EUROPEAN COMMUNITY
STUDIES ASSOCIATION CANADA

POLICY MEMO

Frugal Four and the Fiscal Policy Regime of the EU. From austerity to mutual spending?

Kurt Hübner and Henrik Jacobsen
University of British Columbia

August 2020

Co-funded by the Erasmus+ Programme of the European Union

ECSA-C Research Group: Political Economy

Led by Kurt Hübner, Jean Monnet Chair for European Integration and Global Political Economy, Institute for European Studies, University of British Columbia

ECSAC EUROPEAN COMMUNITY STUDIES ASSOCIATION CANADA

POLICY MEMO

Frugal Four and the Fiscal Policy Regime of the EU. From austerity to mutual spending?

Kurt Hübner and Henrik Jacobsen
University of British Columbia

August 2020

ECSA-C Research Group: Political Economy
Led by Kurt Hübner, Jean Monnet Chair for European Integration and Global Political Economy, Institute for European Studies, University of British Columbia

Executive Summary

Twelve years after the global financial crisis and ten years after the start of the eurozone crisis, governments around the world again are in crisis-fighting mode. Covid-19 led to various levels of economic lockdowns, eventually resulting in historical reductions of economic output as well as large jumps in unemployment numbers. The OECD (June 2020) stated that the ensuing recession would cause damages as no other recession in the last 100 years. The Spring 2020 Forecast of the European Commission suggested that 2020 will see the most severe EU-wide recession in recent history, which will further widen and deepen the gaps between member states. Governments and central banks, as well as international organizations, quickly started to mobilize enormous financial resources to inject *liquidity* into economies. This will not be the end of state action. What is needed are ambitious recovery programs, probably running over a couple of years - depending on the shape of economic recovery. Following a joint political initiative by France and Germany, the Commission of the EU quickly proposed a Recovery Plan that foresaw a volume of overall Euro 750 bn to move member economies on a sustainable growth path. Rather than following the design of rescue packages of the Eurozone crises, France and Germany suggested grant-based programs. These plans immediately met political resistance in some European capitals, which only could be overcome in lengthy negotiations that resulted in a scaled-down version of the initial plan. Why the political opposition in a situation of profound misery? How to interpret the policy changes of the Commission and countries like Germany? And, will the outcome of negotiations avoid a policy turn towards austerity in the next round?

Background

As a general rule, the more coherent the mix of fiscal and monetary policy is, the better the chances to stabilize and then to lift the growth path of an economy. When it comes to the EU, and in particular to the Eurozone, this rule is not easy to apply as the economic policy tool kit of the Eurozone differs starkly from the tool kit of nation-state-based economies. The design of the common currency foresaw a unified monetary policy by the newly created European Central Bank that came with an emphasis to keep inflation down. Fiscal policy, on the other hand, stayed in the political realm of nation-states, governed by the Stability and Growth Pact and its various incarnations that set limits for public debts and budget deficits. Latest, the eurozone crisis demonstrated not only the potentially damaging character of the fiscal rules but also the incomplete character of the monetary union. The lack of a proper anti-cyclical fiscal policy and the restrictive mandate of the ECB brought the Eurozone close to the brink, as did the strict conditionality attached to the various rescue packages provided by the EU. It needed the threat of private financial markets that the ECB under the leadership of Mario Draghi changed course by unilaterally extending the mandate of the ECB. His 'whatever-it-takes'- approach communicated – successfully – to the financial markets that the ECB was willing to act as a lender of last resort, very much like central banks of other advanced economies. This policy turn gave political leaders urgently needed time to adjust the fiscal policy framework and to partially complete the monetary union by adding components like banking and capital unions. Progress is slow, though. Most critical, the member states of the EU were not willing to provide the Commission with debt instruments that would allow for some fiscal policy initiatives.

The Covid-19 pandemic brought new life into the debate. The joint initiative by France and Germany to introduce a grant-based Recovery Fund on the EU-level was nothing less than a massive step towards a collective debt instrument1 The EU-

1 This initiative came as a surprise as Germany's coalition government in the past was not willing to make use of its fiscal space. The change in policy stance marks a turnaround that may also reflect economic policy consideration in the German Finance Ministry, see https://www.ft.com/content/2503ce9c-cde9-4301-bba0-8301f7deaf3b?shareType=nongift.

