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The Next Generation EU — an Indebted Generation?

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BENJAMIN RUTLEDGE

WWW.POLITIKASPOLECNOST.CZ

OFFICE@POLITICSANDSOCIETY.CZ

The Next Generation EU – an Indebted Generation?

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The European Union (EU) has taken massive new steps to combat the economic crisis from the coronavirus crisis and lockdowns. The European Council came to an agreement to issue 750 billion euros in grants and low interest loans to the member states in need in an agreement called Next Generation EU (NGEU). The relief package has strengthened the image of the EU after a rough year so far. The relief package will have positive, negative, intended and unintended consequences that must be considered. Moreover, the amount might not be enough. This paper will look at the political and economical impacts on the EU and member states.

Political Impacts and Expectations

The European Council reached the NGEU deal on July 21, 2020, to grant 750 billion euros to EU member states affected by the Coronavirus. The deal is an unifying accomplishment after the Union was hit by the coronavirus, Brexit negotiations, and democratic backsliding. The heads of states debated the details for four days before the deal was reached. The goal of the deal was to "preserve the health of the citizens and prevent a collapse of the economy".[1] Problems arose between the "Frugal Four" and the EU southern member states with indebted, stagnant economies. The Frugal Four is a nickname for Austria, Denmark, the Netherlands, and Sweden because of the responsible, conservative fiscal policies. These four states came to agreement with Italy, Greece, and Spain to divide the package into 390 billion euros in grants and 360 billion in loans.[2] Germany and France acted as the mediators to work out discrepancies as Polish Prime Minister Mateusz Morawiecki even claimed the Frugal Fours are "a group of stingy, egotistic states."[3] In the end and for the better, all prime ministers compromised and claimed a victory for the Union's unity and solidarity.

The Next Generation EU agreement is part of the next years' budget: the Multiannual Financial Framework. One condition of the EU budget is to allocate 30% to combating climate change in order to be climate neutral by 2050.[4] The EU will raise the 750 billion euros on the capital market through bonds. To receive the aid, member states will have to create their own "recovery and resilience plans" that must be approved by a qualified majority of the Council of the EU.[5] Another aspect of the agreement is the emphasis on stabilizing liberal democracy.

Next Generation EU does not contain any articles requiring immediate support for rule of law and liberal democracy, but it does allow the member states to vote on future rules regarding good governance. Hungarian prime minister Viktor Orbán declared this a "huge victory," but the funds could be held back from Hungary if 55% of member states and a corresponding 65%

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[1] EUCO 10/20, General Secretariat of the Council, European Council, July 21, 2020, https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf, 1.

[2] EUCO 10/20, European Council, 5.

[3] Al Jazeera, "EU Leaders Agree on $860bn Joint-Debt Economic Relief Package," July 21, 2020, https://www.aljazeera.com/ajimpact/eu-leaders-agree-860bn-joint-debt-economic-relief-package-200721035119795.html.

[4] Christine Wang and Silvia Amaro, "EU Leaders Reach $2 Trillion Deal on Recovery Plan after Marathon Summit," CNBC, July 21, 2020, https://www.cnbc.com/2020/07/21/eu-leaders-reach-a-breakthrough-on-the-regions-recovery-fund.html.

[5] EUCO 10/20, European Council, 7.

of the EU population vote for measures of good governance.[6] The implementation of democratic governance into relief package requirements will depend on the qualified majority voting. The Netherlands and other northern countries have been joined by France in protesting the issuance of funds to countries that infringe upon human rights and liberal democracy.[7] Although quite improbable, The EU could use the Relief Package as leverage to re-implement the EU Charter on Fundamental Rights. Member states can expect demands for democratic rule of law with the funds.

Economic Impacts

The NGEU is expected to reinforce the Union's financial solidarity. Member states can still count on aid from the supranational institutions in time of need. The member states can share some of the costs of new investments with the EU. French President Macron shared, "This recovery fund will help us to almost double the European budget for the years to come."[8] The member states are responsible for creating and implementing the financial aid. This supports the EU's principle of subsidiarity and economic cooperation. The detailed dates and amounts listed on the official publication promote transparency and accountability. The NGEU and Multiannual budget should work hand in hand with national relief packages already passed.

