent to which individual member states have been financially afflicted by the crisis. The staff working document does not spell out in clear prose the criteria which underpin the allocation keys but Breugel, the most reliable think-tank in Brussels, informs us[7] that they are three:

> "The allocation depends on(a) the 2019 population (b) the inverse of 2019 GDP per capita, and (c) the 2015 – 2019 unemployment rate, all relative to the EU 27 value. Relative GDP per capita is measured in current euro values (not in purchasing power parity) and the inverse of its ratio to the EU average is capped on 1.5. The unemployment ratio is capped at 1.5 for countries with GDP per capita below the EU average and at 0.75 for countries with GDP per capita above the EU average."

A person of suspicious inclination will immediately observe that these parameters can be abused to produce a wanted result. Why, for instance, is the PPP-correction dropped? Normally it is applied to achieve a fairer comparison of material wealth. Together with the cap on unemployment ratio for richer countries and the use of the inverse per capita ratio it favours lower-income countries.

But the most surprising aspect is that only one of the three criteria is related to the size of a country and then only to the population and not directly to the economy (and only partly corrected by the per capita factor). If recovery had been the primary aim the support should have been proportionate to the economy in distress.

It is recognized in the treaties that some regions are entitled to various forms of support simply because they are poorer than others. Financial resources to the tune of 2 - 4 per cent

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[6] It is a coincident but still worth a footnote. The politically neutral president of the Commission, Ursula von der Leyen has appeared in a video clip and expressed support for the conservative Croatian party HDZ.

[7] Having the cake, but slicing it differently: how is the grand EU recovery fund is allocated? Blog post by Zsolt Darvas (July 23, 2020) https://www.breugel.org/2020/07/having-the-cake-how-eu-recovery-fund/

of the recipients GDP are therefore transferred via the EU budget each year.[8] But the recovery programme should provide funds to poorer countries only if and to the extent that it is required to get the European economy going. From that vantage point it is difficult to understand the two criteria favouring the lower-income Member States. Neither low income per capita, nor high unemployment in the past are calibrated to the efforts needed in individual counties. The poorer Member States in Central and Eastern Europe are growing *much faster* than the EU average and have done so for a long time, they are less indebted, their rate unemployment is low or modest and they have been radically less impacted by the corona crisis.

Far more important is that these countries have all gone through the mill. Some thirty years ago they were centrally planned, communist and completely non-resilient members of the Soviet sphere. When that system fell apart their production dropped precipitously before they – with limited external help – bounced back with resilient alacrity.

It needs to be repeated, they seem to be in much better economic shape than other Member States – and better prepared to recover by their own efforts. The Commission´s worries that some countries – "predominantly ones located in Central and Eastern Europe" – will have difficulties to recover lost economic ground are both unfounded and unwarranted. We shall return to this enigma.

If it had been a recovery plan aimed at giving succour to countries that run the risk of being stuck with "sluggish growth, high unemployment and a permanently weakened corporate sector" a number of other criteria suggest themselves. High *public* and *private* indebtedness make it difficult to borrow the money needed to stimulate the economy. Rate of growth before the pandemic is a sign of economic vitality that should reduce the entitlement to support. Uneven income distribution could be a sign of vulnerability but it is difficult to measure. Significant loss of competitiveness vis-à-vis other member states, in particular inside the eurozone, should sound the alarm bells. The Commission stresses rightly that countries with "sizeable tourism sectors," automotive and textile industries are particularly exposed to job losses but these circumstances affect only indirectly the allocation keys. The extent to which the corona crisis has afflicted health and social systems differ widely among Member States. None of these factors has influenced the distribution of grants and loans. It is not surprising that the level of corruption was never considered as a criterion, but it is well documented that it has a negative impact on the socially effective allocation of resources.

Not so huge and not in time

In practically all media reports reference is made to the "huge" EU recovery fund and also trained economists trying to estimate the macroeconomic effects have assumed that it is a net addition of 750 billion euro during a short period of time. Thus, *The Economist* claims that "the NGEU is worth some 4,7 % of the EUs annual GDP…. and comes on top of national governments stimulus efforts." But, not even the Commission. is that optimistic. The

[8] EEAG – Report on the European Economy,2018, p.15. The Marshall Plan provided recipient countries with funds corresponding to 2 percent of their GDP between 1948 and 1951, or about $ 115 billion in today´s money.

standard assumption is that Member States will use 100 per cent of grants and 50 per cent of loans for “public investments.” In an alternative scenario 50 per cent of both grants and loans are effectively spent. Since the funds will be disbursed, in equal portions over a period of four years the net annual effect would be less than 0.6 per cent of GDP.

However, even this modest contribution may be too optimistic. Take Sweden as an example of how net contributors will act. Sweden will put in 25,6 billion and receive 16,6 billion. The net transfer of money to other Member States is 9 billion. Assume that the Swedish government has planned to borrow and spend 50 billion to stimulate the economy. If so, Sweden will now borrow only 34,4 billion since the rest, 16,6 billion, is “provided” by Brussels. Macron has just unveiled an extra 100 billion stimulus package to be spent over two years. Even though France is a net contributor, some two-fifths of the sum will come from the recovery fund. On its own the French government could have borrowed all it needs on equally good terms. The net effect is zero for all net contributors which together account for two thirds of the EU GDP. If anything, the net effect is negative since the debt incurred on behalf of other Member States may affect their credit rating.

The Member States in Central and Eastern Europe and the Baltics are in a position to finance their own recovery. Now they borrow somewhat less but they will still spend more than they intended. It is reasonable to assume that half of their net receipts, amounting to 107 billion euro, will be an extra boost to the European economy. Greece, Italy, Spain and Portugal will put in some 185 billion and receive 380 billion. It is reasonable to assume that they will spend more than their net receipts of 190 billion. A total annual effect of 250 - 300 billion is a reasonable estimate.

In the commission´s first plan the dosh should be splashed out over two years. Now it is four. The net effect in 2021could then be a little bit more than 0,4 percent of the union´s GDP.[9]

But the timing of the effort is more important than the money. In order to be fully effective spending should have started before the summer. That will not happen. It will take time to get the necessary legislation in place and spending will only take place when the Commission has certified that it will be in line with its wishes and unaffected by corruption.

Around 75 per cent of the money is allocated to recovery programmes aligned to the European Semester.[10] The other 25 per cent are itemized for cohesion, agriculture, climate change and loans and equity-type funding for private sector investments. Each country is obliged to present a “resilient and sustainable programme” (COM(2020)456final).

The Commission recognizes that it will take time before the money can be disbursed. Commitments are scheduled to be made 2020 – 23 but spending will continue until 2026.

Who will get it in the end?

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[9] It may be slightly higher since the union´s GDP is supposed to be 4 – 5 per cent smaller in 2021.

[10] The European Semester, introduced in 2010, is a key instrument to ensure that Member States pursue sound fiscal policies in order to avoid macroeconomic imbalances. Each Member State submit its national budget and financial plan to be analysed and commented upon by the Commission. The Council of Ministers may or may not adopt The Commission´s suggestions for policy changes and additional reforms. Compliance is voluntary.