Co-funded by the Erasmus+ Programme of the European Union

Commission picked up this initiative and proposed an ambitious recovery plan that would mobilize Euro 750 bn.2 This does not mean that the Commission out of sudden would reign fiscal policy. The plan was presented as a one-time step that would not intervene in the national prerogative of fiscal policy. Still, borrowing against the EU budget and asking for new taxation instruments would give the EU unseen fiscal policy power. The immediate protest of the 'frugal four' (Austria, Netherlands, Denmark and Sweden) indicated that this plan would not move forward smoothly. Other member states expressed early on concerns that the plan may undermine their position in the political fight about the design of the upcoming seven-year budget of the EU.3

The game of the past, where strict budget rules deliberately constrained national fiscal policy, and it is up to the ECB to save the day is no longer in the cards. The verdict of the Second Chamber of the German Federal Constitutional Court on the legality of the bond purchase program of the ECB from 2015 potentially opened a new battlefield where policy actions of the ECB may get restricted by national legal considerations of member states. This battle is on hold for the moment. The German Supreme Court decision, paradoxically, stressed that the stability exercise couldn't longer only be guaranteed by the ECB. One can assume that this verdict played a substantial background role during the Council negotiations in July 2020.

2 The actual amount of the policy proposal is not clear yet. The one extreme states: "Next Generation EU will raise money by temporarily lifting the maximum amount that the EU can request from Member States to cover its financial obligations to 2.0% of EU Gross National Income. This will allow the Commission to use its strong credit rating to borrow €750 billion on the financial markets. This additional funding will be repaid over a long period of time through future EU budgets –between 2028 and 2058. When adding Next Generation EU to the proposed size of the 2021-2027 MFF of €1.1 trillion, the total financial firepower of the EU budget reaches €1.85 trillion, equivalent to around 13% of EU GDP at 2019 levels (Maarten Verwey, Sven Langedijk, Robert Kuenzel 09 June 2020). Darvas (June 2020) argues that those figures actually inflate the size of the program as most parts will be distributed over some years. Also, it is not clear yet whether the underlying financing mechanism will be accepted by the member states.

3 The Financial Times reports that "Leaders from Austria, Sweden, the Netherlands, Belgium and Ireland demanded changes on Friday to the "allocation key" that will decide how €310bn of borrowed EU money is distributed to countries suffering the worst economic effects of the coronavirus crisis." https://www.ft.com/content/4a5255d7-b48a-42d9-a401-b638af4fd862?shareType=nongift. The current governor of the Bank of Finland and well-known neoliberal hawk Olli Rehn makes the case that the program must be governed by the European Semester and its conditionalities and supervision rules (https://www.ft.com/content/4fabc80f-b1e3-4dc0-9026-0978607fa62d?shareType=nongift).

Economic Divergence and Political Convergence

The political-economic constellation within the EU can be roughly sketched by looking at a few leading economic indicators. For this brief analysis, we focus on the growth rate of real GDP, the current account as share in GDP, public budget deficits and general government debt as share in GDP. Table 1 presents data for the EU-average, the average for the Eurozone, and then data for three groupings of member states. Group 1 consists of Germany and France as the two governments that favoured the most advanced version of a joint fiscal policy instrument. Group 2 depicts the 'frugal four' that oppose the Recovery Fund-initiative by proposing a solely credit-based plan with strict conditionalities. Group 3 are countries of 'the South,' i.e. member states that already suffered strongly from the previous eurozone crisis. Those three groups differ in many aspects.

The data are taken from the spring forecast of the Commission. It should be stressed that the projections seem to be overly optimistic and that the actual economic outcomes will be worse. Still, the data offer some insight. In 2020, group 2-economies – like all other economies - will suffer from sharp reductions of real GDP, but the projected reductions are not as high as in the case of EU-average. As a consequence, the 'frugal four' will run public budget deficits below EU-average.

Moreover, they have in common that they show far above the average current account shares in GDP. Germany and France, which make up group 1, differ in economic terms. We group them jointly due to their historical role as 'engine of European Integration.' Group 1 and group 2, both are net contributors to the EU budget. Group 2 stand out in their strong export-orientation, indicated by the above-the-average shares of the current account in GDP. Group 3 consists of economies that suffered most during the eurozone crisis, and they all -besides Portugal – experience considerable reductions in real GDP and thus enormous public deficits that add substantially to their debt shares in GDP. In particular, Italy and Spain suffered horrendously from the pandemic and thus showed severe adverse economic effects.

