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The Legacy of the Pandemic: How Covid-19 is Reshaping Economic Policy in the EU

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ABSTRACT

The economic policy response to the Covid pandemic broke new ground, in terms of its ambition, the tools used, and its institutional characteristics. This paper argues that three sets of factors explain this: our evolving understanding of macroeconomics; the nature of the current crisis; and the policy learning from the financial crisis. It also reviews the emerging institutional landscape at EU level, with its combination of rules-based and institutional features, and assesses the critical factors for successful implementation of the Recovery and Resilience Plans at national level. The paper finally contends that four sets of issues will be important in shaping the legacy of the pandemic for European integration: redefining the new boundaries between state and market; revisiting the nature of subsidiarity; reconnecting the EU domestic with the global agenda; and learning to respond to longer term structural shifts.

1. The EU: A History of Resilience

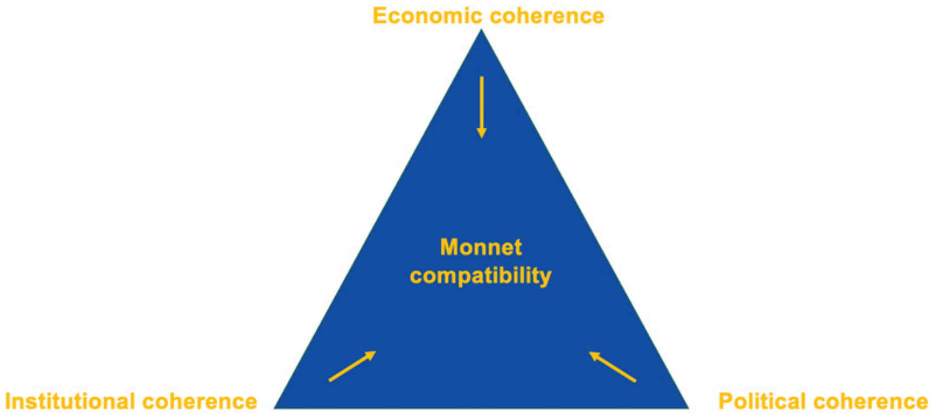
The EU is navigating its third crisis in the space of a single decade, following the eurozone financial crisis and the migration crisis. Jean Monnet famously stated that 'Europe will be forged in crises and it will be the sum of solutions adopted for those crises'. Indeed, as in previous crisis episodes, the policy solutions are to be found at the intersection of what economic policy suggests and political reality and institutions allow, and reflect a combination of principles, flexibility and pragmatism. But every crisis has its own characteristics, and prompts its own response. This crisis is different, and the policy response, with the Next Generation EU initiative at its heart, is breaking new ground.

Successful crisis response needs to pass what could be called the 'Monnet Compatibility Test' (see Figure 1). It needs to be economically coherent, marshalling the policy tools and mechanisms that provide for an effective crisis response, addressing root causes,

1 European Commission and European University Institute, respectively. Marco Buti writes in his personal capacity. We thank Moreno Bertoldi for useful comments and Oscar Polli for excellent research assistance.

and allowing European economies to recover, while minimising the damage. In the complex EU institutional framework, it also needs to have institutional coherence, leveraging common governance mechanisms while respecting both subsidiarity and the EU Treaties. Finally, it needs to be politically coherent, maintaining citizens' support in what tend to be traumatic and divisive periods. Unfortunately, combining all three proves to be a very difficult task.

Figure 1 The Monnet Compatibility Test



In this paper, we (loosely) apply the Monnet Compatibility Test to the economic policy response to the pandemic. Section 2 reviews policy decisions taken at EU and national level to tackle the economic fallout of Covid-19. The following three sections sketch out the reasons why the current response is different and more ambitious than the policy response to the financial crisis: the evolution of our understanding of macroeconomics (section 3), the nature of the current crisis (section 4), and the policy learning from the financial crisis (section 5). We then review the changes in EU governance and the conditions for success of the national Recovery and Resilience Plans under Next-Generation EU (sections 6 and 7, respectively). In the final section, we examine the factors that will shape the legacy of the pandemic for European integration.

