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New challenges for Eurozone Governance: Are there joint solutions for common threats?

Editors: José Caetano, Isabel vieira e António Caleiro

Chapter Proposal

Europe at the crossroad of the Covid-19 crisis: integrated macroeconomic policy solutions for an asymmetric area

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Abstract

The economic crisis triggered by the COVID–19 pandemics raised once again doubts about the eurozone's ability to deal with common serious economic problems. The effects of the 2008 – 2009's economic and financial crisis have not been completely exhausted, and a new crisis of yet unknown proportions emerged, bringing with it the traditional divergences between a common and integrated approach to problems and a country-based approach conditioned by Euro Area restrictive and asymmetric macroeconomic rules.

This chapter aims at contributing to a paradigm shift in the governance of the eurozone towards a less dominant tendency for ruling according to the interests of the most powerful economies, namely Germany, and to a more comprehensive and integrated approach of the eurozone dissimilar dynamics and asymmetries, including the case of small economies like Portugal.

Two dimensions of this need for a new paradigm of eurozone governance are considered. Firstly, the need for a change in the economic policy concerning the crisis recovery, from a supply-push to a demand-pull orientation, supported on a fiscal and monetary policy mix, integrated in a comphrensive macroeconomic approacch. It is important to recognize the role of the ECB since the 2008 – 2009's crisis and in the current context but also the need for a more active intervention of fiscal policy, both converging towards a growth-oriented policy. Secondly, the need for a shift in external relations towards a more global integration-oriented policy, with the Eurozone positioning itself as an alternative to the current polarization between the United States and China.

Our conclusions point to the need to i) give priority to growth and employment; ii) promote long-term economic sustainability based on integrated macroeconomic policies, the reduction of income concentration and the reconstitution of strong middle classes; iii) reorientate international relations into a perspective of cooperation; iv) reinforce regulation and global governance; and v) eliminate exceptional situations, such as offshores, tax havens and other forms of economic controls escape.

Keywords: European Union, Euro, Economic Crisis, COVID-19
JEL: C65, F4, F5, H63.

1. INTRODUCTION

Forecasts published by national and international institutions at the end of the first semester of 2020 confirm what was anticipated: the Covid-19 economic crisis will cause deep falls in output and employment, fueled by the joint contraction of consumption, investment and international trade, with consequent effects on public deficits and debts. The European Commission (EC) reviewed down the Spring numbers, pointing to a GDP decline between 8.3% and 8.7% and inflation between 0.6% and 0.3% for the European Union (EU) and the Euro Area (EA), respectively. The forecasts also show a wider divergence, with countries like Italy, Spain, France and Portugal facing drop downs between 10 and 11%, while Finland, Netherlands, Germany, Luxemburg and Malta, staying between 6% and 6.8% (See, EC, 2020). However, it is too early to draw definitive conclusions. These effects will tend to extend over time, depending on the evolution of the disease itself, and on how the confidence of consumers, investors and other economic agents will recover. And, notably, on the economic policy measures that are to be adopted, at both international and national levels.
As the economic downturn deepened, the comparison with the 2008-2009 global economic and financial crisis generalized, with a consensus around the idea that the consequences will be much deeper, despite economic projections of institutions as the IMF, the European Central Bank (ECB) or the European Commission, opening up to the possibility of a quick recovery, already in 2021 – the V-recovery. The impacts can go far beyond these forecasts if no radical measures are adopted. At the end of 2019, with no signs of what the pandemic would become, economic forecasts for 2020 pointed to a significant reduction of the international economic dynamics. Comparisons with the previous crisis may not be enough to be fully aware of what is at stake.
It is also too early to detect how the pandemic will affect the role and ability of international institutions. In this area too, the signs are contradictory. On the one hand, it is evident the enormous role that international institutions can play on the management of this global crisis dynamics. But, on the other hand, there is also a temptation for unilateral, bilateral or *ad hoc* groups interventions, with opposite goals, diminishing the ability and legitimacy of these institutions to intervene.
What is happening in Europe is also far from what would be expected. The ECB's timely and focused intervention continues to work. But the European Council and even the European Commission have been slow and shallow to react.
This essay discusses the current economic crisis triggered by Covid-19, trying to capture similarities and specificities with previous crises, particularly with the 2008-2009 crisis. It seeks to highlight the factors that, originating in this crisis projected its influence until the present and are negatively conditioning the ability to manage the recovery process,

undermining the very role and *raison d'être* of European institutions. Finally, it discusses the need for a change of the macroeconomic policy references, both at fiscal and monetary levels, incorporating the experience of the last decade, particularly the one resulting from the ECB unconventional monetary policy.
Section 2 discusses global economic trends that were triggered by the 1970s crisis and originated qualitative changes on the global economic dynamics. Section 3 focuses on the European economy aiming to capture the process of real convergence and changes in the income distribution between countries. The challenges to European governance posed by the Covid-19 crisis are discussed in section 4. Section 5 focuses the discussion on the need for monetary policy reform, as decided recently by the ECB. Finally, section 6 concludes.

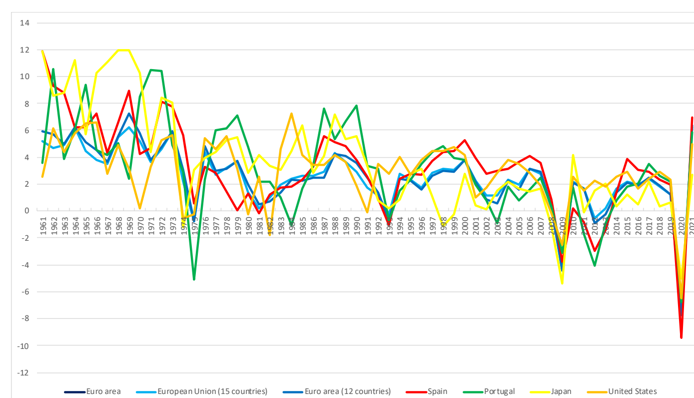
2. COVID – 19 CRISIS: EXOGENOUS SHOCK VERSUS CYCLICAL CRISIS

We could ask ourselves if it makes sense to compare the economic crisis triggered by the Covid – 19 with the economic and financial crisis, triggered by the American subprime crisis. The answer is positive, not in the sense that the current crisis can be considered as a mechanical expression of the world economy dynamics, as some forecasts at the end of 2019 pointed out, but in the sense that how it develops today, and the recovery may occur, is intrinsically linked to the response that was given to the previous crisis and to how the world economy has developed from then until today.

