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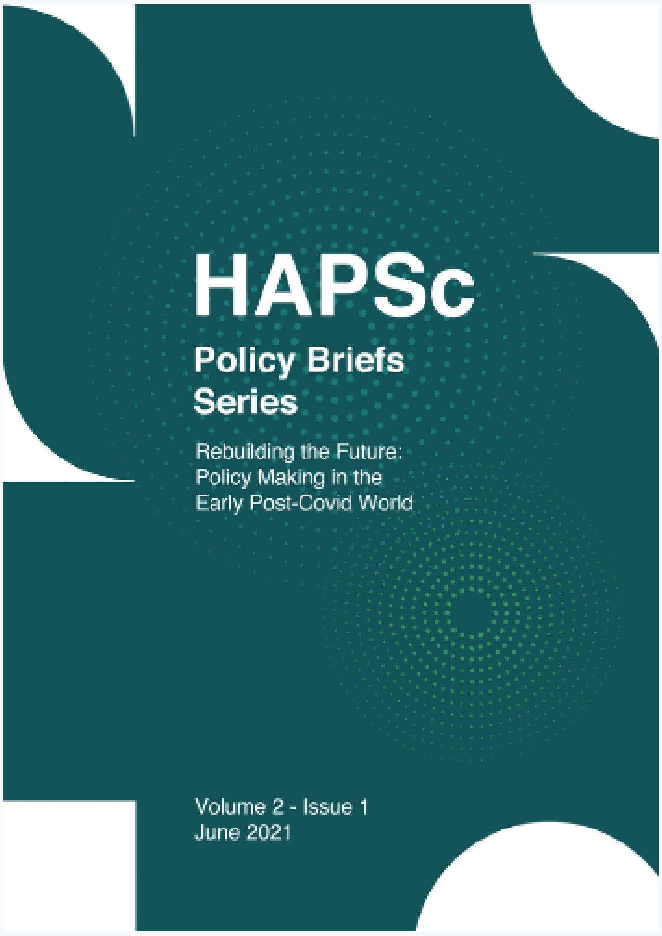

Post-COVID Prospects for the EMU: The Pandemic Core-Periphery Divide, Palliative Measures and the Stakes of the Conference on the Future of Europe

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Post-COVID Prospects for the EMU: The Pandemic Core-Periphery Divide, Palliative Measures and the Stakes of the Conference on the Future of Europe[1]

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Abstract

The policy brief draws from previous and ongoing research on the heterogeneities of the impact of the - in principle - symmetric shock of the pandemic within the EU. Considering the pre-existing gaps within the core and periphery, further worsened by the Covid-19 outbreak, the analysis presents the economic and social prospects in 2020 and in the years to come across the Member States. In doing so the work identifies the key challenges in line with the legacy of the Eurozone crisis and well-established limits of EMU governance assessing palliative emergency instruments such as Next Generation EU against the benchmark of the scale of the core-periphery divide. In doing so the contribution puts forward policy recommendation for ambitious reform of economic governance of the Eurozone, against the backdrop of an unprecedented window of opportunity for transnational solidarity opened by the pandemic crisis in parallel with the onset of the Conference of the Future of Europe.

Keywords: Covid-19; pandemic; NGEU; EMU reform; Eurozone; CoFoE; periphery.

Introduction

The Covid-19 pandemic has heavily impacted global and European societies, worsening existing and introducing additional policy challenges. Within the EU, the outbreak situates itself along the deep-rooted legacy of the Great Recession in an era which pairs strong political divisions and conflict among the Member States with an ongoing reform debate in the context of the Conference on the Future of Europe. The impact of the outbreak, its implications and the future prospects for recovery and reconstruction are a tale of many 'Europes', with sharp distinctions across the old continent hardly fully repaired of even comprehensively mitigated by current common action.

The contribution highlights how the symmetric shock of the outbreak turns, however, into very asymmetric consequences across the Member States, worsening divergences between the core and periphery and carrying problematic political implications for after the crisis. At the same time the sheer scale of the tragedy and unprecedented challenge of the recovery have facilitated a – albeit temporary – suspension of long-time vetoes resulting in programs such as Support to mitigate Unemployment Risks in an Emergency (SURE) and Next Generation EU (NGEU) unthinkable ahead

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of the outbreak and even in its early stages. Against this background, the commencing Conference on the Future of Europe (CoFoE) takes place within a window of opportunity for a rethinking of current boundaries of economic and political integration within the EU. Nevertheless, outlooks presented below indicate the temporary and short-lived nature of such opening. Through a critical assessment of the Covid-19 crisis and the current paths towards a joint recovery and reconstruction effort we pinpoint the limits of existing measures and highlight policy recommendations for comprehensive and ambitious Economic and Monetary Union (EMU) reform, at the same time indicating the high stakes of the CoFoE to take place in the year ahead.

