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IN BRIEF
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Whatever it takes, for as long as is needed: Mapping a new European Recovery Programme

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At its core, the Coronavirus (COVID19) pandemic is a human tragedy. However, it has also become clear that the negative economic and social impacts are deeper and broader than were first anticipated. The continuing spread of this virus and the required measures to contain it have resulted in a concurrent slowdown in all major global economies. This represents an unprecedented challenge to the economic integrity of the EU, its constituent member states, and the global trading framework.

This is unlike any other crisis in modern history, and its impacts will be far-reaching.

The scale of this economic shock should not be underestimated. Although the worst of the public health crisis may pass in the coming months, the economic effects will be longer lasting than is commonly appreciated. The OECD has already warned that "*life, and economic activity, is not going to be normalised any time soon*."

The speed of the ongoing economic contraction has resulted in a near breakdown of traditional market functions. An additional 1 million people in Belgium claimed temporary unemployment benefits in less than three weeks. In Britain, the collapse in demand is greater than at any other time in modern history – including the outbreak of war in 1914 and 1939. The U.S. economy is forecast to decline by up to 30% between April and June 2020. The WTO predicts that this global recession will be considerably worse than the contraction caused by the global financial crisis of 2008.

Economic support will be required long after the virus is contained.

Unfortunately, a scenario envisaging longer-term economic contraction arising from a global pandemic is now the default working assumption. This takes account of the fact that even if the virus has largely been contained within Europe by Quarter 3, 2020, some economic and social restrictions will need to remain until well into 2021.

In this context, the need for increased public spending from member states will persist into next year. Given the uncertainty regarding employment and business viability, this fiscal stimulus will be important in restarting economic growth in 2021. These measures may require additional spending equating to several percentage points of GDP and will be in addition to the current costs associated with supporting healthcare systems, workers, and businesses. As noted by Bruegel's Nicolas Veron, given the toil this crisis will take on the banking system, this spending will need to come predominantly from the public purse.

In this context, the lessons of 2010 and 2011 should be understood at a political level. Then, the premature withdrawal of fiscal stimulus had a negative impact on the future growth rates of the Eurozone as a whole. The repetition of this mistake in 2021 would likely have a whole array of negative socio-political impacts. This is due to the financial crisis' legacy effects in many member states. It would also pose political challenges, given the current debate about "*solidarity*" in the Eurozone. Put simply, an expansive fiscal policy will be required to continue into 2021. This is due to the current extraordinary economic conditions. Such a policy will then be tapered off on a phased basis as economic conditions improve.

Immediate crisis response measures are creating space for longer-term reform.

Consistent with earlier estimates, the cost of COVID19 is currently projected to total 12% to 16% of European GDP. In Germany, announced measures to deal with COVID-19 equate to at least 10% of the economy. Within the Eurozone, current national fiscal measures are estimated at 2% of GDP with liquidity support schemes (mostly for workers and companies) representing an additional 13% of economic output. However, given that the socio-economic restrictions currently in place are still of uncertain duration, further (even larger) support measures may be required in the coming weeks and months.

The "*whatever it takes*" scale of these support measures (supplemented by actions at EU and ECB level) has ensured that Europe, as part of the global economy, has maintained its core operational functions. The financial markets remain operational (notwithstanding a high degree of volatility). The supply of essential goods (such as food and medical supplies) have, despite some temporary delays, been maintained and, in many cases, have been significantly enhanced.

Political wrangling destabilises the Eurozone and increases the risk of contagion.

Although the initial economic response from member states was flexible and of significant impact, the extended length of the economic slowdown significantly increases the risk of contagion.

Two interlinked areas are particularly vulnerable; Firstly, the banking sectors of countries with an existing high level of non-performing loans on their balance sheets. Italy is the most obvious example. Secondly, the broader stability of the Eurozone area, given existing structural weaknesses (unfinished Banking Union, high linkages between sovereign debt holdings and national banking systems).

