European economic recovery

SUMMARY

A more united Europe has the potential to deliver greater benefits for its citizens, more effectively and efficiently, by offering a level of strategic scale and depth that no individual Member State, or even group of Member States, can achieve on their own. In particular, the combination of Europe's single market and economic and monetary union, used to their full potential and complemented by progress in other policy areas, such as the Green Deal, could prove to be key assets for a strong European recovery from the serious economic shock recently administered by the coronavirus pandemic.

An intensive debate has therefore opened up about the potential benefits of moving towards a higher degree of risk-sharing and collective 'strategic autonomy' for the Union, based on stronger and deeper common policies at EU level. The recent European Commission proposal for a 'Next Generation EU' recovery plan is likely to prove an important staging-point in this process. In practice, the size of the recovery response, the policy areas chosen for deepening, the financing options available to support them, and the degree to which they are matched by a greater willingness of the Union to 'act as one' on the international stage, are all likely to be determining factors in the outcome.

This paper analyses some of the issues arising specifically in the economic field in the aftermath of the coronavirus crisis and looks at a range of policy initiatives that could help build a broadly based and sustainable European economic recovery and a more resilient European Union.

Introduction

The measures taken to fight the on-going coronavirus pandemic have severely affected the functioning of the global economy. Trade and investment channels have been disrupted, the movement of citizens has been seriously constrained, and businesses have been forced to operate at reduced capacity or to temporarily abandon their activities. Confidence levels have fallen markedly and labour markets have been disrupted. As a result of this direct shock to the economy, the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD) and the European Central Bank (ECB) have recently forecast a contraction in GDP in Europe for 2020 of between 5 and 12 per cent. The European Commission expects GDP to shrink by almost 8 % in 2020 and Member States to run on average a fiscal deficit of around 9 % of GDP, which could imply a significant deterioration in public debt positions. Whilst a rebound is predicted in 2021, it remains subject to considerable uncertainty at this stage. The repercussions of the crisis could involve a fall in investment, leading to an increase in unemployment and fewer available resources for many policy priorities. The response from the EU institutions, Member-State governments and the ECB has therefore needed to be ambitious and dynamic.

As regards immediate **monetary policy**, the ECB maintained its interest rates at historically low levels. Currently, the marginal lending facility is at 0.25 %, while the main refinancing operations rate is at 0.00 % and the deposit facility is at -0.50 %, thus in theory providing strong incentives for banks to increase lending. The ECB also announced a series of additional unconventional monetary policy

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measures that can be used until the end of the year to purchase assets. These mainly consist of purchases under the Pandemic Emergency Purchase Programme (PEPP), with an overall envelope of **€1 350 billion**, which could still be extended, if necessary. This is combined with an increased expanded asset purchase programme (APP) of **€120 billion** and with monthly purchases of **€20 billion**. The ECB has reduced the interest rate on its targeted longer-term refinancing operations (TLTRO III). The ECB also decided on a new series of non-targeted pandemic emergency longer-term refinancing operations (PELTROs) to support liquidity conditions in the euro-area financial system and to contribute to preserving the smooth functioning of money markets by providing an effective liquidity backstop. Finally, the ECB also **eased collateral rules** to ensure that banks can continue to make use of the refinancing facilities, ensuring that the monetary policy tools remain effective even in times of severe financial market stress.

As regards immediate **economic and fiscal policy** intervention, the European Commission, in cooperation with the European Parliament and the European Council, has proposed a series of concrete actions to mitigate the impact of the crisis. In addition to supporting public health systems, boosting medical research, coordinating repatriation and controlling EU external borders, economic stabilisation measures have been implemented. This is done through the EU budget, the European Investment Bank (EIB) and the European Stability Mechanism (ESM) and through action at Member-State level. In total, **more than €4.1 trillion has been mobilised** so far in the European Union to respond to the economic consequences of the coronavirus pandemic.