The problem is not only that negotiations with 27 Member States will take time but the German-French idea that most of the money will be distributed free of charge. If it had only been loans, the Commission could have disposed of them quickly in support of the activities planned and already implemented. But grants cannot simply be given away.

If we look at Transparency International´s corruption index we can see that the worst performer in the Donor´s Club, France, touch base with the top performer on the recipient side, Estonia, on spot 23. All other net contributors are among the 20 least corrupt countries in the world. Denmark, Finland and Sweden, in that order, collect the medals.[11] On the other side we find Portugal, Poland, Lithuania, Slovenia, Spain and Latvia between spot 28 and 40. The rest starts with Croatia, the Slovak Republic and Hungary, sharing spot 50, and ends with Italy (61), Bulgaria (69) and Slovenia (72).[12] Transparency International´s ranking correspond broadly with the EU´s own study *Quality and Corruption from a European Perspective*[13].

If the Commission is serious about its promise that the grants will not disappear in the vaults of Swiss banks it will take time to negotiate the necessary terms and conditions before the money can be disbursed. But what is ironclad on paper is weak on the ground since the Commission does not have the capabilities to follow the money. The resources provided for common agricultural policy and regional support are policed by national authorities which have only weak incentives to discover misappropriations since it will lead to the return of money to Brussels.[14] Now the money will either be spent quickly and unwisely or when the Commission can guarantee that most of it will be used for intended purposes.

A pertinent question is if Sweden must negotiate with the Commission in order to be able to spend its own money.

Grants or loans – does it matter?

The main bone of contention, the proportion between loans and grants, is of little economic significance. The difference between, on the one hand, a 37-year loan, starting with a long grace period, and a rate of interest close to zero and, on the other, an outright grant is not important. In fact, countries that claim that they cannot invest this kind of loans in such a way that they strengthen their ability to pay back should receive neither loans nor grants – they need intensive economic care. The difference is a matter of principle – but a principle that matters. Not only will grants delay disbursements because conditions will have to be negotiated. This situation will create a multitude of conflict zones since the use of funds will have to be monitored by members of the donor community. It will also be a formidable political boost to incumbent governments in Hungary, Poland and other countries and

[11] Transparency International´s Corruption Perception Index (CPI) focuses on “officials using public office for private gain” which explains why Denmark and Sweden come out so well even though some of their banks functioned as laundromats for dirty Russian money.

[12] As a consequence of a mistake, Slovenia appears both in spot 35 and 72 on Transparency International´s index.

[13] Charron, Nicholas; Victor Lapuente and Bo Rothstein (2013): Quality of Government and Corruption from a European Perspective. Cheltenham: Edward Elgar Publishing.

[14] It is emblematic of continental European media´s self-imposed caution that the misuse of CAP funding has been uncovered by *New York Times* and the passport racket has been reported by *Al Jazeera* and, at best, regurgitated by media in Member States.

provide them with ample resources for generous patronage. But most importantly, if grants are agreed upon as part of the programme, we have *de facto* created a transfer union.

The problem of delay is compounded by the Commission´s demand to be given extended authority to collect taxes to finance interests on the loan until amortizations kick in. This requires an agreement which must be ratified by parliaments and the outcome is not a given.

The Commission recognizes that interest must be paid on the borrowed funds before amortizations start in 2028. The solution, presented in COM(2020)456final, is a number of new taxes to be collected by the Commission as Own Resources. The existing carbon trading system should be extended and the revenue funnelled directly to Brussels. A levy on plastic waste could strengthen the union´s budget to the tune of 7 billion euro. A carbon border-adjustment mechanism (a tariff on climate-unfriendly imports) could be even more profitable. Less lucrative but politically more combustible is the suggestion to tax companies that have “benefitted” from the single market – read American high-tech companies. The idea to introduce a “digital tax” paid by companies with a turnover exceeding 750 million euro is a surprise in a programme aiming at promoting digitalisation.[15]

Keynes is back

The Commission asserts that the overall package is “self-financing.” This is based on the assumption that a multiplier transforms one invested euro to an addition to the GDP higher than one euro. With regard to the funds allocated to EFSI (European Fund for Strategic Investment) and InvestEU the multiplier is expected to be as high as 1,5.[16] The assumption, already mentioned, is that Member States will use 50 per cent of loans and 100 per cent of grants for “additional public investment.” (Why countries, and in particular donors, would make this distinction between the origin of funds is unclear). In a less optimistic scenario only half of the grants are additional.

Investments in the optimistic scenario are expected to raise the real level of EU GDP by 1,75 per cent in 2021 and 2022, and by 2,25 in 2023. As a consequence, the debt-to-GDP ratios for the beneficiaries will decline while the donors will see only a modest increase in the medium term Oddly enough, in the less optimistic scenario where only 50 per cent of loans and grants translate into additional public investment, the GDP effects are only “somewhat smaller.”

As a surviving believer in keynesian economics I wish these calculations will come true but one must wonder why this kind of fiscal magic so far has been strictly *verboten* inside the eurozone. In the Commission´s more optimistic scenario 625 billion euro is committed over four years – some 155 billion a year. As a share of the EU GDP of 14 000 billion it comes to 1,3 per cent. In the less optimistic scenario 375 billion is stretched out over four years which allows for an annual dosh of less than 100 billion or 0,5 per cent of the annual GDP. In my realistic scenario it comes down a peg to 0,4. If a significant part of actual spending is

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[15] The EU budget powering the plan for Europe. European Commission.
[16] These programmes were practically eliminated by the European Council.

delayed until 2025 – 26 the effect will be further reduced. The effect on future rates of growth is marginal compared to what will be achieved by the stratospheric amounts of money - some 20 per cent of GDP - Member States are expected borrow and spend on their own during the coming two years.

Is the Single Market in danger?

The Commission keeps repeating that the crisis will "increase divergence, tilt the economic playing field and undermine the Single Market." The main reason is that the pandemic is likely to harm "the least resilient and still-converging Member States most."

But it is indeed difficult to see why the internal market should be in peril. And if it is, there must be other reasons than those given by the Commission. For instance, there is no reason to expect that the divergence between Member States will increase. In fact, the gap is rapidly closing since the countries in Central and Eastern Europe and the Baltics are growing much faster than the rest. By just any metric, these countries appear to be more resilient than other Member States and all of them have been far less harmed by the pandemic. And even if the gap should widen it will not affect the functioning of the market. It can easily accommodate the fact that some actors have more purchasing power than others.

The problem seems to be that the support through what is innocuously called "the temporary State Aid framework" varies widely. The reality is that the Commission has put on hold all restrictions on state aid and allowed Member States to inundate the corporate sector with financial support beyond their wildest dreams. The total figure (including the UK) was already in May 1.9 trillion. According to information provided by the Commission, Germany accounts for 996 billion, equivalent to around 29 % of GDP and 52 per cent of all state aid provided, followed by France (around 324 billion and 13,4 per cent of GDP), Italy (around 302 billion and 17 per cent of GDP) and Belgium (around 54 billion and 11 per cent of GDP). The aid granted by the vast majority of the other Member States ranges in lower-single digits of GDP, including Spain with around 27 billion (2,2 per cent of GDP).