The actions of the ECB, while vital, cannot replace the decisions of national political leaders in strengthening the Eurozone's internal architecture. Unfortunately, the political wrangling over how to deploy the resources of the European Stability Mechanism (ESM) and the potential issuing of "*Corona bonds*" has restricted the ability of the Eurozone to consider a (much needed) more comprehensive reform agenda for the single currency area.

The longer such disagreements persist, the greater the likelihood of contagion. The direct impact of these disagreements will be to increase market speculation as to the long-term viability of the Euro. These disagreements also cast doubt on the ability of national politicians to provide the leadership necessary in this time of crisis.

Unfortunately, these are policy differences that remain unresolved from the financial crisis of 2010. As a result, current debates surrounding economic support measures have been subsumed into the broader debate regarding solidarity within Europe. These debates are amplified given the public health nature of the COVID19 crisis and the legacy of the recent financial crises.

However, notwithstanding these disagreements, reform of the Eurozone is no longer just a subject of academic interest. It is a political prerogative given the underlying weaknesses of the single currency area and the increasing potential for fragmentation.

Politics must adjust to the new economic reality. A European Recovery Programme must reflect this new landscape.

This economic crisis is so deep, so fundamental to the functioning of the social market economy that many illusions of returning to pre-COVID19 norms must be dispelled. Politics, and more importantly, the political economy of the Eurozone, must adjust to this new reality.

The post-crisis landscape will include significantly higher levels of public debt. A weakened banking system will need support to restart new lending to the private sector. Even with the mitigation measures announced for small and medium-sized businesses, it is likely that many will find it difficult to restart operations and to pay their outstanding legacy debts.

There can be no going back to the old normal. Just as after the two World Wars of the twentieth century, Europe's economy will be forced to adapt to these new realities. Mario Draghi has recently noted the sufferings of Europeans in the 1920's as their governments attempted to return to 1914 economic norms, whatever the political or social cost. Ultimately, such attempts proved futile and economically destructive.

Conversely, in the late 1940s, it was the economic stimulus provided by the United States in the shape of the European Recovery Programme (Marshall Plan) which helped lay the basis for economic recovery in Western Europe; A recovery that stimulated the process of European integration which remains in place today.

Key objectives of a new European Recovery Programme

In this context, amid this unprecedented economic contraction, a new European Recovery Programme is required. A programme whose key objectives should include, but not be limited to:

- Ensuring Europe's healthcare systems have the necessary resources to provide care to all those who require it;
- Returning citizens to work;
- Helping companies of all sizes to restart and expand their operations;
- Facilitating an enhanced social market economic model for the post-COVID19 age based on the principles of sustainability and resilience;
- Reforming and strengthening the Eurozone;
- Renewing the solidarity between national states which lies at the heart of the European integration process; and
- Facilitating a stronger, more geopolitical Europe which will be better able to deal with (and respond to) future global shocks.

A Recovery Programme must be based on five core economic and political commitments.

1. The Euro - Whatever it Takes

A clear political commitment to the Euro is required, which restates the single currency area as the driver of economic growth in Europe. A clear signal should be sent to the financial markets highlighting that - whatever the current political disagreements - all member states stand committed to the Eurozone.

To put into context, COVID19 has emphasised that the Euro faces three possible scenarios for its future development:

(a) *Further Integration* – including greater Political Union, a level of fiscal harmonisation and debt mutualisation.

(b) *Disintegration* – unable to agree on a common path forward, the financial markets will eventually speculate that political unity no longer exists to keep the single currency area together.

(c) *Decentralisation* – based on the work of Professor Charles Wyplosz, among others, a structurally reworked Euro-zone is possible. This model places member states – not the European Commission – as the driver of development within the single currency area. This is a monetary union structure loosely based on the existing Federal Reserve system in the United States.

