ACCADEMIA NAZIONALE DEI LINCEI

The Covid crisis and a possible turning point for the European Union

Statement by the Lincei Committee on Covid-19

Summary

Introduction

The Covid-related health emergency has hit all countries in the world, but it has had a particularly violent impact on Italy. The overwhelming figures of infected people and victims are probably underestimated. Faced with the spread of the epidemic, the Italian government has taken, and presumably will have to go back to taking, drastic measures aimed at curbing the infection.

These measures inevitably affect both the personal rights of freedom, social coexistence and the economy. In some countries initially affected to a lesser extent by the epidemic, these measures have been criticized, sometimes even disdained, the protection of the economy being given priority, only to change strategy when the impact of the epidemic became manifest. *We agree with the need for measures aimed at curbing the epidemic, and we refuse to apply to the assessment of these measures the cost-benefit estimates put forward by several parties, which imply the attribution of a quantitative value to human life.*

We are now entering a stage in which the restrictive measures are being gradually slackened and – hopefully – overcome. Predictably, the recovery of personal freedoms and social coexistence can be faster, obviously excluding the scenario of a second wave of infection, while economic problems will remain open in all their seriousness for a long period.

From this point of view, it should first be made clear that the economic and financial setbacks, with their social consequences, do not stem exclusively from the so-called "lockdown" measures, and will not automatically disappear when these measures are no longer needed. In the past years, the global economy, and especially the major economies, did not show high growth rates as in the past, to the point that various economists were already speaking of "secular stagnation". This is even truer for Italy, which before the outbreak of the infection had not yet recovered the level of GDP it had before the great financial crisis of more than ten years ago. Regardless of the containment measures, in our country, as in many others, the epidemic has had a strongly negative impact. This has to be put down both to the disruption of the so-called global value chains (the fragmentation of production in various countries, with a complex network global supplies and sub-supplies), and – above all – to the sharp drop in consumption and investments. The drop has been immediate in some areas (personal services, tourism and transport) but it also appears substantial in a more general perspective, due to the uncertainty that suddenly emerged and to the dramatic initial stock market crashes, resulting in a negative "wealth effect" in many countries.[1] Against this background, the immediate intervention of the central banks managed to rein in the fall of the stock markets, but the infection containment measures have added new limits both to the supply side, in sectors where production activity has stopped, and to the demand side, in sectors where consumption requires or depends on physical presence.[2] Today, with the gradual restart in many countries – including ours – if on one hand it is mandatory to avoid a new increase in the number of infections, on the other hand many economic difficulties arise. The demand for export goods unavoidably has diminished, liquidity problems for families and businesses add up to the weight of old and new debts, and this can in turn create problems to banks and insurance companies. Furthermore, the governments' economic effort – mandatory in what is proving to be the worst crisis of the century – will leave behind a heavy burden resting upon public finances.

Consequently, the whole world, along with a tragically large number of human lives being lost, faces a dramatic economic crisis. We have already experienced a strong financial instability, hitherto kept under partial control by monetary policy authorities, including the European Central Bank (ECB), but with the risk of a sudden backfire. The simultaneous and widespread stop of several production activities and various types of consumer-and-investment activities (in the economic language, a simultaneous shock on the supply and demand side) leads to an income drop affecting, in a highly unequal manner, the various economic areas and social classes. This adds to the dramatic cases of sudden impoverishment in families struck by illnesses and bereavement. To give just a few examples, white-collar workers can often work from home, while blue-collar workers cannot; the shutdown of schools has a very different impact between male and female parents; in some sectors – for example, tourism, entertainment and culture in general, transport – the prospects for a recovery of their economic activity look rather grim.

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[1] This is the loss of value of the savings accumulated by families and businesses under the form of financial securities: a loss that can induce a substantial drop in consumption and investments in countries where the financialisation of the economy is more marked. A first OECD report is available at the address https://www.oecd-ilibrary.org/deliver/7969896b-en.pdf?itemId=%2Fcontent%2Fpublication%2F7969896b-en&mimeType=pdf

[2] In Italy, the fields of activity closed with the Prime Ministerial Decree (DPCM) of 25 March 2020, and now gradually reopening, are about half of the total, which provide slightly more than a third of the final consumption, half of the exports, and two thirds of national investments. Individual companies could, however, request the Prefect to be allowed to continue their activity for specific reasons and under particular conditions, and many did.