2.1. The cyclical dynamics of the post-1973-1975 crisis

The two crises can be inserted in a new dynamic of the world economy, triggered by the oil crisis of the early 1970s, which interrupted the cycle of continuous economic growth that lasted since the end of World War II. At the time, the cyclical sequence of crisis and recession that characterized the world economy before the Second World War, and whose paradigmatic expression was the crisis of 1929, was thought to be over.

Fig. 2.1: Real GDP, Annual Growth Rates, 1961 – 2019
(2020 e 2021: projections)

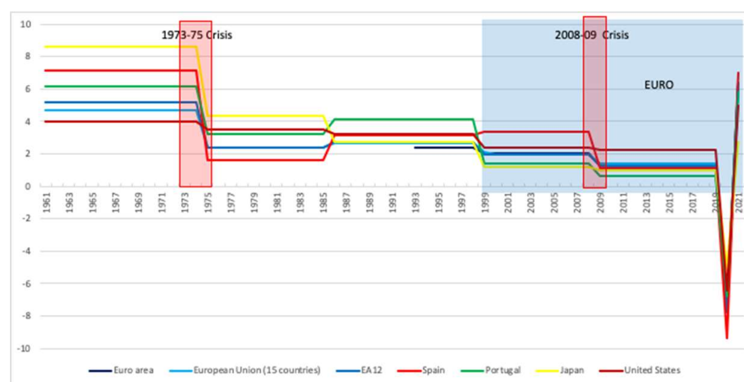


Source: AMECO, June 2020

After the 1970s, the business cycle reemerged, as can be attested by the successive crises of the early 1980s, the early 1990s, the beginning of the new millennium, in 2008/2009, and finally in 2020, with a regularity that can be quantified between 8 and 11 years (Figure 2.1).

Since the end of 2018 the European and world economies were showing signs of deceleration, forcing central banks, and the ECB in particular, to strengthen their countercyclical monetary policies as if the world economy was just waiting for a new crisis. In the 2008-2009 crisis, the American subprime crisis was the trigger and contagion resulted from free capital movements, that spread the crisis like an oil slick across the world economy through the global financial system. In the 2020 crisis, the detonating element was Covid-19 and contagion took place through the free movement of people, which spread the elements of contamination affecting the economic system. Two types of freedoms that are at the origin and characterize the current global economy.

Fig. 2.2: Real GDP Average Growth Rates
Periods: 1961-1974; 1975-1985; 1986-1998; 1999-2008; 2009-2021.
2020 and 2021 (Forecasts)



Source: AMECO, June 2020

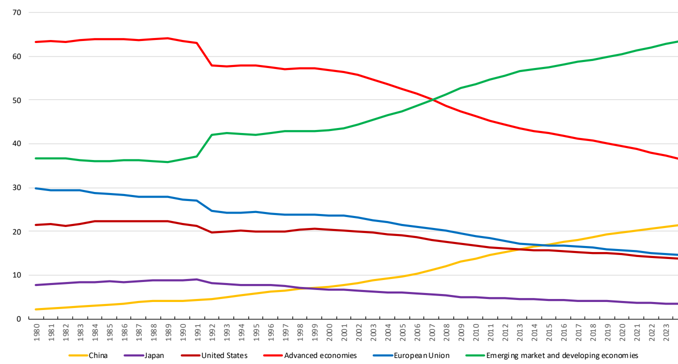
It is worth noting the average growth rates by periods (Figure 2.2), taking as reference important events in the process of European integration and the evolution of the world economy: the 1974-1975 crisis; the Single European Act in 1986; the creation of the euro in 1999; the 2008-2009 crisis.

It is evident how the 1970s crisis represents a decisive turning point. From then on, all major economies suffered an intense reduction of their dynamism, that tended to be accentuated in each subsequent period, and that in Europe was particularly evident following the creation of the euro. The performance of the American economy is noteworthy. The less dynamic economy at the time, with growth rates of about 4% between 1961-1974, demonstrated high resilience, managing to maintain growth rates above those of the Euro Area in the successive periods up to the current crisis. It is also impressive the loss of dynamism of Japan, accentuated at the turn of the 1980s to the 1990s, being currently one of the economies with lowest growth rates. Figure 2.2 also shows the loss of dynamism of the Portuguese economy, despite the relatively good performance from 1986, the period from the entry into the European Communities, until the creation of the euro. Unlike its neighbour Spain, which reveals a remarkable capacity for adaptation. From the 2008-2009 crisis, the retraction is widespread, with the greater resilience of the American economy.

The collective performance of the most developed economies had important consequences for the global economy. If the 2008-2009 economic and financial crisis interrupted a process of globalization pushed since the 1980s by financial leverage at an unknown scale, hegemonized by the United States and fueled by the dynamics of the so-called twin deficits (internal and external), the Covid-19 crisis interrupts a process whose hegemonies are

difficult to characterize, but in which there was evidence of a growing affirmation of the Chinese economy.

