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Massive but divisive:

# Crisis management and EU responses to COVID-19

**Policy Brief**

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## Summary

- Coordinated crisis management among EU member states took weeks to develop. The initial response was slow, at times contradictory, frequently displaying nation-state unilateralism and obviously divisive.
- An unprecedented architecture of fiscal and monetary partnership is building in Europe. The ECB is taking the lead in this construction process, with national governments asserting their political prerogatives while the Commission in Brussels is careful not to overstep the national sovereignty of its member states.
- The controversy over the issuance of a corona bond re-opened the debate that divided euro area countries during the sovereign debt crisis in 2010-12. But even the Covid-19 pandemic raging across Europe was not able to rupture the dogma of "No to euro [corona] bonds".
- The ESM has considerable financial means to mobilize through its member states and on international capital markets. But it is also an institution originating in the specifics of the sovereign debt crisis in the euro area 2010-12, the controversies over moral hazard and the advocacy - or relaxation - of policy conditionality for its credit lines.
- The next seven-year budget of the EU will need to be comprehensively reworked in terms of its spending volumes, priority interventions and phasing of funding. This will not make current negotiations, let alone any compromise easier. Expenditure in the budget will have to be increased, thereby posing a further challenge for net contributors.
- As the crisis response to Covid-19 has highlighted manifest fault lines among EU member states, these divisions could morph into bigger controversies during uncoordinated exit strategies. Once the cessation of economic activity can start to unwind, the debate across Europe will accelerate over budget rules, further relief programmes and the demand for forbearance.

"*When Europe really needed to be there for each other, too many initially looked out for themselves. When Europe really needed an 'all for one' spirit, too many initially gave an 'only for me' response*". European Commission President Ursula von der Leyen during a debate in the European Parliament about the EU's crisis response to the Covid-19[1] outbreak, 26th March 2020.[2]



1 We use the term Covid-19 to describe the illness caused by the new corona virus. It is worth keeping in mind that other epidemics such as Ebola (in 2005 and 2014), MERS (in 2012 and 2013), SARS (in 2002), and Zika (in 2007 and 2015) as well as the H1N1 episode (in 2009) have caused major loss of life and economic disruptions across continents during the past two decades. But they were not pandemics and never reached the United States and Europe the way Covid-19 has affected societies across the globe.

2 The president of the European Research Council — the EU's top scientist resigned on April 07th 2020. Professor Mauro Ferrari explained that he was "extremely disappointed by the European response to Covid-19…the complete absence of co-ordination of healthcare policies among member states, the recurrent opposition to cohesive financial support initiatives, the pervasive one-sided border closures" in the EU.

## Introduction

These are unprecedented and fast-moving times across the European continent. The experiences are transformative for citizens, businesses and governments. In late January 2020, the European Union lost its first member by voluntary exit. Re-elected prime Minister Boris Johnson "got Brexit done." In February, the Turkish president Erdogan announced the opening of his border with Greece, intentionally contributing to the resurgence of immigration from the Middle East.

While policy makers in Brussels, London and across the European continent were seeking to come to terms with the consequences of these twin developments, a perfect storm was gathering in Wuhan, the capital city of landlocked Hubei province in central China. The coronavirus health emergency was initially suppressed by local authorities, thereby delaying a crisis response across China. The spreading of the coronavirus is now a shared global experience. Calls for collective action in this series of cascading crises are proliferating across Europe. Energetic intervention by different European institutions and national governments is taking place. But coordination remains a challenge and the tendency that each nation takes care of itself first and foremost has again highlighted pre-existing divisions and fault lines among EU member states.

## I. Massive – but divisive - European responses

The sheer volume of activity is unmatched in living memory. A chain of government initiatives and European interventions is unfolding whose duration is unknown and its economic consequences beyond established modes of statistical projections. However, this crisis management took weeks to develop. The initial response was slow, at times contradictory, frequently displaying nation-state unilateralism and obviously divisive. In its wake the Covid-19 pandemic is transforming two pillars of EU integration: the Single Market and the Schengen area. Both are now considered either an infectious risk and/or a health threat, leading to the unprecedented imposition of Europe-wide travel restrictions and the closure of external borders.

