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The Case for Corona Bonds*

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Abstract

Corona bonds are feasible and important to preserve the European project. We set out a number of principles that might serve as a blueprint for the European institutions. Importantly, Corona bonds could be issued through a new public law entity and include all the safeguards required for the protection of the fundamental values of the EU. This proposal is pragmatic in the sense that it facilitates the choice European leaders have to make now; necessary to secure the resilience of the European Union. The political risks are significantly higher now than in 2010. The gargantuan challenge of tackling the combined impact of climate change, migration, digitalization, geopolitical shifts, and the spread of autocracy, requires leadership and joint action by the Council and the Eurogroup.

Governments, economists and intellectuals have called for common European bonds or increased own EU funds to address the recession induced by Covid19. Unfortunately, the German government, joined by the other members of the "Frugal Four" (Austria, Finland, the Netherlands), has categorically rejected to look into any such measures and favours using the ESM. This reaction created a *déjà vu* experience for citizens and governments of the heavily affected southern Member States of the EU. The proposal to use the ESM raises fears of another wave of austerity amounting to yet another lost decade for economic, social, and ecological development in Europe.

Meanwhile, however, even some members of the Christian Democrats raise doubts about the strategy of their leaders. The understanding that the Corona crisis combines multiple risks, including financial

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instability, migration, and authoritarianism, seems to gain ground. Consequently, any response will require greater European solidarity, which has been fundamentally absent. When the Eurogroup meets on Tuesday, April 7, it will be decided whether the idea of Corona bonds will be consigned to the scrap heap of history. Should Europe continue on the path of austerity, the European Union will have to ask itself to what extent it still contributes to “Europe as a Way of Life”, as Tony Judt famously called the postwar European welfare state model.

To facilitate this deliberation, it is therefore high time to submit a concrete proposal for the practical realization of Corona bonds. The purpose of this contribution is to set out a number of principles that might serve as a blueprint for the European institutions. In light of the urgency of the situation, the proposal sketches out the main issues only.

Purpose and Use of Proceeds of Corona Bonds

It is of crucial importance that Corona Bonds are beneficial for all Member States. The purpose is not an act of charity for the weaker, but of protecting the common European project against a challenge that affects all through fault of none. The purpose is to ensure that Europe as a whole emerges from this unexpected crisis stronger and readier to meet the many other challenges which have been temporarily been put on the back burner, but which remain unresolved. One part of the financing volume should therefore serve common European projects involving all Member States that provide effective relief to Europe’s most urgent crises. The other part should be made available to individual Member States on the basis of a common programmatic framework.

Possible common European projects could include: (1) Health: Gearing up pandemic response in Europe; establishing a network for the production, storage, and distribution of essential equipment; Investments in research, specifically in the fields of public health and medicine. Building European competence centres where there are none. (2) Digitalization: Enhancing Europe’s digital infrastructure; seed money for start-ups. (3) Migration: Common asylum application processing, accommodation and provisioning of refugees and migrants in full compliance with fundamental rights. (4) Rule of Law: Investments in strictly independent public broadcast networks, preferably European ones. (5) Climate: Fund ecological investments, improve the European railroad infrastructure, reconsider privatization where appropriate, revisit the regulation of public utilities, invest in research and development, invest in renewable energy, including the local production of crucial components.

Financing lines for individual member states could include: (1) Healthcare: Investments in hospital infrastructure and the training of doctors and nurses; (2) Labour and Industry: investments in reindustrialization strategies, also with a view to re-Europeanize crucial parts of value chains; European wage guarantee funds (already proposed by v.d. Leyen); survival fund for small businesses (e.g. in the tourism sector); qualification measures, survival fund for crucial infrastructure (e.g. airports and airlines).

Volume and Maturities of the Corona Bonds

Economists have proposed a volume of EUR 1,000 bn (one trillion). The maturities should overall be long given the long-term character of most of the financed projects.

Principal and Interest Repayments

Each Member State would be responsible for a share of the principal and interest repayments of the Corona Bonds in accordance with the key for GDP-based contributions to the EU budget. Each Member State would fund these payments from its tax revenue. Special tax revenue specifically earmarked for debt service of these Bonds could also be raised on a EU-wide basis through common taxes (on the basis of Art. 115 AEUV or on a separate treaty basis), e.g. financial transaction taxes, air traffic taxes, CO2 taxes, a common digital tax, etc.

