COVID-19 and the EU: crisis too far or transformative moment?

Will the COVID-19 pandemic prompt the EU to take the decisive integrative steps that it failed to take in the context of the Eurozone crisis? Or will this be a crisis too far?

The COVID-19 pandemic poses an existential threat to the European Union. As its member states take unprecedented steps to deal with an acute public health crisis, so many of the EU's pre-existing challenges have intensified and all at once. Foremost among those is the design of the EU's economic governance regime, which has been the source of significant division within the EU since the Eurozone (EZ) crisis. Those political divisions have dramatically resurfaced in recent weeks, rendering a full reckoning with this issue both extremely difficult and more urgent than ever.

EZ states have been forced to throw money at this crisis, but they have very different views on how that spending should be funded. In a repeat of the EZ crisis, northern and southern member states have very different preferences. The southern states—Spain, Italy, and France—favor the introduction of a common debt instrument, so-called 'coronabonds', comparable to the 'Eurobonds' mooted during the EZ crisis. This would help to keep borrowing costs manageable for all. But Germany and other northern states—most vocally the Netherlands, Austria, and Finland—have long been opposed to such a scheme due to concerns around potentially higher borrowing costs and so-called 'moral hazard' in the south. In 2012 Merkel stated that we would not see Eurobonds, 'as long as I live'.

The preferred northern alternative is the deployment of the European Stability Mechanism (ESM)—a permanent support fund established during the EZ crisis. The primary fear of southern states is that ESM loans would come with the same conditionality—in short, a commitment to pursue an economically counterproductive and socially damaging austerity—that was applied to so-called 'memorandum' states (most notably, Greece) in the context of the EZ crisis.

The 9 April deal that emerged from the marathon Eurogroup finance ministers meeting, while welcome, did not overcome these divisions. It includes a commitment to support member state unemployment insurance programmes; support for SMEs; and a new ESM credit line, specifically for addressing the health aspects of the pandemic. Overall the package of (mainly loans) is worth around €540bn. Although the new ESM credit line is light on conditionality, the stigma of resorting to it could be enough to increase borrowing costs for those using it. And concerns remain, particularly in Italy, that states taking on this debt may in the long-term have to resort to other ESM credit lines that *would* include conditions. Most significantly, talks around a long-term recovery strategy were deferred, including discussions on coronabonds.

In the context of these divisions, the ECB intervened—as it had during the EZ crisis—with the announcement of its €750 billion 'Pandemic Emergency Purchase Programme' (PEPP) in mid-March. This is a form of Quantitative Easing (QE) that has already been widely deployed by the ECB, but now with some of the limits on its use removed with respect to government bonds. The aim is to keep borrowing costs sustainable, especially for southern states. Announcing PEPP, ECB President Christine Lagarde echoed her predecessor, Mario Draghi's infamous 2012 "whatever it takes" speech, asserting that "there are no limits to our commitment to the euro".

This time around it is doubtful whether the ECB will be able to make good on that commitment. Notably, the cost of Italian public debt was rising in mid-April following the Eurogroup deal and despite significant ECB bond purchases. More generally, as Eric Jones has explained, the financial risk accruing to member states in relying on the ECB is greater than it would be if Eurobonds were introduced. Ultimately, far bolder action will be needed on the fiscal side and the sooner the better (preferably at this week's European Council meeting). But, as during the EZ crisis, that will not be easy to achieve politically.

Merkel and other northern leaders fear that if they were to agree to some form of collectivized debt instrument, this would not be without domestic political consequence. Just as the EZ crisis precipitated anti-German sentiment in southern states, so it precipitated anti-southern-Europe sentiment in Germany and the north. In particular, the idea that a hard-working and frugal north bailed out a lazy and profligate south was widely and successfully peddled.

This idea is bogus: it ignores northern responsibility for imbalances in the EZ.

German current account surpluses, built on the back of low wages were pumped into a booming southern Europe via German banks in the early and mid-2000s. So-called 'bailouts' were, to a large extent, bailouts of those very banks. As to the specifics of Eurobonds, the commonly accepted idea that in lowering the borrowing costs of the southerners they will increase the costs of the northerners is also not necessarily true (if, as Paetz and Kaczmarczyk have recently argued, the ECB commits to purchase those bonds).

Bogus or not, these arguments have political traction in Germany, including among Merkel's Christian Democrats (CDU), and the fear exists that they could be effectively deployed by populist parties such as Alternative for Germany (AfD) (which was founded in 2013 during the EZ crisis). Even if they personally soften their view on debt mutualization, the calculation for Merkel and other northern leaders in the weeks ahead will be whether they are able to credibly shift this widely embedded narrative. If they feel they cannot, the political consequences in the south could be huge.

In Italy, there has been a resurgence of anti-EU and anti-German rhetoric from its populist parties. Even among the pro-EU mainstream, support for the EU is under significant strain. While the political fighting has so far been primarily domestic in Spain, its Prime Minister has publicly backed coronabonds. And in an unusually outspoken critique of northern members, French President Macron stated that "they're in favor of Europe when it means exporting to you the goods they produce… But they're not for Europe when it means sharing the burden."

A eurosceptic politics is poised then—in northern and southern EZ states—to take advantage of the current crisis and could render stillborn the collective action that this moment requires of the EU.

But there is some hope to be found in the fact that this crisis is different and widely understood to be so. Conceptions of what is economically and politically possible are opening up precisely because the pandemic is both so grave and so 'fast-burning'. Macro-economic rule-books are being ripped-up: debt and deficit limits have been suspended; orthodox economists in northern states are coming around to Eurobonds; and talk of 'helicopter' monetary financing, although not technically permitted under EU law, is widespread. Recent evidence suggests that public attitudes in Germany may be far more malleable than often supposed. And, for now, at least, it is proving harder for northern states to successfully re-play the EZ crisis blame-game, as the Dutch finance minister discovered.

Transformative reforms—including fiscal integration, a pan-EU interventionist industrial policy and a broadened mandate for the ECB—*may* then be possible this time around. And it is to be hoped that those reforms will become locked-in and purposed to address the slower-burning, but no less serious, climate crisis; in other words, put to the service of a European Green New Deal. This would go a long way to blunting the nationalist and anti-democratic threat in the EZ and wider EU. It would also allow for greater EU autonomy in a rapidly shifting and increasingly unpredictable global order.

None of this will be easy. But the alternatives should focus minds.

Source: http://speri.dept.shef.ac.uk/2020/04/20/covid-19-and-the-eu-crisis-too-far-or-transformative-moment/