*"However, this crisis management took weeks to develop. The initial response was slow, at times contradictory, frequently displaying nation-state unilateralism and obviously divisive."*

**Table 1: Covid-19 Measures of European Institutions, March-April 2020** (in euros)

| | ECB | EC | EIB | ESM |
|---|---|---|---|---|
| **Fiscal Measures** | | Activated escape clause in SGP* | | |
| **Monetary Measures** | **750 billion** Pandemic Emergency Purchase Programme **120 billion** Increase of Asset Purchase Programme Acceptance of junk-rated Greek sovereign debt as collateral for banks' access to liquidity | | | |
| **Credits Loan Guarantees** | | **37 billion** State aid programmes for Greece, Portugal, Poland** | **25 billion** Pan-European Guarantee Fund (Proposed) Leveraged to **200 billion** | **410 billion** (Available) **240 billion** Pre-cautionary credit lines (Proposed) |
| **Labour Market Policies** | | **100 billion** SURE*** | | |
| **SME Programme** | | | **20 billion** | |
| **Cohesion Policy** | | **37 billion** Corona Response Investment Initiative | | |
| **Structural Funds** | | Reassigning Funds EU budget 2014-2020 | | |
| **Vaccine Research** | | **37.5 million** | | |

* Stability and Growth Pact.
** These programmes chiefly comprise state guarantees on working capital loans.
*** SURE (Support mitigation Unemployment Risks in Emergency). The financial assistance to Member States is in the form of loans granted on favourable terms. They can be used for short time working arrangements, the so-called *Kurzarbeitergeld* (German original).
Sources: Compilation by the author based on press releases from the ECB, European Commission, EIB and ESM. The package of measures reached at the meeting of the euro group of finance ministers on 09th April 2020 has been taken into account.

The reputational damage to the Single Market calls into question its *raison d'être*. In early March, Italy was the first EU member state forced to respond to the deepening pandemic by curtailing freedom of movement across the country and imposing external border restrictions for citizens and commerce. A month later, 12 EU countries had entirely closed their borders to non-residents. The rest of the member states had imposed targeted restrictions. The repatriation of citizens trapped abroad behind borders became a national obligation. Integrated supply chains are disrupted when cross-border trade is curtailed. This is also affecting a sector which is urgently needed to remain open for exchange: health supplies, medical gear, protective masks, etc.

*"The coronavirus pandemic has reintroduced the martial rhetoric of "bazookas" which were previously brought into firing position during the sovereign debt crises of 2012-2015."*

Where the European Commission lacks executive authority to force countries to reopen external borders the uninterrupted flow of capital is being addressed by the European Central Bank (ECB). On March 18th it launched the *Pandemic Emergency Purchase Programme* (PEPP).[3] The volume is initially set at 750 billion euro but can be increased to an unlimited monetary capacity. The coronavirus pandemic has reintroduced the martial rhetoric of "bazookas" which were previously brought into firing position during the sovereign debt crises of 2012-2015. The ECB's "new bazooka" now includes the purchase of sovereign and corporate bonds from all euro areas member states; including for the first time Greece (approximately 12 billion euro). The PEPP package gives the ECB unrestricted leverage to buy whatever fixed income it wants, from whoever it wants.

The European Commission supplemented the ECB's unprecedented crisis intervention with the temporary suspension of fiscal rules in the *Stability and Growth Pact* (SGP). The activation of the so-called 'escape clause' is the first time the Commission resorts to this means since the creation of the SGP in 1997. The single-largest (by financing volume) intervention of the Commission concerns a new €100 billion job-support programme for members hit by the coronavirus crisis. In addition, the Commission relaxed EU state aid regulations for member states regarding state guarantees for bank lending. It is also considering a proposal that would permit member states to provide financial assistance in equity or hybrid capital instruments to those businesses directly affected by the pandemic. Since mid-March 2020, the EU has adopted 41 emergency measures in 16 countries, including – despite Brexit – in the UK.

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Similarly, national governments are responding with different means and volumes of intervention. They have introduced measures ranging from loan guarantees for businesses, to deferred taxes, extended unemployment benefits and increased health expenditure. Germany proceeded with the most aggressive fiscal measures and other support schemes, equivalent to approximately 25 (!) percent of GDP so far. The government in Berlin even cast aside its constitutional debt brake (the so-called *Schuldenbremse*). The 'black zero" is no longer the holy grail for fiscal policy in Germany and the government announced a EUR 750 billion package in new spending and lending from KfW (*Kreditanstalt für Wiederaufbau*), a federal development bank. France, the Netherlands and Italy have introduced a similar combination of unprecedented fiscal measures and targeted relief packages for businesses and households.