Co-funded by the Erasmus+ Programme of the European Union

	Real GDP (5year average 2011-2015)	Real GDP projection 2020	Current account (5year average; share on GDP)	Current account projection 2020	Budget deficit (5 year average)	Budget deficit 2020 projection	Public debt (5year average; share in GDP)	Public debt 2020 projection
EU average	1	-7.4	2.4	3.1	-3	-8.3	86.5	95.12
Eurozone average	0.8	-7.7	2.5	3.4	-3.1	-8.5	92.8	102.7
Germany	1.7	-6.5	7.2	6.1	0.1	-7	77.5	75.6
France	1	-8.2	-1.-	-0.1	-4.3	-9.9	92.5	116.5
Austria	1.1	-5.5	2.1	0.9	-2.1	-6.1	82.9	78.8
Denmark	1.3	-5.9	7.6	6.2	-1.4	-7.2	43.8	44.7
Netherlands	0.8	-6.8	9	9	-3.1	-6.3	65.6	62.1
Sweden	2.1	-6.1	4.3	3.7	-0.8	-5.6	40.9	42.6
Greece	-3.9	-9.7	-3.8	0.1	-8.3	-6.4	172.8	196.4
Spain	0	-9.4	0.6	3.2	-7.7	-10.1	90.4	115.6
Italy	-0.7	-9.5	0.3	3.4	-3	-11.1	129.9	158.9
Portugal	-0.8	-6.8	-1.2	-0.6	-6.2	-6.5	127.8	131.6

Group 3 is in urgent need of financial support as they would have to pay risk premia deftly on their national debt. At the same time, they need strong fiscal impulses to bring them back on a sustainable growth path. The 'frugal four' were not interested in hand-out grants to group 3 as they are in a position to overcome the Covid-19 crisis acceptably, and more so don't want to enter risk-sharing by moving towards a collective debt instrument. Instead, they favoured the provision of a fund that would hand out credits tied to strict conditionalities. After years of political stalemate, the German coalition government eventually signalled that it was willing to converge to the long-standing demands of President Macron. According to this plan, the Commission would borrow on markets. Still, instead of lending the money to national governments tied with conditionalities, it would spend the funds itself within the framework of a recovery plan. Such an instrument would lift some of the pressure on the national debt and keep risk premium on a lower level. This joint initiative has been wrapped into the plan suggested by the EU Commission.

Collective Debt Instruments and National Debates

It is without exaggeration that Covid-19 poses severe challenges for the EU and, in particular, for the Eurozone. The OECD, in its June 2020-forecast, suggests a drop of GDP for the Eurozone of -9.1 % in 2020, and of – 11.5% in case of a second Covid-19 wave. And this despite active national fiscal policy programs. In its most recent *Financial Stability Report*, the ECB referred to the medium-term problem of the rise in public debt, in particular in countries that already have high debt shares and suffer from enormous budget deficits. If those economies need to pile up more debt of their own, they risk punishments from financial markets, which quickly can turn into a next (and final?) eurozone crisis. The EU responded quickly to the immediate outbreak of the pandemic by relaxing state aid rules, and by activating the general escape clause in the Stability and Growth Pact. This first step was complemented by 'The Next Generation EU'-Plan that suggested to mobilize overall Euro 1.85 trillion. Not that this would be all new money. The total amount entails previously budgeted funds, and thus the newly mobilized amount of money is much smaller than the advertised sum. Still, the plan is courageous for three reasons. First, it suggests that a substantial part of the Euro 750 bn would be handed out as grants rather than as loans with political conditionalities. Second, the funding is supposed to come from private credit markets where the Commission wants to raise money against its long-term budget. Third, the Commission wants to get some – limited – taxation power either by eventually enacting the long-discussed financial transaction tax or by introducing a tax on digital business.

'Next Generation EU' can be seen as a timely step in the right direction, not least as it promises to breathe some confidence into European economies. The European Commission is now set to raise €750bn on capital markets, to be distributed through €390bn of grants to member states and €360bn of loans. The figures indicate the fights between member states. Not only was the suggested amount of 500 bn in the form of grants significantly reduced, but also the 'frugal four' accomplished the feast to win significant rebates. Austria's annual reduction will be doubled to €565m a year compared with previous proposals, while the Netherlands' rebate will jump from €1.57bn to €1.92bn. The rebates for Denmark and Sweden are smaller but still relevant compared to the initial budget plans of the Commission.

SURE / ESM Pandemic Crisis Support / EIB Guarantee Fund for Workers and Businesses	**€540 billion**
Next Generation EU	**Temporary reinforcement €750 billion**
Multiannual Financial Framework	**€1 100 billion**

'Next Generation EU' is a step forward and is changing the fiscal policy playing field fundamentally. And yet, it does not constitute a 'Hamilton Moment' that transforms the EU into a nation-state entity, as German Finance Minister Scholz initially suggested.[4] The 'Next Generation'-Plan comes with rather vague suggestions for generating 'own resources' which were already fought about in the past. Things are getting even messier when the plan will be put in action as it is not clear in detail for what kind of purposes grants and loans will be used on the national level.

