

Priests and Sinners: The Euro Framing of the Covid Crisis

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Presentation prepared for COVID19 Crisis Response:

Perspectives from Social Science



Core argument

1. The core problem of the eurozone is economic polarisation:
 - The euro is growing apart because it has unequal and imbalanced growth models
 - This divergence will be exacerbated by the cost of paying for the Covid-19 crisis
 - The structure of unequal economies is framed as a morality tale
2. The intergovernmental method amplifies the morality tale:
 - Nationalist politics in the euro group is focused on domestic public opinion
 - This narrative pits the “prudent and responsible” north against the “spend thrift” south
 - The gives asymmetric bargaining power to those with more fiscal capacity (high priests)
3. The need for a common euro response is obvious:
 - But the only actor really capable of this is the ECB
 - The ECB is the only thing keeping the euro together.
 - This creates *reverse* moral hazard – it allows the high priests to keep pontificating rather than internalise the cost of the euro area growing more and more unequal.

1. Economic polarisation in the eurozone

- In the study of comparative and international political economy, it is widely accepted that the euro area contains qualitatively distinct regional varieties of capitalism and growth regimes:
 - Export-oriented growth models in the North
 - FDI-oriented growth models in Ireland and Eastern/Central Europe
 - Domestic-demand oriented growth models in the South
- These are stylised. All countries obviously have domestic and export-oriented sectors.
 - Small countries (and Germany) typically depend more on key export firms/sectors for growth
 - Typically, all countries have higher-growth cities (Barcelona, Milan, Paris, Amsterdam, Dublin)
- Southern European countries (France, Italy, Spain) have large internal domestic markets:
 - The vast majority of small and micro businesses are focused on this market.
 - These firms and businesses account for 90 percent of employment.
 - Domestic demand and high levels of consumption is key for growth.
- Germany imagines the eurozone as though it were a small open exporting economy.
 - For the high-priests, an economy built on domestic consumption is morally inferior.

The damning legacy of the euro crisis

- The different developmental trajectory of euro countries has led to institutionally distinct:
 - Labour markets and occupational structures
 - Higher educational and training regimes
 - Social insurance and social protection regimes
- The EU policy response to the euro crisis politicised these qualitative differences
 - The high priests commanded a *convergence* with a one-size-fits all fiscal regime.
 - The objective of this was to encourage *export-oriented* growth for all member-states
 - This was to be complemented with strict adherence to fiscal and economic governance rules
- To promote export-oriented *growth*, debtor/deficit countries were penanced with:
 - Implementing supply-side structural reforms
 - Fiscal austerity and labour market liberalisation
 - Weakened public sectors (health and education)
- Unsurprisingly, the recipe did not create the conditions for high-tech export growth:
 - The latter would take decades of public investment and a new state-led industrial policy.
 - It simply crippled their domestic demand and consumption oriented growth models

2. Moral tales in the eurozone

- Southern European countries entered the Covid-19 crisis with much less fiscal capacity.
 - The source of this problem is a decade of weak economic growth!
- From the high-priest perspective, the source of weak growth can be traced to the South not completing their penance, and not following the fiscal and economic governance rules.
 - They supposedly spent all their money on “booze and women”.
- In practice, the more these countries followed the fiscal rules, and tightened their belt, the more they undermined the political and institutional conditions for growth.
 - Italy, Spain, France have large internal markets, with huge intra-regional performance.
- Furthermore, the countries with the highest levels of household debt are in Scandinavia.
 - Italy has run a primary fiscal surplus for over twenty years!
- The effect of cultural narratives on euro area policies are not easy to test empirically.
 - They have become a cognitive short cut for explaining structurally different political economies.

The Church of the Euro Group....

- These narratives and myths initially framed the intergovernmental response to the crisis.
 - Deepening the distrust between countries and national electorates.
- The national-interest based politics of the euro group amplifies the morality tale
 - The euro group does not keep minutes and has no formal-legislative legitimacy
 - But it shapes and frames the policy debate for the European Council
- The intergovernmental nature of the euro group means that:
 - National politicians think about their party interests and national media/public opinion
 - Party interests are focused on maintaining their core domestic electoral constituencies
- The outcome is an asymmetry of bargaining power that favours stronger economies
 - But at what cost? Dutch behaving more like high-priests than merchants.
 - Ireland realised this – don't throw stones in glass houses (when others consider you a tax haven)

Moralising against your own interests

- Penancing your euro neighbours with more national debt and restricting their economic recovery is not in anybody's self interest.
 - It will deepen the economic divide between different regions of the euro.
- In order to reduce the *divergence* in economic performance between regions of the euro area , large demand-led countries need to be given the flexibility to invest in their own economic *growth* models and developmental paths.
 - This is why changing the EU state aid rules is welcome.
 - This is why changing the euro fiscal rules is welcome.
 - This is why creating the space for investment is welcome.
- But it begs a fundamental question – can diverse national/regional varieties of capitalism co-exist within the rules and constraints of the single currency?
 - At what point does strict adherence to traditional rules/norms risk bringing down the church?

3. The saviour of the ECB....

- The ECB response to the crisis has postponed this question.
 - The PEPP bond buying program has bought time.
 - It has made the ESM broadly irrelevant (for the moment).
 - It has made the cost of national borrowing more affordable (for the moment).
- But the political problem is whether the cost of recovery should be nationalised or Europeanised.
 - (A) Common debt instrument – *coronabonds*
 - (B) Common spending instrument – *EU perpetual debt*
 - There seems to be agreement on (B), but not whether member-states be issued *grants* (C) or *loans* (D) ?
- If the high-priests oppose (A) but accept (B) + (D), then the response will continue to be nationalised, albeit with EU level support. This will deepen the economic polarisation that already exists.
- As long as the ECB keeps the tap running, the high-priests can continue to pontificate.
 - They don't need to internalise the risk of a euro break up.
 - They don't need to internalise the cost of the euro area growing more and more unequal.

Conclusion

- It is not in anyone's interest to see the euro area grow more and more unequal.
- The reasons for the economic polarisation are far more complex than a morality tale.
- If member-states are serious about *convergence* they need to be able to invest equally.
- Those who have economically benefited the most from the euro (and have most to lose from losing it) have a political responsibility to explain this to their domestic electorate/media.
- This shift may be occurring within the CDU/SPD coalition in Germany.
 - Growing realisation that Germany will not be able to export its way out of the crisis.
 - Growing realisation that Matteo Salvini and *La Lega* in Italy are a far bigger threat to the future of the euro
- But for the moment, the only actor holding everything together is the ECB.

The end.

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