Many measures have been launched both nationally and internationally, aimed at providing an immediate relief from the effects of the most pressing economic disasters, but we are still far from a coherent relaunch strategy. The dramatic drop in the national income that we will experience in the coming months and, if far-reaching interventions are lacking, the negative prospects for the economy over a wider span of time will imply a sharp surge in unemployment and inequalities. *This can result in a dramatic social crisis*.

A social crisis, in turn, can have devastating political effects, as history teaches. Compared to the past, technological developments in the field of communications and information, which certainly contribute to growth, also appear to provide a new tool for social control that has to be carefully regulated to help fight the epidemic *without jeopardizing democracy and the rule of law*.

This paper – the first of a series of documents being prepared – aims at considering the main economic problems from a European standpoint. It seems thus appropriate to begin by outlining the European situation, the legal and institutional system in which economic and social policies and related aspects are organized, both because of the international nature of the ongoing crisis, irrespective of borders and nations, and because many of the solutions needed must be sought within the European Union. That, indeed, is the setting where the bulk of the debate is taking place in our country and in the other Member States.

1. A historical restatement: the reasons of the European Union

After the tragedies of the two World Wars, the united Europe ideal appeared as the right answer to the call for an appeasement between rival nations. It was also a project of economic resurgence through the creation of a large common market, capable of exploiting the economies of scale and scope allowed by technological development: consequently, the European ideal could reconcile the ideals of peace and prosperity.

The six founding countries of the European Common Market (ECM), and those that progressively joined in, gradually started pursuing a twofold objective: a closer cooperation and the geographical expansion of such cooperation. The two targets soon appeared partially in contrast. After the fall of the Berlin Wall, the Kohl-Mitterrand agreement allowed the obstacles to German unification, viewed with hesitancy by various European countries, to be removed, while a new opening towards the East was balanced by the strengthening of the European Union.

The launch of the single currency represented an important step in the process of consolidation. This, in theory, should have flanked and favoured a progressive and rapid strengthening of the European institutions in all fields. The establishment of the Union, however, actually came to a stop after the launch of the euro. The simultaneous entry into the Union of various ex-Komintern and ex-Yugoslavia countries has in part slowed down the process. *However, it must be stressed that such a turning point in the international political scenario was essential to grant stability and provide this group of countries a solid bond with the western world*. This was a comparatively important result (just think, on the opposite, of the Ukrainian events), which confirms the positive view on the crucial role of the Union.

The role of a European single market is therefore substantial both internally and for international stability. However, the common market and the common currency call for appropriate institutions in order to govern their dynamics with an effective and democratic approach. On the other hand, the (hopefully) temporary frozen process of consolidation of the Union leaves us with an unaccomplished legacy, as the political leadership is still decentralized and not fully transparent, and the main initiatives of economic policy, especially in times of crisis, are left to the ECB alone.

The great 2008 financial crisis, and the public-debt crisis that followed, have evidenced that the institutional architecture of the euro is far from being complete and has to be hastily strengthened. As is known, the European Union responded "too little, too late" to the first crisis in 2008, leaving the door open to a second crisis, in 2010. On the whole, the response focused on strengthening the ECB's role and tools, thus launching expansionary monetary policy measures that have expanded its balance sheet to an such an extent that, at the outbreak of today's crisis, it has not yet been reabsorbed. The elbowroom for fiscal policies has been considerably narrowed and, above all, there has been a substantial lack of coordination between the single Member States and between them and the European institutions. All countries have adopted, or have been forced to adopt, the same policies of spending containment and revenue increases, rather than set out to coordinate a form of expansion in some countries, which would lighten the impact of fiscal consolidation in the other countries. Moreover, this has worsened the territorial and macroeconomic imbalances within the Union, and has accentuated the competitive rather than cooperative nature of national economic policies.

