An $826 Billion Battle is Brewing in Europe

(Bloomberg Opinion) — The European Union's pandemic recovery plan has all the hallmarks of a historic leap in the dark for the 27-member bloc.

It aims to unleash as much as 750 billion euros ($826 billion) of fiscal stimulus, fueled by joint borrowing on financial markets — a big deal for member states that have always jealously guarded the power to tax and spend. The fact that the plan unveiled by Commission boss Ursula von der Leyen is so clearly aligned with the proposal from France's Emmanuel Macron and Germany's Angela Merkel is especially positive: Paris's desire for continental assertiveness and foreign-policy grandeur hasn't always matched Berlin's focus on balanced budgets.

Still, unlike the days of Charles de Gaulle and Konrad Adenauer, or Francois Mitterrand and Helmut Kohl, the greater sprawl and complexity of Europe mean such breakthroughs need more than just France and Germany's blessing to secure buy-in across the continent. A bust-up is looming over what should be spent and how, and it will be a bitter one.

At the center of the battle are the so-called "frugal four" — the Netherlands, Sweden, Austria and Denmark — taking up a combative role similar to that of the British when they were members. As wealthy net contributors to the bloc's budget, they've already been pushing back against what they see as unfair increases to the share they're expected to chip in after Brexit; February negotiations on the next seven-year budget went nowhere after 28 hours of talks.

The Covid-19 crisis has redoubled efforts by the frugal four to push back against perceived profligacy, as the EU considers a bigger budget outlay than before, at 1.1 trillion euros (still only about 1% of gross national income), adds on pandemic stimulus tools and proposes aid in the form of grants rather than loans to be paid back — a package worth 2.4 trillion euros. The budget hard-liners may lack the diplomatic heft of Germany, but they can't be ignored, as the plan needs unanimous support across national parliaments.

Their counter-proposal has yet to be fleshed out, but their public preference for loans over grants is unlikely to be an all-or-nothing fight. Pushing loans onto highly indebted countries such as Italy would likely make it harder for them to borrow and spend the kind of funds needed to kick-start the recovery. (The government in Rome is due to receive 82 billion euros in emergency grants.)

It also doesn't make sense to assume that money sent to virus-scarred countries is wasted unless it's directly repaid. The cash will help to rebuild a single market that was brought to its knees by the pandemic — an obvious boon to trade-focused countries like the Netherlands, ranked as the No. 2 source of exports between EU members. Few countries will be spared recession — the frugal four's economies are set to shrink between 3% and 6% this year. The EU looked like a sinking ship during the crisis; this new plan is trying to plug the leak, repair the hull and navigate choppy economic waters over the next decade through investment priorities such as the Green Deal, according to Charles de Marcilly, former adviser to the EPSC think tank. This will benefitwas all member states.

Assuming pragmatism wins out here, which is no sure thing, there might be some compromise to be found by tweaking the current split of grants versus loans, proposed at 500 billion euros and 250 billion euros respectively. The Commission also seems to have already backed down from getting rid of prized budget rebates, which give money back to countries footing outsized EU bills. But the potential depth of voter disgruntlement in a country like the Netherlands — where Prime Minister Mark Rutte's coalition partners appear skeptical of the EU plan — will lead to talk of more conditionality.

The EU budget itself might offer some potential for tweaks: Agricultural subsidies and cohesion funds for poorer areas of Europe account for about 71% of the budget, according to Bruegel, a think tank that has called for a "structural rethink" of how they're paid. There might be ways to improve oversight of this cash while maintaining its intended benefits.

What could make this particular fight so toxic is the internal distrust that has flared up as a result of the virus, from anger in Italy over a lack of support from EU partners to threats to the rule of law in Eastern European member states. The bloc's members went their own way during the crisis, closing borders and hoarding equipment; they now have to go back to trusting each other, and also trusting that Brussels will fairly enforce the single market’s rules as it crosses the Rubicon of large-scale borrowing.

It’s encouraging that Germany, historically a frugal Northern state, realizes geopolitical pressure on the EU from the U.S., and China requires radical steps. “(The plan is) about making Europe stronger and working on better sovereignty of our European Union,” German Finance Minister Olaf Scholz told Politico. Talk of grand visions tends to leave the frugal camp cold, though. “When you have visions, go see a doctor,” Rutte once said. If budget divides can’t be bridged, there’ll be some dark sights ahead.

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