4 See https://www.ft.com/content/2735a3f1-bc58-477c-9315-c98129d12852

Country analyses: Fiscal policies and political implications

This section presents four case studies on how EU-members have positioned themselves on the question of a common EU-recovery fund. It selects its four cases (The Netherlands, France, Italy and Germany) according to two considerations: Country preferences for joint fiscal tools ('frugal' vs 'bazooka') and degree of affectedness by the corona-pandemic (high vs moderate). Overall, countries that are relatively modestly affected by the virus tend to be more frugal than counties that are more severely affected. There are no cases of profoundly affected countries with frugal policy preferences.

The Netherlands

The Netherlands is a case of frugal policy preferences and moderate affectedness by the corona-crisis. Its budget deficit is expected to be far below the EU-average for the current fiscal year. However, The Netherlands have experienced some instability in their government, which suggests a domestic origin for Mark Rutte's frugal stance in the EU. After starting into his third cabinet with significant delays in coalition formation, Rutte lost the majority for his four-party coalition in October 2019 when a member of his party turned independent. With the next general elections scheduled for March 2021, he likely wanted to score with the domestic audience as a tough negotiator at the EU-level.

However, it appears Rutte's strategy may have backfired with him in the uncomfortable middle ground of being too frugal for many of his EU-colleagues and not frugal enough for his domestic supporters following the EU budget summit meeting in July 2020.[5] The next Dutch election will show whether the balancing act of Rutte was successful. At least he can argue that he achieved a further increase of the Dutch budget rebate and also hint to the clause that the dispersion of funds will be controlled for proper use. In this sense, the Dutch restrictive stance on fiscal policy builds on established institutional mechanisms from the Eurozone crisis, such as the ESM, which was "always intended to be a tough financial workout that forced as much structural adjustment for as little credit as possible".[6]

5 Eline Schaart, 'Mark Rutte: Too Frugal and Not Frugal Enough', POLITICO, 23 July 2020, https://www.politico.eu/article/the-mark-rutte-paradox-too-frugal-and-not-frugal-enough-mff-budget-europe/.

6 Adam Tooze, ''Corona Bonds' and Europe's North-South Divide', *Social Europe* (blog), 13 April 2020, https://www.socialeurope.eu/corona-bonds-and-europes-north-south-divide.

Co-funded by the Erasmus+ Programme of the European Union

Italy

Italy is representing a diametrically opposed view to the Netherlands, asking for more ambitious policy instruments than the ones from the last crisis. Italy faced a very severe COVID-outbreak early in the pandemic. It is a strange coincidence that EU-countries already at the centre of the Eurozone crisis (e.g. Spain, Italy) should be hard hit again by the pandemic, whose onset, at least, is subject to stochastic processes,[7] it is not subject to "legacy issues" and the corresponding moral hazard of mutual support.[8] Interestingly, the virus hit a region of Italy first (the North, particularly Lombardy) that is the most institutionally developed in the country.

The Corona-crisis is adding to an already existing stream of Euroscepticism in Italy, most commonly associated with the *Lega* under its leader and former Deputy Prime Minister Matteo Salvini. However, as a result of the pusillanimity in addressing the effects of the Corona-crisis in the EU's South collectively, new more centrist voices have joined the EU-skeptical voices, including Italy's President Sergio Mattarella.[9] This is in response to the EU as not being seen to develop a sufficiently tailored support scheme for different EU countries. The corona crisis-hit Italy merely half a year after the breakdown of the coalition between the Five Star Movement and the *Lega* as Salvini had speculated on new elections following his exit from the coalition. Instead, the Five Star Movement managed to broker a new coalition with the *Partito Democratico* to keep the independent Giuseppe Conte in office as Prime Minister. At the moment of writing, it is still unclear to what extent the corona crisis will have a lasting impact on party support in Italy and whether the incumbent government's crisis management can counterbalance increasing public support for the far-right *Lega*.

In Italy, Merkel's view of the Corona-crisis as a 'symmetrical shock' is taken as a cynical stab at solidarity – In contrast, the corona crisis may concern all EU countries, and their ability to respond to the crisis is shaped by the effects of earlier crises and available fiscal room for manoeuvre. In other words, asymmetrical shock interacts with asymmetrical economic and institutional conditions and can, therefore, lead to widely divergent outcomes.

France

France is a compelling intermediary case. It has been strongly affected by the corona-pandemic quite early on, with health facilities being completely overtaken in the East of the country. However, contrary to Italy, France had been in decently good shape in terms of the state budget and economic growth before the corona epidemic. Prior to the corona crisis, President Macron, who had run on a pro-EU platform, faced significant domestic criticism over his pro-market reforms (most importantly, the wave of *yellow vest* protests).

