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Rediscovering Economic Policy in Europe?

Nicola Acocella✉
Emeritus
Sapienza University of Rome

Abstract: This paper, on the one side, deals with developments in economic policy as a discipline and, on the other, tries to check whether the recent pandemic has had (or could have) an influence on the direction of changes of the European Union institutional design, which was born under the influence of free-market doctrine and the *Ordnungspolitik*, now outdated. The provisions implemented due to the pandemic could (or could not) be a durable route for pursuing a number of targets, among which promotion of economic growth and reduction of inequality within and among European countries.

JEL classification: B29, F33, H77, N44
Keywords: Economic policy; Free-market doctrine; European institutions; Asymmetries and imbalances; Impact of pandemic

✉ Address: Sapienza University of Rome, Via Castro Laurenziano, 9, 00161 Rome.
Mail: nicola.acocella@uniroma1.it.

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1 Economic Policy as a Discipline

1.1 The Birth of the Discipline and its Development

The "core" of the discipline of economic policy to some extent autonomous from economic analysis emerged in the United Kingdom, Poland, Scandinavian countries and the Netherlands. It had, first, to justify the action of public institutions after Adam Smith's statement about the virtues of competitive markets. In addition, it should prescribe a set of rules for consistent and effective public action. These two branches would constitute the core of the discipline that has emerged in the 20th century. This core is articulated in its two "pillars", respectively, the "logic" and the "theory" of economic policy to be applied to real situations of specific countries or regions according to their historical and institutional backgrounds.

Adam Smith first suggested a theory of institutions and a role for the state. He is usually considered as claiming that the action of individuals motivated by self-interest and acting in a free market would ensure, as led by an "invisible hand", some kind of social benefit, thus limiting government action to a few essential actions (Smith, 1776)[1]. After Smith, in the course of the Nineteenth century, a stiffer line of reasoning had developed in the economic discipline, asserting the reasons for a "night-watchman" state.

Over the years, the night-watchman position became an exception, as most classical and marginalist economists tended to state a number of specific or general cases, in addition to those claimed by Smith and supporters of the night-watchman argument, where government intervention was in order. All the same, until the 1930s, there were only some "general" principles, stated mainly by Sidgwick (1883), Marshall (1890), Pigou (1912; 1920), and others, justifying microeconomic government intervention in a market economy, due -using the concepts developed by Marshall and Pigou- to divergences between the marginal private and social net product. However, in most cases, only a set of practical rules was stated, aiming at asserting technical procedures of government intervention in the realm of microeconomics (in particular, customs policy, price controls and taxation) and banking and monetary theory.

The 1930s and following decades saw a number of developments laying down further essential theoretical seeds, partly following the emergence of new pressing practical requirements, such as those deriving from the Great Crisis.

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1 However, a simplistic version of Smith's thought based on the dominance of interests, with no role for sentiments, must be refuted. From another point of view, Smith believes that both the market and the state play an important role.

First, on the side of the justification for government intervention in market economies, a debate began in the 1930s and continued in the 1940s involving some leading economists of the time, such as Robbins, Harrod, Hotelling, Kaldor, Hicks, Scitovsky and Little. This concerned the principles of government intervention, the role of distributive considerations vis-à-vis those of efficiency, the need for effective or potential compensation and the possibility -and necessity[2]- of taking both efficiency and distributional aspects into consideration in order to maximise a society's economic welfare starting from individual preferences mainly.

Moreover, a further justification of government intervention -in addition to microeconomic failures of the market- was laid down in macroeconomic terms. A subject such as macroeconomic analysis and policy barely existed until the 1930s[3], as these only started with Michał Kalecki (1933)[4], Ragnar Frisch (1934) and John Maynard Keynes (1936) contributions, which, however, were not easily accepted in many European countries. The logic of economic policy had thus a complete articulation.

Finally, the possibility of empirical testing of theoretical propositions as a consequence of the birth of econometrics offered the opportunity to take into account the multiple interrelations that exist in an economic system for coordinating government interventions directed at a set of different targets.

In the 1950s a new important seed was added that contributed to the foundation of economic policy as a discipline. This was the statement of the principles for coordinated and consistent policy action, the so-called theory of economic policy developed by Ragnar Frisch (1949, 1950, 1957), Jan Tinbergen (1952, 1956), Henry Theil (1956, 1964) and James Meade (1951, 1955). Economic policy as a discipline had finally a core including a complete logic -i.e., a set of principles stating the foundations- of government interventions from both microeconomic and macroeconomic perspectives and a theory of government intervention, i.e., a full guide for consistent and effective policy action. However, the two pillars were still not linked one to the other to serve as a cornerstone for the new discipline of economic policy, a branch of the economic science tied to, but separate from, economic analysis and public finance.

These advances made it possible for an autonomous discipline to finally sprout, mainly in Scandinavian countries and the Netherlands in the 1950s.

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2 The result of the impossibility of separating efficiency from equity considerations made it impossible to follow John Stuart Mill's precept of the necessity for economic policy to intervene only for distributional matters.