[3] It should not be forgotten that the ECB's president Christine Lagarde first had to complete a policy U-turn before launching PEPP. A few days earlier she had argued that "we are not here to close spreads; this is not the function or the mission of the ECB". Ms Lagarde even went as far as saying that she did not seek to be "whatever it takes, number two" (referring to her predecessor, Mario Draghi).

**Table 2: Policy Response Measures* as a percentage of GDP by governments in Europe**

| | Supplementary Budget | Public Loan Guarantees |
|---|---|---|
| **Germany** | 4.9 % (€ 156 billion) | 25% (€ 825 billion) |
| **France** | 2.0 % (€ 45 billion) | 13 % (€ 300 billion) |
| **Italy** | 1.4 % (€ 25 billion) | 20 % (€ 350 billion) |
| **The Netherlands** | 1 to 3 % (€ 10 – 20 billion) | 5 to 6 % (€ 35 – 45 billion) |
| **Spain** | 1.0% (€ 13.9 billion) | Not available<br>Introduction of basic income |
| **Austria** | 9.0 % (€ 38 billion) | 8.5 % (€ 34 billion) |
| **Ireland** | 2.0 % (€ 7.2 billion in total) | |
| **Greece** | 5.0 % (€ 10 billion in total) | |
| **Portugal** | 5.6 % (€ 10.9 billion in total) | |

* Measures combine fiscal packages and various liquidity as well as loan support schemes by national governments. The data is as of 10th April 2020.

Source: Compilation by the author and Süddeutsche Zeitung, 03rd April 2020, "Nachsicht statt Vorsicht", online available: http://sz.de/1.4865922). See also IMF Policy Response Tracker Covid-19, https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19.

*"Unlike in 2010-12, the "whatever it takes" moment in Europe took weeks rather than months, or even years to arrive, as it did during the sovereign debt crisis."*

What is emerging from the overview in tables 1 and 2 is threefold?

- The time to confront Covid-19 and its economic consequences is essential. This emergency implies that policy implementation is confronted by different constituencies with moral hazard allegations, lack of transparency, concerns regarding oversight, fairness and accountability. Equities must be weighed, trade-offs made, potential mistakes tolerated for the time being.
- Unlike in 2010-12, the "whatever it takes" moment in Europe took weeks rather than months, or even years to arrive, as it did during the sovereign debt crisis. Because of pre-existing conditions the ECB was in a position to quickly re-activate and expand its QE programme, albeit under a new name and justification.
- An unprecedented architecture of fiscal and monetary partnership is building in Europe. The ECB is taking the lead in this construction process, with national governments asserting their political prerogatives while the Commission in Brussels is careful not to overstep the national sovereignty of its member states. It remains to be seen how this newly emerging working arrangement between the ECB, national governments and the Commission reshuffles institutional capacity and risk sharing in Europe.

*"the conceptual framework that informs these interventions continues to be rooted in the traditional toolbox of European crisis management dating back to 2010."*

- The toolbox of policy instruments illustrated in both tables underscores its hitherto unprecedented financial volume and range of combinations between credit facilities, loan guarantees, targeted financial interventions for SMEs and specific labour market policies. But the conceptual framework that informs these interventions continues to be rooted in the traditional toolbox of European crisis management dating back to 2010-12.
- One notable exception to this form of path dependency is the intended introduction of a universal basic income by the government in Spain. According to Economy Minister Nadia Calvino, the roll out of a basic income is to become "a structural instrument, a permanent instrument".
- During the sovereign debt crisis in 2010-12 various EU member states constantly argued for rules-based policy making. Now the mantra of compliance to existing monetary rules and fiscal conditionality is suspended. The devotion to "technocratic obligations" is being radically overwhelmed by events across Europe. The Dutch academic Luuk van Middelaar calls this development a move from "a system based purely on the politics of rules to a system that can also engage in the politics of events."[4]
- The policy responses to the Covid-19 pandemic by governments ranging from Berlin to Paris, Rome, Madrid and Athens signify the "biggest paradigmatic shift in economic policy that Europe has witnessed since the 1980s."[5] The manner in which most of these responses have been undertaken at the level of national governments is characterized by acting alone and within established roadmaps. The interventions have been justified as a matter of urgency and by asserting national sovereignty to do so.