Fig. 2.3: Share of world GDP (PPP)



Source: IMF, WEO Database, 2019

The stability of the shares of advanced, emerging and developing economies in the world GDP, measured in PPP, begins a sustained reversion process during the early 1990s crisis, which is accentuated by the crisis of the early 2000s and undergoes a reversal following the 2008-2009 crisis (see Figure 2.3). Three qualitative features arise from this trend: a greater relative loss of the European Union countries, when compared to the United States; a marked emergence of China, accelerated by the 2008-2009 crisis; and the persistent loss of Japan. Alongside, there was a retraction of the initiatives to organize the western matrix globalization, such as the Transatlantic Trade and Investment Partnership Agreement (TTIP), or the Trans-Pacific Partnership Agreement (TPP), and an expansion of initiatives carried out by China, such as the "Belt and Road Initiative".
To what extent the Covid-19 crisis may deepen the broader crisis of the globalization model that emerged in the aftermath of the 2008-2009 crisis, is still an open question, whose answer will depend on how it will affect the system of international relations and how the economic and political leaders will respond to the problems of the international institutions that should govern the global economy.

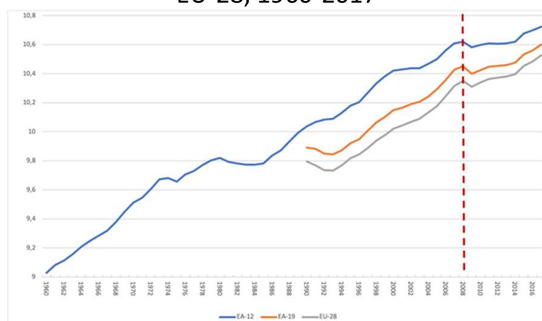
3. THE PARTICULAR DYNAMICS OF THE EUROPEAN UNION INTEGRATION: A DISTRESSED AND DIVERGENT PROCESS

This section deals with the European integration process, discussing its effects on the convergence of GDP per capita and income distribution across countries, and the asymmetry that exists in the current account balances between Euro Area member states. These effects are verified at a global level, but its European features can be seen as a consequence of the economic and political options from the last decades, including the architecture of the euro system.

3.1. Real convergence and inequality

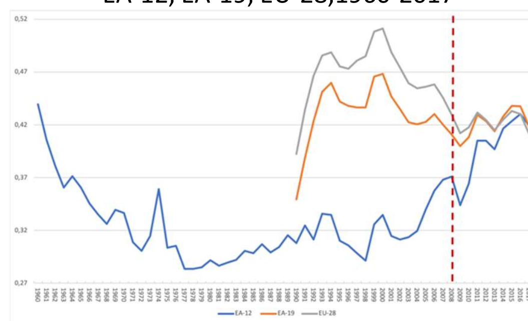
Figure 3.1 displays the dynamics of the average logarithm of GDP per capita between 1960 and 2017 using Penn World Tables (PWT) data,[1] version 9.1, and distinguishing the founders of the euro, the Euro Area, and the European Union. Even if Greece is not a founding member, having entered on January 1, 2001, it is included in the first group (EA-12). Given the nonexistence of data, the larger groups of the 19 Euro Area (EA-19) and 28 European Union (EU-28) member states are represented from 1990 onwards.

Fig. 3.1: Average GDP per capita, EA-12, EA-19, EU-28, 1960-2017



Source: authors' calculations using Penn World Tables 9.1 data

Fig. 3.2. Sigma-convergence, GDP per capita, EA-12, EA-19, EU-28,1960-2017



Source: authors' calculations using Penn World Tables 9.1 data

The figure shows GDP per capita increasing on average for the EU-28, although with periods of marked deceleration, occurring immediately after major crises, as the beginnings of the 1970s or the 1980s. The EA-12 countries faced a significant halt and even a slight drop in average GDP per capita following the 2008-2009 crisis, in comparison to the average growth rate of either EU-28 or the EA-19 members, suggesting different convergence speeds within the EU. Figure 3.2 presents the coefficient of variation for the three groups confirming that after the 1970s crisis EA-12 countries ceased convergence, to regain it in the second half of the 1990s. The introduction of the euro caused divergence between their incomes per capita that was intensified with the 2008-2009 crisis. Between either EA-19 or EU-28 countries real convergence was a fact from the early 2000s, which most likely indicates the catching-up of lower-income countries from Central and Eastern Europe to the EU. That process was interrupted by the 2008-2009 crisis.

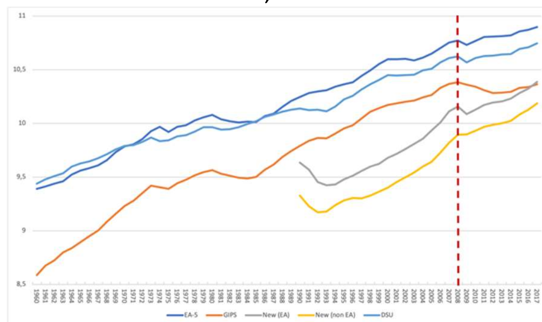
Crises episodes affect countries differently given their idiosyncrasies. By identifying homogeneous groups within the EU it is possible to deepen the analysis of real convergence and how it was affected by crises. There were selected five EU groups. A first group abridges five of the founders of the European Union (EA-5), that can be identified as the EMU core. Italy is not incorporated given this country sovereign debt sustainability issues after the 2008-2009 crisis. The second group corresponds to Greece, Italy, Portugal and Spain (GIPS) that share in common their recent sovereign debt performance and having been forced to adopt contractionary policy measures. Ireland is not integrated into this group given its exceptional

[1] The preference for the PWT dataset is justified based on the need to establish comparisons between economies that have their economic activity expressed in different national currencies. The data used in this analysis correspond to the logarithm of the expenditure-side real GDP at chained purchasing power parities and measured in millions of 2011US$, divided by the total population.

and divergent performance in recent years. The new EU members that have been integrating the EMU from 2007 to 2015 (Cyprus, Estonia, Latvia, Lithuania, Malta, Slovakia, and Slovenia), form the fourth group (new EA). The new entrants that have not adopted the euro (new non-EA) corresponding to Bulgaria, Croatia, Czech Republic, Hungary, Poland, and Romania form the fourth group. These two groups represent the lower-income countries of the EU and have been benefiting from EU-funds to promote their long-term sustainable growth, however, the first set has gone through an additional convergence effort to adopt the euro. Finally, Denmark, Sweden, and the UK (DSU) represent old members of the EU with high-income levels and that have opted to keep their national monetary independence.