The Commission was not in a position to prevent Member States from responding vigorously to the crisis but it should have set out principles for support to individual companies. The risk that a few countries will have difficulties to regain competitiveness inside the currency union is real enough but for the large majority it is not a problem. Given the severe impact of the covid 19 and the length of the lock-down the figure for Spain is suspiciously low but the country´s problems are real. However, the main reason why the countries in Central and Eastern Europe are in the single digit-range is that they have been much less impacted by the pandemic than others.

What happened in Brussels?

The media coverage before the meeting in Brussels focussed on whether the recovery fund should distribute its resources as grants or loans. In the good old days when borrowers were charged for the right to dispose of other people´s money this would have been an issue of economic significance. But now the difference between a grant and a 37-year long loan, beginning with a seven-year long grace period and carrying a rate of interest close to zero is essentially political since it has institutional implications for the development of the union. The tug of war between the proponents of only grants - Germany, France and all the prospective beneficiaries- and the frugal four insisting on loans was portrayed as intense. But as soon as the four presented an early compromise that included a substantial proportion of grants the outcome was a given. The only remaining issue then concerned what was referred to as “the rule of law.” But when it dawned upon the participants that an agreement was necessary to “save Europe” the frugal four caved in.

In order to understand fully what happened these 4 days and 4 nights in July it is good to know how international negotiations are organized and conducted. The practice at all UN meetings is to elect what is called a bureau. Normally it consists of the chairperson and his or her deputies, chairpersons of important committees and the rapporteur. They will be responsible for the allocation of time, produce written texts as a basis for negotiations and draft and submit the final report for the consideration of the meeting. They will also conduct the all-important bilaterals with parties that have particular concerns or strong wishes. They are the only ones who have full control of what is happening and knowledge of the implications of the last-minute changes when the whole group is convinced that “we are doomed to succeed.”

Thus, the president of the European Council, Charles Michel, and Angela Merkel, as holder of the rotating EU presidency, are self-evident members of a bureau. Probably also the president of the Commission, Ursula von der Leyen. To judge from several photographs also the French president Emmanuel Macron attended meetings with the bureau. These four persons and some close collaborators were the only ones that knew the implications of all the changes in the text since they drafted most of it.

The reallocation of grants and loans

So far the Commission has not issued a report on the results of the European Council which can be compared to proposals in the staff working document SWD(2020)98 final. However, many changes, presumedly the most important ones, are contained in the conclusions from the European Council (EUCO 10/20). And in most cases, it is possible to calculate the financial implications of changes made.

The most important change of financial consequence is related to the cross-country allocations of NGEU grants – reduced from 500 billion euro in the Commission´s original proposal to the compromise of 390 billion (of which 12,5 are guarantees). The European Council accepted the Commission´s allocation key for 2021-22 and decided that 70 per cent of grants should committed in these years. The remaining 30 per cent shall be fully committed by the end of 2023. “In the allocation key for the year 2023 the 2015-19 unemployment criterion is replaced, in equal proportion, by the loss in real GDP observed over 2020 and by the cumulative loss in in real GDP observed over the period 2020-21 and will be calculated by June 2022.” For some countries the capping of disbursements from special programmes like ReactEU (Recovery Assistance for Cohesion and the Territories of Europe) also had significant effects.[17]

The overall effect of the changes made by the European Council are presented in table 2 in the Breugel paper referred to above. For 16 of the 27 Member States the receipts of grants are reduced by roughly a third (from 29 to 35 per cent). The cut is somewhat bigger for Bulgaria (37 per cent)[18], Estonia (40) and Finland (39). Six countries lose less money– Portugal and Poland (minus 28 per cent)), the Netherlands (19), Spain (12), Malta (10) and Italy (1). The winner is Germany which takes home an extra 13,4 billion euro, or 40 per cent more than the allocation on the basis of the previous criteria, with France in second place – plus 7,4 billion euro or 17 per cent. Sweden´s loss amounts to 1,5 billion euro (or 16 billion Kronor).

The reason for the distribution in favour of Germany and France is a general reduction of the low-income factor and the added weight of countries´ size. Under the previous regime Germany was severely punished for its low unemployment during 2015-19. France benefits both from its size and the fact that its high unemployment was subject to the 0,75 cap for higher-income countries. Spain´s size does not fully compensate for the "loss" of the high unemployment factor. Two Member States were saved from the rules on capping and redistribution." To support the most important sectors that will be crucial to lay the basis for a sound recovery following the COVID-19 crisis in certain Member States, ReactEU will provide the following additional allocations: Luxembourg (EUR 100 million); Malta (EUR 50 million)." Luxembourg is, by far, the richest member of the union and Malta ´s economy is growing radically faster than all others (partly as a result of the remunerative sale of a passport to anyone willing and able to pay).[19]

The members of the bureau were certainly aware of the financial implications of these changes but it seems unlikely that other participants were able to do the figures. However, it must be applauded that the size of economies was brought to bear on the allocation keys.

Conditional disbursement

Other "corrections" of the NGEU by the European Council are financially less substantial but the conditions for disbursement are important. The European Council underlines the need for "swift deployment" and invites the Commission to submit to its October meeting proposals to accelerate and facilitate procedures for the Member States´ "national recovery and resilience plans setting out the reform and investment agenda for the years 2021-23. These plans shall be assessed by the Commission and be approved only if they meet "the

[17] To calculate the effects of changes in the ReactEU programme is a daunting undertaking.
[18] Due to the ReactEU-effect.
[19] At least ten Member States sell passports but Cyprus, Ireland and Malta take pride of place. They charge more, the residency requirements are lenient and the qualifying period is short or non-existing (cf. Judith Gold and Ahmed El-Ashram: A Passport of Convenience in *Finance & Development*, December 2015). European passports are much sought after because they offer visa-free access to 182 countries and the right to do business in all Member States. Many of the customers have good reason to leave their native country in haste. Demand is particularly strong in countries that were members of the Soviet sphere, China, Pakistan and Saudi Arabia. It is alleged that Cyprus, since 2014, have collected some 7 billion euros from individuals of uncertain moral rectitude. Some 600 – 700 Russian billionaires are proud citizens of Malta

highest score of assessment" with relation to a large number of specific requirements. Disbursement will be subject to "the satisfactory fulfilment of the relevant milestones and targets:"

> "The Commission shall ask the opinion of the Economic and Financial Committee on the satisfactory fulfilment of the relevant milestones and targets. The Economic and Financial Committee shall strive to reach consensus. If, exceptionally, one or more Member States consider that there are serious deviations from the satisfactory fulfilment of the relevant milestones and targets, they may request the President of the European Council to refer the matter to the next European Council
>
> The Commission shall adopt a decision on the assessment of the satisfactory fulfilment of the relevant milestones and targets and on the approval of payments in accordance with the examination procedure.
>
> If the matter was referred to the European Council, no Commission decision concerning the fulfilment of the milestones and targets and on the approval of payments will be taken until the next European Council has exhaustively discussed the matter. This process shall, as a rule, not take longer than three months after the Commission has asked the Economic and Financial Committee for its opinion. This process will be in line with Article 17 TEU and Article 317 TEU."