*"in the face of a symmetric shock such as Covid-19, certain policy responses and health consequences across the EU have been asymmetrical."*

The aforementioned arrangements – urgent as they appear – should not disguise the fact that in the face of a symmetric shock such as Covid-19, certain policy responses and health consequences across the EU have been asymmetrical. This discrepancy was painfully evident when Italy's ambassador to the EU strongly criticized his European peers for failing to help his country at the outset of the Covid-19 pandemic. In early March 2020, the German government implemented a ban on exports of surgical face masks. Shipments even had to be turned back at the border! Instead of urging its European peers to keep external borders open as it did at the height of the refugee movements across the continent in 2015, federal and regional governments from Berlin to Munich were implicitly advocating a "Germany First" policy!

Resorting to inward-looking national reactions instead of responding coherently as a bloc underscored the limits of intra-EU solidarity. In the hour of greatest need, such solidarity is arguably in high demand, but when push comes to shove these appeals can be in low supply as the region of Lombardy in northern Italy painfully discovered. Instead, it was China[6] that quickly filled the void. Beijing has flown in medical masks, test kits and ventilators to Italy, Belgium, Spain and Greece. These supplies have partly

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[4] See Luuk van Middelaar (2019): "Alarums and Excursions: Improvising Politics on the European Stage." Agenda Publishing. Mr. van Middelaar is the former speechwriter for Herman Van Rompuy, the first full-time president of the European Council, from 2010 to 2014.

[5] Kevin Featherstone: "Coronavirus Kills off Neoliberalism", in Kathimerini, English edition, 03rd April 2020.

[6] The same applies to EU accession countries currently negotiating membership requirements. The EU has limits on exports of medical equipment to non-EU countries. Therefore, Serbia turned to China for medical emergency assistance. President Aleksandar Vučić made his vocal disavowal of the EU's policies loud and clear when stating that "I believe in Chinese help. The only country that can help us is China. To the others, thanks a lot for nothing."

*"It was China that quickly filled the void. Beijing has flown in medical masks, test kits and ventilators to Italy, Belgium, Spain*

been donated others sold at discounted market prices as these countries face acute shortages of medical gear to fight Covid-19. In Italy, Chinese health officials are advising regional authorities on how to implement strict lockdowns. Put otherwise, China is in a position to exploit Covid-19 as a diplomatic opportunity among EU member states.

Under the impact of the Covid-19 pandemic widening the policy space for common interventions by EU member states continues to be obstructed by institutional hurdles. Key members insist that now is not the time for the introduction of root and branch [fiscal] alternatives at the European level. Section II discusses the contrarian initiative by nine euro area countries to make the urgent case for the availability of such alternatives and the manner in which they are being rejected by a coalition of 'usual suspects'.

## II. Mutualised corona bonds: If Not Now – When Then?

As the debate about crisis management and innovative interventions multiplies across Europe, it is worth recalling a mostly forgotten historical precedent. In 1975, the then existing European Economic Community (ECC) issued a *Community Bond* to mitigate the effects of the oil price shock in 1974. Primary beneficiaries of the never before used procedure were the Italian and Irish governments to assist covering their oil-payment deficits. More than four decades later the heads of state and prime ministers of nine EU member states - who are also all part of the euro area – made the case in a letter to Charles Michel, president of the European Council for a "*common debt instrument…We need to recognize the severity of the situation and the necessity for further action to buttress our economies today*,".

The majority of member states in the European Council, meeting for the first time ever through teleconferencing, rejected the proposal. Narrow interests prevailed. Neither were stigmatization and finger pointing missing. Economic nationalists such as the Dutch finance minister Wopke Hoekstra had the audacity to criticize some countries – without explicitly naming them - for their continued fiscal profligacy. Consequently, both Giuseppe Conte of Italy and Pedro Sánchez of Spain jointly rejected the draft conclusions of the European Council. That also was a first among prime ministers participating in a European Council!