In this situation, the corona crisis can be seen as a mixed blessing for Macron: On the one hand, he faces significant opposition for his crisis management and the massive shutdown he imposed on the country (even though that may have been necessary, in the end). When it comes to financing the Covid-recovery package, French President Emmanuel Macron appears to have finally succeeded in pushing through his idea of collective debt against resistance from particularly Germany fearing a 'transfer-union' (now coming under the guises of 'Corona-bonds'). Moreover, given the severe impact of the corona crisis on France, the country can even be expected to benefit significantly from an EU-recovery package distributed according to the severity of the economic downturn. That would make France the only major receiver of funds from the recovery package that had not already figured prominently in the Eurozone crisis.

Germany

Germany's management of the corona crisis has received a lot of positive international attention (even though it may have been in the lucky position of a relatively late outbreak, with possibilities to learn from events in Italy and France). Germany entered the crisis with a balanced budget and several years of decent to sound economic growth.

The corona crisis resulted in a notable realignment of German policy priorities, which started with a domestic policy change: On March 13, German Finance Minister Olaf Scholz announced quasi limitless cash support for struggling German companies,

7 Olivier Hoslet, 'Europa in Der Coronakrise: Jeder Kämpft Für Sich Allein', Der Spiegel, 14 April 2020, https://www.spiegel.de/consent-a-?targetUrl=https%3A%2F%2Fwww.spiegel.de%2Fwirtschaft%2Feuropa-in-der-corona-krise-jeder-kaempft-fuer-sich-allein-a-00000000-0002-0001-0000-000170435647&ref=https%3A%2F%2Fwww.google.com%2F.

8 Jacob Funk Kirkegaard, 'Europe Is at Last Channeling Alexander Hamilton', PIIE, 23 March 2020, https://www.piie.com/blogs/realtime-economic-issues-watch/europe-last-channeling-alexander-hamilton.

9 Miles Johnson, Sam Fleming, and Guy Chazan, 'Coronovirus: Is Europe Losing Italy?', *Financial Times*, 16 May 2020; Wolfgang Münchau, 'Italy Is in More Danger than the Eurozone Will Acknowledge', Financial Times, 19 April 2020, https://www.ft.com/content/8e03cf2e-80bd-11ea-8fdb-7ec06edeef84.

Co-funded by the Erasmus+ Programme of the European Union

breaking the German principle of 'balanced budget' the federal government had pursued for several years. He described this stance as a big 'bazooka'. This domestic policy change was followed by a change in stance on EU policy when Chancellor Merkel and French President Macron jointly put forward an EU-wide recovery proposal on May 20th, 2020. This suggestion envisioned common EU-borrowing to finance grants to countries particularly hard-hit by the Covid-19 crisis. This is a policy reversal compared to Merkel's position ever since the Eurozone crisis of limiting a 'transfer-union' between a frugal North and a spending-spree South in the EU.

Formation of policy camps: Fiscal frugality vs fiscal bazooka

The various micro-dynamics described in the previous section coalesce into a major fault line at the EU-level between 'frugal' and 'bazooka'. A recurring discussion since the Eurocrisis has been whether financial assistance for struggling EU-members should be tied to some conditions such as economic and fiscal policy reforms.[10] This debate came to the fore again during Covid-19 with the mid-June discussions about an EU-wide financial package to assist Italy and Spain in particular and the ensuing debate about the relative proportion of subsidies and credits in this package. The policy change and subsequent realignment of Germany in the fiscal policy camps created a new dimension of organized frugality by other EU states, most notable the 'frugal four' (Austria, Denmark, The Netherlands, and Sweden), which suddenly saw themselves faced with an historically unprecedented 'bazooka-alignment' between Germany, France, and Southern European states such as Spain and Italy.

The coalition of the 'frugal four' as the other side of the emerging fault line thus initially formed as a coherent group of countries against the Franco-German recovery proposal. As stated above, members of this frugal coalition are in the comfortable position of likely running budget deficits far below the EU-average in the current fiscal year. They put two aspects of the Franco-German proposal up for contention: (1) The relative balance of subsidies ('free money') and credits in the recovery package; and (2) the question to what extent help from the fund should be linked to structural reforms.[11]

Studying the agency of the frugal four raises the question if and how domestic conflicts can influence the course of European integration.[12] Interestingly, party ideology seems to play only a minor role for explaining political attitudes towards a common fiscal policy. The common denominator of national constellations is that in all cases, we find coalition governments. Austria is governed by the conservative Austrian People's Party (ÖVP) and the Green Party; Sweden is run by a coalition government of Social Democrats and the Green Party; the Netherlands has a broad-based coalition government of coalition government of the People's Party for Freedom and Democracy (VVD), Christian Democratic Appeal (CDA), Democrats 66 (D66) and Christian Union (CU); and Germany is governed by a coalition of CDU/CSU and SPD. The composition of those coalition governments is not helpful, though, in explaining policy choices. Various party coalitions come out with similar preferences, independent of their positioning in the traditional left-right continuum.