In this regard, it might be useful to point out that while the economic theory recognizes the positive effects of a competition between businesses, there are no correspondingly sound reasons for claiming that competition between countries is preferable to cooperation. At a European level, the double crisis – which we believe encompasses the years at least from 2008 to 2013 – has evidenced that regarding the strategy for growth and prosperity two great alternatives are possible, as explained in Attachment 3. On the one hand, stands a competitive strategy inspired by neoliberal principles (based on the expansionary austerity theory) or by ordoliberal principles (putting an emphasis on international competitiveness); on the other hand, a strategy based on investment and demand-led growth is envisioned. So far, at a European level, the first approach has been preferred. The experience of these years, however, has shown that the heavy social consequences of austerity policies and the so-called "structural reforms" have brought along a centrifugal drift founded on nationalist feelings and mistrust towards the European institutions, which today hinders any agreement on common and shared solutions.

It is essential that the political approach can rise to the challenge of today's dramatic, haunting problems and those that we still have to face. With the sovereign debt crisis, the debate has sometimes taken up the tone not of a rational discussion on the merits and costs of Keynesian policies at European level, but has rather focused on the identification of the "merits" and "faults" of creditors and debtors. Such a moralistic approach has often failed to realize that the origin of the crisis lies largely in a series of problems, like the unaccomplished institutional architecture of the euro; speculation on poorly regulated financial markets; the deepening of international macroeconomic imbalances; and the inheritance of debts accumulated in previous decades. Such issues have little to do with the recent decisions taken by the governments or the citizens of single countries.[3] This time, the exogenous nature of the crisis, with problems arising in an area entirely unrelated to the management of national economies, could encourage taking the road of investment and cooperation at European and international level.

2. The Covid 19 crisis: a change is needed

The coronavirus crisis now brings Europe to a turning point. The establishment of the single currency has to be bolstered by taking substantial steps forward. In particular, tax havens within the Union have to be abolished, and tax policy must be coordinated with the construction of a common budget with strong income and expenditure capacities, for example in research investments, in the protection of the environment, in communication and transport infrastructure, until a true federal union is actually accomplished.[4] Otherwise, the European Union will remain a confederation of sovereign states, and in that case, the single currency is not going to survive.

As it happened with the global financial crisis and the sovereign debt crisis, this time too the first response of the European Union has focused on ultra-expansionary monetary policies and on a differentiated and non-coordinated response of national fiscal policies. Even when called upon the adoption of health and public order measures, countries have disagreed about the timing and methods of the shutdown first, and then about the restart plans, potentially increasing the risk of infection between countries.

As we shall examine later on, the response given by the ECB has indeed quenched a potentially dramatic financial crisis in its early stage, albeit leaving a strong instability behind. However, if an adequate coordinated fiscal policy response is not implemented, there is a high risk that the abundance of liquidity might generate speculative bubbles and instability of financial markets, as we are already witnessing, in the face of a stagnation of production and persistent unemployment, which are likely to get worse. Stabilization policies and policies aimed at granting the sustainability of credits and debts should be the

[3] See Attachment 2.

[4] Possibilities to pursue a tax *level playing field*, so that tax havens can be overcome, are dealt with separately in Attachment 1.

main remit of monetary policy; fiscal policy should instead take on the role of supporting and stimulating economic growth, above all through investment policies.

Unlike the previous crisis, coordination and support tools for national fiscal policies, as well as cooperation schemes in the health and research fields, have been launched or are being discussed this time. We hope that in the coming weeks and months the adoption of incisive common fiscal policies – such as those recently proposed by the European Commission – will support and confirm these positive initiatives. Conversely, the lack of shared measures could cast very negative effects on national economies.

Delays and divisions in the EU response to the Covid 19 crisis spread the distrust in the ideals of the European unity, thus putting the single currency at risk and, along with it, the construction of the European Union itself.

3. Importance and limits of immediate intervention

The immediate action taken by the European Union involved the monetary policy managed by the ECB and the overall macroeconomic policy, shared by the various political authorities of the Union. On this side, the debate on a wide gamut of measures is still open.