Many 'Europes': outbreak, containment and fiscal responses

Especially in the early phase of the pandemic, the outbreak hit primarily Southern countries, which topped the 2020 death-toll ranking. Considering the first wave until end August 2020, Spain and Italy (622 and 587 deaths-per-million respectively) are only surpassed by Belgium, racking nearly six times the casualties (111) of Germany (CSSE, 2020). By end year Italy surpassed Spain (over 1226 victims-per-million) while Germany and many others remained far behind in the human cost of the pandemic ('just' 403 deaths-per-million). Similarly, differences emerge also in terms of cases: nearly 10'000 per million in Spain by end August while not reaching 3'000 in Germany. Heterogeneity extends from the severity of the outbreak to its mortality, not unlinked with the pre-existing context – for example within the healthcare system – and policy choices for the containment of the outbreak. In turn, differences resonated with the economic performance across the EU27 in 2020 and onward as highlighted by early analyses of the pandemic (Ceron et al., 2020; Colfer, 2020; de Jong and Ho, 2021).

Along with differences in severity of the outbreak by cases and deaths and to some extent different levels of preparedness across Member States – which may be partially to blame on the legacy of the economic crisis – somewhat parallel divergences emerged in containment measures. As displayed by the Oxford Covid Government Response Tracker (OxCGRT), even in the early stages of the pandemic Member States split nearly evenly in April across different levels of restrictions, to converge in May and June towards similarly decreasing stringency over time, but with sizeable tails at both ends of the distribution (Hale et al., 2020). Differences remained substantial over the remaining period of the year. In the broadest terms such dynamics translate in countries displaying on average more severe lockdowns and closures in the south west of Europe, followed by a middling level of restrictions in the core and some parts of the East, with very limited measures in some Nordic and Baltic countries, partially reflecting areas somewhat spared by the outbreak. Such differences come with likewise quite asymmetric prospects for Member States' economies during 2020. From this perspective, it should be noted that the geographic distribution of the OxCGRT's Stringency Index averaged over 2020 – capturing containment measures such as lockdowns, school closures and limits to businesses and movement – peaks in Italy. More periphery countries such as Portugal and Spain, follow. Other Southern Member States (such as Greece) mildly impacted by the health crisis are not far behind, with their Stringency Index surpassing overflown countries such as Belgium. (Hale et al., 2020)

Considering the diverging impact of Covid-19 in the Eurozone, the fiscal pandemic response aligns with the narrative as well. Quite problematically, the ranking of countries mobilizing the most resources far from aligns with Member States leading by outbreak and/or stringency of restrictions to economic activities. The budgetary impact of Covid-19 related measures ranges from barely 1% of GDP in Romania to nearly 7 in Lithuania (European Commission, 2020). At the lower end of the spectrum, one finds heavily impacted countries: Spain barely surpassing 1% and Portugal around 3%, well below the EU average of 4%. On the opposite end, countries like Austria and Denmark, relatively spared comparatively, stacked up support measures exceeding 5% of GDP. Differences do not stop at the overall values of the fiscal stimulus deployed in 2020 as substantial heterogeneities extend to the chosen measures (Andreson et al., 2020). The more fragile Southern economies – along with countries in the east which did not face quite as much of a health shock – rely substantially less on direct fiscal measures and more on public guarantees and deferrals. For example, if the immediate fiscal impulse in Germany is assessed as worth 8.3% of GDP – comparable with interventions in the UK and US – Spain stops at 4.3%, Italy at 3.4, Greece at 3.1 and Portugal at 2.5. A closer look at the fiscal measures of the four biggest Member States during the first wave reinforces the more modest support both in terms of scale and composition within the periphery: in Italy and Spain support measures paled in comparison to Germany (Ceron et al., 2020).

The persistent (core-periphery) economic divide

The pandemic hence bears different implications for countries' economic performances in 2020. Against the benchmark of an overall expected drop of 6.8% of GDP in the Eurozone, heterogeneities are sizable (European Commission, 2021). Countries such as Luxembourg and Ireland regained or even overshoot by the third quarter (Q3) all the ground lost in the first two quarters of 2020. Countries like Greece barely experienced any rebound in Q3 leaving them with a cumulative gap above 10% of GDP. Croatia, Spain, Malta, Portugal and Cyprus are short to follow, with Italy not far behind leaving Southern Member States all clocking at or above minus 5% of GDP. Such divergent paths are not short-term: the core-periphery divide is a persistent feature of the pandemic aftermath. Most of the EU27 are forecasted to fully recover 2019 levels of GDP in 2021 or 2022, with Italy and Spain as the sole exceptions (European Commission, 2020).