- Around €2.7 trillion[1] is linked to the response at Member State level. This corresponds to national liquidity measures, including the schemes approved under the **temporary EU State aid rules** and measures taken under the flexibility arrangements of the **EU budgetary rules** (general escape clause). This is naturally to be welcomed, but could also be a source of concern in the medium term, as fiscal space varies greatly between Member States. However, it should also be considered that, in a monetary union, additional spending in one geographical area will inevitably generate spill-overs towards the rest of the union.
- Initially at EU level, a temporary **Support to Mitigate Unemployment Risks in an Emergency (SURE)** instrument was designed to provide temporary funding to Member States of up to **€100 billion**, by covering part of the costs related to the creation or extension of national short-time work schemes. In addition, direct EU budget support of up to **€70 billion** will be provided, mainly through the **Coronavirus Response Investment Initiative**. The initiative uses unspent cohesion policy funds and allows more flexibility and more up-front spending by providing 100 % financing from the EU for measures to fight the crisis.
- The **European Investment Bank** (EIB) Group will aim to generate an additional **€200 billion** of investment, in particular by supporting small and medium-sized businesses. The **ESM** will establish Pandemic Crisis Support, based on its Enhanced Conditions Credit Line (ECCL) and available to all euro-area countries. Access granted will be up to 2 % of the respective Member State's GDP as of end-2019, as a benchmark, which could amount to a combined volume of around **€240 billion**.
- More recently, the European Commission proposed the Next Generation EU recovery plan, after an ambitious Franco-German proposal, and building upon a forward-looking resolution by the European Parliament. Next Generation EU aims at raising money by temporarily lifting the own resources ceiling to 2.0 % of EU gross national income, allowing the Commission to borrow **€750 billion** on the financial markets. This additional funding will be channelled through EU programmes and repaid over a long period of time through future EU budgets. In addition, the Commission has also proposed a revamped long-term EU budget and a number of new own resources to complement the Next Generation EU proposal.

Whether these moves towards greater common action will prove to be a 'defining moment' for the future of Europe will depend on a number of factors. It will be particularly crucial that monetary and fiscal policy objectives should remain complementary and well aligned in the medium term, to avoid some of the tensions experienced in the aftermath of the 2008 financial crisis. A well-balanced economic recovery package will also have to address the lack of implementation of some structural policies and propose an economic exit strategy with a long-term vision for the development of Europe. Action at EU level should also aim at ensuring that imbalances do not further increase as a result of the crisis because, as recently recalled by Jacques Delors,[2] such a prospect could represent a potentially 'mortal' threat to the European Union. This crisis has already invoked a measure of deep introspection, as well as evidence of some willingness to develop new common European architecture that pays greater respect to the principles of responsibility, solidarity and unity.

Improved coordination of fiscal and monetary policies

Towards an EU Treasury

Unless fiscal policies are effectively coordinated and are complementary to monetary policy, significant negative 'spill-over' effects could occur between the Member States participating in an economic and monetary union. The European Parliament[3] has proposed the creation of an **EU Treasury** that could equip the Union with greater capacity to apply the existing economic governance framework and facilitate development of the euro area. In response, the Commission proposed in 2017 that such a Treasury could be entrusted with (i) the economic and fiscal surveillance of the euro area and of its Member States, as well as (ii) the coordination of issuing a possible European safe asset, and (iii) the management of the macro-economic stabilisation function.[4] The Treasury could be placed under the responsibility of an EU Finance Minister.

The resulting improved fiscal coordination would increase responsibility, sustainability and resilience in Member States and confidence between them. It would then make solidarity measures easier to apply and more efficient, should they be needed. However, very little progress has been made and only scattered initiatives such as the creation of a European Monetary Fund (EMF) to replace the ESM in 2025, or the setting-up of a budgetary instrument for convergence and competitiveness (BICC) for the euro area have been agreed upon. This thus again leaves economic and monetary union (EMU) at the mercy of uncoordinated actions at Member State level, as well as prone to unnecessary and sometimes irresponsible divergence.

Developing a common unemployment insurance scheme

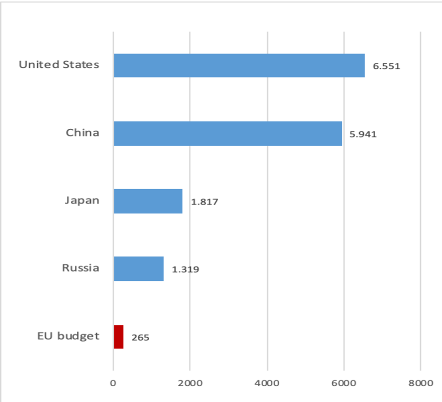
Since the last financial and sovereign debt crises, considerable research and attention has been devoted to the setting-up of an **EU common unemployment insurance scheme**. Such a scheme could act as an automatic stabiliser during a serious economic downturn, as unemployment benefits are counter-cyclical by nature and very responsive to shocks. Announced by the European Commission, the current proposal for a temporary instrument, SURE, worth up to €100 billion, to help protect jobs and people in work, is an encouraging step towards such a common unemployment insurance scheme. In particular, it could help Member States facing budgetary difficulties to maintain their national work schemes. The scheme is unconditional and applicable to self-employed workers, which is welcome given the importance of this type of work arrangement in some Member States. The scheme is not, however, an automatic transfer, as it is designed as a loan and is limited in both duration and the maximum amount it can provide. It might thus be reserved for some Member States, depending on the financing conditions prevailing on the markets.[5]