Unfortunately, the milestones and targets that shall be satisfactorily fulfilled are nowhere else mentioned in the text – much less defined. It is possible to guess but that is hardly enough in a confrontational quasilegal process. A reasonable assumption is that disbursements will be part of the procedures of the European Semester but the conclusions from the European Council do not say so.

Patronizing the past at the expense of the future

The package presented by the Commission in May was a merger of the long-term budget for 2021 – 27 (MFF) and the recovery plan (NGEU). It also included proposals for several new taxes that would substantially increase the union´s Own Resources. This effort to conflate the budget and the recovery plan for mutual benefit presented, even to a seasoned observer as the assistant editor of EU Law Live, Dolores Utrilla, an "unprecedented level of complexity in the use of sectoral mechanisms and programmes closely interconnected with each other." [20]Only the scaffolds of this structure are still standing, the content is all but gone. The last minutes reallocations of funding by the European Council, in order to save the deal, prioritized cash contributions to agriculture, cohesion policies and substantially increased rebates on the membership fees for the frugal four and Germany.

On the losing side we find research, hit particularly hard, innovation, the academic exchange programme Erasmus+, the EU4Health and InvestEU (a scheme to boost public and private investments).[21]In May, the Commission proposed that funds amounting to 94,4 billion euro should be allocated to the research programme Horizon Europe. The contribution from the recovery programme was 13,5 billion. The heads of states and governments pared it down to 81 billion, of which 5 billion come from the NGEU. It is extremely rare that eurocrats vent their frustration in public but Paul Webb, head of the Commission´s unit for research budget

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[20] Dolores Utrilla: The Commission´s long-term budget proposal and the EU recovery plan: dissecting the jigsaw puzzle. EULawLive, August 06, 2020.

[21] https://sciencebusiness.net/framework-programmes/news/leaders-agree-slimmed-down-eu809b-horizon-europe.

and long-term budget synergies, deplored, on Twitter, that research seemed “to be the cash cow in the negotiations.”[22] It is a substantial reduction from what was planned to be part of a modernized, future-oriented budget but compared to the previous MFF it is not dramatic. In real terms the allocation for research remains almost exactly on the same level as the budget that included the UK. Thus, there will be more money to be contested by the scientific community in the remaining 27 member states. True to form, the president of the European Council, Charles Michel, has blamed the frugal four for the looting of the research budget and encouraged the scientific community to foment a rebellion in Austria, Denmark, the Netherlands and Sweden. The fact is that the full responsibility for the reallocation of budget appropriations should be placed at the door of the bureau and its chair. Only they could control the last-minute emendations to the text.

Different programmes aligned with Horizon Europe in support of research and innovation has also been severely reduced by the European Council and Erasmus+ will get 5 billion euro less than proposed by the Commission. InvestEU was slated to get 30 billion. The heads of states and governments considered 7 billion to be enough. The Commission suggested that 9,4 billion should be allocated to deal with the health consequences of covid-19 on an EU-wide basis. Now the budget for EU4Health is reduced to less than 2 billion.

A gift to Mr Rutte

In the section on Revenue we find an innocuous paragraph 143, under the heading Traditional Own Resources, informing us that “From 1 January 2021, Member States shall retain by way of collection costs, 25 % of the amounts collected by them.” This is surprising to say the least. Tariffs and other fees collected at the border are the most traditional of the union´s Own Resources and it is reasonable that income linked to imports to the union as such should be funnelled to a common treasury. At present, Member States keep 20 per cent of the proceeds which is way above the actual cost in our digital age. The Commission had therefore suggested that the percentage should be reduced to still generous 12,5 per cent (COM 5846/20). There is no explanation for this important change made by the European Council. But the beneficiary is the Dutch prime minister Mark Rutte, who was the only real threat to the deal on the partition between loans and grants. Rotterdam is by far the biggest port for cargo in the EU27 – and much of the cargo is destined to other countries than the Netherlands.

Imports to theEU28 in 2018 was some 2 trillion euro which gave rise to tariff duties amounting to 25 billion, of which 20 billion helped finance the EU budget. The change proposed by the Commission would have increased the union´s Own Resources by 2 billion. Compared with the recommendation by the European Council it is a loss of some 3,5 billion. If the UK, as now seems likely, will trade with the EU27 on WTO-terms there will be a significant increase of tariff duties.[23]

The rule of law

[22] https://twitter.com/webbo_Paul/sstatus/1285249232744652800

[23] The consequences of the change are intelligible only if you know the background. As a matter of fact, a preponderant part of the arcane text adopted in Brussels was incomprehensible also for the participants.

During the negotiations the “rule of law” surfaced as a deal-breaking bone of contention. The reason may have been that some governments realized that it would be embarrassing and politically costly to defend a deal that would transfer literally huge (as a percentage of GDP) amounts of money to gravely corrupt Member States and hefty sums to Poland and Hungary – two countries under investigation for lack of respect for the rule of law. A first observation is that this issue should have been effectively dealt with a long time ago. Respect for the rule of law and democratic fair play is an obligation a country assumes when it becomes member of the union. The Commission, as a guardian of the treaty, could have pursued the issue with much greater vigour if it had regarded it as essential.

At present a country in breach of its treaty obligations is safe as long as it has one accomplice. In order to punish a Member States all others must vote in favour. However, that is not a good reason not to force a vote. If a Member States clearly violates the rule of law by politicizing the courts or silences critical voices in the media it would be useful to ask the Member States who are ready to forgive and forget to stand up and be counted. For many net contributors to the budget it would indeed be informative to find out how many Member States are ready to condone corrupt practices and lack of respect for democracy.

It is now asserted by the union´s Heads of State and Governments that this system will be changed. However, a tonic dose of scepticism is called for. The text agreed to is weak beyond belief, which may be the reason why it appears twice in the conclusions from the European Council. In its first appearance it applies only to the MFF. It is repeated some ten pages later, in a section concerning both MFF and NGEU:

> “The Union´s financial interests shall be protected in accordance with the general principles embedded in the Union Treaties, in particular the values of Article 2 TEU

> “The European Council underlines the importance of the protection of the Union´s financial interests. The European Council underlines the importance of the respect of the rule of law.

These two paragraphs add nothing to what is already union law but the distinction between “financial interests” and the “respect of the rule of law” is ominous. That money shall be protected necessarily entails some kind of vigilance on the part of EU institutions (unless, of course, it is already protected). As far as the rule of law is concerned the European Council simply underlines its importance. In diplomatic parlance this means nothing. Journalists have a trick to find out if political statements have any substance. A sentence must make sense only if that is true also for its opposite. Could the European Council have said that respect for the rule of law is unimportant?

And it gets worse. The next paragraph which introduces the possibility to adopt measures “by the Council by qualified majority”[24] refers only to financial interests. A “regime of conditionality to protect the budget and Next Generation EU will be introduced.” The

[24] It is important to be aware of the difference between the European Council and the Council. The former is a meeting with Heads of State and Prime Ministers. This body has no legislative authority but is confined to set out general guidelines for the EU. It goes without saying that ministers who attend the Council, which together with the EU parliament is a legislative body, toe the national party line.