The countries publicly calling for the issuance of so-called corona bonds are Italy, France, Belgium, Greece, Portugal, Spain, Ireland, Slovenia and Luxembourg. Notably missing from this list are northern European members of the euro area. Germany, the Netherlands, Finland, Austria, Slovakia and the three Baltic states have opposed the introduction of mutualized corona bonds.[7] The FT called it "*the most heavyweight endorsement of a move towards true fiscal union in the history of the single currency area*", but immediately also cautioned that "*for now, that call will go unheeded*."

*"The legal case for a corona bond specified as a post-Covid-19 investment programme across the EU can be made."*

The legal case for a corona bond specified as a post-Covid-19 investment programme across the EU can be made. A corona bond would have to be (i) defined in terms of total volume, (ii) time-specific (duration) and (iii) targeted, e.g. for health-care expenditure and post-pandemic recovery. The historically unique situation creates new legal challenges on how to construct such loans. They cannot be solved under current

[7] The governments in Malta and Cyprus have neither voiced support nor rejection of corona bonds.

time constraints. According to the EU department of the German *Bundestag* two criteria for the admissibility of corona bonds have to be taken into consideration:

- What are the incentives and how can they be guaranteed that euro area countries continue to have sound fiscal policies once a corona bond has been issued?
- What clauses must be agreed so that a member state continues to be liable for his share of the corona bond issue (Treaty on the Functioning of the European Union (TFEU), article 122 and 125)?

The controversy over the issuance of a corona bond re-opened a debate that divided euro area countries during the sovereign debt crisis in 2010-12. Nine years ago, the issuance of a joint debt instrument was blocked by a group of euro area countries led by Germany's then finance minister Wolfgang Schäuble. Today's German Economy Minister Peter Altmaier argued in a newspaper interview against "*ingenious new ideas that are often the return of long-rejected concepts*". Mr. Altmaier went as far as saying that the debate over corona bonds is a "*ghost debate*."

*"Thinking big, fast and furious was possible within the ECB (after initial hesitation), but still lacks both the political speed and will among numerous euro area members."*

If ever there was a time that conditions required to break this deadlock, this was *not* it! Not even the Covid-19 pandemic raging across Europe is able to rupture the dogma of "No to euro [corona] bonds". The University of Columbia economics professor Adam Tooze desperately asked, "*if risk sharing is not possible even under these circumstances, you have to wonder if it will ever be conceivable. And this leads to the question: What is the point of the eurozone?*"[8] Thinking big, fast and furious was possible within the ECB (after initial hesitation), but still lacks both the political speed and will among numerous euro area members.

Could there be a way out of this conundrum? One option fundamentally changes the functioning and architecture of the euro area. In an editorial for the *Financial Times* (29th March 2020), Wolfgang Münchau proposed setting up a mutualised bond backed by a 'coalition of the willing'. In doing so these countries "*could then challenge the European Central Bank to buy these securities as part of its pandemic emergency purchasing programme. Legally, a mutualised debt instrument between a group of sovereign states would still count as national debt. The repayment obligation would be shared*."

Such a coalition would risk splitting the German French axis. Both countries are on opposite sides of this debate. If a German-led veto[9] continues to prevail, any other [watered-down] solution carries the burden of proof if it could avert secondary effects such as a major debt crisis in Italy and Spain. Unless the subscribed capital is increased by member states, the ESM's current lending capacity is too small to assist Italy, Spain and France simultaneously. In recognition of this limitation a Dutch proposal calls for the introduction of a 'corona fund'. EU member states would be making "voluntary contributions" which can be used as grants.

[8] See Yannis Palaiologos, Interview with Adam Tooze: "We Are Facing the Prospect of a Catastrophe", Kathimerini, English Edition, 31.03.2020.

[9] A growing number of German economists, some of which objected to the introduction of euro bonds in 2011-12, are now supporting a mutualised debt instrument during the pandemic. The Council of Economic Experts, which advises chancellor Merkel, is split on the issue of European crisis bonds. Secondly, even in the unlikely event of a compromise among euro area countries, parliaments have to be consulted and in the German case the federal constitutional court would certainly be asked to provide a ruling.