Increasing recurrent common budgetary resources

Even taking the latest Commission proposal into account, so far, the other major global economies have mobilised more **budgetary resources** in common than the EU (see Figure 1). Moreover, the 'Next Generation EU' package is temporary and will not necessarily raise 'European budgetary potential' in the long-term. One solution, which would also contribute to enhancing the euro's global status, would be the creation of eurobonds. Given unresolved concerns regarding the mutualisation of risk, however, this option is unlikely to gather sufficient support at the current juncture, as illustrated recently with the debate on 'corona-bonds'.

Figure 1 - Scale of common budgetary resources in major jurisdictions

(€ billion per year - purchasing power parity)



Source: IMF and latest Commission proposal for the 2021-2027 MFF, including Next Generation EU.

Another proposal, recently suggested by the European Parliament in its proposal for the next MFF, is to equip the EU budget with the possibility of collecting tax revenues. Digital taxation has been under discussion for several years without significant progress so far. A tax on plastic, a financial transaction tax, a border adjustment mechanism or using the emissions trading scheme are also under discussion. Building upon these proposals, the Commission has presented a revamped long-term EU budget and a number of new own resources to complement the Next Generation EU proposal.

A recovery package to foster solidarity and sustainable growth

In addition to improved fiscal coordination and a stable long-term solution for the EU budget, **funding for a recovery package is necessary for inclusive and sustainable development**. The last crisis demonstrated the economic and social damage that could result from the lack of such an adjustment tool within a monetary union. This is even truer in this case, as the ECB's capacities are already heavily solicited. This question has generated an extremely active and lively debate in academic and think-tank circles.[6] The main issue is how to arrive at a mechanism that is not only counter-cyclical but also avoids adding more debt and divergence between Member States. In response to this challenge, the Commission's Next Generation EU recovery plan proposes a **€750 billion** package, of which **€500 billion will be in the form of grants**. Next Generation EU funds will be invested across three pillars:

- First, support to Member States in respect of investment and reforms. This will mainly consist of a new **Recovery and Resilience Facility** of €560 billion and a €55 billion top-up of the current cohesion policy programmes under the new **REACT-EU initiative**, as well as a proposal to strengthen the **Just Transition Fund up to €40 billion**.
- Second, kick-starting the EU economy by incentivising private investment will include a new **Solvency Support Instrument** with a budget of €31 billion. An upgraded **InvestEU** will include a new Strategic Investment Facility, to a level of €15.3 billion.
- Third, addressing the specific lessons of the coronavirus crisis will mainly consist of a new health programme, **EU4Health**, with a budget of €9.4 billion, as well as €94.4 billion for **Horizon Europe**. An additional €16.5 billion will be directed towards external action. This is a significant step towards greater European solidarity which, when channelled effectively and efficiently, could also prove instrumental in boosting Europe's potential growth and sustainability. In particular, an evaluation of the added value of the various projects to be financed could be crucial for a sustainable recovery and to avoid any crowding effects or investment in unproductive projects.

A stronger and deeper single market

Completing a barrier-free single market

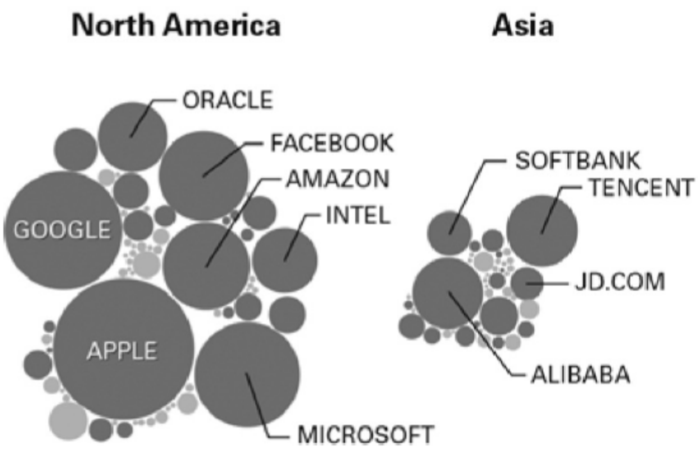
The European **single market** is one of the greatest achievements of the European integration process to date, benefiting millions of businesses and consumers, in what is now the largest combined marketplace in the world. However, the current crisis has revealed some temporary challenges to the functioning of that market. Moreover, despite the progress made, the cross-border provision of services is still largely under-developed, as the regulation of services remains fragmented and as some excessive requirements persist.