Commission will put forward measures to be dealt with by the Council and thereafter the European Council “will revert rapidly to the matter.” In a following paragraph the “Commission is invited to present further measures to protect the EU budget and Next Generation EU against fraud and irregularities.”

The Commission may very well consider measures aiming specifically at the rule of law but the possibility of a qualified majority is now compromised. Peer pressure in the Council works only if a solid majority of the Member States is certain that none of them is next in line to be accused of fraud and irregularities. At present a majority of Member States figure way down on Transparency International´s list of Europe´s most corrupt countries. And it is of more than cursory interest that a majority of the commissioners hail from countries where the political system is compromised by alleged or confirmed connections with criminal corruption.

According to diplomatic sources the text that was finally adopted by acclamation was in advance examined by Germany, France, the four Visegrad countries, the frugal four and Latvia, whose prime minister Krisjanis Karins drafted the final version. *The Economist* claims that the “the studiously ambiguous language” was “shaped by Angela Merkel´s team.”

The proponents of the idea to enforce respect of the rule of law by peer pressure seem to be serenely untroubled about the kind of union they are creating. A system where politicians evaluate each other´s behaviour and punish what they dislike will, if it works, create a multitude of conflict zones inside the union. A government that have been punished will soon, maybe because of popular anger, be forced to get even. We may actually end up with a case where a country accused of financial irregularities is acquitted by a majority. Let´s assume that Romania stands accused of having misappropriated EU funds (I have concrete personal experience, confirmed by the Commission, that this is likely to happen seven days a week) and that Member States are asked to adjudicate. Many of them realize that they may end up in the docks. They will not be willing to punish a comrade in arms. They may recuse themselves or vote against. In that case we will have a verdict in favour of corruption. The worst possible outcome is that the system will work as intended.

It seems evident that a neutral institution should initiate legal proceedings while courts should interpret the laws and mete out penalties. In this case the natural solution should be to charge the Commission with the responsibility to take action and let the European Court of Justice (ECJ) pass a verdict on the basis of legislation. But this option becomes less natural when half the commissioners hail from countries that may end up in the dock. If the European Council seriously wants to pursue the matter it should create the office of a prosecutor with the sole task of prevent financial irregularities and enforce respect for the rule of law. Political prestige should be weeded out to the fullest extent possible.

Finally – why should the system work in the future when it has failed us in the past. After all, it has never been allowed to filch public money for personal and political gain. Victor Orban is apparently the master at the dark arts of gaming the rules of the common agricultural policy – but he is not alone. The *New York Times* has recently documented, thoroughly unassisted by the Commission, how Orban has used EU subsidies to finance “a patronage system that enriches his friends and family, protects his political interests and punishes his rival.” Arm-twisted redistribution of farmland entitled to cash subsidies seems to be a favoured political currency. All over Central and Eastern Europe the bulk of EU money “goes to the connected and powerful few.” Subsidies have underwritten Mafia-style land grabs in Slovakia and Bulgaria. The billionaire agriculturalist, Andrej Babis, who is also the prime minister of the Czech Republic collected, according to *New York Times*, “at least $ 42 million in agricultural subsidies last year.”[25]

It does not help that the entire system – one of the largest subsidy programmes in the world – is shrouded in secrecy and that the European Court of Justice has ruled that the public shall not have access to records which show who the recipients of agricultural subsidies actually are.

Even if the Commission would want to act, which it doesn´t, it couldn´t. The dispensation of justice in these cases is, for all practical purposes, in the hands of national authorities (which are in the hands of the alleged wrongdoers). More important and much more controversial than an independent prosecutor is, that recipient countries would have to carry at least part of the burden of proof that money has been used for its intended purposes.

It is a pipe dream to believe that a qualified majority of European ministers will sell Victor Orban down the river.

The union, its budget and its future.

The budget does not tell you why the union is an important institution and has the potential to be a very important one. The content is a legacy of political rescue operations in the past. If France, when the Treaty of Rome was negotiated, had not made its participation subject to an agreement on a common agricultural policy (CAP), budget outlays would have been confined to negligible administrative costs. For a long time, agriculture accounted for 90 per cent of the union´s expenditure. Much of it was the cost of storing huge, unsaleable surpluses of milk, sugar, grain, butter and meat created by eye-watering production subsidies. The European definition of solidarity is the acceptance of common responsibility for financing the union´s activities and keep mum about *juste retour.* This stricture was studiously observed until Margaret Thatcher entered the scene in 1979.

The other major item of expenditure is related to the accession of the United Kingdom (UK) in 1973 to what was then called the European Economic Community (EEC) or, in Britain, more often the Common Market. Since the UK imported a lot more than other Member States from third countries and had a small agricultural sector it would inevitably pay a net contribution out of proportion to its economic heft. The solution was to set up a small

[25] Selam Gebrekidan; Matt Apuzzo and Benjamin Novak: The Money Farmers: How Oligarchs and Populists Milk the E.U. for Millions in New York Times, Nov. 3, 2019; Matt Apuzzo: E.U. Lawmakers Condemn Subsidy Corruption but Disagree on What to Do in New York Times, Dec. 17, 2019. It is emblematic of the media climate in continental Europe that we owe these revelations to American journalists.

European Fund for Regional Development (EFRD) and design it in such a way that some 30 per cent of the funds were channelled to the UK. The programmes for regional support, now referred to as cohesion policies, increased significantly apace with the enlargement of the union to welcome poorer countries from Southern, Central and Eastern Europe.

Subsidiarity is pure common sense

In the MFF recommended by the European Council[26]agriculture and cohesion policies account for two thirds of the total expenditure. But the design and delivery procedures have changed. Until 2003 agricultural subsidies came in the form of guaranteed high prices or reimbursement for land in fallow. Now owners of land historically entitled to support, receive cash grants related to area on condition that the land is or can be used for food production. EFRD basically paid recipient member states a lump sum on the basis of certain criteria and accepted an *ex post* statement of account. Now disbursements from bewildering multitude of programmes are subject to numerous conditions and matching contributions of variable severity. Net contributors to the cohesion programmes must also develop sophisticated plans before they can engage the Commission in negotiations to get back their own money – and then only if they put in an additional 40 per cent as a matching contribution.[27] Some of the projects financed by the European Social Fund are so small that they should be the exclusive responsibility of the parish council.

If we accept that countries that are net recipients of agricultural and cohesion funds should be indemnified it is easy to see a radical and natural reform of the budget. Since agriculture is the most down to earth activity we know (pun intended) it should, in line with the principle of subsidiarity, be renationalised. Each country could then design its agricultural policy in accordance with national priorities. The common cash limit for subsidies per hector provide a level playing field for honest competition. Net contributors to cohesion funding should at a minimum be spared the self-flagellation of having to use administrative and financial resources to retrieve their own money. Rules and regulations for disbursement to net recipients must be simplified and become more transparent.