3 This does not imply the absence of any kind of macroeconomic interventions in previous years. To be true, these were generally 'negative' (tending e.g. to balanced budgets) rather than 'active' or 'positive' actions. A possible exception were interventions of the Bank of England reacting to deficits of the UK balance of payments.

4 Kalecki's contributions remained practically unknown in Western countries, at least until 1935, when they appeared in Econometrica and Revue d'Economie Politique (see Kalecki, 1935a; 1935b).

Zeuthen (1958) finally linked the two pillars of the discipline. The geographical location of the fathers of the discipline was the product of a number of circumstances: not only the political trends and social substrate prevailing in those countries but also their full participation in -or even anticipation of- the wave of theoretical innovations that had produced the slow but steady developments of the essential seeds of the discipline.

Italy had been rather isolated from such developments -at least those in which we are interested- during the Fascist phase, but in the 1950s it was ready to import theoretical advances from abroad as a result of the concurrence of specific circumstances rather different, however, from those operating in Scandinavian countries, the Netherlands and the U.K.. The leading Italian economists that introduced the main elements of the new wave were Marrama, Di Fenizio, Caffè, Graziani. Starting late did not prevent theorists in this country from soon borrowing the new discipline in the early 1960s (see the translation of Zeuthen, 1958). Moreover, they offered -in the years after 2005, together with other theorists well trained in the original, classical theory of economic policy- possibly decisive advances for its re-emergence, after a long decline starting in the 1970s, as an effect of what seemed to be a fatal critique of part of its core, i.e., the theory of economic policy.

Other countries too were isolated and some of them -such as Germany- remained in this position also after WWII. An "Ordoliberal" theory was developed in this country by the Freiburg School between the Thirties and the Fifties, which holds that the state must first[5] create a proper legal environment and regulation for the economy (Ordnungspolitik) in order to maintain a healthy level of competition and avoid the emergence of monopoly (or oligopoly), which would reduce the advantages offered by the market economy, and possibly undermine good government, by transforming economic power into political power. This theory was largely implemented in the Fifties and the Sixties and then again -after the parenthesis of Social Democratic government- in the Eighties. This is important to explain some foundations of the European institutions, as certainly Germany exerted a heavy influence in their construction[6].

1.2 Its Dismantling: From the Keynesian to the Chicago School

In fact, the theory of economic policy had been apparently dismantled - even before the final statement of the discipline- by a number of critiques. These started with Arrow's theorem (Arrow, 1951) stating the impossibility of taking people's preferences as a reference for public action, which seemed to make it impossible for the theory of economic policy to serve as a basis for democratic interventions by governments.

A few decades later, Phelps and Friedman arrived at the conclusion that monetary policy aiming at higher employment is ineffective in the long run

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5 To be complete, this policy also implemented social security, incomes policy and price level stability.

6 For many of the previous remarks see Acocella (2018).

if people have "adaptive" expectations (Phelps, 1967; Friedman, 1968). Finally, and more forcefully, arrived Lucas (1976) conclusion about the ineffectiveness of economic policy with 'rational' expectations, which seemed to be a well-founded assumption for rational people.

As for practical orientations of policy action, Thatcher's and Reagan's election as the UK Prime Minister and the USA President in 1979 and 1980, respectively, signed a first practical victory of the new ideas about the effectiveness of economic policy. The attitude of the German government gave way to the same practical result, even if its inspiration was different, as said before.

A second practical victory of these ideas has to do with the tracts of the institutions designed for the European Monetary Union in 1991-1992. We will deal at length with these in the next section.

1.3 Revaluation of the Classical Approach: Re-establishing the two Pillars

This revaluation refers first to the critique of Arrow's impossibility theorem. Arrow's axioms normally reflect value judgements, which may be more or less acceptable. A long debate, involving also Sen's and Nussbaum's concepts of justice[7], has shown the possibility of constructing a social ordering (see, e. g., Arrow et al., 1997), which makes the first pillar of the core of economic policy well founded.

The critique to the second pillar of the core, i.e., the theory of economic policy, was not addressed for a long time, which contributed, from the theoretical point of view, to the decline of economic policy as an autonomous discipline and, from a practical one, to a number of practical decisions, including that referring to the choice of the institutional design of the European Monetary Union. As said, we will deal with this in the next section. As to the former pillar, it must first to be said that, as a consequence of assuming rational expectations, for a long-time mainstream economics has been trapped in Lucas critique. Its overcoming passed through the demonstration of the equivalence of rational expectations to a strategic game (Acocella and Di Bartolomeo, 2005; 2006).

It is easy to understand that assuming rational expectations amounts to an implicit change in the nature of the economic system of interest to the policymaker. In a parametric setting such as that assumed by the classical theory of economic policy, there are certainly links between the decisions of the government and the private sector. These go, however, one way only, from the former to the latter. Otherwise, the government could not have any influence on the private sector. However, such links are defined, at least from the point of view of the public sector, in an unchanging context of the

[7] Their theory is based on the innovative concept of capabilities, which are the abilities of goods to achieve the essential benefits of people, such as being well nourished, healthy and able to move; having self-respect; being respected and able to take part in the life and progress of the community.

rules of the game. In fact, the policymaker perfectly knows the parameters of the latter's choice functions (e.g., the consumption function), and these do not change when he sets his instruments (interest rate, tax rates, etc.). The private sector has objectives that conflict with those of the policymaker, but can only change its behaviour in a way known to the public sector and cannot neutralise its action.