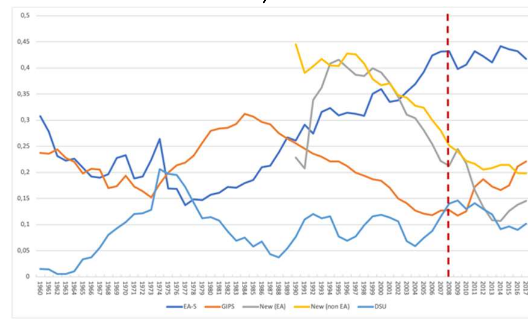
Figure 3.3. confirms average GDP per capita differing between EU groups. If the euro core, followed close by the three monetary independent countries, keep the income per capita lead, the GIPS countries assume an intermediate position, but following 2014 are overtaken by the new entrants in the EMU. The new entrants that are not in EMU occupy the bottom of the income distribution in the region. The GIPS caught up with the core, narrowing their GDP per capita gap, in different stages up to the 2000s. The introduction of the common currency slowed-down this process and culminated into a divergence path triggered by the 2008 financial crisis and the consequent sovereign debt crisis. On their turn, the Eastern European countries also suffered from the 2008 financial distress but recovered their convergence path, displaying a steep increase in their average GDP per capita in the aftermath of the crisis.

Fig. 3.3. Average GDP per capita by groups of countries, 1960-2017



Source: authors' calculations using Penn World Tables 9.1 data

Fig. 3.4. Sigma-convergence by groups of countries, 1960-2017



Source: authors' calculations using Penn World Tables 9.1 data

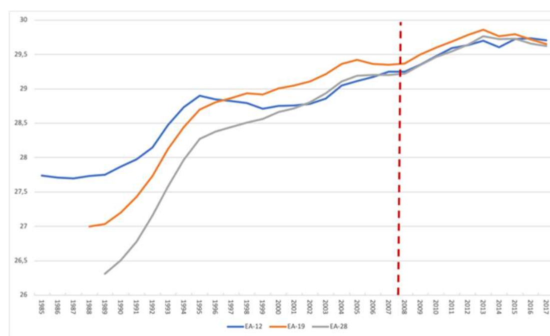
Sigma-convergence dynamics within these groups are displayed in Figure 3.4. These groups, often assumed homogeneous, do not present linear convergence processes among them. The core group converged up to the 1970s when a divergent process began its path and was mostly intensified by the introduction of the euro. Southern European countries are seen to diverge between the early 1970s and the middle 1980s by the time they entered a convergence era that finished after the adoption of the euro and was even inflected after 2008. The new member states describe a convergence path until about 2013, and diverge afterwards, while the lower average GDP per capita group experiences the most pronounced convergence process. As expected, the average dispersion within each of these sub-groups is never as high as their average dispersion towards the European Union, indicating higher proximity between them than among each of these groups and the rest of the European Union, and suggesting the existence of a multi-speed Europe.

It is striking how each economic crisis represented a break on the European Union convergence process, major crises as the 2008-2009 crisis contributing to increase divergence within the whole group. While despite several stress episodes, the core managed to assume

a leading path, the countries that lag and whose convergence process was mainly pushed by the transfer of European funds tend to experience deeper drops and to be shoved away from the main growth path, deepening the multi-speed Europe and creating tension in the integration process. The last 20 years have been particularly strained, the adoption of the single currency putting a halt in the European growth path of its 12 founders and promoting real divergence between then. As aggravating, the disruption of the financial crisis followed by the adoption of contractionary policy measures that were more severe in certain non-core members further contributed to asymmetric paths within the Euro Area and EU.

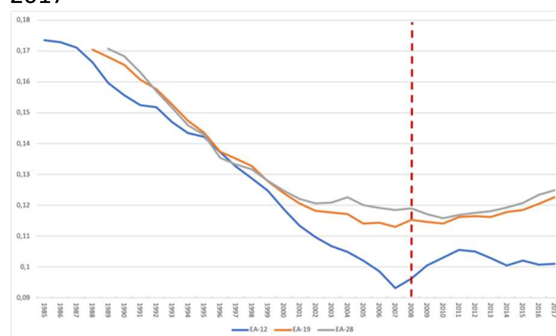
GDP per capita gives a perception of each country average performance. The recent discussion on inequality has brought to the limelight the divergence of income between households within the same country. Countries may be getting richer while increasing the polarization between the rich and poor fractions of their population. To analyze how, on average, polarization is taking place in EU countries this analysis focus on the Gini coefficient for disposable income retrieved from the Standardized World Income Inequality Database (SWIID) by Solt (2016). The data for the 12-Euro Area founders are available between 1983 and 2017, and from 1988 for the 28 EU countries.[2]

Fig. 3.5. Average Gini coefficient of disposable income, EA-12, EA-19, EU-28, 1983-2017



Source: authors' calculations using SWIID 8.3 data

Fig. 3.6. Sigma-convergence, Gini coefficient of disposable income, EA-12, EA-19, EU-28, 1983-2017



Source: authors' calculations using SWIID 8.3 data

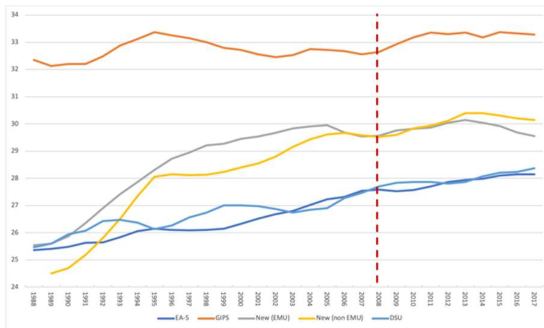
The most outstanding feature from Figure 3.5 is the significant increase in the average Gini coefficient in the last 30 years, implying a strong increase in inequality, transversal to all EU countries. As a consequence, Figure 3.6 that displays the coefficient of dispersion for the distribution of disposable income, points to an increase in the convergence between countries. Combined, these indicators mean less-equal societies in the European Union. The 2008-2009 crisis has caused an increase in across the EU.