The obligation of each Member State to make its contribution to the debt service of the Corona Bonds should be expressly made a prior obligation of that Member State. This means that the Member State would have to allocate the relevant proportion from its tax revenues and transfer it to the entity issuing the Corona Bonds in priority to other budget obligations. In practice, a mechanism of this sort would provide for the debt service to be made on a several basis, thereby minimising concerns for unnecessary cross-subsidies between Member States. Nonetheless, the obligations of the entity issuing the Corona Bonds should be joint and several to ensure that these Bonds have the highest possible rating and to signal to the markets that Europe stands together.

GDP-Indexing

It may be appropriate that at least some of these bonds be GDP linked which will make interest rate and principal payments dependent on the future economic development. This will have two benefits. First, it will provide fiscal space and avoid pro-cyclical effects for the budgets of the Member States. Second, it will make all Member States (and their taxpayers who support them) investors who have an interest in the future prosperity of Europe as a whole.

Collateral Benefits

One side-effect of the bonds would be the much-requested creation of a safe asset for institutional and retail investors alike.

The Institutional Framework

The long-term character of most projects requires a long lifespan of the entity issuing the Corona Bonds. Using the EU directly would likely overstretch the competencies of the EU under Article 122 TFEU. One might overcome this problem by using Article 352 para. 1 TFEU (as in case of the 1975 community bonds established by regulation 397/75). However, this avenue requires unanimity and may allow certain Member States to block measures introduced to defend the values of the EU stipulated in Article 2 TEU. Also, to be a credible counterparty, the EU would have to have considerable own rights of taxation, a development which is unlikely to occur soon. And one might doubt whether domestic constitutional courts would accept handing enormous fiscal powers to the Union without a profound refurbishment of its institutional framework.

While we understand that using the ESM as an existing institution is attractive to many decision-makers and would come with a low legal risk from the perspective of the European treaties, the purpose of the proposed Corona Bonds shows that the ESM under its current form would not be an adequate vehicle. It is structured for individual countries in distress, i.e. for asymmetric shocks, and it requires "strict conditionality" according to Art. 3 ESM Treaty and Art. 136(3) TFEU. It is true that the European Court of Justice has in the past shown flexibility in adjusting similarly strict provisions to changed circumstances. However, the ESM has been established as a rescue mechanism for individual member states in distress. It has not been established to promote common European projects, which is the purpose of the Corona bonds.

Another major drawback of the ESM is that funding lines for individual Member States increase those Member States' level of indebtedness. This might worsen, rather than improve, those members' funding situation.

Moreover, not all member states are members of the ESM. The Corona crisis and associated recession is, however, a problem affecting the entire Union. The ESM should not be transformed into a Corona vehicle as it continues to play a role as a backstop for the European Monetary Union (EMU). There is little point in involving non-Eurozone countries in this business by making them ESM members.

Nonetheless, the establishment of the ESM could inform the current process. It was preceded by the EFSF, used a private-law entity governed by Luxembourg law, given the urgency and the time required to set up a new treaty entity. On balance, a public law vehicle, if properly designed, seems preferable as it comes with the necessary guarantees for ensuring democratic legitimacy, judicial review, and fundamental and human rights. Therefore, a new international Corona Bond Treaty (CBT) open to all EU Member States, which are prepared to accept its goals, modes of operation and values, lends itself as an adequate, pragmatic way forward.

Although immediate action is required, there is still sufficient time and a wealth of experience to enable Europe to establish the CBT as a new entity outside of the Treaties. As the financial implications of almost any European funding scheme would require the consent of Member State parliaments, the timing would allow for the simultaneous adoption and ratification of a treaty. There is no need to build up a new institution, as the administration of the CBT could be delegated to existing institutions. Both the Commission and the ESM have the experience required for issuing and managing bonds. Disbursement and monitoring of funds could be delegated to the Commission. From a legal point of view, such delegations seems unproblematic. It should be extended to the European Parliament and the Court of Justice to ensure strong political and legal accountability. Careful thought would need to be given to ensure that, as a matter of institutional design, the EU institutions acting under this Treaty are indeed suitably accountable.

The Member States would have to extend financial guarantees for the CBT. The guarantees of each Member State could be restricted to their share in the fund in accordance with the key for GNI based contributions or any other repartition scheme.