In a rational expectations context, instead, the private sector reacts to actions or changes of regime decided by the policymaker by changing the rules dictating its choice and can thus neutralise the policies in advance due to the rational expectations context. This would change not just the outcomes but also the way the system itself behaves. The policymaker then faces a system that is no longer parametric, and this in itself leads, according to Lucas, to a loss of control of the economy, i.e., policy ineffectiveness. In more technical terms, this would make the multipliers of policy instruments endogenously determined and conditional on the responses by the private sector.

This implication – though reasonable – might not survive an explicit way of dealing with the underlying conflict between the policymaker and the private sector in terms of a policy-game[8]. Put differently, this critique holds for the Tinbergen-Theil theory of economic policy, but that is not to say that it is true also of a revised or new theory of economic policy in strategic setting. It all depends on whether the private-sector reactions (or anticipations) can be accommodated in the policymaker's decisions or whether the private-sector reactions are strong enough to exactly offset what the policymaker is trying to do. In general, private agents can neither offset those actions completely nor would they try to do so.

The theoretical tools devised by the classical theory of economic policy are relevant for finding the outcome of a conflict. In fact, when a player has a number of instruments at least equal to that of his or her targets, his or her actions will determine the outcome of the game and reach the desired target values, notwithstanding actions by his opponent(s). This unless another player with target values different from those of the first player has a number of instruments at least equal to that of his or her targets. In this case, no equilibrium would arise[9]. This theory holds for both a static and a dynamic setting (see Acocella and Di Bartolomeo, 2005; 2006; Acocella et al., 2013). It thus opens the way for a new role of public institutions, no longer leaving the market dominate the economic scene in each state or union of countries.

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[8] A "policy-game" is a game that explicitly models the behaviour of players, the private sector and the policymaker, which are each conscious that their actions affect each other and can change them accordingly.

[9] If the target values do not differ, in principle, there are multiple solutions in the target space, but -because of this- the equilibrium in the space of instruments cannot be defined.

2 The Institutional Design and Policies of the EU

2.1 Their Content

The institutions designed at Maastricht are very simple. They are based on a monetary union, i.e., adoption of a common currency, the euro, issued by the European Central Bank, with no fiscal union and limits set to fiscal policy for each country, as established by the Stability and Growth Pact, to which a fiscal compact was added later. Practically no rule was devised for limiting current account imbalances. An asymmetric one was indeed conceived, setting unequal limits (lower current account deficits and higher current account surpluses), but it was even practically disobeyed by surplus countries, with no sanction[10].

A limited common budget was established for facing current expenses and expenses for some microeconomic policies, such as social and cohesion policy, regional policy, industrial, agricultural, and trade policies, but the size of the budget has been reduced over time, until it arrived at only 1% of the European Union's GDP.

2.1 Their Inspiration

The actual design of the EMU was largely contained in the Delors Report, after the practical rejection of most targets and instruments of the Werner plan[11]. This is the common name of the Report (dated April 1989) of a Committee established by the European Economic Community (Committee for the study of economic and monetary union, 1989). This Report was tailored to the experience of the European member states in the 1970s and 1980s. It evolved due to politically propitious circumstances, being partly mutilated, in particular with respect to common policies, and was implemented at the beginning of the 1990s.

In addition to a common currency, it required "binding rules" on the "size and the financing of national budgetary deficits", while rejecting increases in the size of the European budget as well as introduction of practically any other centralized European institution for the pursuit of economic policy, such as a fiscal union, common wage or industrial policy, on the base of the subsidiarity principle. Implementation of this Report was decided by the Maastricht Treaty of 1992, which was preceded by the Maastricht Accords of the previous year. The reasons underlying its conception and/or acceptance can be analyzed in terms of a strictly political, or of a political economy type, or strictly economic considerations. We refer to each in turn.

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10 Some authors such as Parguez (1999) and Bell (2003) place less emphasis on the role of current account imbalances as a cause of the crisis, due to the presence of the TARGET2 system that settles payments and their imbalances within the EMU.

11 This Plan devised a prospect of currency unification, a common fiscal policy and coordination of regional and structural policies.

Strictly political arguments can explain the Accords. The German unification made some kind of stronger tie between European countries necessary, which could also be seen as a continuation of the older argument of the necessity to keep Europe united in order to avoid political or even military confrontation. Undoubtedly, German unification had increased the power of this country. Thus, the desire became stronger "to strengthen the binds of the newly united Germany to the western nations" (Sadeh and Verdun, 2009: 280), even if the prospect for monetary unification had been devised before the destruction of the "Wall" by the Delors Report. In turn, "Germany agreed to EMU in return for international legitimacy for its unification and to prepare the then European Community to its eventual enlargement to the east" (Sadeh and Verdun, 2009: 280). Therefore, the Maastricht accords of 1991 that decided the establishment of the monetary union formally accepted the whole content of the Delors Report, determining -as said- applicability of the subsidiarity principle to all policies, with the exception of monetary policy. This represented the European political response to German unification. In particular, the Accords were a political bargain by the two most important EU members, France and Germany, as each tried to secure its vital objectives (Baun, 1995-1996).