2. The Covid Economic Policy Repsonse

Faced with what amounted to a 'sudden stop' of economic activity because of the lockdowns and the simultaneous supply and demand shock in economic systems, the economic policy response at the level of EU Member States was generally swift and decisive. It was aimed at maintaining liquidity through cash, debt and guarantees, ensuring households can delay payments, and workers receive pay-checks even in quarantine or if temporarily laid off; at the same time preventing mass insolvencies, ensuring firms have cash flows to pay workers and suppliers, especially among small and young businesses. The logic was to focus on disaster relief first, followed by policies to facilitate the recovery.

EU member states differed both in generosity and in their mix of policy instruments, reflecting in part diverse underlying fiscal conditions. Such differences, however, were significantly less prominent than in the eurozone crisis, so that taken together, the overall fiscal effort, as well as the liquidity provisions, added in 2020 to a substantial 2,5 trillion euro response (see Table 1), with a significant part of the effort carried over into 2021.

Table 1 National and EU responses to the Covid crisis

		Fiscal	Liquidity
National, EU-27	2020 measures	500bn	2500bn
EU	SURE, ESM, EIB		540bn
	NG-EU	390+bn	360bn
ECB	PEPP		1850bn

Source: European Commission

While the economic response first came at the national level, it was decisions by the EU institutions (ECB, Commission, Council) that set the stage for recovery and altered the discourse on economic policy and governance moving forwards. In a benign environment of low interest rates, the ECB quickly adopted a key role in ensuring the crisis did not spill over to financial markets, and moved to stabilise markets for sovereign debt. It expanded its targeted and non-targeted refinancing operations, amended its collateral policy (expanding accepted collateral and eligibility, reducing haircuts) and crucially both renewed and expanded its asset purchases programme, while inaugurating the large mission-specific Pandemic Emergency Purchase Programme (PEPP), which included flexibility in the capital key and issuance share.

At the level of the European Commission, the early activation of the general escape clause in Stability and Growth Pact (SGP) rules allowed member states to proceed with large scale fiscal relaxation. This was supplemented by measures for liquidity provision aimed at protecting firms (the relaxation of state aid rules allowing the activation of national guarantees, and coupled with increased overall lending capacity by the EIB), safeguarding jobs (Commission borrowing and lending to governments to finance expenditures related to short time work - SURE) and assisting sovereigns (for the euro area, the decisions on European Stability Mechanism (ESM) pandemic crisis support).

In terms of EU decision-making however, the seminal moment was the July 2020 EU Council decision (European Council 2020), which put in place a new fiscal and governance framework. This built on a Franco-German proposal, that for the first time allowed for direct transfers to countries, in addition to loans, and on proposals by the Commission to finance such combined grants and loans by borrowing in markets and temporarily lifting the 'own resources' EU ceiling. The resulting EU Recovery Plan has two pillars (European Commission 2021c): a new recovery instrument of €750 billion, which involves funding raised on financial markets for 2021-2024 (Next Generation EU); and a reinforced long-term EU budget for 2021-2027 (€1.1 billion). Together, these are aimed at assisting Member States to recover and 'build back better', by aligning public and private investment with broader EU goals – notably its green and digital agenda.

These decisions represent a clear break with precedent. This is true in terms of instruments (the use of grants, the push for new 'own resources', the issuance of common debt on the part of the Commission); institutional mechanics (the return of the Community method); as well as in terms of the sheer magnitude of the underlying fiscal effort and liquidity provision.

In terms of the magnitude of the effort and its adequacy to the task at hand, we would be amiss if we did not make reference to the ongoing debate comparing the EU response with that of the United States.

There are a number of elements to this debate: first, whether the US policy response is economically appropriate (discussion focusing on the output gap versus the war-like crisis response) and conversely whether in comparison, the EU effort is too timid; second, what secondary impact the heating of the US economy will have on the EU economy (Andersson et al. 2021, ECB 2021).

On the first issue, whilst the jury is still out, given its composition, the $1.9tr is likely not to display a huge multiplier, so the impact on inflation may turn out less than feared. Moreover, the infrastructure plan announced by President Biden at the end of March will be spread over 10 years and will be partly financed by higher taxes, which will limit its stimulative impact. While there is no doubt that in headline numbers the fiscal expansion in the EU will remain lower than that in the United States, in terms of composition, its quality will be higher and should give rise to stronger fiscal multipliers.

