Europe Is Still Waiting for a Recovery Fund Breakthrough

by Caroline D. Rose - July 10, 2020

Earlier this month, the European Commission released its **midyear assessment** of the state of European economies. The so-called summer interim report was a lot less sunny than the commission's **initial predictions** in May. Right out of the gate, Brussels defined the coronavirus crisis as a watershed in European history, with the report's first sentence stating that in the first half of 2020 the Continent has seen its "deepest output contraction since World War II." The majority of EU member states' economic forecasts, with notable exceptions like Germany, were revised downward by significant margins. Of course, these figures aren't set in stone. Accounting for uncertainties over supply chain disruptions, investor confidence, external demand and a potential second wave of infections, the picture for Europe's economy could very well become bleaker.

The 52-page report factored in a slew of economic indicators, assessing countries' lockdown measures and fiscal responses, pre-COVID economic prognoses, net exports, affected industries, changes in inflation rates and joblessness, just to name a few. The report did not, however, account for one potential fiscal boost in its calculations: the "Next Generation EU" 750 billion-euro ($850 billion) recovery package, which will bring the size of the bloc's revised 2021-27 budget up to 1.85 trillion euros. EU heads of state and government are due to discuss the recovery program on July 17-18, with the most ambitious among them hoping to secure an agreement before returning home. However helpful these measures could be for European economies, approval has been held hostage by a preexisting dispute between the northern "frugal four" bloc and southern, Mediterranean member states, leading to greater resentment on both sides.

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In France, Italy, Portugal and Spain – countries that were hit hard by both the virus and its economic aftermath – public disapproval over the EU's crisis management system is steadily rising, compelling leaders to toughen their stance against fellow leaders who are standing in the way of the recovery fund. Could public resentment toward Brussels translate into more support for far-right, euroskeptic political parties, or perhaps even the EU's immediate collapse? Not necessarily. Though southern European economies aren't giving the EU a total vote of confidence, they are desperate for any glimmer of financial assistance that they can get, forced to settle for the best of a series of bad options.

The Tug of War Over Funding

Though tensions have always existed between the EU's northern and southern members over issues like economic integration, the positions of the two sides have hardened in the face of the

COVID-19 recession and the ensuing four months of argument about the size and scope of a potential fiscal rescue package. Italy, the worst-hit European economy (its gross domestic product is projected to decline by 11.25 percent in 2020 compared to 2019, with a slow return to pre-crisis levels expected toward the end of 2021), has led the southern bloc in a monthslong campaign for EU assistance for other devastated economies like Spain, Portugal, France and Greece. The southern bloc has advocated EU-disseminated grants with no strings attached, accomplished through the creation of new EU-level taxes and a raising of the budget's resource ceiling to 2 percent of EU gross national income (from around 1 percent in the 2014-20 budget).

Wary of unconditional requirements and accumulating EU debt, the frugal four (the Netherlands, Austria, Denmark and Sweden) have hit the brakes. Eurozone member states already agreed to authorize a **credit line totaling 240 billion euros** for the 19 states that use the euro with minimal conditions attached, but as yet, no member state has asked to use that money. Led by The Hague, the frugals have obstructed the consensus needed for the bigger fund to pass. While they debated, by the end of the first quarter Italy and France had **lost 5.3 percent** of their GDP.