The Rule of Law Crisis

The extraordinary measures that European governments are taking in relation to the pandemic are challenging our concepts of openness, democratic accountability and the rule of law. Governments tread a course which most acknowledge to be difficult. It will be important to ensure that the functioning of the CBT promotes the fundamental values of the EU and does not assist governments which fail to meet these values. Appropriate provisions setting standards for these values should be included in the CBT. States willing to be CBT members should be able to comply with these standards. One option would be to use simple majorities wherever possible.

Article 125 TFEU: No-Bailout and Moral Hazard

Any proposal to structure common-bond issuances in Europe must consider Article 125 TFEU, the famous "no-bailout" provision. Wherever else this Article may apply, it does not apply to Corona bonds. Its purpose is to prevent a bail-out, i.e. the mutualisation of the debt of one or more Member States. Corona bonds are mutual debts from the very beginning, and their mutual character is not just a formality as they are supposed to fund common European projects with some of the revenue. In this regard, Corona bonds differ significantly from Eurobond proposals, which are meant to contribute directly to each Member State's own budget. Even to the extent that the proceeds from Corona bonds are used for the benefit of individual Member States, this will still occur within the frame of common

European projects. In fact, Article 125 para. 1 TFEU states that its provisions are "without prejudice to mutual financial guarantees for the joint execution of a specific project."

Even if Article 125 TFEU applied to the CBT, the Court of Justice established in Pringle that this treaty provision has the purpose to ensure Member States follow a path of stability. It would be precisely the purpose of a CBT to bring member states back on a path of economic and financial stability. Moreover, given the program character of CBT, which should not be confused with regular conditionalities, the nature and purpose of the CBT does not raise a risk of moral hazard.

Constitutional Issues

The CBT might raise constitutional issues in many member states which are too many to be covered here. This part is therefore limited to possible objections from Karlsruhe, the court most critical of financial risks accruing from EU membership. In its ESM judgment, the BVerfG has established an array of conditions which need to be respected to guarantee the budget autonomy of the Bundestag, a feature that partakes in Germany's constitutional identity. One of these conditions is a cap on the overall financial risk, which the CBT meets (EUR 1,000 bn). The overall share of the debt to be guaranteed by Germany should not exceed constitutional limits. Given that the entire or most of the EU-27 would likely participate in a CBT, Germany's share of the burden would not be much larger than its stake in the ESM if measured in absolute numbers.

To the extent that CBT would not be financed through specific taxes, the members would have to pay contributions in accordance with their share of the GNI contributions to the EU budget. While these regular contributions would be small enough not raise any constitutional difficulties, things are different for the question what should happen with the funds. Even though usage of the funds is not asymmetric as in case of the ESM, it does not seem unlikely that the BVerfG would insist on a role for the Bundestag in the design of the CBT. CBT would yield considerable fiscal power after all. It is also unsure whether the BVerfG would allow the CBT to compensate for the loss of influence of national parliaments by giving the European Parliament a much stronger role than it plays in the frame of the ESM, including the right to approve the annual CBT budget. One might be hopeful in this regard, as the 2019 Banking Union judgment of the BVerfG positively recognizes the role of the European Parliament in the Banking Dialogue. Nevertheless, foundational financial decisions, including the adoption or modification of project lines, might still require the consent of the Bundestag. For this reason, a possible CBT would require unanimity for key financial decisions, both on the asset and on the liability side of its balance sheet.

Conclusion

Corona bonds are needed to preserve the European project, and they are feasible. They can be issued through a new public law entity and include all the safeguards required for the protection of the fundamental values of the EU. Not all of the undersigned support all points of this proposal equally. Not all points of the proposal might attract high praise from the point of view of constitutional theory. From this perspective, they raise issues that, with time, will need to be carefully considered. But this proposal is a pragmatic one to facilitate the choice European leaders now have to make: to finally show some resolve and to unite in the midst of a divided world, or to retreat along ill-perceived national lines. The political risks are significantly higher now than in 2010. The gargantuan challenge of tackling the combined impact of climate change, migration, digitalization, geopolitical shifts, and the spread of autocracy, requires leadership in deeds. This may be the last real chance for the Council and the Eurogroup to show leadership and statesmanship.