Still, given the sheer size of the US fiscal and monetary stimulus, consolidated growth over the next two years will likely be higher in the United States than in the EU. Because of this, on the second issue, Europe is likely to benefit from positive demand spillovers, whilst the negative spillovers, arising from higher interest rates and a stronger dollar, are more likely to affect emerging market economies, especially those holding a large share of dollar denominated debt.

However one judges the EU economic policy stance vis-a-vis that of the United States, the decisions taken do represent a significant 'stepping up' and a break with past EU policy. What has underpinned this shift? We contend that three broad factors have driven what we are observing. The first is the evolution in our understanding of macroeconomic policy beyond the EU - the new macro paradigm. The second is the different nature of the current crisis. And the third is policy learning from the eurozone financial crisis. Together, these explain why decisions taken to date differ in scope and nature from those in the financial crisis and potentially set the stage for closer European economic and political integration post-crisis.

3. How Macroeconomics Has Changed

Keynes famously quipped about the power of the ideas of economists and their influence in policy-making that 'madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back'. While this description may not be particularly flattering to politicians, it nevertheless retains an element of truth. Though not always, economic policy-making often follows the evolution of academic understanding in the field – with a lag. And over the course of the last two decades, the paradigm of macroeconomic policy in open economies has shifted.

There is nothing new here of course; over the long-term, the consensus in macroeconomics has constantly evolved, chiefly in response to crises or to an apparent disconnect between theory and reality. In this vein, the global financial crisis led to a change of the thinking in macroeconomics around a number of issues. Chief among these is the insufficient focus on the complex role of banks and of financial institutions in general in the economy, and the associated risks related to liquidity and eventually solvency for economic stability. The nature of macro financial linkages have become more important in the economic discourse.

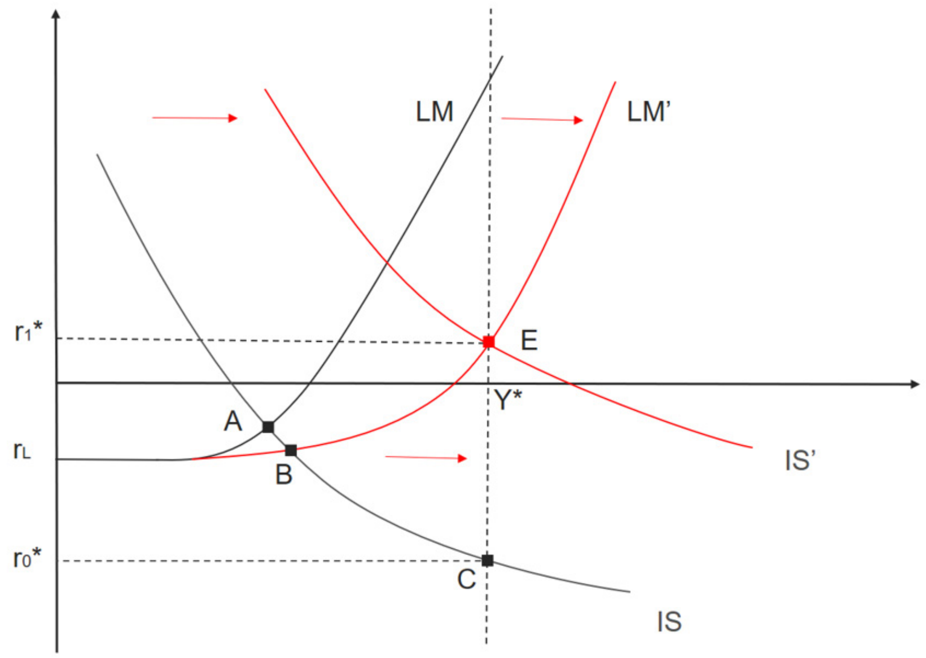
A related set of issues centres on the possibility of secular stagnation in economies (Summers 2013, Teulings and Baldwin 2014), an old concept that has seen some resurgence, suggesting that a number of factors (ranging from demographics to globalisation and the debt overhang) are dragging down the equilibrium real interest rate as well as long-term growth, despite advances in technology and productivity. In an environment characterised by persistently deficient aggregate demand, economies would be operating at the 'effective lower bound' (ELB), which is, however, higher than the equilibrium real interest rate: this is captured in Figure 2 by r_0^* being lower than r_L, the rate at the ELB.

