Emerging stronger from the crisis

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Europe needs to do more at federal level if a recovery plan is to be successful.

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In addition to the cost in terms of human health and lives, the coronavirus pandemic has taken a wrecking ball to the global economy. Even as Europe appears to have left behind the worst of the health crisis—although possibly merely its first wave—the extent of the economic damage has become apparent. In its spring economic forecast, the European Commission pencilled in a massive hit to growth in 2020: -7.4 per cent across the European Union 27, -7.7 per cent in the euro area and even more substantial losses, approaching 10 per cent, in the hardest-hit countries (Greece, Italy, Spain).

The good news is that it appears that lessons have been learned from the euro-area crisis. The European Central Bank reacted swiftly, massively increasing liquidity support and relaxing its bond-purchasing rules. The commission has relaxed the potentially restrictive state-aid and fiscal rules and begun to mobilise resources at EU level to combat the immediate impacts of the Covid-19 crisis.

Almost all the support measures actually implemented—such the SURE programme to support short-time working schemes and the new credit line under the European Stability Mechanism—come however in the form of loans. Countries will benefit only to the extent of the difference between the interest rates (and terms) of the loans made available through these different programmes and those they could have obtained on the financial markets.

If the ECB's current measures go unchallenged, that difference is likely to remain relatively minor in macroeconomic terms. Such loans do, though, offer additional security to member states that their borrowing costs will not suddenly rise as a result of a crisis of confidence. Moreover, the measures serve to take the pressure off the ECB and supposedly demonstrate the member states' political will to take action. This makes it easier for the bank to carry on with the same policies, which is important in the wake of the adverse ruling by the German Constitutional Court in early May.

Recognition of reality

Given the severity of the current crisis, European policy-makers have belatedly at least recognised that, if lasting damage is to be averted, it will be necessary to communitarise (part of) the additional public debt accumulated by the member states as a result of the

pandemic. Not least in Germany, policy-makers—notably including the chancellor, Angela Merkel—have been at pains to get the message across to voters that the country cannot thrive if large parts of Europe are in penury. Such recognition of economic reality was sorely missed in 2011-12.

This is the basis of the European Commission's proposal for a recovery plan, on the back of Spanish and then Franco-German initiatives. If implemented, it will mark a sea-change in European integration:

- joint borrowing with a distribution of the proceeds in terms of need;
- an envelope of around 5 per cent of (annual) gross domestic product;
- substantial redistribution, geographically and intertemporally, with debt service pushed far into the future, and
- creation of a European safe asset.

A few months ago, no one would seriously have forecast that a proposal with such features would be on the table. Looking forward, while the Recovery Fund is explicitly conceived to be temporary, it can be used as a blueprint for discussions about a permanent eurozone fiscal capacity.

Questions remain

Yet, even if the recovery plan is adopted in something close to its proposed form—this will hopefully be decided at a European Council meeting in mid-July but might well be postponed until after the summer—questions remain. Let me mention four.

A fund of the order of three-quarters of a trillion euro sounds big but devolves to around €1,500 per citizen, spread over several years. Will this be sufficient? If a recovery sets in towards the end of the year, prompted by vigorous national stimulus packages, and there is no further derailment via a severe second wave of the pandemic, then maybe—at least in terms of the goals of repairing the damage caused and bringing about a cyclical recovery. But if the coronavirus raises its head again in Europe during the winter, even this unprecedented fund will quickly prove inadequate.

A second question relates to the links between EU funds and member-state policies. There are concerns that the possibility of the commission withholding financial support could be used to force through, in a non-transparent way, a one-sided vision of appropriate economic (and social) policies. Equally, though, in a monetary union, national economic policies have important cross-border externalities. There is an objective need for policy co-ordination and the fact that policy recommendations under the European Semester have been largely ignored—the failure to sanction Germany for its persistent excessive current-account surpluses being a case in point—is a serious weakness of economic governance.

The way to resolve this dilemma is to reform the European Semester and the associated Macroeconomic Imbalance Procedure. As argued in more detail by Sebastian Dullien and colleagues, the MIP needs to be made completely symmetrical in terms of the set of

indicators. Country-specific recommendations (CSR) should also be limited to those areas where there are clear cross-border implications; otherwise subsidiarity considerations suggest that member-state autonomy should be respected. Greater involvement of the European Parliament to improve democratic oversight and transparency are also priorities—the CSR process can no longer remain a purely technocratic exercise and its essentially political nature must be fully recognised.

Reform and investment

Nor should it be forgotten that Europe's fiscal and economic-governance rules are in urgent need of reform. If the existing fiscal rules, currently suspended, are reimposed unchanged, a further wave of austerity would immediately kill off any recovery. The commission rightly launched a consultation procedure on reform at the start of the year; it must not be derailed by the pandemic. The Macroeconomic Policy Institute (IMK) has just published a set of interlocking reform proposals.

Finally, what is still lacking, even in the recovery plan, is a genuinely European answer to the longer-run, intertwined challenges facing the union. All the proposals amount to various forms of grants or loans to member states to facilitate the implementation of what remain—even if there is some co-ordination—member-state policies. Still missing is a concrete programme of substantial, EU-wide, public investment in areas such as the transport infrastructure, power grids and decarbonisation programmes and, not least, public health.

Creel and colleagues present concrete and costed examples of such projects in these fields. They include: a high-speed rail network which would connect the capital cities of the EU, shortening travel times and largely displacing inner-EU air travel; an electricity grid to transmit electricity efficiently from where it can be produced from renewable sources to consumers and producers; and a public health strategy investing in the human capital of health workers, providing emergency support and co-ordination, under the auspices of an adequately funded EU agency.

Alongside a packet of support measures for member states of half a trillion euro, a ten-year investment programme in such European-level measures, with a budget of €1.5 trillion, could eminently be financed on the markets at very low interest rates. It would create a high-volume, safe asset which would facilitate ECB monetary policy and provide private investors with a vehicle in which to place their funds safely, avoiding panics and bank-sovereign 'doom loops'. The associated investment would provide the necessary boost (also via an expectation-stabilising effect) in the short run, while making a major contribution to longer-run goals: raising living standards, promoting cohesion and accelerating the needed decarbonisation of economic activity.

What is encouraging is that, faced with the pandemic-induced crisis, just as in the financial crisis, old taboos are being broken. The EU that emerges is likely to be quite different from the union that entered the crisis in 2020. Yet there is opposition, and much remains to be done to convince foot-draggers of the economic advantages and in

many cases the necessity of co-ordinated action at the EU level itself. As the founding father Robert Schuman already recognised back in the 1950s, it is by visibly delivering concrete public goods, which citizens value, that Europe is built.