EU Recovery Deal

Why in news?

The European Union (EU) signed an agreement to counter the effects of coronavirus on the region's economies.

What are the chief elements of the agreement?

- Euro 1.1 trillion budget for the EU over the next seven years.
- Euro 360 billion in low-interest loans for countries most hit by Covid-19.
- Euro 390 billion in grants to the worst affected economies.

What is so special about the recovery package?

- Its size roughly $2 trillion is 75% of India's annual GDP.
- Instead of individual countries raising funds, the EU as a whole will borrow Euro 750 billion (for grants and loans) from the markets.
- This is an economically as well as politically radical departure from the past.
- The EU could impose taxes in the region to partially pay for the fund.
- This, along with the Budget details, will entail a fiscal coordination among the member states for the next seven years.
- Almost a third of the overall package — Euro 500 billion — has been earmarked towards countering climate change.

What are the implications?

- In terms of the EU's GDP, this agreement's size is roughly 5%.
- Given that the economy is likely to contract by more, this deal is just the **first step** in terms of reviving the region's ailing economies.
- Even after the member states ratify the deal, **implementation** will be another kettle of fish.
- This is because many countries may resist the reforms agenda that many of these grants and cheap loans might entail.
- However, the political significance of the deal cannot be overemphasized.
- EU has concluded the deal despite **significant differences** among a whole host of countries.
- Germany, Austria, Denmark, the Netherlands and Sweden opposed to massive borrowings that would have the taxpayers paying back for decades.

- Under the current arrangement, the borrowings would be done by 2023 and paid back by 2058.
- On the other hand, economies such as Italy and Spain, which are severely hit, are urging for a less onerous recovery package.

How is this different from the EU response to the 2008 crisis?

- In the aftermath of the 2008 crisis, there was high levels of national debt and their abysmal sovereign rating.
- Several EU countries found that they could not raise loans from the markets at affordable interest rates.
- So, the EU had created the European Financial Stability Facility (EFSF).
- The EFSF worked as an intermediary between the investors and the heavily-indebted EU countries in such a way that,
    1. Investors got more security for their investment,
    2. EU countries got loans at lower rates.
- The EFSF and the European Stability Mechanism, which succeeded it in 2013, together disbursed Euro 255 billion in loans.
- The current structure is different in that it allocates nearly Euro 400 billion in grants, apart from Euro 360 billion in loans.
- Moreover, the loans do not come stapled with demands of fiscal austerity.
- However, they are likely to ask for certain basic rule of law to be adhered to.

How does this compare with what India is doing?

- The key deficiency in India’s Covid relief package (roughly 10% of GDP) is the inadequate government spending (just 1% of GDP).
- For spending more, Indian government would have to borrow more.
- However, without substantially higher spending, the economy would struggle for longer.
- The key component in the EU package is the Euro 390 billion of grants.
- Cheap loans and credit guarantees are useful.
- But, in a falling economy and with acute economic stress in the MSME sector, grants and wage subsidies might be more useful.

Source: The Indian Express

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