The policy implications of this shift in macroeconomic thinking are stark and are already having an impact on policy-making consensus, including in Europe. They relate to a number of policy issues and tools: the overall macro policy stance, our understanding of debt sustainability, the mix of fiscal and monetary policy, and the role of central banks.

In a situation of persistent excess savings, with economies operating at, or close to, the ELB and little or no inflation, there are strong arguments for a macroeconomic policy stance that attempts to counteract chronically deficient aggregate demand and reach full-employment output with a more expansionary stance of fiscal policy (bringing the economy from point B to point E in Figure 2). This would seem to reverse the overarching emphasis on 'prudent' fiscal policies that dominated over a long period.

A corollary relates to the size of fiscal deficits and debt sustainability. In an environment of persistently low interest rates, there is increasing support from academic writing for higher 'upper bounds' of fiscal positions as well as a discussion on the quality of fiscal expenditures that enter into their measurement. Equally, with debt to GDP levels historically high, the emphasis on establishing debt sustainability has complemented the focus on headline debt to GDP ratios with a more complex analysis reflecting i.a. the capacity to service debt.

Figure 2 Policy Mix at the Effective Lower Bound



Central to this new policy discussion is the fiscal-monetary policy mix and the role of central banks. Operating at or near the ELB, central banks including the ECB have increasingly resorted to unconventional measures, with an emphasis on asset purchases. This has raised a number of issues. The first is the delimitation between fiscal and monetary policy: the expansion of their portfolio with government securities effectively blurs the lines between classic monetary policy and government finance.

The second - and related - is their call to governments (repeatedly by the ECB) to step up fiscal policy so as to avoid central banks bearing the brunt of policy adjustment: this is based on the awareness that, in the presence of a very large demand shortfall, the Keynesian spillovers dominate the spillovers via public debt sustainability[2]. And the third is their increasingly important role in acting as a safety valve in avoiding disruption emanating from the financial sector.

The need to ensure a 'congruent' policy mix (Bartsch et al. 2021) underpins an evolution in the relations between monetary and fiscal authorities in Europe. The ongoing monetary strategy review undertaken by the ECB and the review of the macroeconomic surveillance framework launched by the Commission, whilst institutionally independent, will need to result ex post in a coherent framework in both the short run and in the medium to long run.

4. The Different Features of the Covid Crisis

The second broad reason explaining the different policy response at EU level is the features of the Covid-19 crisis compared to the eurozone crisis. In Table 2, we attempt to capture this difference along several dimensions. As argued in Buti (2020b), a key difference relates to the exogenous nature of the pandemic shock. Whilst a number of policy circles viewed the eurozone crisis as self-inflicted because of reckless behaviour, such arguments did not gain traction in the case of the pandemic. The way in which the eurozone crisis unfolded also tainted the narrative on its nature: the discovery of massive cheating in Greece's budgetary accounts implied that the financial crisis was 'read' through fiscal lenses. This didn't happen during the pandemic. The risk of fragmentation between countries, regions or sectors as a result of the Covid-19 shock – which some have characterised as a K-shape recovery – has also justified such help to be delivered via multi-year investment and reform programmes.

These differences in the nature and incidence of the crisis allowed for a completely different political narrative to develop, which eventually culminated in a very different policy response. In the eurozone crisis, the prevailing narrative was one of moral hazard; avoiding it implied the design of policies that could demonstrate policy mistakes had consequences. Creditors dictated the rescue conditions. The leading role of the European Council within an intergovernmental setting was the way to impose those conditions. At a second stage, the rationale for a collective response was the preservation of the euro.

In contrast, the narrative during the current crisis is almost completely devoid of moral hazard elements. The focus is on a common threat that requires a common response. Countries who were hit hardest could benefit from EU solidarity. This also allowed policymakers to avoid operating under the so-called 'ultima ratio' doctrine, where the EU help would come only at the very end, after all domestic actions by vulnerable countries had been exhausted, and was actually conditional on such actions been undertaken.