In a close-up analysis of the Gini coefficients of disposable income for the previous five groups, once more the multi-speed Europe stands out, as can be inspected in Figure 3.7. The GIPS, the group that recently lost track on the GDP per capita convergence process, are the more unequal countries. The richer countries, either belonging or not to the Euro Area, correspond to the most equal societies, although keeping increasing the average Gini

[2] Malta is the exception, data for this country starting in 1999. The coefficient of variation for the EA-19 was calculated considering 18 countries until 1998 and adjusting for Malta data afterwards. Bulgaria and Romania have data from 1989 onwards, implying data for the EU-28 starting there, and the coefficient of variation was again adjusted for Malta following 1999.

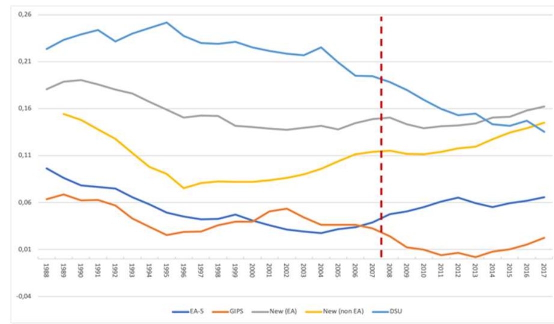
coefficient, especially after the 2000s. In between the extremes stand the new member countries, mostly former socialist economies that have faced a significant rise in their income inequality after their political regime switch. For all groups, the 2008-2009 crisis represented an increase in the average Gini coefficient, suggesting that, within each country, less economic growth has nurtured increased inequality.

Fig. 3.7. Average Gini coefficient of disposable income by groups of countries, 1988-2017



Source: authors' calculations using SWIID 8.3 data

Fig. 3.8. Sigma-convergence, Gini coefficient of disposable income by groups of countries, 1988-2017



Source: authors' calculations using SWIID 8.3 data

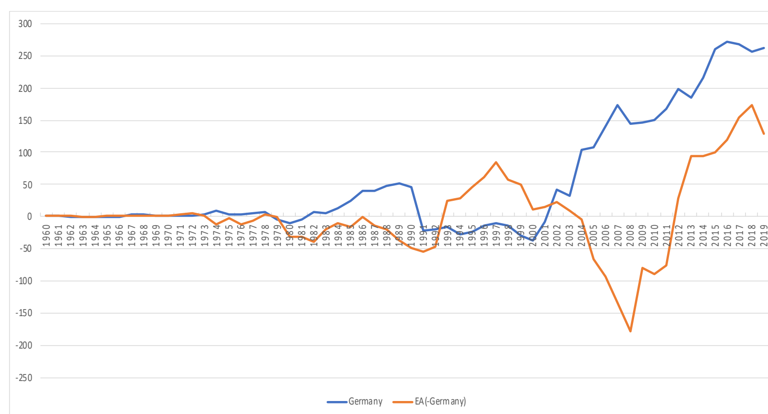
Figure 3.8 reveals a stronger similarity in inequality between the group of GIPS, displaying low dispersion and increased convergence of their Gini coefficient. The core Euro Area members show a propensity to converge at this level. The degree of inequality between the new member countries is diverging, especially among those that are not part of the Euro Area.

In sum, the European integration process has two major challenges to deal with. First, how to invert the recently widened gap between its members' GDP per capita. This problem is of especial concern for countries that entered a divergent path, especially as a consequence of the last crisis. As a paradox, the euro, the tool that should promote convergence, seems to have further deepened existing asymmetries. A new problem is how to equally distribute income between households within each country, an issue that was aggravated following the last crisis, contributing to stagnating the middle-class income and compromising the ability of the EU to fight back recessions with the traditional policy tools designed to stimulate aggregate demand.

3.2. Euro Area current accounts

This section ends with a reference to the Euro Area current accounts' dynamics (Figure 3.9), focusing on the twelve oldest countries.

Figure 3.9: Current Accounts of Germany and the Euro Area (Germany excluded)
(Billions of euros)



Source: AMECO, June 2020

At first glance, there is a symmetric evolution of the current account of Germany and the Euro Area excluding Germany, reflecting a reverse dynamic that began in the 1970s, following the oil crisis. The German current account evolved favourably during the 1980s, until its reunification and throughout the 1990s, when the positions were reversed reflecting Germany economic adjustment that negatively affected its net exports and had a positive impact on the other Euro Area countries net exports. At the beginning of the new century, coinciding with the creation of the euro, a new inflexion occurs, marked by a sharp rise in the German current account and a sharp fall in the other countries. The 2008-2009 crisis reshaped these dynamics, by breaking up the inverse relationship, as a result of both the policies designed to correct the existent external deficits and the redirection of trade towards world markets. It is clear the effect that the creation of the euro had on German external dynamics, undoubtedly favourable in comparison to the other countries that reveal a negative shock. Germany benefited from the introduction of the single currency, strengthening its external competitiveness and avoiding the otherwise inevitable appreciation of the mark against the other European currencies. This feature has been maintained and reinforced until today, despite the recovery verified in the remaining countries.

4. THE CURRENT CRISIS: CHALLENGES FOR EUROPEAN GOVERNANCE

It is time to prepare the economic recovery and correct the structural weaknesses that for long interfere with the functioning of national, European and international institutions, and deepened after the 2008-2009 crisis. This goal should be articulated with an economic recovery plan that can deal with the structural problems that have been contributing to the EU weak economic growth. In parallel, it is vital to start a process of institutional and policy reforms that will allow Europe to recover its internal dynamism and capacity for international affirmation.