These countries show some support for the hypothesis that fragmented party systems tend to cater to fiscal fringe positions. Rutte's four-party coalition, for example, lost its majority in the Dutch parliament, and Eurosceptic parties made clear that they are not willing to support the plan of the Commission. This rejection seems to reflect the sentiment of voters. A recent poll for Dutch newspaper Volkskrant from I & O Research found that 61 percent of Dutch voters did not support the EU recovery plan.[13] Accordingly, the Netherlands acted in the Council negotiations in the strictest of all manners. Austria, on the other hand, was a supportive partner despite the fact that its stable two-party coalition was not dependent on support from other parties. Nevertheless, Chancellor Kurz demonstrated a strict 'frugal' attitude when it came to fiscal policy action on the European level.

Fiscal frugality thus seems to be a cross-party attitude that reflects deeply entrenched views about public debt and deficits. That states should not live beyond their means has been a sentiment which played out forcefully during the Eurozone

10 Frankfurter Allgemeine, 'Gespräch mit der EU: Italien verspricht Reformen', *FAZ.NET*, 14 June 2020, https://www.faz.net/1.6814235.

11 Maïa de la Baume, David M. Herszenhorn, and Hans von der Burchard, 'Franco-German Recovery Deal Meets Resistance', POLITICO, 19 May 2020, https://www.politico.eu/article/franco-german-recovery-deal-meets-resistance/.

12 Swen Hutter and Hanspeter Kriesi, 'Politicizing Europe in Times of Crisis', *Journal of European Public Policy* 26, no. 7 (3 July 2019): 996–1017, https://doi.org/10.1080/13501763.2019.1619801

13 Mehreen Khan, ''Frugal four' chief Mark Rutte leads opposition to EU recovery plan', Financial Times, June 17, 2020, https://www.ft.com/content/8e30fd89-4958-491e-9f30-8c0b5f8b4cef.

Co-funded by the Erasmus+ Programme of the European Union

crisis, where Germany and also the Netherlands and Austria were critical forces to move the EU on a strict austerity path. The German coalition government, though, changed its attitude fundamentally and now represents jointly with France the fiscal policy avantgarde in the EU.

The policy stance of the 'frugal four' has been softened slightly when the sheer size and depth of the economic lockdown effects became more and more visible. Still, rather than supporting the fiscal policy plan of the Commission, the *frugal four* continued to insist that any EU rescue package must be in line with established rules:

"We fully support the creation of a time-limited emergency recovery fund. We want it to target those that have been hit hardest by the Covid-19 crisis. We believe that when we borrow money together in the EU, the fundamentally sound way to use that money is to convert it into loans for those who need them, on the best possible terms."[14]

However, apart from the 'frugal-vs-bazooka' fault line, there is a separate dimension underlying fiscal policy camp formation in the EU, which is the ensuing discussion about the next 7-year budget of the EU, which coincides with the Covid-recovery-programme under development this summer. Therefore, concerns about weakened bargaining positions in the upcoming EU-budget are likely to drive some EU states in their position on Covid-recovery measures. Indeed, in addition to the frugal four, there have been some reserved voices from East European leaders concerning a common EU-recovery fund (traditionally major receivers of EU funds), potentially fearing a redistribution of EU-grants away from them towards Southern Europe. On the other hand, there are new tendencies in such Eastern European countries as Hungary to concentrate power in single political leader, which might open up new discussions about the EU's democracy criteria.[15]

Conclusion: National Interests and European Public Policy

In summary, in this brief, we traced the formation of a significant new fault line among EU-members concerning the question of post-Covid economic recovery. We described the formation of 'frugal' and 'bazooka' policy camps. This fault line is a major departure from previous policy coalitions dating back to the Eurozone crisis, which roughly boiled down to a spending-spree South vs an austere North. This shift in coalition dynamics is driven by Germany's realignment to the French position. Moreover, we have also pointed out that other various 'orthodox' explanations of these new fault lines, particularly those based on party ideology, do not really give us an explanatory handle on why these specific policy camps have formed. So, is this still EU politics 'as we know it' or will we need new post-viral ways for understanding European politics? To conclude, we briefly speculate on how three existing approaches in the study of European integration could still be useful for making sense of European politics in the corona-era.

First of all, there is the role, identity could play.[16] For instance, in an interview with the German weekly 'Der Spiegel,' Austria's Chancellor Kurtz posed the rhetorical question why an Austrian coiffeur should pay with her taxes for rescuing European economies.[17] The message is obvious: politics has to play to the national crowd. The more voter preferences are tilted towards narrowly defined national interests, the less the political will to engage in collective public policy on the EU-level. And yet, more than sixty years after the start of European Integration and contrary to the expectations of a harmonious coexistence of national and European identities,[18] differences in identity orientation appear to be driving the major fault lines of the corona crisis in the EU.