The devastating and sudden impact of the pandemic triggered what is commonly considered a very fast response by EU standards: in addition to the prompt action by the ECB, the Commission made sweeping proposals in May 2020 and by end-2020 an agreement at EU level had been achieved. Additionally, the parliamentary ratification of the increased ceiling of the 'own resources' part of the EU budget (necessary to

2 When Keynesian spillovers prevail and monetary policy is pushed against the ELB, fiscal dominance is actually achieved via excessive fiscal prudence, thereby turning on its head Sargent and Wallace 'unpleasant monetarist arithmetic' (Sargent and Wallace 1981). See Buti (2020a).

allow the Commission to borrow in markets) is planned to be completed in Spring 2021; under normal circumstances, that process would take between two and three years. It is important that delays are not incurred in the present phase of the final lap of the ratification process and the roll out of the RRPs (see below).

Table 2 Comparing Crises

	Eurozone Crisis	Covid Crisis
Source	Fiscal shock and/or financial sector imbalances	Combined supply and demand shock
Nature	Endogenous and asymmetric in origin	Exogenous and common in origin
Impact	Severe; asymmetrical on countries	Severe; asymmetrical on countries (and sectors)
Timing	Full economic shock felt over 1-2 years	Immediate economic shock over 1-2 quarters
Recovery	Slow, but durable	Fast(er), but fragmented

5. Policy Learning from the Financial Crisis

The eurozone financial crisis put EU governance rules and institutions in a stress test, as the very existence of the common currency area was called into question. As a result, old rules had to be reinterpreted, new policy tools were devised, new institutions were created, and an overhaul of the EU economic governance started in earnest. However, to justify rescue plans in creditor countries, there was an urge to return to normality, withdraw the fiscal support and start implementing the rules again as quickly as possible. Whilst the institutional and political conditions at the time make ex-post rationalisation a treacherous exercise, it is fair to conclude that the response to the eurozone crisis was sub-optimal.

In our view, the main lessons from the eurozone crisis which are relevant for devising the response to the Covid crisis are the following (see also Buti 2020b):

First, monetary policy has to be very forceful to stop self-fulfilling dynamics, or the realisation of negative equilibria. Whilst the ECB reacted very quickly in the summer of 2007, with liquidity provisions at the first signs of market dislocations, it was more hesitant compared to other central banks in relaxing the monetary stance and embarking on asset purchases. It was only in summer 2015, in the aftermath of the 'whatever it takes' statement by Mario Draghi, that the ECB came to be perceived by the markets as standing fully behind the integrity of the eurozone. A certain amount of risk sharing is needed in the Economic and Monetary Union (EMU), either openly via national budgets, or indirectly via the ECB balance sheet – yet for a time this was in short supply.

Second, after a very severe shock, early withdrawal of fiscal stimulus is very costly. Analyses pioneered by Olivier Blanchard (see Blanchard and Leigh 2013, 2014) showed that fiscal multipliers are much higher under large negative output gaps, especially if monetary policy approaches the effective lower bound. Again, in retrospect, after a strong fiscal expansion in 2009 which helped stem the negative shock, EU countries were too quick to 'declare victory' and embark in sharp fiscal retrenchment.

Third, achieving an appropriate euro area fiscal stance only via horizontal coordination of national policies is exceedingly difficult. During the eurozone crisis, countries with fiscal space focused on their domestic situation and refused to use it, whilst countries with fragile fiscal conditions frantically searched for a fiscal space they objectively did not have.

As a consequence, when the appropriate fiscal stance at the aggregate level was attained, this was usually via the wrong country distribution, which also meant lower effectiveness due to lower multipliers. The intergovernmental *forma mentis* at the time, led to the ruling out of a central fiscal response, either at EU or eurozone level, which meant a failure of subsidiarity.

The response to the pandemic benefitted from learning the lessons of the eurozone crisis. As recalled above, both the ECB and national fiscal policies reacted swiftly and massively. In addition, the commitment to keep a supportive fiscal stance in 2021 and 2022, helped by extending the General Escape Clause of the SGP to 2022 (European Commission 2021b), showed the awareness of maintaining support to the economy for as long as it takes. This was clearly communicated by monetary and policy authorities on both sides of the Atlantic, who stressed that the risk of doing too little largely outweighed that of doing too much. Finally, the Next Generation EU (NG-EU) initiative ensured a degree of vertical policy coordination and complemented the national fiscal expansions.