4.1. Immediate responses

Notwithstanding the initial hesitations, the ECB showed once again that it is at the forefront of combating the economic consequences of the pandemic, reinforcing the quantitative and qualitative unconventional monetary policy measures, thus guaranteeing the channels and flows of liquidity supply to the economies. On March 18, it advanced with the Pandemic Emergency Purchase Program (PEPP), a new temporary asset purchase program (APP), in the amount of 750 billion euros, in addition to other measures already underway. On April 30, in the face of a deteriorating economic environment, the ECB reduced the interest rate on the new specific liquidity-providing facility, under particular conditions, to negative levels that could go up to -1%, while easing the collateral, extending lending terms at negative rates and launching a new series of non-targeted long-term refinancing operations (Non-Targeted Pandemic Emergency Longer-Term Refinancing Operations - PELTRO). On June 4, facing worsening economic conditions, the ECB decided to increase the PEPP envelope by an extra 600 million euros, to a total of 1350 million euros, in addition to reaffirming the continuation of measures in a time horizon compatible with the response to the development of the crisis. The most interesting feature about the ECB's general stance is its analysis of the current economic situation and the priorities that must be established to fight the crisis, namely the need to take into account the legacy of the previous crisis, that is the constraints imposed by high public debts and weak growth.

On March 20, after a first major announcement of measures, and the reference to a 'flexibilization' of the Stability and Growth Pact, while reaffirming the countries' need to assume their "full responsibility", the President of the European Commission came a little later to amend the hand. It was considered that, for the first time since 2011, when the restrictive budgetary measures were introduced, Europe met the conditions to activate the so-called "escape clause", which allows exceeding the 3% limit on the budget deficit. In early April, Ecofin announced a package of 540 billion euros to combat the crisis distributed as the instrument SURE, a temporary line to support the effects on employment comprising 100 billion euros, 200 billion euros to support SMEs, managed by the European Investment Bank, and 240 billion euros to finance direct and indirect costs from measures taken to contain, cure and prevent Covid-19. These measures were included within the framework of economic and fiscal coordination and surveillance which, in practice, means falling within budgetary constraints.

Even if limited, these measures revealed and strengthen the contradictions that have marked the European economy since the 2008-2009 crisis and that are at the basis of its identity crisis. As a consequence, the opposition between a "frugal" North and a "spending" South reappeared. To establish the modalities of support for economic recovery, a painful process of discussions begun, resulting in the announcement of drip-feed measures and, culminating by the end of May on a new financial package worth 750 billion euros. The most decisive aspect of this package is the opening, for the first time in the history of European institutions, to the possibility of issuing European common debt.

Even if the intervention of the Commission and the European Council is an ongoing process, some preliminary remarks can be made. First, measures that should have a quick decision process, and be focused, easy and transparent to apply, turn out to be the opposite, with no guarantees that they will be implemented effectively and sufficiently, especially if the economic environment worsens beyond expected. Note that the final decision on the 750

billion euros package was scheduled for almost two months after its announcement. Second, despite the publicized amounts, the economy is still effectively sustained by the comprehensive and in time intervention of the ECB. Third, notwithstanding the link between financing and structural reforms and the promotion of growth based on the green and digital economy, a consistent action program, that at once responds to immediate problems in an integrated way and to the structural constraints facing the European Union and the Euro Area, is still lacking. This is reflected in the weak economic dynamism of the past two decades. Fourth, there is no certainty that the current lavishness will not turn into future “frugality”. It is symptomatic the gradual change in the speech by the same national officials who previously advocated a radical change in the position of the European institutions. Finally, a more positive aspect is the opening up for the possibility of issuing common debt, which can be a beginning for the deepening of fiscal integration and macroeconomic management in the Euro Area. However, it is not yet clear how this whole process will take place, nor how the distribution of responsibilities will be made.

4.2. Short-term challenges

A structural problem, which reduces the leeway for the several Member States, is the size of public debts and the impact that the expected generalized increase in public deficits will have on them. Part of the efforts to find a consensus for the economic recovery program result precisely from the last crisis spectrum, when the solutions approved to revert the downturn led to the emergence of the sovereign debt crisis and the consequent adoption of austerity policies. The European Union needs an effective economic recovery plan, articulated with recovery programs at the national level. If conditioned by public debts inherited from the previous crisis, and whose dimension, to a large extent, is the result of the tightening policies adopted since then, the risk of failure is great and may open the path to the implosion of the euro.

The immediate goals must be the safeguard of incomes and restoring the economy, taking “all measures that are necessary” to ensure that this is achieved. The economic policy priority should be the recovery of employment, ensuring that the employment-income-expenditure circuit recovers momentum in parallel with setting the foundations for the recovery of the longer-term investment-growth circuit. These dynamics need to be restored at the European level, and on a global scale, requiring broader institutional coordination and increased responsibility of international institutions, like the IMF or the World Bank, particularly in what concerns the coordination with developing countries.

4.3. Medium- and long-term challenges: a new Marshall Plan?

Under circumstances of severe economic struggle like the current one, the Marshall Plan appears as a reference. However, it is worth underlining today’s differences in comparison to the aftermath of the Second World War.

First, the world is not suffering physical destruction of facilities, buildings, equipment, infrastructure, transport and logistics systems. Nor the inoperability of research and technological development systems, of financial systems and national and international institutions, as was the case at the time. Presently, the challenge is not the physical reconstruction of economic structures but restoring normal economic circuits. This requires a more qualitative, flexible and decentralized intervention, and thus finer tuning and greater

dependence on macroeconomic management, both at the fiscal and monetary levels. Today, there is a huge amount of human, physical, technological, institutional, political, and natural resources that, if properly combined, are capable to answer all problems, including health needs. Above all, there are European and international institutions, with extensive experience, created precisely to respond to these problems and with the ability to think the long term. There is also the awareness that the way out of the present crisis will condition the future of the European and international economy in the coming years, if not decades, and the development of the European project itself.