As to underlying political economy factors, especially American authors tended to view the Treaty as a European response to globalisation, aiming at strengthening cooperation and instituting some kind of governance (Keohane, Hoffmann, 1994). Neo-functionalists, instead, see the Accords simply as an inevitable outgrowth of previous common policies, in particular, the Single Market (Tranholm-Mikkelsen, 1991)[12].

Also, strictly economic considerations are various:

1. A first justification of the monetary unification can be found in the benefits accruing to all countries adopting a single currency as an effect of forming a currency area, independently of whether conditions for an optimum currency area were satisfied or not before. One such justification sees the EMU as a "natural" evolution of previous institutions; this can recall one of the previous political economy considerations, but is based on more strictly economic arguments.
2. Another justification is based on the need for a stabilisation of the exchange rates between European countries, deriving from the partial failure of the European Monetary System (EMS), which had ensured a reduction of the exchange rate fluctuations between the various countries, but had not completely eliminated exchange rate adjustments among the twelve countries. Stability of exchange rates was required

[12] In different terms, some authors believe that European integration is related to the growth and the new qualities of globalisation, which require supra-national regulation. According to Neo-functionalism, instead, the integration of EU states – through the executive power and the interest groups – is an inevitable outgrowth of previous common policies and satisfies the pursuit of the welfare objective and peace.

especially by Germany, which wanted to avoid the realignments by countries with a higher rise in nominal wages and prices tending to regain their competitiveness[13].

The second justification has also to do with the impossible trilemma, or "trinity" (due to Fleming, 1962, and Mundell, 1961; 1962; 1963), which states the impossibility of simultaneously pursuing the following three objectives: a fixed exchange rate, free capital movements and independent monetary policies.

The reasoning underlying the impossible trinity is based on the uncovered interest rate parity condition, which states equalisation of international (nominal) interest rates up to expected changes in exchange rates as the outcome of free capital movements. The following three situations could arise, which show the reasons of the impossibility in detail:

a. If there are to be independent monetary policies in the various countries together with free capital movements, there would be a tendency to changing exchange rates, as capital would move from countries with lower to those with higher interest rates, in case exchange rates remained fixed.
b. If there are to be credibly fixed exchange rates and free capital movements, there should be no independent monetary policies, as these would cause capital flows pressing on fixed exchange rates.
c. If we aim at having independent monetary policies and fixed exchange rates, we cannot have free capital movements. In case these were free, they would push for higher returns, making it impossible to keep the rates fixed.

As the three objectives mentioned above cannot be pursued at the same time, an international institution will have to opt for one of three policy options, respectively, with reference to the conditions just indicated: a) independent monetary policies of each country, free capital flows and flexible exchange rates; b) fixed exchange rates between the countries, free capital movements, no independent monetary policies; c) fixed exchange rates, independent monetary policy, no free capital flows.

In devising new institutions for the EU, the Maastricht Treaty reacted to the memory of the failure of the EMS and its underlying factors and chose the second option. The other two options were seen as either dangerous with respect to the final aims of European integration; or as politically unacceptable, in that they involved a departure from free-market principles (in the case of the third option) and/or from monetary discipline and price stability (in the case of the first option). Free-markets were thought to be helpful in furthering integration and economic progress. Price stability was one of the overriding targets of some countries, notably Germany.

13 Deeper considerations in favour of these two justifications and the related literature can be found in Acocella (2020: chapters 3 and 7).

3 Structural Imbalances and the Impact of the Financial Crisis

Expectations for the possible accomplishments of the European Monetary Union were high (e.g., European Commission, 1990, 1991). Only a few critiques, which grew later, were raised against the project of a monetary union, claiming that this was deprived of some essential preconditions for its proper functioning and aimed almost exclusively at achieving monetary stability while not being complemented by other institutional pillars tending to cope with imbalances and stimulate growth in an uneven environment.

However, there were asymmetries between the different countries. They had been reduced, but not eliminated, in the transition to the EMU and also afterwards. The asymmetries were due to behavioral and structural factors -also of an inertial kind- in peripheral countries (but also in the core to some extent). Asymmetries showed themselves mainly in the public accounts of some of them as well as in other features of the economies of all peripheral countries, such as higher inflation rates. They derived mostly from diffuse inefficiencies, but also, to some extent, from the Balassa-Samuelson effect.

Persisting these structural differences between peripheral and core countries, together with the high (low) level of domestic demand deriving from high (low) public spending, the current account of the balance of payments of the former (the latter) would tend to be negative (positive). However, this did not worry the majority of scholars. Blanchard and Giavazzi (2002: 186) concluded that “although benign neglect may not be optimal, it appears to be a reasonable course of action.” Any imbalance in the current account would be cleared by free movements of capital and, in any case, over time, the common currency as well as integration of markets and limits to public deficits and debts would induce policymakers and other agents to change their conduct. This change in the conduct of public and private agents in higher-inflation countries was at least an implicit assumption behind the institutional design of the EMU.