In sum, through the prism of the Monnet Compatibility Test, the policy response during the eurozone crisis did not fully meet the economic and institutional criteria. Judging by the large support to NG-EU also in so-called 'frugal countries' (see European Parliament 2021, European Commission and European Parliament 2021), one can conclude that the political compatibility is also more likely to be met this time round, compared to the political divisiveness which marred public opinion during the eurozone crisis.

6. Getting the EU Governance Right

Over the past several years, a growing debate has emphasised the importance of institution building relative to a purely rules-based system. Mario Draghi has made this point forcefully in comparing the effectiveness of monetary policy to fiscal policy coordination and response (Draghi 2019).

To be sure, during the financial crisis there was a strengthening of rules-based coordination and institution building. However, as illustrated in Table 3, this took a very specific complexion: both the main new institution – the ESM – and the most important strengthening of fiscal rules – the Fiscal Compact – were not only intergovernmental in nature, but the adoption of the latter was a condition for the adoption of the former. The first pillar of the Banking Union – the Single Supervisory Mechanism (SSM) – was instead supranational, but the second pillar - the Single Resolution Board (SRB) - was mixed; at the same time, the necessary third pillar – the single deposit guarantee system or EDIS – is still under discussion.

On the contrary, the main innovations during the response to the pandemic had a very clear supranational status: this is the case for the Recovery and Resilience Facility, within NG-EU. The support for short time work, SURE, has an intergovernmental component, since borrowing by the Commission takes place on the back of guarantees provided by national budgets. However, it is clearly identified in the markets and the public as a Community instrument and indeed this is one of the reasons for the market success and large access by member states compared to the ESM pandemic facility.

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Table 3 Coordination processes in the EU: institution-building vs. rules-based coordination

Coordination mode	Financial Crisis	Covid-19 Crisis
Insititution Building	• European Financial Stability Facility (EFSFS)/ European Stability Mechanism (ESM) • Single Supervisory Mechanism (SSM) • Single Resolution Board (SRB) • European Fiscal Board (EFB)/National Fiscal Councils (NFCs)	• Recovery and Resilience Facility (RRF) • Support to mitigate unemployment risks in an emergency (SURE) • ESM Pandemic Crisis Support (PCS)
Rules-Based	• Fiscal Compact • Strengthened SGP • Macroeconomic Imbalances Procedure	• SGP General Escape Clause • *[Review of the Six-Pack and Two-Pack]*

Key: Intergovernmental / Supranational / Mixed

In sum, the response to the Covid 19 crisis is proving very different to that prevailing during the eurozone crisis. What is emerging is a more balanced institutional landscape with a more robust combination of rules-based and institutional features, which has the potential to lead to more effective vertical coordination. Once again, the Monnet Compatibility Test, most notably institutional coherence, appears to be better satisfied in the current situation. This evolving institutional landscape should also be reflected in the outcome of the ongoing review of the EU macroeconomic policy framework.

7. Making Sure the Covid Response Works - Looking at Member States

For the politics to be conducive to more EU integration, there is one essential precondition: that the novel mechanisms and tools currently put into place to address the economic fallout from the Covid pandemic are indeed successful in helping European economies 'build back better', and are widely seen as doing so. This implies that the degree of success of national efforts based on EU funding goes beyond the positive impact on member state economies; they will provide a narrative for the evolution of overall EU governance as well.

The timeline for the Recovery Plan process is now fully set out, but the effective use of the large sums involved in the time horizon prescribed represents a huge challenge, as 'Next Generation EU' funds require committing the resources by the end of 2023 and completing the payments by the end of 2026 (European Council 2020). To this end, Member States are currently finalising with the Commission their national Recovery and Resilience Plans (RRPs), setting out a detailed reform and investment agenda based on specific guidelines (European Commission 2021a) and offering a narrative consistent with overall EU objectives (Table 4).

