Integration at a Crossroads: The Future of the EU and German European Policy

Factsheet: "Economic Recovery and Solidarity"

The COVID-19 crisis has affected our societies in profound and multifaceted ways. Far beyond the public health threat, the crisis has caused economic dislocations as well as social disruptions testing political processes and institutions. In particular, specific measures taken by national governments to contain the virus as fast and effectively as possible put a strain on multiple economic strands testing the solidarity between EU member states.

- What would make the economic recovery in the EU a success?
- How can the EU counteract rising public debt levels and stabilise sovereign bond markets?
- Can the recovery plans support the achievement of the European Green Deal's goals and what can

Goal

The EU has launched the largest aid programme in its history - financed by joint debt. With the "Next-Generation-EU" fund (NGEU), a recovery package worth 750 billion adopted in July 2020, the EU wants to cushion the economic consequences of the COVID-19 crises and support economic recovery. The post-pandemic Europe should be more environmentally friendly, more digital, more resilient to crises and better able to withstand current and future challenges. The Commission plans to raise around 80 billion euros in bonds by the end of 2021, after assessing the member states' recovery and resilience plans. The establishment of a sovereign debt restructuring mechanism (SDRM) is one of the important issues in the debate on a viable constitution for the European Monetary Union (EMU). The conditions created by the COVID-19 pandemic and the NGEU could potentially be an opportunity to usher in a Fiscal Union of states.

Challenges

- The asymmetries in the incomplete economic governance of the Eurozone as well as more far-reaching reforms in this realm – notably, the adoption of mutualised Euro-denominated debt and the generalised use of grants over loans – demand for further consideration.
- Member states have very different interests, especially along the ever-existing North-South divide. Two specific risks with which Southern and Eastern member states might be confronted are the traditionally slow absorption rate of European structural investment funds and limits to the capacity of national governments to channel very large amounts of public investment.
- The time-limited nature of the NGEU and Support to mitigate Unemployment Risks in an Emergency (SURE), as well as the limited potential of additional loans through the reformed ESM question the efficiency to prevent a future sovereign debt crisis and to address the structural shortcomings of the EMU.
- The common debt issuance of the EU results in significant redistribution across member states. Three dimensions might lead to potential conflict in this regard: the fiscal dimension, the rule-of-law dimension and the policy dimension, especially the climate and digitalisation agendas. Relatedly, the main risks to the success of the member states' respective recovery programmes correspond to: potential mistargeting due to the wide range of objectives and eligible measures; the maintenance of

unsustainable sectors; delays in implementation; and the lack of capacity to implement such a complex programme above the normal EU budget. These risks could lead to ineffective programmes that are unable to generate the kind of returns necessary to ensure economic sustainability and achieve social and environmental goals.

Possible Solutions

- While additional borrowing is highly problematic for a number of member state governments, more EMU-specific transfers and permanent mechanisms are needed.
- Risks attached to the recovery programmes of member states can be mitigated or avoided by implementing serious structural reforms in member states, specifically in their public administrations, labour market laws and programmes, and fiscal systems.
- There is a necessity for introducing better management and control systems at EU level e.g., through a single audit system.
- The implementation of well-designed active labour market policies that prepare member states for more digital, sustainable and flexible economies is also urgently needed.
- Member states have to elaborate a clear framework for public private partnerships (PPPs) to ensure that they are used more effectively. If such a legal framework is not in place, this could lead to a suboptimal risk distribution between the public and private sector (e.g., placing excessive risk on the public sector).

German Dimension

- *Relevance:* Germany's economy contracted by just under 5% in 2020, outperforming most European peers. A green transition is key to Germany's recovery program, while further growth in exports and services sector is expected in line with re-opening plans.
- *Position:* Although Germany had always rejected ideas about joint borrowing, the COVID-19 pandemic changed Germany's attitude. German Chancellor Merkel presented the initiative for the Recovery Fund together with French President Macron, although emphasising that the plan and programme was targeted and limited in time and that the European Commission was given a one-off authorisation to borrow bonds on behalf of the EU.
- *Outlook in view of German federal elections:*[1] CDU/CSU do not believe that the EU will need a Fiscal Union. They explicitly want to swiftly reinstate fiscal rules of the Stability and Growth Pact and the Fiscal Treaty after the COVID-19 pandemic, highlighting that the common raising of debt is only a temporary stand-alone solution, which must never be an entry into a Debt Union. The FDP shares the same opinion. Conversely and besides maintaining that the Stability and Growth Pact should develop into a sustainability pact, the SPD calls on sticking to Europe's common investment policy, which was started in the COVID-19 crisis, instead of returning to the austerity policies of the past. The EU must be able to act in terms of fiscal policy and develop into a genuine fiscal, economic and social union. The Green Party favours a sustainable investment fund, which the EU should use as an instrument for a sustainable, own fiscal policy. The EU should also receive the revenues of the carbon border adjustment mechanism. Similarly, DIE LINKE believes that in view of the challenges posed by the pandemic and climate catastrophe, the EU budget must be expanded by issuing European bonds. On the contrary, the AfD demands an immediate halt to all EU borrowing.

[1] Based on the party's respective electoral programme of 2021.