Second, there are long-standing discussions about whether the EU possesses effective problem-solving abilities.[19] Does the EU have the right institutional architecture to respond timely and adequately to the corona-crisis? For instance, ESM Director Klaus Regling fears that it could take years to set-

14 Stefan Lofvsen: *The writer is prime minister of Sweden. Prime Ministers Mette Frederiksen of Denmark and Mark Rutte of the Netherlands and Chancellor Sebastian Kurz of Austria co-wrote this article.* https://www.ft.com/content/7c47fa9d-6d54-4bde-a1da-2c407a52e471?shareType=nongift

15 Valerie Hopkins, 'Orban Handed Power to Rule by Decree in Hungary', Financial Times, 30 March 2020, https://www.ft.com/content/4dc85972-e917-4c8d-9db1-8e72400b9e8a.

16 Sean Carey, 'Undivided Loyalties: Is National Identity an Obstacle to European Integration?', *European Union Politics*, 29 June 2016, https://doi.org/10.1177/1465116502003004001.

17 Der Spiegel, 24/2020

18 Thomas Risse, 'Neofunctionalism, European Identity, and the Puzzles of European Integration', *Journal of European Public Policy* 12, no. 2 (1 April 2005): 291–309, https://doi.org/10.1080/13501760500044033.

19 Fritz Scharpf, *Governing in Europe: Effective and Democratic?, Governing in Europe: Effective and Democratic?* (Oxford: Oxford University Press, 1999).

up an appropriate Covid-recovery programme,[20] leading others to suggest that the countries supporting Corona-Bonds should just go ahead on their own as a 'coalition-of-the-willing'.[21] Moreover, while we found that the dominant EU fault line breaks down into 'frugal-vs-bazooka' approaches, we should pause a moment to wonder why there is little more variation within these camps. However, different ways of financing a recovery package will come with very differing implications for which socio-economic groups will bear the main burden for the ensuing debt. For instance, there appears to be an unstated consensus among policy-makers on using debt-driven instruments rather than issuing new financial levies,[22] as for instance suggested by Daniel Gros[23] with his 'financial solidarity levy' on financial assets, a wealth tax on individuals,[24] exemptions from the EU budget,[25] or an oil tax capitalising on the current historical low of world oil prices.[26] Consistent with this view, in this paper, we have identified a lack of common fiscal policy tools to address the ensuing post-Covid economic crisis and a lack of willingness (and ability) to act jointly. EU provisions for concerted action and common responsibilities during the corona crisis are generally weak. Despite the historically promising outcomes of Franco-German initiatives in driving forward European integration, it is unclear how far these proposals will go as Bazooka-type policy instruments such as joint borrowing, by contrast, will eventually have to be integrated with control over spending and revenues, making a reform of EU oversight structures necessary.[27]

Finally, there is the question how policy issues are framed and what this implies for political conflict formation.[28] For instance, one may wonder why the debate about economic support for struggling economies in Southern Europe is too frequently framed in terms of solidarity or charity rather than important risk management measures for the entire EU.[29] We suggest that the frugal four tend to neglect the latter and are only hesitantlyb willing to provide means out of solidarity.

There seems therefore enough reason to think that, despite significant political realignments, the corona-crisis will not completely invalidate what we know about EU politics. However, an ordinary return to 'the EU as we know it' seems unlikely as well: While governments will most probably not accumulate uncontrollable public debts as a result of Covid-measures,[30] the standpoints of the frugal four does raise a broader issue, which is the question to what extent the fight against Covid-19 itself and the following economic recovery could exhaust the financial and economic resources in some EU-countries so strongly that investments in other future projects will become prohibitively expensive. Some need to reallocate priorities to adjust to new fiscal realities seems very likely. Time and further economic developments will show whether the frugal four will experience a revival as a further increase of public debt may encourage to return to fiscal austerity measures, nationally as well as on the level of the EU. Indeed, there is for instance the question to what extent the von der Leyen Commission will be able to follow through on its green policy agenda. This emphasises the question to what extent it may be possible to build environmental reforms into a post-Covid recovery package. This kind of more comprehensive thinking about the direction of a recovery programme has been lacking in the current policy debate so far.[31] On the other hand,

20 Johanna Geron, 'New Euro Zone "corona Bonds" Body Could Take Years to Set up - Bailout Fund', *Reuter*s, 31 March 2020, https://uk.reuters.com/article/uk-health-coronavirus-eurozone-bonds-idUKKBN21I1NI.