Given the structure of the budget it is inevitable that negotiations become a pork-barrel brawl between net donors and recipients. Total expenditures stack up to only one per cent of EU GDP but, as already mentioned, a near majority of Member States collect amounts that correspond to 2 – 4 per cent of their GDP – enough to define their European priorities. For the rich Western European Member States the budget, as it now stands, is primarily a cost and the ambition is to keep it down. If agriculture and cohesion was netted out, the budget would become much smaller but it would set the scene for deliberations about the future course of the union and include issues of common interest for all Member States. Hopefully, negotiations would focus less on figures and more on content. As matters now stand, it is a no brainer for richer Member States to plump for research when the

[26] Since the European Council does not have any legislative competence it is right to call their decision a recommendation.

[27] In the Commissions document it is repeatedly underlined that the disbursement of NGEU funds will require increased flexibility and only modest demand for matching contributions. But it also stressed that national plans will be carefully scrutinized in order to weed out corrupt practices.

alternatives are either subsidies to rich landowners (some of which are multinational companies) or cohesion grants bundled in red tape. Judged on its own merit it will be necessary to evaluate what kind of research cooperation is likely to produce European added value.

It is important to keep in mind in mind that the essential activities of the union are financed from national budgets and take place in Member States. If, for instance, the Council of Ministers agreed on a radical programme to reduce emissions of carbon dioxide the execution would take place in Member States and be paid from national treasuries with a possible exception for subsidies to recalcitrant participants. Only a fraction of European funding for research is channelled through the EU budget and all action takes place in national institutions. In labs and libraries all over Europe scientists and scholars are working side by side – some are paid from the EU budget; most of them from national public and private sources.

Reforming the budget along the lines suggested above and in accordance with the constitutional prescription of subsidiarity will have several significant advantages. The present allocation of funds is likely to have a marginally negative effect on European competitiveness. For instance, CAP subsidies are internalized in the price of land which makes its alternative use for housing more expensive. Cohesion spending in rich Member States distort incentives and spending in net recipients are subject to a bewildering web of conditions. It is unlikely that successful research programmes could compensate for these drawbacks.

It will be easier to deal with these issues at the lowest possible level where politicians and the electorate have access to rich information and ability to assess the consequences of decisions taken or not taken. Issues will be contested by political parties in a democratic comfort zone and resolved by accountable government or local assemblies. The electorate can identify whom to praise or blame. The incentives will be straightforward – each Member State will strike its own balance between food production, various environmental concerns and the use of land. Richer Member States will simply let their citizens be the judge of how much support different regions need or deserve.

A budget for the future

The main advantage at the European level is that negotiations about a modernized MFF (which preferably should take place every five years) would turn on future-oriented issues of common interest for all MS. When research cooperation is judged on its own merit deliberations can focus on how joint efforts can create more added value than existing "organic" networks. The much-hyped flagship projects should be reviewed. My assumption is that European research programmes can be useful but it is not permissible to take for granted, as is done in the Lamy report[28] that that researchers perform better if they are paid from Brussels. We cannot have a policy based on hypocrisy

[28] LAB-FAB-APP – Investing in the European future we want. My critical review is published in *Respons*, mars 2018.

It is pretty certain that it would be rewarding if the EU could play a more active role in financing of expensive scientific infrastructure. There is a European Road Map, which lists Europe´s need for investments in specific projects,[29]but action depends on national initiative. The full responsibility to negotiate commitments to co-finance investments and running costs as well as project management rests with individual host governments. The European Spallation Source (ESS) was for many years a European top priority but work started only when competing projects in Japan and the US were already up and running. That it is now under construction in Lund and Köbenhavn, is due to generous financial commitments and work done by the Swedish and Danish governments with only vocal support from the Commission in Brussels. Since contributions from other countries are made in kind, i.e. different sorts of scientific equipment and instruments, the project is a complex jigsaw puzzle.[30] To finance these projects from a common budget and buy specified equipment and expertise from the best suppliers would facilitate research cooperation and save a lot of time and money.

European enthusiasm for industrial cooperation has waxed and waned and always been stronger on the continent than in the Anglo-Saxon periphery. But the EU certainly needs to take a hard look at its deficit in respect of artificial intelligence (AI), digitalisation and cloud services. Ursula von der Leyen, in her guidelines for the 2019-24 Commission, admits that, maybe, Europe "is falling behind certain tech giants."[31]This is an understatement. Even if it is disputed what we shall mean by AI it is abundantly clear that the market is dominated by the US and China and the tech giants are, in capitalised order, Apple, Microsoft, Amazon, Alphabet (owner of Google), Facebook, Alibaba and Tencent. Amazon is by far the biggest supplier of cloud services (that´s where it earns it keep) followed by Microsoft and Alibaba. According to a report from Stanford University the US and China account for a preponderant share of all AI-investments and hold 85 per cent of all patents. The only other countries which rate a mention are the UK and Israel. The head of the Brussels based think-tank Breugel, Guntram Wolff, deplores that the EU is only a bit player. A serious effort to retrieve lost ground in the technosphere will require a lot more resources than is now allocated in the MFF.

It´s not the money, stupid

But the most important remits for the union are not related to the size of its budget. First and foremost, the EU is charged with the responsibility to develop and regulate the world´s largest domestic market. It is a mundane, not very glamorous task of immense importance for the material well-being of citizens and competitiveness of companies. The eurocrats are doing a pretty good job at it and certainly far better than the US administration. On both sides of the Atlantic competition authorities have allowed the tech giants to swallow up all upstarts that could be a future challenger but the Commission has been far more aggressive

[29] European Strategy Forum for Research Infrastructure (ESFRI) Road Map 2021.

[30] At present, only 10 Member States have joined the Consortium together with Norway, Switzerland and the UK.

[31] When the French and Dutch electorate in 2005, with resounding clarity, turned down a proposed constitutional treaty, Jean-Claude Juncker declared that this did not really happen. *The Economist* instituted the Louis XVI prize in honour of politicians out of touch with reality. Juncker was the first laureate.

than the Department of Justice in Washington in dealing with this problem. The task is not getting easier. Products and, in particular, services are becoming more complex. Old rules about market dominance and price competition are turned upside down when marginal costs are negative. The fundamental criteria for effective markets are disputed. The Commission need to pluck up the courage to demand resources to recruit the talent needed to keep up with events.

None of the Member States can effectively enforce a fair tax policy on its own. The strategy so far has been to convince tax havens all over the world to share information about money stashed away – legally or not. The pickings are thin on the ground. An alternative approach would be to turn the table on companies and individuals that aggressively use all available means to reduce their European taxes. Taxes are the price we pay for civilisation. Companies and people choosing to do business in the world´s largest, best regulated market, ruled by law and protected from blatant corruption should be forced to contribute to keep the good times coming. People who prefer to live in true democracies embedded in tax financed culture galore are supposed to chip in. If not, they should hawk their goods and find entertainment in the Cayman Islands or St. Kitts and Nevis (combined population 116 904 individuals in 2017).

In this area the US is far more aggressive than the EU will ever be. The Department of Justice in Washington has arrogated the power to go after any company who has come close to the dollar or registered a transaction in a server within US jurisdiction. European companies have accepted to pay billions just in order to avoid the cost of a legal process. The simplest solution for the EU would be to copy the American strict legislation against corrupt practices.