## III. Can the European Stability Mechanism bridge the gap?

*"The ESM has considerable financial means to mobilize through its member states and on international capital markets. But it is also an institution originating in the specifics of the sovereign debt crisis, the controversies over moral hazard and the advocacy – or relaxation - of policy conditionality for its credit lines."*

Apart from the political disputes surrounding corona bonds, the operational mandate of the European Stability Mechanism (ESM) remains a matter of controversy among participating countries. The ESM currently has a total of €410 billion of subscribed capital for lending at its disposal. Beneficiary countries are euro area states. The mandate of the ESM and the political rationale when it was established in 2012 should not be ignored. The ESM has considerable financial means to mobilize through its member states and on international capital markets. But it is also an institution originating in the specifics of the sovereign debt crisis, the controversies over moral hazard and the advocacy – or relaxation - of policy conditionality for its credit lines.

The compromise relief package that euro group finance ministers struck on April 9th, 2020 – after a failed attempt two days earlier – reflects the institutional and political challenges involved in the degree of burden sharing needed. The different measures total €500 billion, including €240 billion of "pandemic credit lines" via the ESM. In order for the latter credit facility to be recommended for approval next week by heads of state and prime ministers, various countries – chiefly among them The Netherlands, Germany and Austria – shifted their demand for economic surveillance. No conditionality is attached for immediate healthcare spending related to Covid-19. However, the broader definition of funding "support for the wider economy" comes with strings attached. For their part, Italy and Spain accepted a delay on any agreement comprising corona bonds. The issue of a "Recovery Fund" will be discussed at the forthcoming EU summit. Italy insisted that the fund enables common debt issuance.[10] But the size and sources of funding remain unresolved.

For the ESM to make access to its credit lines less cumbersome and politically toxic the rule book will have to change. This is already a work in progress. Euro area heads of state and prime ministers had intended to conclude the outstanding matter by December 2019. For domestic political reasons Italy objected to parts of the reform proposals, e.g. risk-weighting sovereign debt holdings. These included new conditions called "single limb collective action clauses" (CACS) in sovereign bond issues. The delay in this reform process is now a key reason why various countries object to the introduction of Corona bonds while it also limits the operational capacity of the ESM to introduce its version of "whatever it takes".

*"It is necessary to recall the bitter controversies from the Greek example in 2014 when a pre-cautionary credit line was being advocated by the ESM to the then government of prime minister A. Samaras."*

Given how politically toxic euro or corona bonds are for the 'usual suspects', one alternative being considered by the finance ministers of the euro group consists in the ESM issuing pre-cautionary credit lines to any euro area country that would request such a facility. Could such a facility be used for fiscal stimulus in Spain and Greece? Could it even entail the refinancing of Italy's national debt? These questions point to the conditionality attached to such a loan facility It is necessary to recall the bitter controversies from the Greek example in 2014 when a pre-cautionary credit line was being advocated by the ESM to the then government of prime minister A. Samaras. Strict fiscal supervision through third [international] parties, including running primary budgetary surpluses for decades and the monitoring of compliance would essentially undermine the political sovereignty of countries making such a (poisoned) request.

The new European Commission under president Ursula von der Leyen defined itself as wanting to be a "geopolitical" Commission. Three months after its inauguration it has

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[10] The precise wording of the euro group statement refers to governments working on "innovative financial instruments, consistent with EU Treaties" to fund the recovery.

*"The new European Commission under president Ursula von der Leyen defined itself as wanting to be a "geopolitical" Commission. Three months after its inauguration it has to reckon that it is primarily the ECB and EU member states that are taking (back) control of key elements of crisis management during the Covid-19 pandemic."*

to reckon that it is primarily the ECB and EU member states that are taking (back) control of key elements of crisis management during the Covid-19 pandemic. Some observers have argued that the EU is rightly getting out of the way of national governments as they respond to the spreading coronavirus. Nor can the Commission build hospitals, produce ventilators and export face masks. To date the domain of public health policy remains an exclusive national competence under the EU treaties. Moreover, the Commission's crisis response capacity is currently constrained by complex and politically contentious negotiations with EU member states over the size and configuration of the next multi-annual financial framework (MFF) for 2021-2027. These negotiations have repeatedly failed to reach a compromise in the past months prior to the Covid-19 crisis.

- The French finance minister, Bruno Le Maire has proposed that the next MFF should include "*a fund which would be limited in time with an indebtedness possibility for the long-term response to the crisis*" (FT, 01.04.2020).
- The managing director of the ESM, Klaus Regling suggested in a commentary (03rd April 2020) that Italy should "probably" not be a net contributor to the next EU budget.