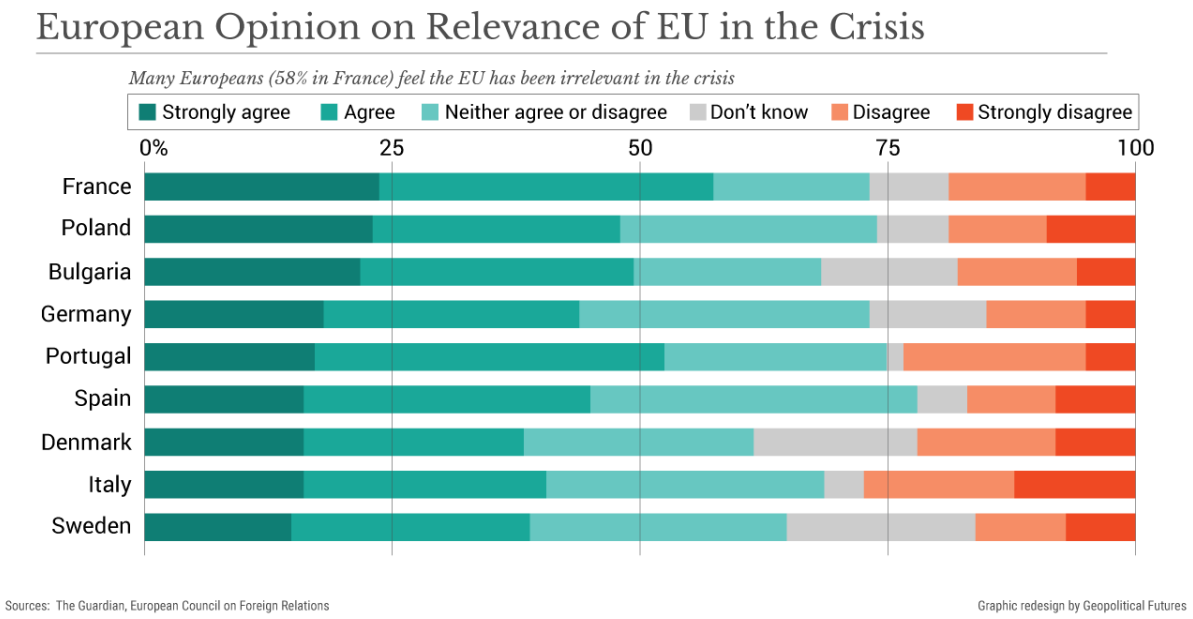
Desperate to move the discussion forward, in mid-May France and Germany proposed a 500 billion-euro package, to be raised on capital markets and distributed as budget transfers. The plan was **hailed as Europe's "Hamiltonian moment,"** drawing comparisons to the U.S. federal government's assumption of states' debts under Treasury Secretary Alexander Hamilton. Later that month, the European Commission produced the Next Generation EU plan, which essentially took the Franco-German proposal and added another 250 billion euros' worth of conditional loans, intended to appease both sides and create space for bargaining.

The frugals, however, have continued to stand their ground, though there are indications that all but the Netherlands are wavering. Crucially, the proposal requires unanimous approval, which means the Netherlands can continue to block an agreement even if it's on its own, putting other leaders in the awkward position of having to travel to The Hague to court Prime Minister Mark Rutte. In June, French President Emmanuel Macron wined and dined Rutte. German Chancellor Angela Merkel, whose country assumed the rotating EU presidency at the start of this month, spoke about the deal as a "unique opportunity" for the EU, and also met with Rutte on Thursday. Southern member states have also gone the extra mile to try to convince The Hague of their seriousness. As Italy is expected to be the largest recipient of the funds (172 billion euros), Rome rolled out a bunch of reforms to cut red tape that its prime minister overzealously billed as the "mother of all reforms." Greece, which is slated to receive 32 billion euros in the proposal, has **advanced its own agenda of green and digital reform** to try to sway the Dutch. Days from the EU summit, however, the chances that the

recovery deal passes are still far from certain.

Political Reverberations

The north-south divide has played a key role in delaying EU COVID-19 assistance and in delivering the financial response that its constituents expected. And this has led to a large drop in overall confidence in the EU's crisis management capabilities. In late June, the European Council on Foreign Relations released a **poll** measuring European sentiment toward the EU's handling of COVID-19. Of the 11,000 citizens it polled from nine countries (Italy, Spain, France, Germany, Poland, Sweden, Denmark Portugal and Bulgaria), about a third had lost confidence in governmental capacity to act, with rising distrust with expertise and raised perceptions of the EU as an "irrelevant actor." But the results differed between the north and the south. Roughly 63 percent of Italians agreed that the EU failed its citizens. France followed closely behind at 61 percent, saying the EU responded poorly. And in Italy, Spain, and France, 58 percent, 50 percent, and 41 percent of respondents, respectively, confirmed that their attitudes about the EU had worsened over the course of the pandemic.