21 Wolfgang Münchau, 'Go-It-Alone Eurozone "Coronabonds" Are Worth the Risk', Financial Times, 29 March 2020, https://www.ft.com/content/d28914c0-7036-11ea-9bca-bf503995cd6f.

22 Arnaud Boot et al., 'Corona and Financial Stability 2.0: Act Jointly Now, but Also Think about Tomorrow', SAFE Policy Letter (Leibniz Institute for Financial Research, March 2020).

23 A Corona Financial Solidarity Levy', *VoxEU.Org* (blog), 22 April 2020, https://voxeu.org/article/corona-financial-solidarity-levy.

24 Camille Landais, Emmanuel Saez, and Gabriel Zucman, 'A Progressive European Wealth Tax to Fund the European COVID Response', *VoxEU.Org* (blog), 3 April 2020, https://voxeu.org/article/progressive-european-wealth-tax-fund-european-covid-response.

25 Daniel Gros, 'EU Solidarity in Exceptional Times: Corona Transfers Instead of Coronabonds', *VoxEU.Org* (blog), 5 April 2020, https://voxeu.org/article/corona-transfers-instead-coronabonds.

26 Jacob Funk Kirkegaard, 'Europe Should Seize Oil Price Windfall to Fund Its Pandemic Response', PIIE, 2 April 2020, https://www.piie.com/blogs/realtime-economic-issues-watch/europe-should-seize-oil-price-windfall-fund-its-pandemic.

27 Guntram B. Wolff, 'EU Debt as Insurance against Catastrophic Events in the Euro Area: The Key Questions and Some Answers | Bruegel', 22 April 2020, https://www.bruegel.org/2020/04/eu-debt-as-insurance-against-catastrophic-events-in-the-euro-area-the-key-questions-and-some-answers/.

28 Falk Daviter, 'Policy Framing in the European Union', *Journal of European Public Policy* 14, no. 4 (1 June 2007): 654–66, https://doi.org/10.1080/13501760701314474.

29 Münchau, 'Italy Is in More Danger than the Eurozone Will Acknowledge'.

30 Gayn Davies, 'Can the World Afford Fiscal and Monetary Stimulus on This Scale?', 31 March 2020, https://www.fulcrumasset.com/blog/blog/can-the-world-economy-afford-this-scale-of-fiscal-and-monetary-stimulus/; Stephanie Kelton and Edward Chancellor, 'Can Governments Afford the Debts They Are Piling up to Stabilise Economies?', The Financial Times, 4 May 2020, https://www.ft.com/content/53cb3f6a-895d-11ea-a109-483c62d17528.

31 Agnès Bénassy-Quéré et al., 'Repair and Reconstruct: A Recovery Initiative',

these kinds of comprehensive projections are difficult to make as uncertainty about which policy measures to take is corroborated by the inherent uncertainty in economic projections in a major economic crisis.[32]

Authors

Kurt Hübner holds the Jean Monnet Chair for European Integration and Global Political Economy at the Institute for European Studies, University of British Columbia. His research includes global and European currency regimes, international regimes of foreign direct investment, and the relations between innovation and sustainability. His latest research focuses on the economic and socio-political foundations of technical innovations in a transatlantic perspective, and the ongoing processes of currency competition and currency cooperation (Euro-Dollar-Renminbi). Currently, Dr. Hübner is directing a project on EU-Canada as Global Economic Policy Actor, and recently he was part of a consortium on EU-North America-Asia relations. His most recent book publication deals with 'Europe, Canada and the Comprehensive Economic and Trade Agreement (Routldege).

Henrik Jacobsen is a PhD Student in the Department of Political Science at the University of British Columbia (Vancouver). He is holding an MPhil in Politics from the University of Oxford and a BA in International Politics & History from Jacobs University (Bremen, Germany). He is specialising in the study of executive government and urban politics.

VoxEU.Org (blog), 20 April 2020, https://voxeu.org/article/repair-and-reconstruct-recovery-initiative.

32 Gayn Davies, 'Can the World Afford Fiscal and Monetary Stimulus on This Scale?', 31 March 2020, https://www.fulcrumasset.com/blog/blog/can-the-world-economy-afford-this-scale-of-fiscal-and-monetary-stimulus/; Stephanie Kelton and Edward Chancellor, 'Can Governments Afford the Debts They Are Piling up to Stabilise Economies?', The Financial Times, 4 May 2020, https://www.ft.com/content/53cb3f6a-895d-11ea-a109-483c62d17528.

Co-funded by the Erasmus+ Programme of the European Union

The European Commission support for the production of this publication does not constitute an endorsement of the contents which reflects the views only of the authors, and the Commission cannot be held responsible for any use which may be made of the information contained therein.