These agents would introduce needed reforms, with the result of eliminating public accounts imbalances, reducing public debt, rising competitiveness, and reducing risk prospects (see, e.g., European Commission, 1990; 1991; Fernandez-Villaverde et al., 2013). This would occur not only in higher-inflation countries, but also in other countries, such as France, that suffered from other kinds of imbalances.

Germany current account imbalance is to be analyzed in more details. This country pursued an export-oriented strategy even before 1999 and then with labour market reforms (the Hartz reforms) in 2003-4 and managed to tighten fiscal policy, while acting also on the other factors that affect efficiency and prices. Peripheral countries did not catch the implications of this and lulled in their apparent prosperity due to expansionary budget balances (in some countries) and capital inflows from the other EMU countries that had experienced or were experiencing a fall in relative inflation (notably, Germany). When the financial crisis occurred, a big turmoil ensued, as German capital owners who had invested in peripheral countries withdrew their capital, which implied that governments of the latter had to rescue ailing banks, with an ensuing rise of public debt and the possibility of a sovereign crisis.

4 The Impact of the Pandemic and the Provisions to Face It

4.1 The Impact of the Pandemic

In 2020 employment fell in the range between 1 and 6% in the United Kingdom and the EMU, on one side, and the United States, on the other. The reduction in employment is attributable essentially to small businesses. In addition, certain sectors (hotels, restaurants, food, education, real estate and transportation) and less educated, younger and lower paid workers with temporary contracts were particularly affected. As said, small businesses have suffered the most from the pandemic up to a certain date, as shown by the evidence available in relation to the United States. This is due to three reasons: first, their structural weakness, which had led 60% of them to lay off at least one worker before government provisions were introduced; second, owners' expectations, already negative to begin with, deteriorated over time, with 37% of respondents initially having negative expectations for the next two years, a percentage that later grew to 46%; and finally, smaller businesses are not at all aware of existing government provisions (Humphries et al., 2020). However, later evidence shows that these effects have been reversed in later months (Decker and Haltiwanger, 2022).

In Europe among the medium-high GDP countries Spain (-10.8%) and Greece (-8.2%) GDP showed some of the highest drop in 2020. The Italian GDP suffered a contraction of 9% in 2020 and partially recovered in 2021 (+6%). In 2020 domestic demand fell by 7.5%, net exports of goods and services by 0.2%, while in 2021 they reduced by 27%. In December 2020 in this country the unemployment rate has risen to 9%, while employment has dropped to 58%. The outlook is partially encouraging, but Italy and most other countries will have to wait until 2023 to return to the GDP level of 2019: according to OECD estimates, Italian GDP will grow by 4.1% in 2021, with another jump of 4% the following year.

To make a comparison, the first two European economies, Germany and France, closed 2020 with a contraction of GDP equal to - respectively – 4.6% and 8%, partly recovering in 2021 (2.9% and 7%), respectively.

4.2 The Interventions

Apart from the interventions of the monetary authorities and macroprudential policy, new credit measures have been implemented at the European Union level. As for the European Stability Mechanism

(ESM)[14], the details of the financing were only clarified in early May 2020. On the occasion of the epidemic, it was specified that conditionality relates only to the object of expenditure (medical and health care), and not to the adoption of other measures to reorganize the existing public debt, which would otherwise have slowed the use of the Mechanism by heavily indebted countries such as Italy. The loans have a term of ten years and a rate of 0.1% is applied to them. If we consider that the interest rate on Italian 10-year BTPs was 1.83% at the beginning of May 2020, recourse to the ESM became convenient for Italy, as it ensured a lower financing cost of 1.73 % per year. On a loan of up to 36 billion, the savings would have been greater than 600 million euros per year (Accademia dei Lincei, 2020). Since then, the interest rate has lowered in this country by about 1 p.p., but the ESM loans are still convenient. However, it should also be noted that access to the Mechanism by a country could imply a reduction in its credibility and therefore an increase in the cost of other loans.

The EU Commission can authorize state support for: 1) direct subsidies and tax breaks aimed at meeting urgent liquidity needs up to € 800,000 per company; 2) state guarantees on bank loans; 3) public loans at subsidized rates; 4) aid to banks to finance businesses; 5) short-term export credit insurance; 6) support for research and development against Coronavirus; 7) deferral or suspension of taxes; 8) income support for employees.

In addition, the European Investment Bank (EIB) has created guarantee funds for bank loans to companies with an endowment capable of supporting loans for a total of 240 billion euros. The funds should be financed by EU member countries according to their participation in the Bank's capital. Various funds were then set up such as SURE (Support to mitigate Unemployment Risks in an Emergency) and other funds for a total of 540 billion euros. SURE is a new instrument that should guarantee temporary support to reduce the risk of unemployment in emergency situations and could raise up to 100 billion on the market through a system of guarantees by member countries to finance those countries that were in difficulty (European Commission, 2020a). In addition, the EIB will set up a pan-European guarantee fund to support European workers and businesses affected by the pandemic crisis, and finally the agreement to channel support through the ESM has been confirmed. In July 2020, the so-called 'Recovery Fund' was also defined. It has been renamed 'Next Generation EU' (European Commission, 2020b). With this newly created fund, the European Commission intends to raise up to 750 billion on the market[15], giving long-term funds as collateral made available by a

[14] This is the institution created by the euro area member countries to provide emergency loans for a total of €700 billion to states that undertake reform programmes.