Actions have already been taken to respond to coronavirus-related challenges. For instance, the European Commission addressed export bans and issued border management guidance to maintain availability of essential goods, particularly to ensure the free flow of products such as face masks, medical supplies and food. In the medium term, if remaining barriers were eliminated and existing European laws were applied effectively, the single market could still yield substantial additional benefits for the EU economy. The Commission has thus released a communication on single market barriers and a communication on a long-term action plan for better implementation and enforcement of single market rules. These form part of a renewed effort to further reap the benefits of a completed and well-functioning single market.

Completing the digital single market

The digitalisation of the economy is now progressing rapidly, generating changes in many aspects of people's lives. It has proved exceptionally important in the on-going coronavirus crisis, offering possibilities for teleworking for millions of workers and wide access to the purchase of goods and services, in particular for the most vulnerable. It is therefore essential that EU businesses and governments should continue to grasp the full opportunities of producing and providing digital related services and technologies. As shown in Figure 2 below, digital businesses worldwide are currently mainly of US or Chinese origin. The notion of a **lack of EU 'digital sovereignty'** is increasingly used to describe this relative state of dependence.

Figure 2 - Digital businesses with market capitalisation of more than US$1 billion, by region



Source: World Bank and UNCTAD, 2019.

The process of **completing the digital single market** in Europe is a key priority for the European Parliament. The recent vote on copyright, the recommendation on the digital services act, the emerging policies on the European data economy and artificial intelligence, and the new industrial strategy and single market strategy are all encouraging steps in this direction. A deeper and more coherent digital single market should help enable more EU players with global ambitions to emerge. Common rules to ensure that digital business activities are taxed in a fair and transparent way and that sufficient competition is guaranteed would also need to be ensured. Joint standards for

Investing in an effective Green Deal

In 2019, the European Commission presented a communication on a **European Green Deal** that sets priorities to make Europe the first climate-neutral continent by 2050, safeguard biodiversity and establish a circular economy, while boosting the competitiveness of European industry and ensuring a just transition. This has been further underpinned by the Commission's proposal for a European climate law that sets out the objectives and framework to achieve the goals of the European Green Deal. The Green Deal is also supported by an investment plan, which aims at contributing to financing a sustainable transition, while supporting the regions and communities most exposed to its impact. The plan addresses three aspects: i) mobilising funding worth at least **€1 trillion from the EU budget and other public and private sources over the next decade**; ii) putting sustainability at the heart of investment decisions across all sectors; and iii) providing support for public administrations and project promoters to create a robust flow of sustainable projects. If fully implemented, such a plan could constitute a key pillar of a renewed growth strategy for Europe. The Commission's proposed Next Generation EU recovery plan could lend significant credibility to European ambitions in this area. The Union will nevertheless also have to increase and develop green leadership at global level if it wants to find markets for its green products and like-minded partners on this path.

Developing a more coherent common EU health policy

The European Parliament has expressed strong support for the development of a more coherent **common EU public health policy**, with additional investment **to address inequalities**. The EU currently only has a supporting competence in health policy, and EU spending on health, as set out in the current 2014-2020 multiannual financial framework (MFF), is less than €3 billion per year. As a result, EU health policy focuses, in a limited way, on objectives such as fostering good health, protecting citizens from serious cross-border health threats, supporting dynamic health systems and facilitating access to better and safer healthcare for EU citizens. However, the provision of healthcare in Member States still varies significantly, with differences in the amounts of public money spent, in healthcare system design, and in access to basic and advanced prevention. A renewed strategy in this field, as suggested in the recent Franco-German initiative, accompanied by an increased provision of common resources, could bring considerable benefits. The Next Generation EU recovery plan envisages the development of an **EU4Health** programme equipped with a budget of €9.4 billion, which is positive news for a potential European health policy, and for disease control and prevention.