The Marshall Plan, closely linked to the Bretton Woods monetary system, was a fundamental vehicle for the injection of the international liquidity that allowed the recovery of European economies, and in particular, the reconstruction of the German economy, projecting it to what it is today. If the model followed by the United States contributed to the crisis of the 1970s, it did not fail to favour the rapid recovery of the world economy and to generate high growth rates, for about two decades, until the 1970's crisis. Today, having at its disposal a remarkable instrument, the euro, created in the dynamics of Bretton Woods' ideas, the Euro Area should assume the inheritance of what this agreement represented for the world economy. This means that any immediate economic recovery plan in Europe must be articulated with a deepening of economic integration, fulfilling the goals of economic development and correction of asymmetries while, at the same time, introducing flexibility, paying attention to idiosyncrasies and reinforcing the idea of common interest.

Another aspect to be recovered, present in the broad guidelines of the Bretton Woods economic policies is the concern with the income distribution, insofar as it works as a demand stabilizer, as it did in the three decades that followed the end of the second world war. From the 1980s, with the emergence of supply-side policies, the income policy was relegated to a secondary plan. The deepening of globalization, with the entry into the game of emerging economies, with emphasis on China, and other Asian countries, encouraged the transnationalization of companies, the expansion of the so-called global value chains, the parallel development of the financial sphere, the free movement of capital, goods and people, beyond all previously known limits. If, on the one hand, these changes allowed new economic dynamism, on the other hand, limited income progressions in advanced economies, leading to its concentration.

A European economic recovery plan in the spirit of the Marshall Plan needs to get rid of the current dominant references of economic thought, subordinated to simplistic reasoning of competitiveness-costs, and integrate a production-income logic that ensures the medium to the long-term stability of demand. This European plan has to include and coherently integrate the different national plans. The financing that is necessary to combat the pandemic and to respond to the economic breakdown is not compatible with the traditional and limited mechanisms, nor with the simple relaxation of the rules of the Stability and Growth Pact. Deficits and debts will skyrocket, which will require very long-term financing to be supported either by the ECB's monetary policy or by common debt issuing, something that has been done under the name of unconventional monetary policy. And inflation is the best that can happen to the economy, given the prospect of "biblical destructions"[3*], or a collapse of the European project.

[3] "Biblical destructions" was the expression used by Draghi in its article of Financial Times, Mars, 25th.

5. **THE MONETARY POLICY REFORM**

In January 2020, the ECB decided to open a process of reviewing the monetary policy strategy. This revision process initially planned to take place throughout 2020 and later extended to 2021, should cover different issues such as the quantitative formulation of price stability, the set of monetary policy instruments, economic and monetary analysis, and, communication practices. Besides, other matters such as financial stability and environmental sustainability and employment were under discussion which was a curious and novel way of integrating monetary policy with broad economic policy.

The quantitative formulation of the inflation target, set by the Governing Council of the ECB, at a first stage as "below 2%", and following the strong disinflationary trends caused by the 2008-2009 crisis as "below, but close to 2%", is currently, in a context of deflationary threats, as "symmetric convergence at 2%". The evolution was towards privileging a medium to long term approach, seeking to incorporate the possibility of alternating periods of inflation above and below 2%, to maintain an average of 2%. Given the recent experience of low inflation, it is questionable whether it makes sense to place it as a primary goal of monetary policy. In a logic of greater integration of monetary and fiscal policies, it is reasonable to prioritize growth and employment goals and to ease the inflation target. Established the urge to restore growth and income stability, the inflation target should be put at a secondary level at the current stage of the eurozone economy.

Moreover, it is critical to rethink the instruments used by the ECB to manage the money supply. After 2008, to ease the credit conditions and ensure the functioning of the monetary transmission in a context of a "liquidity trap", the ECB and other central banks adopted the fixing of the interest rate. The experience has shown that the setting of the interest rate is a better way to monitor the achievement of predefined macroeconomic goals.

Another matter of concern is if ECB should leave to commercial banks the prerogative of money creation through loans and the constitution of reserves, or introduce other forms of money creation, as through the financing of public investment. ECB must assume its role as the creditor of last resort, including financing fiscal policy, particularly regarding public investment. Evaluating the recent experience of the private financial sector, there is no valid reason, neither theoretical nor practical, to justify the discrimination of the public sector, as long as adjusted rules and control mechanisms can be established.

To overcome current constraints, the ECB must continue to use the instruments of unconventional monetary policy, particularly the direct channels of relationship with economic agents, to ensure that its goals are achieved (effectiveness), good instruments are used (efficiency) and the results are sustainable (effectiveness). Its statutes should be adapted accordingly.

Alongside, monetary and fiscal policy must be considered in their interactions, converging to an integrated and comprehensive macroeconomic policy within the space of the monetary zone, evaluated by the degree of fulfilment of predefined macroeconomic goals. More doubtful is the link between monetary policy and selective policy options as the green or digital economy, as recently defended. In our view, this is a macroeconomic policy matter *lato sensu*, and not for the monetary policy alone. Monetary policy is meant to accommodate macroeconomic goals, and not to replace policies that, in principle, are better suited to manage specific issues.

Finally, in the context of a transnational, asymmetric and multigovernmental monetary zone with disintegrated fiscal policies, as is the case of the Euro Area, the degree and quality of Central Bank independence should be reconsidered. In the case of the United States, there is a federal government, an integrated fiscal policy and a National Congress before which the Central Bank has to present semi-annual reports on the conduct of monetary policy. In the case of Europe, mixed feelings arise. On the one hand, the ECB should move closer to the American model, integrating monetary and fiscal policy in a more convergent logic, without losing the respective and necessary independence. On the other hand, ECB's independence was crucial for the adoption of unconventional policies that saved the eurozone from an economic catastrophe, notwithstanding the dominant tightening speech. The new ECB model will be the outcome of how European institutions and their reform evolves.

Despite the changes that occurred in the post- 2008-2009 crisis period and the positive impacts that monetary policy brought to the economic context, many problems persist. In particular, growth anaemia that amplifies all the other problems related to the initial architecture of the single currency. For example, the persistence of high interest rate differentials concerning public debt is unacceptable, since asymmetrically benefiting economies that share the same currency.