Faced with the first signs of instability in the financial markets that immediately followed the outbreak of the epidemic in Europe, and taking into account the heavy market reactions to some initial mistakes in the communication, the ECB has taken a series of forceful measures. Firstly, a substantial refinancing of the banking system has secured liquidity to the economy (although the problem of facilitating the provision of liquidity from banks to businesses remains; this is a task of the national authorities, being undertaken through the extension of State guarantees on bank loans to firms). Moreover, and above all, a new program for the purchase of securities, primarily of the public debt of the various euro-area countries, was undertaken; for the first time this had no longer to be linked to proportion to the countries' capital share in the ECB. This second type of intervention aims at countering speculation on yield differentials between the bonds of the various countries (the so-called spreads, identified in particular in the yield difference between the 10-year bonds of the various euro-countries compared to the German *bund*, considered to be the safest sovereign bond). As shown in Attachment 2, a widening of the spreads can generate a public debt crisis in some countries and, at the same time, a crisis in the single currency system. To this regard, it is very important that the ECB has immediately included Greece in its 750 billion euro *Pandemic Emergency Purchase Program* (PEPP), although they considered Greek securities unsuitable for previous monetary policy measures, due to their low credit rating.[5] The underlying principle is that one of the ECB's goals is to ensure a uniform monetary policy among the states that have adopted the euro, and therefore that the ECB itself does not lose control of interest rates in some areas of the Eurozone (in economics jargon, that there are no interruptions in "the transmission of monetary policy").

As far as 'real' markets are concerned, the Union immediately took two important measures. First, a suspension of the Stability and Growth Pact, which allowed Member States to immediately adopt large expansionary fiscal policies, financed by issuing new public debt; secondly, a partial but adequate lift of the ban on State aid for businesses, which allows interventions in sectors and for businesses at risk of bankruptcy because of the health crisis. In both cases, the responsibility and the cost of the choices are delegated onto the national political authorities, in the absence of coordination at the European Union level. National authorities will also remain responsible for managing the greater public debt thus generated.

Initially, many Member States adopted national policies in a competitive spirit. Not only with the unilateral suspension of people's freedom of movement, but also with bans on exports of equipment for medical treatment, sometimes even taking advantage of the borders' shutdown to try to block imports, especially of food farming products, and encourage the export of their own stuff.

The emphasis on monetary policy, and the early competitive rather than cooperative response between member states, perhaps betray the notion that the economic impact of

[5] On April 22 this measure was followed by the decision to also accept securities with a low rating as a guarantee for loans to banks: a potentially important decision if, again, the rating agencies were to aggravate volatility on the markets through pro-cyclical revisions of their evaluations. This happened with Italy, with the rating agency Fitch, on April 28: the ECB's foresighted approach that overcame past self-imposed limits represented an important move for financial stability, as indicated in the Executive Board meeting of March 18.

Covid 19 could be brought to an abrupt halt followed by a rapid recovery – what economists call a "V-shaped" recession. However, these expectations have already proved to be too optimistic. The 2020 Italian Government's Economic and Financial Document (*Documento di Economia e Finanza*) foresees an 8% fall in this year's GDP, while next year the recovery would not exceed 4.7% (in addition, let us recall that such relative recovery is calculated as a percent on a smaller basis, evidently). Several other institutions, including the International Monetary Fund and Standard & Poor's, expect even more marked reductions in the GDP this year and more markedly contained recoveries from next year.

Among the main problems of the nationalistic and competitive nature of the response to the crisis brought on by Covid 19 is the fact that the range of policies adopted has been tailored more on the budgetary availability of individual countries – and on their ability and cost of access to financial markets – than on the acuteness of the epidemic. French President Macron has recalled the different outreach of State aid to companies, an issue – according to the press – also raised by Commission President von der Leyen in the European Council of 23 April. To date, half of the business aid measures approved by the European Commission involve German companies. Even the immediate fiscal policy response in Germany has exceeded 8% of the country's GDP; in France and Denmark they represented 2% of GDP; while in Italy, Spain and Greece they amounted to just 1% of it.[6] To date, the infection seems to have been wider and heavier in countries with a comparatively restricted access to new resources to invest in health systems and tackle the economic fallout of the crisis. Without reciprocal cooperation or economic aid, the medium-term impact of this shock will tend to further increase inequalities between Member States. This is not only a violation of the principle of solidarity, which is among the principles of the EU treaties, but also implies *serious perils for the integrity of the European single market and the risk that the whole Union keeps losing authority and influence in the global economy*.

[6] Adding postponements in the tax deadlines (which will be collected sooner or later) and guarantee measures to loans and liquidity for firms (guarantees that hopefully will not be fully spent) the immediate intervention totals over 65% of Germany's GDP; it amounts to more than 45% for Italy, and slightly under 30% for France and Belgium. Even with such wider measure, Spain would not reach 15% of its GDP. These figures are updated as of May 2020; however, during this period the various countries have approved new measures almost daily. In Italy, the Economic and Financial Document (DEF) for 2020 foresees a net deficit of 10.4% of GDP.