[15] In its essential lines, the Fund follows many of the proposals already suggested by Garicano (2020). Various criticisms have been raised, in particular by Clancy (2020), who points out the relative scarcity of the size of the Fund compared to the initial advances of the President of the European Commission, Ursula Von der Leyen.

(temporary) increase in the European budget 2021-2027 up to 1.8% of the EU GDP (therefore raising the current amount of the budget by around 75%), from new direct contributions (for 390 billion) and greater guarantees from member countries[16]. The funds will be repaid against future budgets, not before 2028 and not after 2058[17]. Coverage will be offered by new EU own resources, such as the Environmental Emissions Trading System, new corrective border levies for products that involve excessive carbon emissions[18] and other resources, such as a new tax on those multinationals that, as said, can use digitalisation for access to tax havens, as also requested by the OECD. On the objectives of the Fund there have been people who understand it as aimed at short-term purposes, that is, it is a tool to support the economy. But various considerations lead instead to favouring those of a structural nature (see in particular Pisani-Ferry, 2020). Moreover, we can add that the long-term, generational objectives transpire from the same denomination.

The use of these funds was also allocated by the European Commission to countries with greater difficulties (see Figure 1), Italy and Spain in the lead, to carry out investments and reforms necessary for recovery. The reason why the Mediterranean countries, also supported by France, have advocated this tool is that, unlike the others, these are resources that are partly made-up by very long-term loans, therefore to be repaid much later in time and at rates lower than those of national bonds, and partly non-repayable. The main recipient will be Italy, which will receive 208.8 billion (of which 81.4 through non-repayable subsidies and 127.4 in loans). Spain will receive a total of €140 billion (72.7 of which non-repayable), France 39 billion, Greece 31.5, Portugal 26.1 and Germany 23.6.

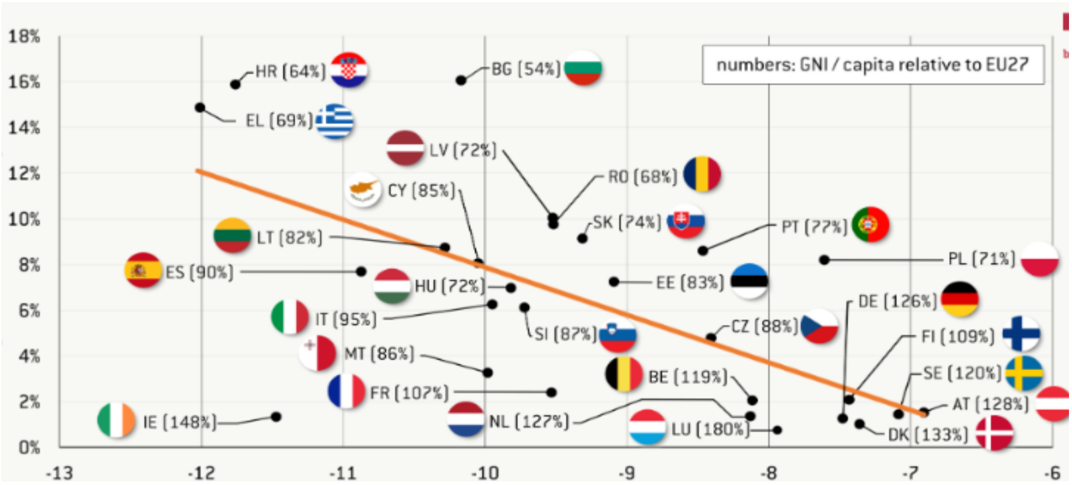
According to the President's initial statements, the total recovery effort would have amounted to 2.4 trillion euros, which is obviously an exaggerated value, perhaps deriving from the sum of inconsistent figures. An in-depth analysis of the issue is in Clancy (2020).

[16] Gros (2020) had made similar proposals for the content of the Fund under consideration, suggesting to activate Coronabonds or, better, transfers from the EU budget, for example, simply by exempting the weaker countries from their contributions to this budget for the next seven years 2021-2027.

[17] Giavazzi and Tabellini (2020) had already suggested the issuance of very long-term (50- or 100-year) or irredeemable securities (i.e., securities having no maturity and with a fixed coupon or consolidated public debt securities), which would not substantially burden the existing public debt of countries and could be bought by the ECB.

[18] By June 2021, a proposal will also be presented for the establishment of a tax on the use of polluting fuels (carbon tax), which will be called the "border adjustment mechanism". This provides for a sort of "climate tariffs" for a series of products imported into the Union from countries that do not apply as stringent standards as the European ones against climate change.

Figure 1. Economic Shock Caused by the Coronavirus and Provisions from the Recovery Fund



Source: Darvas (2020b).