Table 4 Recovery and Resilience Plans: content and processes

Narration	Internal Consistency of NRRPs		
General objectives	*From objectives to projects*	*Cost estimation*	*Monitoring*
• Addressing the challenges and priorities of the European Semester • Stengthening growth, resilience and job creation • Contributing to economic and social cohesion • Contributing to the green/digital transition	• Final & intermediate objectives • Individual projects and investment timeframes • Implementation and acheivement indicators	• Total costs • Correspondence between costs and impacts on employment and the economy • Possible other EU funding	• Accompanying measures (reforms, investments) • Monitoring procedures

Source: Adapted from Buti and Messori (2020)

As member states complete their RRPs and move to the implementation phase, a number of issues will be critical for success:

- **Governance structures.** The new funding tools embody new conditionality rules, as well as milestones and targets for funds disbursement. As a response, EU Member States have been putting in place new governance arrangements for the design and implementation of what will be in many cases a defining national effort. While one size does not fit all and arrangements will vary, they will need to embody a 'whole of government' approach under a strong central direction, with the required flexibility of different administrative structures. Interestingly, this transition seems to be proving easier for countries with experience from support programmes during the eurozone crisis.
- **Investments plus reforms.** A crucial element of the new Recovery Plan is the 'twinning' of investments with reforms in national interventions. It will be important for this complementarity of reform elements and investments to be present in substance in both the design of RRPs as well as in their implementation, going beyond simple 'box-ticking' and a formal adherence to rules, and to ground these on an overarching growth strategy in each country based on green/digital transitions.
- **Conditionality and ownership.** During the eurozone crisis, the heavy conditionality imposed on programme countries meant that in many cases lack of 'ownership' in individual countries undermined the reform effort. A new balance needs to be found under the Recovery Plan, where conditionality is lighter and linked to adequately addressing all or a significant subset of country-specific recommendations made in the context of the European Semester that are relevant for recovery and resilience. While respecting this new setup, the review process will need to reflect this conditionality in a substantive and rigorous way, as it relates to both the efficiency of the use of funds in individual cases, as well as more broadly the future of EU governance.
- **Digital and climate.** In order to 'recover and transform', the twin digital and green transitions have been put at the heart of RRPs. Ensuring the national plans (and their methodology/metrics) attain the digital and climate targets and guaranteeing the 'do-no-significant-harm' principle will be important in this respect, as will be ensuring the additionality of EU funding in these areas, leveraging and not simply displacing private investment projects. In addition, as a number of green and digital projects will be similar across countries, a process of peer-exchange and learning from best practices in implementation should prove useful.

- **Transnational spillovers.** By design, the Recovery Plan prioritises national investments, and their 'ownership' will be national, not EU-wide. In the digital and climate areas however (and even beyond those), there are strong externalities and network spillovers. Neglecting these in the appraisal of projects at national level will result in the loss of an important opportunity to push forward European value-added and European public goods aspects.
- **Fiscal sustainability.** Once the pandemic is over and support is gradually and carefully withdrawn, members states will be left with higher levels of national debt and will have to reverse current fiscal positions. This is why it is important for RRPs to include measures that improve the quality of taxes and of public expenditure and thereby support fiscal sustainability over the medium-term, and clearly distinguishing one-off from recurrent expenditures.
- **Granularity.** For many EU countries, the funding linked to their RRPs will represent a one-off opportunity to reset their national economies. Experience shows that implementing such large investment efforts rests on a host of factors: having clear milestones, setting well-defined targets, adopting proper audits and controls, a robust economic impact assessment and cost estimates, and complementarity with other EU funds. It is this type of granularity that links the design of RRPs to a successful implementation phase.
- **Stakeholders.** Despite their technical elements, and especially since the RRPs will combine reforms and investments towards transformation, their success will hinge on being embedded in societal acceptance. The timing and quality of the involvement of national stakeholders will therefore be important in accompanying the process, and operating at different levels (from central to local), of national administrations and government.

8. Conclusions – Post-Covid Shaping Factors

In addition to its human, economic and social toll, Covid-19 is forcing us to rethink attitudes and policies across a number of areas that go beyond the critical success factors of the economic policy response. Some of the issues that stand out could be grouped under four distinct headings: the new emerging boundaries between state and market; revisiting the notion of subsidiarity in the new environment; reconnecting the EU/domestic with the international/global agenda; and the need for EU economies and policy-making to deal with longer-term structural shifts taking place.