4. The measures under discussion and those that should be implemented

European authorities have already agreed upon some measures, including the reprogramming of the cohesion funds already allocated, with the CRII program. This will allow resources, which the States and Regions often struggle to plan and spend, to be speedily employed with little restrictions. The SURE, a 100 billion temporary instrument to mitigate the emergency-related unemployment risks, based on collective financing on the markets, is also being launched with guarantees provided by each Member State and the redistribution of resources through long-term loans to individual Member States. Moreover, a new credit line is being opened through the European Stability Mechanism (ESM) to finance an immediate expansion of health expenditure in countries with difficulties in financing their public debt on financial markets, up to 2% of the national GDP. Other relevant measures are under discussion, the most important of which are certainly the expansion of the EU budget, at least partially financed through a wider issue of common debt securities, and the creation of a Recovery Fund, aimed at issuing long-term debt securities on the market in order to shift the associated resources to the Member States.

First, it should be stressed that *the various measures are not alternative to each other, but – to a large extent – they are complementary*. The Covid 19 crisis poses both the immediate problem of an extraordinary funding of national health systems, and the macroeconomic problem of a decrease in the demand that requires a large expansionary fiscal policy, as well as the medium-term problem of relaunching the economic activity and recover lost or endangered employment.

The expansion of the EU budget may apply to the next and following years. However, the possibility of adequate expansion requires an immediate issuance of European public debt securities, while the increase in the EU's own revenues would realistically materialize only after the economy starts looking up again.

Some countries reject the proposal to issue common securities for several reasons, none of which seem convincing. In fact, the European Union or its institutions (such as the EIB, the European Investment Bank) already issue common debt securities, and at least the ESM and the SURE program would make use of them, along with the Recovery Fund now being discussed. *The problem may concern the size of these collective financing programs and the criteria according to which the related resources are distributed, and not a tool that in fact is already used*.

An objection to large-scale issuance of joint securities is that they would entail a subsidy by 'virtuous' countries, which enjoy below-average interest rates, to countries burdened by a higher debt service. The problem would not arise if, as happened in the first years of the euro, the markets were not over-sensitive to a *perceived* risk differential between the public debt securities of the various countries. If the institutional mechanisms of the euro were adjusted to eliminate, rather than the risk itself, its misleading perception, the problem would resolve itself (as discussed in Attachment 2).

On the other hand, the persistence of significant differentials in the financing costs of the Member States highlights a desire to discipline national policies through the reactions of the financial markets, and to impose to the single countries one's own political inclinations not only about the size of the public deficit but also about the size of the welfare state. Towards this result (i.e. to restrain the political discretion of the Member States), also works the competition between tax systems within the Union, on which see below and Attachment 1. Legitimately, some European parties, both within the Member States and the Union as a whole, have aimed at a growth model based on exports. Public spending programs financed with budget deficits are against this approach because they would delay the "necessary adjustment" (i.e. the reduction) of prices and wages called for to restore competitiveness to the most indebted countries. In specific countries, these programs might also put up for discussion the austerity policies and prevent further "structural reforms" (a notion that generally refers to liberalization and privatization). However, precisely because they are completely legitimate on a political level, such questions should be debated in the appropriate democratic forums and not surreptitiously imposed on countries in financial difficulty. About this, it should be recalled that there are two main approaches to a country's competitiveness: one, that we have mentioned, based on low costs and prices, and another, based on investments, according to which competitiveness relies on product quality and productivity increases (for more details, see Attachment 3).