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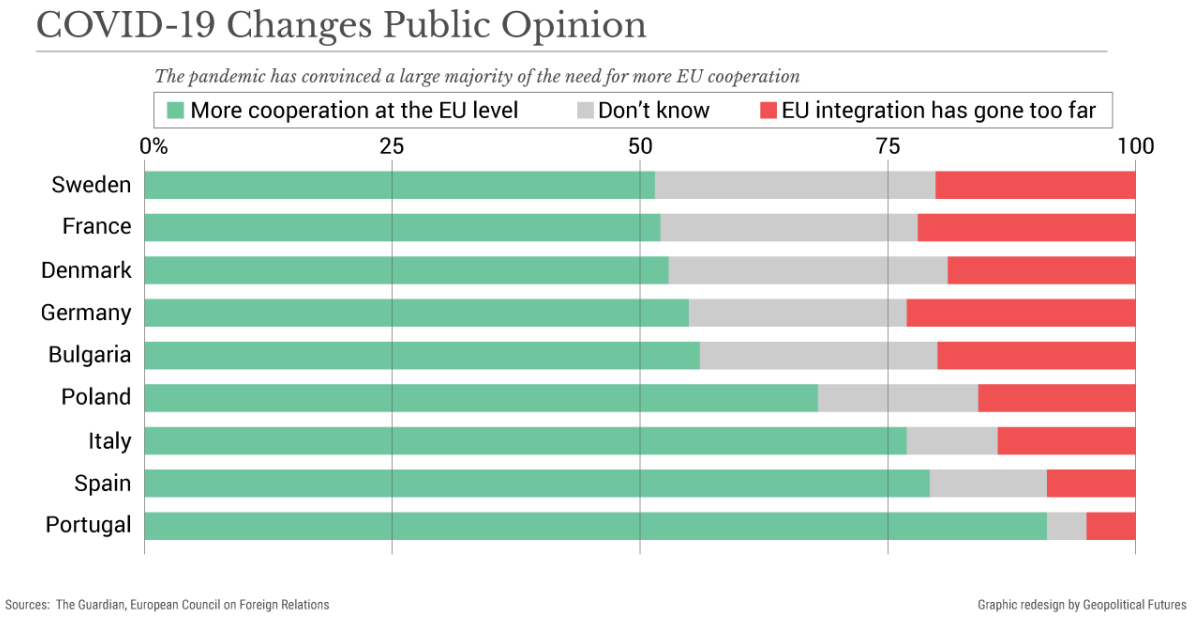
This trend would presumably tip the political scales toward EU fragmentation, translating to support for far-right parties advocating for withdrawal from the EU, particularly in southern countries harboring greater resentment toward Brussels and in frugal four members. In Italy, Prime Minister

Giuseppe Conte warned in an op-ed in late May that the lack of EU action would fuel the flames of nationalism and euroskepticism – forces that would “widen long-term divisions in our union.” Yet, far-right parties like Vox in Spain, National Rally in France, and the League in Italy are sliding in the polls and struggling to mobilize momentum against more moderate ruling parties with soaring approval ratings.



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It’s clear that for the time being, southern economies are holding onto the EU despite plummeting confidence in its institutions and growing resentment of their northern peers. Faced with a 9 percent to 11 percent loss in GDP, the southern bloc is dependent on and desperate for whatever funding the EU can offer. These economic pressures have compelled the southern bloc governments to stick with the EU as the least bad option. Public opinion reflects as much, with constituents withholding a total vote of confidence for the EU but supporting an EU-led recovery and increased EU effort toward burden-sharing.

Can the South Hold On?

If passed, the Next Generation EU package will be considered a Hamiltonian compromise among staunch EU rivals – and a political win for the EU. But economically, it is too little, too late. Even so, the EC report revealed that the future of many European economies is bleaker than what was originally assumed, creating an incentive for them to take whatever they can get. The best the

southern states can hope is that a yes vote from the frugals would create momentum for further, quicker EU stimulus down the line.

They may well need it. In the third and fourth quarters, new economic challenges will start to pile up. While many European governments have been able to conceal rising unemployment through temporary dismissal bans (like those implemented in Spain and Italy) and short-term subsidy schemes, they have yet to implement sustainable, long-term solutions. Economists predict a surge in joblessness when companies with severe liquidity and solvency problems soon go under.

Moreover, the consequences of a long, hot summer of tourist-less beaches, empty restaurants and vacant hotels along the Mediterranean will begin to be felt on southern economies' balance sheets. And as global trade continues to be uncertain, export-dependent economies in the north – many of which will hold elections in the next two years – hang in the balance. These financial constraints will push Europe's economies to become more defensive over their interests, fighting tooth and nail either for the increase or prevention of EU burden-sharing.

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