Nevertheless, it is also true that this was a fertile innovation period that needs to be evaluated and introduced in the "toolboxes" of monetary and macroeconomic policy in general. In particular, it is necessary to discuss how to strengthen the articulation of monetary and fiscal policy to overcome the limitations of the "liquidity trap" into which economies have fallen in the context of the "zero lower bound" and, more recently, of negative interest rates.

The revision of the monetary policy strategy, announced by the ECB, should be an opportunity to correct the weaknesses of the architecture of the euro system that have been preventing the single currency from being an efficient internal and external adjustment mechanism, and that transformed the 2008-2009 crisis into a highly asymmetric shock that hindered economic recovery. Under the presidency of Mario Draghi, the ECB was able to reinvent itself through unconventional monetary policy, becoming the real support of the post-crisis European economic dynamics until the Covid-19 crisis and afterwards.

ECB's independence must be reinterpreted in the sense that it cannot be captured by any country, no matter how large its weight in the single currency. Independence must be understood as the capacity to recognize the interest of the Euro Area as a whole, considering differences between countries and safeguarding the overall consistency of monetary policy with the integrated macroeconomic goals.

The ongoing review of the monetary policy strategy is a unique opportunity to adjust the ECB's rules and statutes to what has been the practice of unconventional monetary policy, freeing it from the attachments that prevent it from exploring its full potential and preparing it for the economic transformation that the eurozone requires to consolidate and assert itself. A central bank, more oriented towards stimulating growth, employment and economic cohesion, aware of Euro Area imbalances and less concerned with inflation, which, in the current phase of the European and world economy, is not a problem.

5.1. The need to rethink the public debt problem in the long term

The measures to combat the economic and social crisis from Covid-19 will inevitably produce deficits and increase public debts. The problem is even more serious within the Euro Area since, in the wake of the 2008-2009 crisis, debts have escalated unequally, projecting

themselves until the present moment, and creating an asymmetry that undermines economic recovery. However, without expansionary fiscal policies, at the national and Euro Area levels, one cannot think of a wide economic recovery that can open up to sustained growth.
As with the Marshall Plan, financing the European economic recovery must be seen from a long-term perspective, which implies a new approach to public debts. First, current debt levels should not be a conditioning factor to access European funds by different countries of either the European Union or the Euro Area, nor should it imply the adoption of tightening policies in the medium or long term, as happened in the previous crisis. Second, Europe's economic recovery plan must include a restructuring of public debts, which comprises extending repayment terms and ECB's guarantees that there will be no discrimination in the access to finance by different countries. Thirdly, a process of mutualization of the eurozone debt should be prepared, starting with new debt from the post-Covid-19 economic recovery plan and being progressively extended to total debt contracted after the operation of the single currency period. In this perspective, a Euro Area Public Debt Agency should be created within the framework of a common macroeconomic policy that includes mutualized debt management. Finally, and as a corollary, the ECB must be called upon to play a role of the creditor of last resort. This stand is in line with what turned out to be the economic needs of the 2008-2009 post-crisis period, namely concerning the malfunctioning of the monetary policy transmission mechanism. There is no reason, to defend that money creation should be only linked to commercial banks interventions and not to the economic policy options of each member state, provided that adequate mechanisms of control and supervision are created.

6. CONCLUSIONS

The Covid-19 crisis risks being a structural turning point on the global economy, questioning everything accepted as normal until now. It should be an opportunity to rethink the European integration project in depth.
Firstly, in terms of its priority goals that should be growth and employment, economic and social cohesion, and an income policy oriented to rebuilding the dynamics of an innovative middle class, with interest in macroeconomic results and a strong democratic and European culture.
The European Union and the Euro Area must recover its foundational ambition of a long-term Development Plan. A plan designed at the European scale, but that can be able to reconcile and integrate the strategic plans defined at the national scale. In this framework, a general principle of flexibility should be introduced that takes into account countries’ idiosyncrasies and their needs for different periods of adjustment.
The founding idea of a European Union and a Euro Area, as a dynamic tool for deepening the European identity and building a common interest, must be redeemed. In this context, the relationship between enlargement and deepening should be managed with care, by accepting the principle of different speeds and adjusting institutions accordingly, allowing to dynamically accommodate different situations, such as Brexit.
In what concerns the global economy, Europe should assume an active role, trying to be a reference. It is important to strengthen ties with developing countries and reinvigorate the role of international institutions. At this level, it is justified to promote a major international conference in which the theme of inequalities, growth and governance of the global economy should be central.

The ongoing review of the monetary policy strategy should be an opportunity to correct the initial architecture of the euro system. The euro should be an instrument to correct asymmetries, which implies integrated macroeconomic management of the monetary zone, taking into account differences between countries. For this, priorities must be reviewed, recognizing that inflation is not a central problem at the moment, and should be replaced by growth and employment.

The integration of monetary, fiscal and income policies, within the framework of overall macroeconomic management of the Euro Area, should be a priority. Accordingly, a European ministry of economy and finance should be created, with competences and abilities to intervene both in the conjunctural framework and in the long-term strategic planning.

The ECB statutes should be revised to incorporate the unconventional monetary policy, including the possibility of financing the public sector following specific supervisory rules and mechanisms. Accordingly, the ECB must assume the role of a creditor of last resort.

A process of mutualisation of public debts must be discussed, including the restructuring of the current debt, with the extension of maturities and amortizations in line with the evolution of growth in each country. Under no circumstances should the current amount of debt be a differentiation condition for access to funding within the framework of Europe's economic recovery plan or other programs that may be launched.

To sum up, European policy makers should i) give priority to growth and employment; ii) promote long-term economic sustainability based on integrated macroeconomic policies, the reduction of income concentration and the reconstitution of strong middle classes; iii) reorientate international relations into a perspective of cooperation; iv) reinforce regulation and global governance; and v) eliminate exceptional situations, such as offshores, tax havens and other forms of economic controls escape.

The Covid-19 crisis can be the opportunity to rebuild the European integration project with more solid foundations and with renewed goals that may meet the new challenges of social and economic development.

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