In any case, the next seven-year MFF will need to be comprehensively reworked in terms of its spending volumes, priority interventions and phasing of funding.[11] This will not make current negotiations, let alone any compromise easier. Expenditure in the budget will have to be increased thereby posing a further challenge for [some] net contributors. But if this challenge yields a compromise, thereby avoiding the obvious alternative of debt mutualization, then countries such as Germany and the Netherlands could be persuaded to accept it.

## IV. Sweeping lockdowns – Pandemic authoritarianism?

The controversies about appropriate fiscal and monetary responses are not the only issues posing an increasing threat to the cohesion of the EU during the pandemic. One aspect of the crisis deserving particular attention concerns political risk. The crisis management of EU member states includes the adoption of emergency powers. Closing territorial borders, issuing stay-at-home orders and curtailing citizens' mobility appear understandable in the current environment. But as is becoming apparent in some countries such sweeping measures are being extended to limit parliamentary rules and govern by decree. As countries adopt tighter restrictions over longer periods of time, the issue of democratic accountability and transparency of decision making cannot be ignored.

*"The parliament in Budapest passed legislation on March 30th, 2020 which gives the Hungarian prime minister Viktor Orbán the authority to rule by decree, ostensibly to tackle the corona virus emergency."*

These concerns are particularly manifesting themselves in Hungary. Covid-19 did not create such political attitudes but is magnifying their reach and rationale. The parliament in Budapest passed legislation on March 30th, 2020 which gives the Hungarian prime minister Viktor Orbán the authority to rule by decree, ostensibly to tackle the corona virus emergency. He can now bypass the assembly on *any* law. Mr. Orbán can further centralise decision-making and govern by fiat without a time limit.

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[11] In early April, Commission president von der Leyen argued in favour of a "Marshall-Plan for Europe." To that end the MFF would have to be restructured wholesale.

Freedom of expression in the media is again curtailed (a ban on what the government will determine qualifies as 'Fake News'). In scope and content these measures are incompatible with normal democratic standards in the EU. As one observer has noted, "Hungary is now at the vanguard of Covid-19 authoritarianism" in Europe.[12] Given the track record of the Hungarian prime minister exploiting the pandemic for political ends should not come as a surprise to observers in Budapest, Brussels or elsewhere in the EU.

In Poland, the planned presidential elections due May 10th will go ahead at the insistence of prime minister Jarosław Kaczyński and the leading candidate from the ruling Law and Justice Party, incumbent Andrzej Duda. Both have refused to cancel the vote due on May 10th. Because of the nation-wide lockdown, an electoral campaign cannot take place. The main opposition candidate, Ms Malgorzata Kidawa-Blonska, called on voters to boycott the poll because of the dangers posed by the accelerating spread of coronavirus. She said that holding the poll under the current circumstances would be an "almost criminal act". In a late-night session of parliament elections rules were changed less than six months before the vote. This violates provisions in the Polish constitution.

It is the reaction of the Commission in Brussels, the EU parliament in Strasbourg and/or NATO representatives that will now have to be closely followed. Is the EU capable - or currently unwilling - to do anything about its rogue member? Without mentioning Hungary or Poland, 13 EU member states jointly issued a statement that they were "deeply concerned about the risk of violations of the principles of rule of law, democracy and fundamental rights" arising from "certain emergency measures" during the pandemic.

## Conclusions:

*"We must prepare – as citizens, policy makers and entrepreneurs – for a new reality in Europe: to consider a continent learning to live with the corona virus until there is a vaccine which may take months or years to develop and administer."*

The past month (mid-March to mid-April 2020) has seen the biggest changes to everyday life in Europe during peacetime. If ever the expression were appropriate, it is now: this time is different. But the unfolding pandemic has not led to an unconditional urgency for cooperation among EU member states. Instead, divisions are again becoming visible that create a sense of déjà vu from the sovereign debt crisis in the euro area in 2010-12.

The Covid-19 emergency threatening political economies is of such a magnitude that it requires a root and branch departure from the established policy playbook in Europe. Questions abound searching for answers. Is it too early to imagine the characteristics of European affairs *after* Corona? How will a roadmap for exit strategies look like? To pose these questions – necessary as they are – nevertheless runs the risk of missing two key ingredients of the current pandemic.