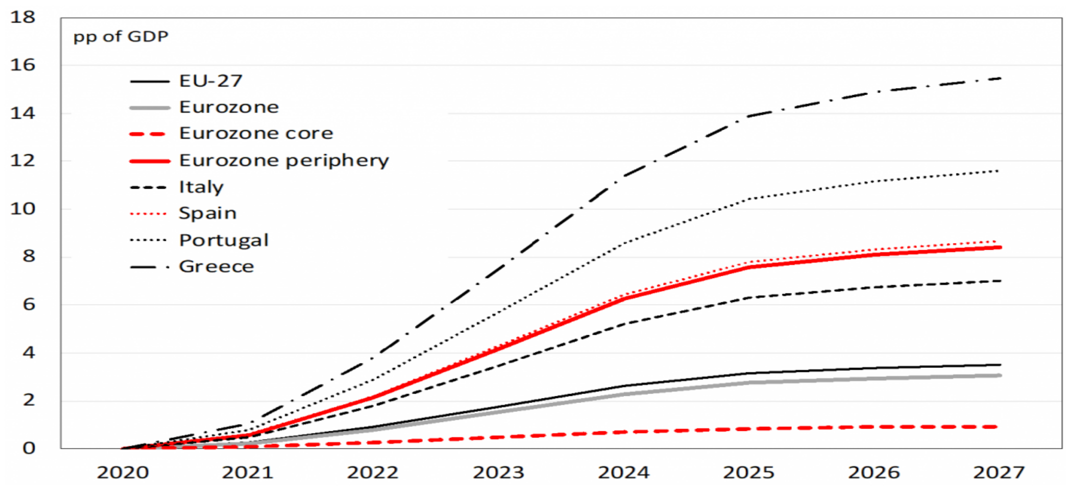
Notes: 1. The horizontal axis measures the size of the shock caused by the epidemic (in terms of the percentage of the change in GDP forecast by the European Commission between Autumn 2019 and Spring 2020). Thus, for example, for Italy, the 2020 forecasts indicate a reduction of about 10%. The vertical axis measures the Fund's provisions in percentage of the countries' net national income. For Italy they should be around 6%.

2. The numbers in parentheses after the country abbreviation indicate its per capita gross national income compared to the EU average for 2021, according to the forecasts of the EU Commission.

The estimated effects on GDP are shown in Figure 2. They are more favourable in the peripheral countries, Greece and Portugal first, and a little less for Italy. The so-called 'frugal' countries (i.e., Austria, Denmark, Finland, Netherlands, Sweden) have objected to the ratification of the Treaty for some months, but in December 2020 an agreement was reached which led to the approval of the Recovery Fund regulation by the European Parliament. By June 2022 most countries had received a large part of the funds allocated to them. Among the exceptions are Ireland, Poland, Slovakia and Bulgaria. Italy had received almost 45.7 bn, out of 137.9 bn allocated to it. Spain had received 19 bn, out of 146.7 bn. According to Darvas (2020a), who takes up statements from the European Commission, the disbursement of 3/4 of the funds will have to wait until 2023. According to Giovannini et al (2020), the disbursements for the loan component will be higher in 2022, while the peak of non-repayable grants should occur in 2024.

Among other measures, the Next Generation EU provides funds equal to 31 billion euros for the recapitalisation of companies, which should mobilise private resources to support economically viable companies in the sectors, regions and countries most affected by the pandemic.

Figure 2. Cumulative Effects of the Next Generation EU Fund



Source: Codogno and Van den Noord (2022)

Through the leverage effect, 300 billion euros should be raised. In reality, this intervention for recapitalising companies, while necessary, appears to be insufficient in the face of their growing debt[19].

Access to funds is not conditional on compliance with the Stability and Growth Pact (which, however, is suspended for now, as we will see shortly), but, obviously, on the adoption of 'structural reforms'. The disbursement of funds is subject to the presentation by individual countries of national spending plans that will be evaluated by the Commission and approved by the Council with a qualified majority, i.e., with the vote of at least 15 countries representing no less than 65% of the EU population. The approval will be accompanied by "country specific recommendations" (CSR). These will in fact constitute the reference for the evaluation of national spending plans, with particular attention to reforms that improve the potential for growth, employment and economic and social resilience. From interviews released by the competent authorities, the various countries could be required to guarantee implementation of policy guidelines such as to ensure: recovery of the economy in a reasonable period of time; sustainability of public debt; improvement in coordination between the different layers of government; strengthening of health and education and distance learning through digital tools; improvement of the efficiency of the judicial system and the public administration; the support of the vulnerable groups most affected by the crisis and of small and medium-sized enterprises and innovative ones; reduction of unemployment and increased investment in the green economy and digitalisation.

As for expansionary fiscal policies in the strict sense, first of all, as said, the Stability and Growth Pact was suspended for 2021 and the European

19 Boot et al. (2020) proposed a European Pandemic Equity Fund, particularly in favour of small and medium-sized enterprises.