There have been multiple economic relief packages from central banks and governments since the start of the coronavirus. Next Generation is not the first EU package passed, and it will most likely not be the last. Historically, fiscal stimulus does not stimulate the economy as originally planned and is followed by additional fiscal stimulus. Fiscal stimulus often goes into certain sectors of the economy but does not provide long term solutions. For example, the Czech Republic went into instant lockdown in spring and has passed numerous stimulus packages. To combat the economic damage from lockdowns, the Czech government has spent hundreds of billions of Czech crowns to help the economy. The government has increased the state budget deficit a staggering *12.5 times higher* from the initial 40 billion CZK to over 500 billion.[9] Even though the economy recovered 6% in Q3, there have been more new lockdowns and stimulus packages in Q4.[10] In comparison, the EU and ECB have passed a list of fiscal stimulus similar to the repeated efforts of Czech national governments. Table 1 shows the list of financial aid for EU member states that have been passed this year before NGEU and the new budget. The list of coronavirus related economic relief will likely grow as virus cases rise and lockdowns follow.

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6 Frida Ghitis, "Why The EU'S Coronavirus Rescue Package Might Save The European Project," World Politics Review, 6 August 2020, https://www.worldpoliticsreview.com/articles/28970/why-the-eu-s-coronavirus-rescue-package-might-save-the-european-project.

7 Ibid.

8 Christine Wang and Silvia Amaro, "EU Leaders Reach $2 Trillion Deal on Recovery Plan after Marathon Summit," CNBC, July 21, 2020, https://www.cnbc.com/2020/07/21/eu-leaders-reach-a-breakthrough-on-the-regions-recovery-fund.html.

9 "Measures Adopted by the Czech Government against the Coronavirus," Government of the Czech Republic, Press Advisories, September 24, 2020, https://www.vlada.cz/en/media-centrum/aktualne/measures-adopted-by-the-czech-government-against-coronavirus-180545/.

10 "Czech Republic GDP Growth Rate," 1995-2020 Data | 2021-2022 Forecast | Calendar, Czech Statistical Office, 2020, https://tradingeconomics.com/czech-republic/gdp-growth.

Table 1: 2020 European Monetary Stimulus Policies

Date (2020)	Amount (€)	Grantor	Title
18 March	750 billion	ECB	Pandemic Emergency Purchase Programme (PEPP), Corporate Sector Purchase Programme (CSPP)
19 March	7.6 billion	EU Commission	"Decreto Rilancio" for Italian tax scheme
1 April	37 billion	EU budget resources	Coronavirus Response Investment Initiative
23 April	540 billion	EU European Council	Support to mitigate Unemployment Risk in an Emergency SURE / ESM Pandemic Crisis Support / EIB Guarantee Fund for Workers and Businesses
2 June	600 billion	ECB	expansion of PEPP
21 July	1.1 trillion	EU 2021–2027 Budget	Multiannual Financial Framework
21 July	750 billion	EU Commission	Next Generation EU

Source: EU[11]

The crisis is far from over as the economic effects will still be felt after the coronavirus is contained. To combat the need to borrow completely, the EU will introduce new taxes to help fund the package. Member states can expect several new taxes and tariffs from Brussels. The NGEU lists "new own resources" to gain some revenue to decrease the need to borrow in section A29 of the package outline.[12] Member states can expect a non-recycled plastic waste tax that comes into effect January 1, 2021.[13] The Commission will also propose a new carbon border adjustment tax and digital duty in 2021.[14] The plastic and carbon tax fall in line with the sustainability goal. Notably, the carbon border mechanism aims to tax EU imports for emission byproducts and protect European industrial competitiveness; the digital duty would target American website companies.[15] The Union may also revise the Emission Trading System and introduce a Financial Transaction Tax.[16] The new taxes will pay for a portion of the NGEU package yet may increase production and consumer cost.

Debt of the Euro

The relief package sets a new direction for the EU as a debt-based institution. Germany has opposed debt at a supranational level for decades but gave in to the decision in the aftermath of the coronavirus lockdowns. Nicolas Véron, senior fellow at the Bruegel think tank in

[11] "Report on the comprehensive economic policy response to the COVID-19 pandemic," European Council, Council of the European Union, 28 April 2020, https://europa.eu/!CK47tD; The EU Budget Powering the Recovery Plan for Europe, European Commission 2020, https://ec.europa.eu/info/sites/info/files/factsheet_1_en.pdf.
[12] EUCO 10/20, European Council, 8.
[13] EUCO 10/20, European Council, 8.
[14] Ibid.
[15] Riccardo Perissich, "Did We Say 'New Own Resources' for the Recovery Fund?," Centre for European Policy Studies, July 9, 2020, https://www.ceps.eu/did-we-say-new-own-resources-for-the-recovery-fund/.
[16] Ibid, 8.