If the union wish to define its presence on the global stage, dominated by the US and China, a first step must be to frame the role it could realistically play. Treaties and declarations are replete with detailed descriptions of a foreign and security policy waiting to materialize. In fact, one third of the Treaty on European Union (TEU) is devoted to this subject and it takes a close reading of the text to realize that it is a chimera. The Member States have divergent views on most key issues and it took three days to negotiate a non-position regarding Venezuela. The EU will not be a military power anytime soon. It is a chagrin to many French politicians and diplomats but need not concern us here.

In the 1940´s all leading Western European politicians, including for once general de Gaulle, agreed that the mainstay of the continent´s security was American boots on the ground as close as possible to the Communist world. Unlike what happened in 1914 and 1939 the US would then be engaged from day one if the only conceivable enemy attacked. This security guarantee was sealed in April 1949 when the charter of the North Atlantic Treaty Organization was signed.

Soft power?

The union´s power is of a different sort but its potential is not fully realized. The EU is the world´s largest provider of development assistance and peace keeping but comes across more as a payer than a player because action isn´t part of a comprehensive foreign policy. Many Member States are being bullied by China, Saudi Arabia, Russia and the US and are pretty helpless on their own. A common EU stance would be much appreciated but the EU don´t have a common policy vis-à-vis these countries. Joint efforts to combat tax evasion are hampered by Member States that prefer to turn a blind eye. The efforts to use access to the Single Market as a means to force other countries to comply with environmental standards have so far been tentative.

However, the soft power emanating from the rules and regulations of the Single Market are real. The controversial data protection regulation (General Data Protection Regulation, GDPR) is rapidly becoming a world standard. It has already inspired 120 countries. It is not only due to the genius of the eurocrats but more to the open and transparent process. The great strength of Europe is that legislation is shaped in a democratic process, politically protected from dark money and enforced (in most countries) by effective and impartial courts.

The business community is hardwired to oppose intrusive legislation but even more averse to legal uncertainty. There are signs that international companies see the value of a legitimizing democratic process even if taxes have to be paid. The global business community would not like a technosphere regulated by a repressive state ruled by a communist party or left at the mercy of a dysfunctional Congress.

The MFF does not reflect what the EU is or does between nine and five but one per cent of the union´s GDP is still, in absolute terms, a huge pot of money. Used strategically it could make a difference and indicate where the future lies. This time it did not even lead to an informed discussion of priorities – in this sense the European Council was an opportunity lost.

An elephant in the room

The recovery plan is obviously not what it pretends to be, but it is not easy to understand what it is. If we disregard the sophisticated models and take as our point of departure the characteristics of the countries that are the main beneficiaries (grants and loans as a share of GDP) we have already shown that all members of the poorest group are growing at a much faster clip than the eurozone average. They have been only lightly touched by the pandemic and their public debts are modest. By any standard, they are more resilient than other Member States. Among the whole group of beneficiaries only Spain, Greece and, in particular, Italy need a helping hand. In general, the Commission´s programme entails a huge transfer of resources to the union´s most corrupt Member States. The three countries that are treated more generously than any other, receiving an amount corresponding to a fifth of GDP, rank at the bottom of the Transparency International´s corruption index. (If the union lavished the same kind of financial care on Sweden Magdalena Andersson would be the happy receiver of 1000 billion Kronor). This cannot be the intended results of any rational support programme.

The alleged recovery package is flawed in any conceivable dimension. The design is fraught with misguided incentives, moral hazards and ominous prejudices. It is also too small. The annual commitment of funds will increase marginally thanks to the NGEU but the actual disbursements will be delayed to the point that the programme becomes macroeconomically irrelevant. Activities to reignite economies are already in full swing all over the world. The IMF predicts that rich countries will borrow and spend around $ 4,2 trillion *this year*, corresponding to 17 per cent of their combined GDP. It seems modest considering what has already been committed. By mid-August ECB had lent 1 600 billion through a plethora of very generous long-term repo operations – it is actually paying commercial banks to extend credit to the economy – and the Commission has already granted exemptions from state aid restrictions to the tune of some 2 000 billion euros. The US Congress has passed some $ 3000 billion worth of fiscal stimulus and Republicans and Democrats are mulling if they shall add 1 or $ 3,5 trillion to that figure. China seems to get away with a misery recovery programme corresponding to 5 per cent of GDP. If recovery was the main aim of NGEU it would be more effective to align disbursements with the activities under way on the basis of national priorities.

A much smarter plan

If we take a step back it is easy to see the problem facing the Commission in April and May when the programme was conceived. The magnitude and configuration of the challenge differed from one country to another but they all needed to borrow loads of money. Governments had made an assessment of what they needed and how it could be financed. Some few countries were in the felicitous position that they could charge lenders a small fee to take care of their dosh – a negative rate of interest. Other countries pay in line with how the rating institutes assess their creditworthiness and some will have difficulties to service a much larger national debt.

The solution to this problem has been pointed out by several Member States – including France. The union should borrow money on behalf of member states in the international capital markets. With the common budget as collateral it would be possible to obtain a fixed low interest for long-term loans. Such a scheme would allow many Member States to borrow vastly more than they would otherwise do. In fact, it has been tried before with, admittedly, mixed results. When the eurozone entered into force all Member States could suddenly, and surprisingly, borrow on the same terms (almost) as Germany. That some countries were less able than others to handle the bounties has taught us a lesson. The banks had foreseen that they would be bailed out.

A scheme based on joint borrowing could be simple, swift and bespoke to each country. Governments that wish to make use of the facility should submit a request based on an assessment of national needs and ability to borrow on the new terms. Countries with a high credit rating (all the donors) would probably not take part. They can already borrow all they need on equally good or better terms and see no need to negotiate with the Commission before they can spend their own money. For less creditworthy Member States the scheme would offer huge subsidies to the tune of 2 – 3 per centage points on borrowed funds. As already underlined, the economic difference between a 57-year long loan and a grant is insignificant. However, experience from 60 years of development aid has taught us that it is unwise to lend money to deeply corrupt governments. In this case it would probably be a good idea to give the Commission authority to withhold cohesion money in case of an unwarranted default. But this was the road not taken.

Epiphany in Berlin

For a very long time and until very recently, Germany, strongly supported by Finland and the frugal four, was opposed to every hint of a transfer union. The change of mind in Berlin was welcomed in many quarters but it must be explained. Why, when it finally vigorously embraced the new approach, did it turn down a simple and effective solution in favour of a tortured combination of loans and grants, intertwined with the long-term budget, out of proportion to what most beneficiaries needed and deserved, obligating all Member States to be both contributors and recipients and subject to strict conditions to be negotiated with the Commission for all Member States?

Maybe we should take our cue from what is *not* said in the C´s documents. The European Central Bank´s massive purchases of government bonds, which have significantly reduced borrowing costs for Italy and Spain and some other countries, are not discussed and the fact that 19 countries are locked into a currency union does not even rate a mention. Instead the Commission keeps ranting about the risk of undermining the internal market – but does not really tell us why.