Commission is studying its suspension also for 2022, which allows individual member countries to adopt significant expansionary fiscal policies financed in deficit. The ban on state aid to companies has also been suspended since mid-March 2020 to December 2021[20].

It would also be desirable to transform part of the national debt into European debt (Eurobonds or similar), to reduce the ratio of public debt to GDP, which is particularly high -or destined to become so- in some countries such as Greece and Italy. The advantages of issuing this form of mutualized debt are many. Among them, the lack of dependence on market ratings (i.e., assessments) of the reliability of sovereign debts and their variations, the reduction of spreads for the most indebted countries, which would thus reduce their exposure to the financial market and the possibility of banks using Eurobonds to diversify their portfolios, often burdened with domestic securities[21].

Further initiatives could concern: 1. the creation of a single European institution to be entrusted with the competences of national institutions, such as the ministries of health, in the event of an epidemic involving more than one country; 2. enhanced cooperation, to carry out a European investment project financed with securities and destined to specific fields (for example, bio-medical research, transport infrastructures, information technologies, giving equal access to the market through a level playing field). In the longer term, it is finally necessary to devise a European industrial policy that not only identifies priority sectors in which to invest, but that also favours aggregations between European companies, for example in the energy, telecommunications and bio-genetics sectors, strengthening European research platforms useful for innovative medium-sized enterprises and start-ups, on the model of CERN (Conseil Européen pour la Recherche Nucléaire, European Center for Nuclear Research), ESA (European Space Agency) and EMBO (European Molecular Biology Organisation). Then, various trans-European infrastructures could be enhanced (Accademia dei Lincei, 2020).

5 Conclusions

The pandemic seems to have been a game-changer in a number of ways, not only in the directions indicated by Gaub and Boswinkel (2020).

In fact, the EU interventions represent some kind of novel line of conduct of the European Union. From the point of view of economic policy, the EU was a kind of 'lame duck', with no enough powers and instruments to face economic problems. Practically, the sole economic policy tool -available to

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20 The apparent generosity of the concession -in the past particularly opposed by Germany- was linked by the media to the fact that German companies have already benefitted from half of the aid measures approved by the European Commission.

21 For previous proposals dealing with Eurobonds see De Grauwe and Moesen (2009), Giudice et al. (2019), Soros (2020).

the EMU only- was monetary policy. Macro-prudential policy had added only recently (again only in the EMU), while fiscal policy and other policy tools were blocked. For the first time, apart from the suspension of the SGP (Stability and Growth Pact), there is a kind of common fiscal policy, an increase in the level of the EU budget and possibly the issuance of common bonds. One can think that, proceeding along this way the precepts of the theory of economic policy presented before can be obeyed: the EMU would have a number of instruments equal to that of the issues that arise in the modern world, crises, stagnation, inequalities and face the challenges of globalization (Acocella, 2022).

The big issue that arises is, however, whether this novelty will be followed in the next years by: 1. a retreat to the course of rules preceding the pandemic or, worse, by disintegration of the Union; or 2. by some kind of confirmation of the new course or, even, a relaunch of the EU. We will call these two prospects, respectively, the pessimistic or optimistic scenarios. Let us examine them in turn.

1. A confirmation of the previous course would derive from a number of considerations. First, according to some authors, the attitude of European citizens -favourable to a new course- must be distinguished from that of the policymakers, especially that of the EU countries that hold a key position in the direction of European affairs, who could be more conservative. Moreover, additional cooperation could not survive the pandemic. According to some authors (Krastev and Leonard, 2020: 22), the drivers of the support for more common action at the EU level is unlikely to last and the cooperation will dissolve after the pandemic, since the roots of the attitude shown on the occasion of the Covid-19 lie in the idea that it is in each country's interest to implement some kind of common action against it. "This is a Europe of necessity rather than of choice".

According to Leigh (2020), something that can indicate this possible course of events is that EU members responded to the epidemic in disarray, each determining its own strategy. In addition, the Recovery Fund is considerably diluted with respect to the original Franco-German proposal, due to the lower size of the grant. In fact, the loan element has a limited attraction since the states could access the financial market on their own, paying very low interest rates. In case of a failure of the Next Generation EU, the prospect could be one of disintegration.

2. The optimistic scenario could and would derive from some kind of effective implementation of the reforms, on the side both of the abatement of the epidemic and of the results obtained by each country -also of peripheral and laggard countries- by the implementation of the aid. This could derive in particular by the improvement of the fundamentals especially of these countries. After all, the taboo of euro-bonds was broken by the Next Generation EU Fund. The philosophical foundation for the

relaunch scenario is a version of the Monnet[22] method, functionalism, and the theory of spill-over (Leigh, 2020).

It is really difficult to say now which scenario will prevail. There are reasons that can support both scenarios, which explains why many authors are undecided about whether the recent steps constitute a foundational Hamiltonian moment or just a transactional and time-limited Marshall plan (Camous and Clayes, 2020).

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[22] Jean Monnet was one of founder fathers of Europe. He said: "l'Europe se fera dans les crises et elle sera la somme des solutions apportées à ces crises" (Europe will be built in crises and it will be the sum of the solutions brought to these crises) (see Monnet, 1978).

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