Brussels, said that the deal will create a big pool of European debt. He explains: "This is meant to be a one-off, but few people really believe that — it will be obvious that it makes more sense to refinance the issuance with new borrowing rather than reimburse with painful taxes, so it makes EU debt a permanent feature."[17] Véron sees the EU becoming a permanent debt based governing body because of the convenience of borrowing instead of *solely* taxing the package into existence.

The EU is funding the majority of NGEU through new EU bonds dubbed "corona bonds." The Commission signed a new Debt Issuance Program on behalf of the EU and European Atomic Energy Community in December 2019.[18] This program allows the sale of EU/Euratom bonds for the emergency relief package can be purchased on the Luxembourg stock exchange from 2021–2024.[19] Bonds are a glorified 'I owe you' that promise future payment plus interest. The EU will borrow for the NGEU until 2026, and it looks to pay off the debt by 2058.[20] The majority of these bonds are being purchased by the European Central Bank, in addition to other banks, financial firms, and corporations.

The European Central Bank (ECB) buys the EU bonds or treasuries through debt issuance. The ECB controls the European monetary system, yet the ECB has a monetary balance sheet of zero. Furthermore, the ECB has shareholders that gain profits, as outlined on their website.[21] This means the bank does not have the actual currency or the income to buy all the EU bonds but prints — or nowadays types into a computer — the currency into existence. The newly created currency is then issued to banks as liquidity or used to buy bonds. The bonds are then used to provide funds for government programs. In June, the ECB announced another 600 billion euros of quantitative easing, bringing the year to date total to 1.3 trillion euros.[22] The quantitative easing Holger Zschaepitz, an analyst for Welt financial firm, reports the ECB balance sheet has run over 6.3514 trillion euros and a stunning 53.3% of the Eurozone's GDP.[23] In comparison, the US Federal Reserve has a balance sheet equal to 32.3% of the American GDP.[24] In addition, banks also create currency by providing low interest loans through the fractional reserve system. The central banks in correlation with national governments are responsible for creating new currency through debt and credit.

All European governments are already debt based and take similar action to fund relief assistance. Germany, Italy, and the Czech Republic have approved the largest relief packages

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[17] John Rees, "As €750B package creates safe asset, EU banking union inches closer," S & P Global, 27 July 2020, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/as-8364-750b-package-creates-safe-asset-eu-banking-union-inches-closer-59580305.

[18] "Investor Presentation," European Commission, European Union, September 2020, 6, https://ec.europa.eu/info/sites/info/files/economy-finance/eu_investor_presentation_en.pdf.

[19] "Investor Presentation," European Commission, European Union, September 2020, 6; The EU Budget Powering the Recovery Plan for Europe, European Commission 2020, https://ec.europa.eu/info/sites/info/files/factsheet_1_en.pdf.

[20] EUCO 10/20, General Secretariat of the Council, European Council, 3.

[21] "Capital Subscription," European Central Bank, January 30, 2020, https://www.ecb.europa.eu/ecb/orga/capital/html/index.en.html.

[22] Ibid.

[23] Omkar Godbole , "ECB Balance Sheet Now Equals 53.3% of Eurozone GDP," FXStreet, July 30, 2020, https://www.fxstreet.com/news/ecb-balance-sheet-now-equals-533-of-eurozone-gdp-202007300056.

[24] Ibid.

that are 28.5%, 21%, and 18% of their GDP respectively.[25] European state governments receive deficit funding when the national central banks and financial investors purchase their bonds. In this way, the NGEU package and state financial relief measures are similar. Both gain funding through central banks when the banks buy their bonds and deposit new currency to the state treasury. Italy will benefit the most from the package as it struggles to improve the economy. Italy is already set to receive an approved 7.6 billion euros by the Commission from March plus the NGEU funds.[26]

Table 2: European Public Financial Indicators

	Gross Public Debt as Percent of GDP		
Year:	**2019**	**2020**	**2021**
Italy	134.8	155.7	152.7
France	98.1	116.5	111.9
Germany	59.8	75.6	71.8
Spain	95.5	115.6	113.7
Euro area	102.7	102.7	98.8
	Primary Balance as Percent of GDP		
Italy	1.7	-6.8	-2
France	-1.6	-8.4	-2.7
Germany	2.3	-6.3	-0.8
Spain	-0.5	-7.7	-4.4
Euro area	1	-6.8	-2

Source: Bank of Italy: Directorate General for Economics, Statistics, and Research[27]

[25] "Coronavirus: Czech Republic's Stimulus Package Is the Third Largest in Europe," Prague Morning, April 1, 2020, https://www.praguemorning.cz/coronavirus-czech-republics-stimulus-package-is-the-third-largest-in-europe/.