The governments in Berlin and Paris, when they prepared their proposal, must have made a thorough analysis of economic situation in Europe when the dimensions of the pandemic crisis dawned upon them. Like the rest of us they must have seen that three countries – Greece, Italy and Spain – where in dire straits. In particular Italy and Greece have had a deplorable beginning of the new millennia. Their public debts were very high even before the pandemic struck. The Greeks have been saved from bankruptcy twice and is now a much poorer country than 20 years ago. Its GDP fell annually on average 2,7 per cent 2008 – 18. Italian membership of the EMU was practically a condition from France which wanted to deprive Rome of the privilege to devalue the lira. And the Italians made a heroic effort to pass the pearly gate to economic bliss. But it has been a miserable zone. Italy has fallen behind all other member states except Greece and unfortunately the rich, industrialised northern part has suffered most. Italy is still the union´s second largest producer of manufactured goods but its heavy industry has been badly savaged by the German *Mittelstand.* When the eurozone took shape Italy´s GDP per capita (PPP) was on par with Germany´s – now it is 20 per cent below. Spain has been badly bruised by the pandemic but before the shock the country experienced a decent growth rate. If Angela Merkel and Emmanuel Macron, like the Commission, were worried that some Member States might “get stuck in a situation of prolonged sluggish growth, high unemployment and permanently weakened corporate sector, resulting in cross-country divergences” they must have realised that only Italy, Greece and, possibly, Spain fit the bill - a fact that represented a clear and present threat to the currency union.

And the situation is about to get significantly worse. The crisis will shift the balance further in Germany´s favour. The country has been only modestly hit by the pandemic and disposes of a formidable economic war chest to add to the 1 000 billion that have already been disbursed (at least as long as there are no restrictions on state aid). The eurozone will be a very uncomfortable place for Italy, Greece and some other countries. The governments in Berlin and Paris must have realised that this situation is not tenable even in the short run.

As Angela Merkel and Emmanuel Macron were cogitating on the future of the union the president of ECB, Christiane Lagarde, must have weighted in and asked for fiscal support to suppress the recession. Her enormous purchases of Italian and Spanish government bonds had been effective but could not work miracles – the yield gap to Germany´s bonds were still some 1,5 per cent. She probably added that the bank was close to breaching the treaty´s rule of not bailing out countries.

For Germany, in particular, and France the currency union is a political commitment that is beyond reproach (as an economic project it is widely regarded as a failure). If Angela Merkel and Emmanuel Macron did not have the monetary union in sight when they came up with the scheme to borrow 500 billion euro and hand over a big chunk to Italy and Spain (which had declared that they were not satisfied with generous loans and demanded cash with no strings attached) it must be regarded as a grave dereliction of duty.

The imminent threat to the currency union is the most likely explanation for Germany´s embrace of a transfer union. We cannot accept the recovery plan endorsed in Brussels as a rational response to an unprecedented economic crisis. The poorer Member States in Central and Eastern Europe would never accept that the common budget would be used as a collateral for funnelling grants to medium rich countries which had only themselves to blame for their agonies – which brings us to our second enigma. Why should obscene amounts of money be allocated to the countries in Central and Eastern Europe which already receive generous annual allowances? The ranting about a threat to the Single Market is nonsense on stilts and the gap between rich and poor is rapidly converging – and this development is likely to continue. The Commission faced the same obstacle as Aneurin Bevan when he needed to win the general practitioners´ support for the creation of National Health Service (NHS) in 1948. He "stuffed their mouths with gold." The Commission needed a vociferous majority to close the deal and put pressure on the frugal minority.

In passing, it is worth mentioning that neither the Commission nor the European Council seem to be concerned about the very real and urgent problems facing many of the countries in Central and Eastern Europe. Their populations are rapidly shrinking and aging.

Admittedly, this is a conspiracy theory but it is also a damned good explanation. All the pieces fall logically into their places in the jigsaw puzzle – from the German pivot; the original German-French proposal, the need to build a robust majority in its favour; the Commission´s supine execution and the corrections made in Brussels.

However, it will not save the currency union. The loans and grants provided to the countries that constitute a threat to the euro are substantial. But as long as a structural imbalance remains inside the half-way house that is the currency union the money is not enough. Many

Italian politicians and most observers in other Member States (but not in the US) expected, or at least hoped, that the EMU´s firm strictures of fiscal rectitude would ween Italy off its default position to devalue the lira. The tragic irony is that it would be costless to remedy Italy´s underlying problem. In a European context the country has extremely high transaction costs because of a byzantine web of rules aided and abetted by corruption. It takes a multitude of permits to set up a small business in the formal sector and the activities will then be inspected, controlled and taxed (legally and criminally) by numerous agencies. It takes ages to settle a commercial dispute. A simpler, fairer and impartial regulation of the business sector would save money and reduce corruption. As long as transaction costs are so high dollops of extra money will not help. Therefore, it bodes ill that prime minister Guiseppe Conte has promised that a large part of the expected largesse will be invested in Mezzogiorno where it will be welcomed by the Camorra in Napoli, the Ndrangheta in Calabria and the Cosa Nostra in Sicily

The party is over

The NGEU will add to European efforts to suppress the recession and sustain the economic recovery. The potential is not insignificant but it is likely to come too late. According to estimates by the Swedish bank SEB OECD-countries will borrow amounts corresponding to 20 per cent of GDP this year when the union will be hard at work to put enabling legislation in place. The economic downturn passed its nadir in April and the recovery is in full swing. Stock markets had their best August since 1986..

In absolute terms Spain, Italy and Greece will receive substantial amounts of grants and subsidized loans. They sorely need the money but it is only a stop gap solution for the ills afflicting the currency union. As part of the bargain, the new Member States in Central and Eastern Europe, already well pandered for in the regular EU budget, will get hugely more than is politically and economically justified or deserved. And incumbent governments will be helped to secure their grip on power.

The once every seven-year opportunity to modernise the MFF was missed. The Commission´s effort to use the NGEU to beef up the forward –looking parts of the budget was quashed by the European Council. When push came to shove, agriculture and cohesion had stronger purchase than academic pursuits.

The corona crisis was certainly unprecedented but the NGEU still sets a precedence for what will be demanded next time around. The legacy will be part of EU lore until the last amortization is made in 2058.

The lip service paid to the “respect for the rule of law” and efforts to weed out corruption are unlikely to get legal teeth. If it happens, there is a risk that the cure is worse than the disease.

The European polity has the bad habit of framing any potential setback as an existential threat to the union. Even observers highly critical of the conclusions from the European Council argue that the compromise was necessary to “save the union.” If so, we must hope that the victory will not turn out to be as expensive as the one won at Ausculum by king Pyrrhus of Epirus.

During the last quarter of a century the economic and political regime in Europe and North America has been sharply focussed on keeping interests down in order to encourage banks to lend and companies to borrow and invest. The inevitable result has been a strong increase of asset prices. The values of real estate, land and share prices have risen strongly and rebounded with vigour after every crisis. The benefits have been amassed by a tiny proportion of humanity. Some members of this minority have voiced the idea that it may be pay-back time. But no government or major political party has suggested that the economic fallout of the pandemic could at least partly be compensated by a wealth tax (paid by people whose consumption would be unaffected). Instead the political leaders who designed the so-called recovery programme decided that their successors would settle the bill. Next Generation EU is therefore an apt name for the recovery programme.