Given the options set out above, the seriousness of the economic situation, and the nature of current political disagreements, the prospect of a decentralised Eurozone should be actively considered. Such an approach would, in the short term, involve completing the Banking Union and further integrating financial markets.

In the longer-term, fiscal responsibility would rest at the national level with the no-bailout clause (set out but ignored in the European Treaties) reapplied. This approach would negate the need for the damaging disagreements currently taking place between Eurozone member states as it would involve no mutualisation of debt. Instead, the issue of reducing legacy public debts can be ad-dressed through the utilisation of member states' central banking profits as set out in Paris and Wyplosz.

An additional *IN BRIEF* setting out this model in further detail will be provided in the coming weeks.

2. The Economy - For as Long as is Needed

As noted, Europe's economy, its citizens, and its businesses will require support until well after the worst of the public health crisis has passed.

More explicit political actions are required, which restate that:

(a) Public financial support will be maintained for as long as it is needed regardless of budgetary implications. This applies to both individuals and businesses;
(b) Such support will be withdrawn on a phased basis as economic conditions improve;
(c) Longer-term supports – in areas like capital investment and infrastructure – will be further supported in a revised Multiannual Financial Framework (EU budget);
(d) Debt rules within the Eurozone will continue to be waived until economic conditions return to a more stable footing. Debate on the nature and implementation of post-crisis debt rules is urgently required at the Eurozone level.

3. Solidarity – Always, No Matter what the Economic Disagreements

Debates within the Eurozone about future support mechanisms – including *Corona bonds* – are no longer solely economic disagreements. The public health nature of the COVID19 pandemic, the legacy of the past decade of financial crises, and perceived feelings of injustice (evident on both sides) have transformed this issue into a much more confrontational (and emotionally charged) discussion.

While the economic arguments are still on-going, the EU should move quickly to under-take a visible political step underlining the solidarity which has traditionally been at the heart of the European Integration process.

Two key actions are proposed.

First, and given that the current COVID19 crisis is, at its very essence, a terrible loss of human life, the EU should classify the pandemic as a natural disaster. Second, Brussels should launch unified, no strings attached, "*Recovery Bonds*", which would help meet the direct healthcare costs incurred by every member state in dealing with the COVID19 outbreak.

In the absence of such a political signal, the economic disagreements will likely continue to weaken relations within the entire EU while simultaneously increasing the likelihood of a future Eurozone crisis.

4. Society, Growth, and Debt – Never let a Crisis go to Waste

The persistent narrative about the Eurozone economy since 2008 has been one of low growth and a multitude of crises (debt, banking, financial). This pandemic represents an opportunity to build a new narrative to guide the wider European economy in the decade ahead. It presents a chance – in the midst of great suffering – to transform Europe's society for the better.

A new European Recovery Programme must lay the basis for our future shared prosperity. As noted, this Programme must be attuned to the economic realities of the post-COVID19 landscape.

In particular, the following key principles should be included:

(a) A new approach to debt (both public and private) will be required given the scale of the debt surge associated with this crisis;
(b) Growth must become the principal mechanism for reducing debt burdens in the medium-term given short-term spending requirements;
(c) The budgetary principle of creating fiscal buffers during periods of economic growth to facilitate additional spending in times of crisis is sound. It must be-come a vital element of a future, normalised fiscal framework as it allows greater fiscal space to counter unforeseen shocks without causing immediate debt pressures from the financial markets;
(d) The private sector – from sole traders to larger companies – remain the central generator of economic growth and employment. They must be given the support required to return to their essential economic role, while avoiding the historic mistake of overregulation.

Irrelevance would be Europe's biggest failure.

Doing nothing is no longer an option for Europe, given the scale of the economic and social crisis unfolding before it. Rahm Emanuel (President Obama's former Chief of Staff) once stated that "You never want a serious crisis to go to waste. And what I mean by that is an opportunity to do things that you thought you could not do before".

Europe's time is now.

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