[26] "State aid: Commission approves €7.6 billion Italian tax schemes to support companies and self-employed workers affected by coronavirus outbreak," European Commission - Press Release, Brussels, 26 June 2020, https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1210.

[27] The Italian Economic in Brief, No. 6 - August 2020, Directorate General for Economics, Statistics, and Research, Banca d'Italia, Eurosistema, August 11, 2020, 16, https://www.bancaditalia.it/pubblicazioni/economia-italiana-in-breve/2020/EIB_11_Agosto_2020_en.pdf?language_id=1.

This has massive implementation on the debt atmosphere. The International Monetary Fund Blog published an article on October 1, 2020, warning of a future debt crisis because of historic high debt levels.[28] Table 2 shows the primary balance and gross public debt as a percent of GDP. The primary balance is the fiscal government difference between revenues and expenditures. The gross public debt is the national debt divided by the GDP. This table highlights the dangerous levels of Euro area debt and predictions for 2020 and 2021. It is virtuous that the EU is making drastic changes to help the member states, but debt levels will have to be stabilized after the pandemic.

EU policy makers must consider the impact of debt accumulation and shrinking national production. Austrian economists argue wealth accumulation comes from a stable currency base. They would maintain economic prosperity comes from the creation of goods and services; once not creating more fiat currency. Every currency in the world is currently fiat, meaning it is government backed but has no intrinsic value (not backed by gold). The NGEU package will aid the entities that receive the distributed funds, while at the same time create inequality for those who do not benefit from the funds. In other words, currency creation and issuance only benefits the ones that directly receive it first.

The global economy went into a deflationary crisis because of the crashing of money velocity and hardship brought by lockdowns, yet the EU and ECB reaction will cause future inflation. Mike Maloney writes in his book *Guide to Investing in Gold and Silver: Protect Your Financial Future* that all fiat currencies in history have *always* perished and became worthless.[29] With this in mind, EU policy makers must use caution when inflating the currency supply and keeping interest rates low, especially in a deflationary economic crisis. When economic activity begins to pick back up, the effects of the inflation will be felt in higher prices. This could come in the form of stagflation or hyperinflation. The EU ministers must recognize the limits the package will have if citizens cannot work, travel and consume goods and services.

Conclusion

In conclusion, does the EU come out reinforced after passing the NGEU package? Somewhat. The Union can take pride in passing such a large passage in four days. The NGEU agreement is proof 27 states can come together in hard times to achieve a complex goal. Member states can expect EU rules and regulation regarding the rule of law and environmental sustainability and new taxes. The commitment to environmental protection, rule of law, and helping the member states during an economic crisis reinforces the EU's position. The most important unifying aspect was the solidarity from the Frugal Four, Germany, France, and Mediterranean member states. The decisive accord that came from contradicting fiscal policies boosts the effectiveness and cooperation of the EU. Brussels should capitalize on this moment to strengthen the Union by funding investment to help average citizens in sectors hurt the most from the pandemic.

On the other hand, the whole process of currency transmission is too slow, and the NGEU is one of many packages passed since the start of this year. Individual European governments

[28] Kristalina Georgieva, Ceyla Pazarbasioglu, and Rhoda Weeks-Brown, "Reform of the International Debt Architecture Is Urgently Needed," International Monetary Fund, IMFBlog, October 1, 2020, https://blogs.imf.org/2020/10/01/reform-of-the-international-debt-architecture-is-urgently-needed/.

[29] Michael Maloney, Guide to Investing in Gold & Silver: Protect Your Financial Future, Scottsdale, AZ: Wealth Cycles, 2015, 151, 217.

have passed stimulus packages; those relief packages were historically not large enough and failed to stimulate the entire economy. The packages do create temporary benefit and inflation but fail to create lasting prosperity that comes through the creation of products and services. The EU must use caution when inflating the currency supply in a deflationary crisis because the euro will drop in value faster, and prices will rise when economic activity increases again. Another vital aspect is the possibility that the EU will become a permanent debt based institution if it does not pay off the debt by 2058. With this in mind, it will be interesting to see how the individual state recovery plans get approved and how the effects of the NGEU play out in the next decade.

BENJAMIN RUTLEDGE
Intern

Benjamin Rutledge is a Czech-American from Mississippi, USA. Following high school graduation, he was appointed to three military service academies and chose the United States Naval Academy.

Later he moved to Prague to continue his bachelors in International Relations at Anglo American University, where he is on the Student Council. In his free time he enjoys soccer, languages, traveling, and investing.

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