Investing in an EU space, defence and cybersecurity industrial base

The United States' unilateral abandonment of the Open Sky Treaty, the Iran nuclear deal and the Intermediate-Range Nuclear Forces Treaty, as well as the new 'space race', cybersecurity threats and growing world tensions, are all reminders that the EU should be ready to assume more responsibility in these areas, while seeking to safeguard and strengthen the North Atlantic Treaty Organization (NATO). It also appears that **space, defence and cybersecurity spending** is increasingly used as a strategic economic tool. These should therefore probably also form part of a renewed European growth strategy. Such investments are more efficient at EU level due to the large economies of scale. Research has also confirmed that these investments have a significant impact on highly skilled employment and R&D. Regarding recent progress in this area, the Commission has proposed a budget of €13 billion for 2021 to 2027 for the European Defence Fund, while the European Defence Agency aims at promoting cooperation through the Cooperative Financial Mechanism (CFM), whilst 13 new collaborative projects have been announced under permanent structured cooperation on defence and security (PESCO). The new EU Cybersecurity Act aims at strengthening the EU Agency for cybersecurity (ENISA) and establishes an EU-wide cybersecurity certification framework. More ambition on European space, defence and cybersecurity would help in further developing a minimum level of common industrial base in this area.

List of potential initiatives

	Initiative	Likely lead EU actor	What should be done?	
		Improved coordination of fiscal and monetary policies		
1	EU Treasury	Council	Improve economic and fiscal surveillance; Control European safe assets; Develop macroeconomic stabilisation functions.	
2	EU common unemployment insurance scheme	EP / Commission	Improve automatic stabiliser function; Evaluate the benefits of the new SURE.	
3	Common budgetary resources	Council	A sustainable and adapted EU budget; Match priorities with credible financial resources; Equip the EU with more own resources.	
4	Recovery package for solidarity and sustainable growth	EU institutions	Support investment and reform; Kick-start the EU economy; Address the lessons of the crisis.	
		A stronger and deeper single market		
5	Barrier-free single market	Commission / EP / Member States	Tackle barriers to single market for goods; Tackle barriers to single market for services; Ensure cross-border provision of services.	
6	Digital single market	EP / Commission	Develop European digital single market; Joint-standards for digitalisation; Ensure fair and transparent taxation.	
7	EU public procurement agency	Council	Save on administration of public procurement; Ensure global level playing-field.	
8	Free movement within Schengen borders	Commission / Member States	Restore coherence and coordination; Ensure crisis-proof Schengen area.	
		Common investment and spending in strategic areas		
9	Investment in R&D, innovation, green technologies and digitalisation	EU institutions	Reach 20-year-old 3 % target for R&D spending; More ambitious IPCEI; Develop venture capital.	
10	Investment in an effective Green Deal	EU institutions	Reap benefits of green transformation; Support green innovation and sustainable finance; Evaluate efficiency and effectiveness of spending in this area.	
11	Common EU health policy	EU institutions	Develop EU health strategy; Invest in coherent EU public health policy to address health inequalities.	
12	Investment in EU space, defence and cybersecurity industrial base	EU institutions	Develop a common EU strategy in these areas; Benefit from a stronger European industrial base; Avoid being left behind in space and cybersecurity technologies.	

Structural reforms for increased EU resilience				
13	Banking union and CMU	Commission	Make progress on risk reduction and risk-sharing; Reduce fragmentation of capital markets; Support sustainable finance.	
14	Making work pay: Certification of job classifications and pay scales	EP / Commission	Certify job classifications and pay scales; Move towards cross-sectoral comparison to restore equity; Enforce equal pay for equal work principle.	
15	Regulatory environment supportive to businesses	Commission	Reduce regulatory burden; Tax system and environment to favour entrepreneurship; Support digitalisation and the green transformation of businesses.	
16	Stress-testing EU policy and legislation	EP / Commission	Improve design of policy and legislation; Develop methodologies for policy stress-testing Generalise use of stress-testing in policy-making;	
Economic policies for EU 'strategic autonomy' and a leading global role				
17	Updating and upgrading EU competition policy	EU institutions	Continue to maintain vibrant competition; Act strategically to take impact of large-scale global competitors into account; Review and adapt state aid, mergers and acquisitions policies for competitiveness.	
18	Harmonising FDI scrutiny and corporate taxation	EU institutions	Continue to develop EU approach to foreign investors in strategic sectors; Harmonise, simplify and improve CIT.	
19	Open and fair external trade policy	Commission / EP	Continue to support multilateral orientation through rules-based approach within World Trade Organization; Continue to improve and upgrade EU trade defence instruments as necessary.	
20	Leading modernisation of international institutions	Council / Commission	Speak with one voice on the international scene and in international institutions; Promote reforms for a level playing-field and for a multilateral global environment; Promote a spirit of cooperation, responsibility and convergence that reduce imbalances.	

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ENDNOTES

1 €2450 billion in national liquidity measures, including schemes approved under temporary, flexible EU state aid rules, and €330 billion for national measures taken under the flexibility of EU budgetary rules (general escape clause).

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