The bleak background evidences how the divergent economic performances – arising ahead of Covid-19 and reinforced by the crisis – imply parallel worsening prospects for public accounts in the South. Countries most impacted by the pandemic – already on frailer economic grounds – had narrower fiscal spaces for the economic response, experiencing worse contractions in GDP. The pandemic is worth deteriorations in budgetary balances in 2020 nearly twice as severe as the financial crisis and skyrocketing public debts (European Commission, 2020). However, such dynamics are once again geographically heterogeneous within the Eurozone. Budget balances in 2020-2022 see Spain and Italy well exceeding the minus 10% benchmark in 2020 and at least in the first instance remaining beyond minus 9 and 8 respectively in 2021 and 2022. Conversely, Sweden and Denmark and within the EA Luxembourg - and to a lesser extent Germany – barely even exceeded the 3% threshold in 2020, expected to return within such limits already in 2021 or at the latest in 2022 (European Commission, 2020). A crisis comparatively more severe – with a potentially quicker but heterogeneous rebound – than the Great Recession, building onto a legacy of core-periphery divergences well established within the literature is bound to likewise put under severe stress an Eurozone governance framework lacking any substantial solidarity and stabilisation mechanism (Camus and Claeys, 2020). Early into the outbreak some of the cornerstones of European economic integration, the Stability and Growth Pact and the state aid regulation, came to a suspension. Months of negotiations, delays and watered-down compromises preceded emergency measures – in themselves a testament to the lack of appropriate mechanism within the existing framework – whose resolutive contribution is, however, far from uncontroversial.

Next Generation EU: palliative solution to structural problems

Firstly, the question arises on the extent to which NGEU may bridge or mitigate the worsening of the core-periphery gaps. Additionally, the lessons from the past (and current) crises, pinpoint the mechanisms and failures within the current governance infrastructure leading to such a divide, opening the interrogative on whether they are corrected by NGEU.

Commission's forecasts already highlight two obstacles which may hinder the effectiveness of NGEU: additionality and productivity (European Commission, 2020). Forecasted impact varies substantially from the best to the worst scenarios. Moreover, while allocations favour worst hit countries, their economic context implies a higher risk of limited additionality – with shrinking fiscal spaces ahead of the deployment of NGEU – and lower productivities. Best case scenario estimates of a medium term output impact of 1.5% of GDP within the Eurozone (e.g. Bańkowski et al., 2021) come indeed with the caveats of the quality of investment, the productivity context and the absorption capacity, for which the South has a less than stellar track record. Another concern is the timing of the plan, slowly progressing from political agreement in July 2020 to the official presentation of the National Recovery and Resilience Plans only by April 2021. Disbursements far from coincide with the heat of the crisis: limited resources reach countries in need by 2022 as grants are expected to peak in 2024 (Darvas, 2020; Giovannini et al., 2020). Grants and guarantees disbursements in 2021 are just 0.28% of GNI in the EU27, shortly exceeding 1 in top-receivers such as Croatia, Bulgaria and Greece, with Spain and Italy only stopping at 0.62 and 0.46 respectively (Darvas, 2020).

Moreover, the Great Recession and aftermath link core-periphery divergence to structural limits of the EMU. The previous crisis left the legacy of a severe gap in GDP prospects and especially investment, further widened by the pandemic (Buti, 2020). NGEU does – partially – address the investment gap, albeit potentially with limited impact on national institutional quality necessary to fully exploit the benefits of the program. Similarly, the limited fiscal space in the South – capping the potential for national support to the economy even with the suspension of the SGP – is similarly partially countered by the joint recovery effort. However, neither tackle the structural shortcomings of the EMU ecosystem: the lack of room for substantial national stimulus requiring on one hand the suspension of the Pact through the general escape clause – unsustainable as a solution in a medium term – and the sole recourse to (horizontal) coordination of domestic fiscal policies in the absence of instruments for effective stabilisation and solidarity (Buti, 2020). Where the NGEU intervenes in this domain it does so solely as a temporary palliative fix to the incompleteness and unfitness of the governance, which hence stands to require comprehensive long-term restructuring.

Policy implications and the stakes of the CoFoE: an ambitious EMU reform agenda

Avoiding the concrete risk of divergences in recoveries further increasing fragmentation in the absence of effective tools to tackle such imbalances is among the key challenges for the EU post-pandemic reconstruction. NGEU, with its highlighted limit in timing, scale and dependence on national circumstances – running against the primary beneficiary of its support – is currently entrusted with halting the further centrifugal pull of the pandemic. A dangerous vortex for the periphery which has already in the past jeopardised the stability of the Eurozone. The divergent recovery paths run unmitigated for two to three years given the delayed deployment of NGEU.

The European (and national) response to the crisis highlights the importance of the ability to support economies through tough times, a need not only fully internalised by the EMU and the SGP, which should be accounted for within the ongoing review of the EU economic governance framework. If a temporary palliative fix is not resolutive to the EMU shortcomings, the feasibility of any form of transnational solidarity is an unexpected innovation of the pandemic context, aided on one side of the symmetric natural disaster like nature of the human tragedy of Covid-19 – with difficult to assign blame to the worst hit Member States (Bremer and Genschel, 2020) – and on the other on the temporality of NGEU. A permanent solution is a major upcoming challenge, as the existing divide is bound to remain a long-term fixture of the Eurozone in the post-pandemic era. At the same time, the solidarity boosting context of the Covid-19 outbreak is conversely far from permanent, along with the window of opportunity for ambitious EMU reform (Ceron et al., 2020). Such compressed time-frame offers a high-stake policy objective for the commencing tightly scheduled Conference on the Future of Europe: equipping the Eurozone for the stormy waters exiting the pandemic, before the taste for solidarity is replaced by political divisions between debtors and frugal countries.

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