- We must prepare – as citizens, policy makers and entrepreneurs – for a new reality in Europe: to consider a continent learning to live ***with*** the corona virus until there

[12] Fareed's Global Briefing, "Hungary: Ground Zero for Pandemic Authoritarianism", 31. March 2020."

*"Disrupting connectivity through the closure of national borders, social distancing as a new form of separation among citizens and between countries as well as quarantines and national lockdowns stand in fundamental contrast to the founding principles and modus operandi of the European Single Market."*

is a vaccine which may take months or years to develop and administer. This conclusion is not about fear mongering, nor about predicting apocalyptic scenarios. It is about prudent, pro-active and pre-emptive policy making by national governments and European coordination where appropriate or called for. Such an approach must include secondary effects, e.g. a future in which COVID could return seasonally.

- The second consideration concerns the evident disruption of a cornerstone of the European Single Market, namely connectivity through open external borders. Disrupting connectivity through the closure of national borders, social distancing as a new form of separation among citizens and between countries as well as quarantines and national lockdowns stand in fundamental contrast to the founding principles and *modus operandi* of the European Single Market.

The coronavirus crisis underscores that national governments across the EU matter. Nation states have been quicker off the mark than the EU in responding to Covid-19. Put otherwise, the crisis response is first and foremost being shaped by decisions taken in Berlin, Paris, Rome and Athens as well as by the ECB. The speed with which the Commission in Brussels and the ESM in Luxemburg can react essentially depends on the political will of coordination among national governments.

While the current focus is on expanding monetary and fiscal policies in a pandemic of unknown duration and depth, we should not ignore the necessary follow-up requirements to discuss what happens next if and when this crisis abates? In other words, as the crisis response to Covid-19 has highlighted manifest fault lines among EU member states, could these divisions morph into bigger controversies during [uncoordinated] exit strategies[13]? Once the cessation of economic activity can start to unwind, the debate across Europe will accelerate over budget rules, further relief[14] programmes and forbearance (for mortgages, loans or supervision). Governments will come under pressure to phase out certain support schemes, redirect spending priorities and even raise taxes. Navigating these debates and their outcomes will be profoundly challenging.

The political task rests in deciding how long emergency policies coping with the pandemic and its consequences take priority over the Maastricht criteria and the reintroduction of the Growth and Stability Pact? Make no mistake, the fiscal hawks in Berlin, the Hague and Helsinki will not go into hibernation. The dispute can be summarized in the issue at hand for Italy and Spain: should they focus scarce resources on debt repayment instead of hospitals in Bergamo and Valencia? The answers to this

[13] Understandably, this debate is hardly visible at present. But it will need to be had, e.g. as regards debt amortization, primary surplus targets in budgets, NPL resolution management, etc. See Bob Traa (2020): "A New Shock to the Economy – Covid-19", in: Kathimerini, English edition, 30th March 2020.

[14] The terms relief and stabilization are used here intentionally. The programmes can hardly be called stimulus packages when borders are closed, travel restrictions apply and national lockdowns shut restaurants, shops and businesses. Stimulus packages will have to be formulated in a post-Covid-19 phase.

binary challenge will affect capital spending, granting debt moratoriums and risks exacerbating tensions between richer and poorer EU member states.

Two final observations. On July 1st, 2020 Germany will take over from Croatia the presidency of the Council of the European Union. It will be the last time that Chancellor Angela Merkel will be holding the keys to the six-months rotating presidency. If there ever was a more important time to show leadership with European characteristics, namely tangible cross-border solidarity and practical burden sharing emanating from the chancellery in Berlin, then the time is now! Merkel's European legacy may well be shaped by what she can initiate during these critical six months.

Secondly, the search for a vaccine or cure could take anything between months and years. The economic consequences and debt levels incurred (sovereign, corporate and private) will be long and hard. Do democracies in Europe, the social contracts in societies and the institutional architecture of the EU have the patience and financial means to last under the conditions of a pandemic for 12 to 18 months as some projections suggest? Put otherwise, how long can different governments fiscally support a prolonged crisis? The answer to this vexing challenge will be as urgent and controversial as the ongoing Covid-19 crisis responses across Europe.