1. **Defining the new boundaries between state and market.** As the pandemic ripped through European societies, it brought with it a new realisation of the importance of well-functioning health systems, as well as the ability of national governments and the EU collective to protect Europeans. This simple realisation is concretely translated in a number of policy shifts, or ongoing discussions, which may break new ground: from an emerging paradigm for fiscal balances and policy mix, to a new social compact (with higher minimum wages, a universal basic income, more progressive tax systems) or to the debate on strategic autonomy in key sectors/products that would increase resilience at national and EU level (encapsulated in the shifts from 'just in time' to 'just in case'). In all these areas, what is underlying is a rethink of the balance between what is provided by states and what is determined mainly by market forces. This policy shift is evident across most EU nations, as well as in the United Kingdom and the United States. In a medium-term perspective, it will be crucial that the renewed emphasis

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on strong social protection does not hamper – but actually enhances – the reallocation of factors of production. Shifting from on-the-job protection to in-the-market protection will be a key challenge.

2. **Revisiting subsidiarity.** A related issue concerns the balance of what belongs to the domain of national policy in member states and what is a matter for the EU collective. This gives a new twist to the discussion on subsidiarity, as can already be seen by the decisions around the EU Recovery Plan or the proposals on a European health union. The pandemic revealed the need for coordination at EU level and forced cooperation in a number of areas, from travel rules to vaccine procurement. Post-crisis, there will be a review of what has worked and what has not: on certain issues, coordination of national policies will suffice; on others, direct supply at EU level will be needed. As health is a global public good, there will be a need to 'elevate' a number of issues surrounding the prevention and management of future pandemics to the to EU level. At the same time, the pandemic has highlighted the importance of rebuilding a more 'dense society', achieving solidarity through a sense of belonging, and not just from the services delivered by the national welfare state. This would suggest moving policy delivery in the opposite direction, to the local level, closer to citizens. In Einaudi's tradition of marrying economic freedom and social cohesion, in the post-Covid world, the role of communities and intermediate bodies will be enhanced (Einaudi 1949, Gigliobianco 2010)[3].
3. **Reconnecting the EU domestic with the global agenda.** Covid-19 is also pushing the EU to reconnect the domestic with the global agenda. This is where the other dimension of strategic autonomy belongs - the one dealing not with global supply chains but instead with new geo-economic relations. In a situation of geopolitical re-ordering, with difficult trade relations and blocs in flux, upgrading the global role of the EU will be essential in order to be able to influence the discussion on European and global public goods (not just health and pandemics, but also climate and digital governance), as well as avoid beggar-thy-neighbour policies in areas such as trade or finance. The domestic ramifications of a more assertive global role of the Union are substantial: the Single Market will need to provide a more 'indigenous' source of growth and enhance the robustness of Europe's value chains; macroeconomic policies will have to reduce the dependency from external demand, acknowledging that persistent current account surpluses are a source of vulnerability. It is also in this context that one should reflect on the need to complete the EMU; while bringing to a conclusion the reforms that started with the eurozone crisis is important in terms of better functioning of the EU and increasing its resilience to shocks, it is also essential for bolstering the international role of the euro and thereby increasing the weight of the European Union on the global economy. The issuance of common EU debt under Next Generation EU will also help to increase the attractiveness of the euro[4].
4. **Responding to longer term shifts.** The final Covid policy take-away concerns the need to respond to longer term structural shifts. In the pandemic, everything digital thrived. At a first level, this clearly requires a European push to digital - and indeed the EU Recovery Plan is supposed to help the EU 'recover and transform' with the twin digital and green transitions. At the same time, the dominance of digital raises new policy issues regarding regulation and competition in digital platforms, as well as issues around

3 The role of communities in breaking the rural-urban divide and the 'third pillar' in finding a new balance between the market and the state are explored by Collier (2018) and Rajan (2019).

4 The huge success of EU debt issuance under the programme SURE shows the large appetite in financial markets for common euro-denominated bonds.

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protection of workers in a new online environment. The changes brought by Covid will also force a broader rethink of the role and nature of work, the role and rights of remote workers and even the new meaning of 'essential workers'.

The policy response to the current crisis has broken new ground. At the same time, the difficulties with vaccines delivery and uncertainties on the follow up at national level on Next Generation EU have shown that the latest advances will need to be consolidated. Whether the response to the pandemic marks a fundamental shift in the paradigm of European integration – and hence ultimately meets the Monnet Compatibility Test - or it remains an 'exceptional one-off' under extreme duress, will depend on addressing the four shaping factors highlighted above.

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