Other reasons against the issuance of common securities concern the implicit "moral hazard" in financing expenditures that are not directly controlled by those who partake in the financing. Basically, northern countries fear they might have to pay off debts originating from the "waste" of southern countries. However, on one hand, it is perfectly possible to restrict the extent of the (risk of) financial responsibility of single countries in repaying other countries' debts. On the other hand – as already mentioned – various spending programs financed with common securities could be jointly managed and administered (e.g. environmental investments, investments in research and development, many infrastructure investments, etc.). If anything, this topic sheds light on the incomplete nature of some EU institutional arrangements, which should be addressed, even if at this stage the urgent call for measures does not leave much room for a debate (although discussions have long been underway). Needless to say, in the European context, traditional clashing views between right and left, such as for example in the votes in the European Parliament, are too often masked by differences between countries, even where the geographical size is not the main dividing line between interests or opinions.[7]

Finally, a point against the issuance of common debt is the reluctance to remove completely interest rate differentials between countries. This corresponds to the wish of some countries to benefit from a competitive advantage in the financing costs of banks and national companies (which are related to the costs of financing the public debt), and perhaps thus to benefit also from the chance of acquiring financial and productive assets of the "peripheral" countries at low cost and profitable conditions.[8] This argument highlights the

[7] For example, in the vote on the resolution "on EU coordinated action to combat the COVID-19 pandemic and its consequences" approved on April 16 by the European Parliament – which includes, *inter alia*, the invitation to the European Commission to propose "recovery bonds" guaranteed by the Union budget (point 17) – 84% of members of the European Parliament (MEPs) voted accordingly to their group, while only 62% voted as the majority of MEPs of their country.

[8] During the period of the Covid-19 crisis, the European Commission has authorized Member States to widely derogate from the State aid rules; many countries have approved or discuss standards, for example on the *golden power* of governments to block foreign acquisitions of companies considered of strategic importance. However, these are extraordinary measures and have a limited duration.

problem mentioned in the beginning: some prefer to maintain a competitive rather than cooperative approach, although there is reason to believe that such a strategy is not only morally unacceptable, but also ineffective.

Altogether, the topics mentioned here appear of secondary importance when compared to the need to combine common monetary policy with a common fiscal policy. This is even truer as regards the policies to be implemented for the recovery, when the state of emergency is over.

In this regard, let us consider the investment programs with loans guaranteed by the EIB. With a subscribed capital of 230 billion that is paid-up for 23 only, the EIB has 500 billion loans in place with a collection on the market of 400 billion and with its own funds of about 100. In recent years, the EIB has spent 60 billion a year, with an investment multiplier of about 5. EIB's shareholders are the EU states with France, Germany and Italy at par in the first place. As can be reckoned from the figures above, an increase in the paid-up capital would multiply the EIB's intervention capacity by large multiples, bringing its power to provide credit up to a few thousand billion. EIB securities are among those purchased by the ECB. This could create a powerful virtuous circuit between monetary policy and investment policy.

As for the Recovery Fund project, presently being debated, details are fundamental. The amount of the mobilized resources, the mechanism for transferring resources to the Member States (whether through loans or non-repayable transfers), the geographical distribution of financial risks and the benefits of spending are still under discussion. Some propose to make extensive use of the leverage mechanism in order to mobilize private sector resources. This, however, would not differentiate the new fund from the activities already carried out by the EIB. Co-financing investments through leverage, insofar as it stimulates additional investments, is a very useful tool, but the extent of the crisis and the social and territorial inequality of its impact require the mobilization of *new* public resources and the transfer of an important part of these resources to the most affected sectors and areas. *It is therefore essential that the Recovery Fund be not used only to make loans to the Member States and that transfers be not merely based on the granting of guarantees for investments in the private sector*.

In this regard, one important problem has to be laid on the table. While many economic activities have been damaged mostly by the restrictive measures of personal freedoms required to reduce the infection, for some sectors, a collapse of the demand is instead predictable. This, if not permanent, will, to say the least, experience a slow recovery only in the medium to long run. Companies in these fields will certainly need support schemes other than those implemented so far, substantially tailored only to deal with liquidity problems. Furthermore, liquidity difficulties in many sectors, and solvency difficulties in others, could have a negative impact on the banking and insurance sectors. For this reason too, measures aimed at medium term recovery should be planned, beyond the current state of emergency. For both these aspects, forms of support and participation in companies' equity should be considered, in addition to or in substitution of financing or loan guarantees. Though with the assumption of business risk, this instrument, currently adopted on a small scale by the European Investment Fund, offers several advantages. Its adoption on a larger scale would not increase the debt of already fragile firms, nor imply a reimbursement of the sums paid before their activities are really recovered, and would allow the public sector to benefit in financial terms when such activities start again (e.g. through the disbursement of dividends or other similar payments).

Finally, as far as the ESM is concerned, the Italian debate seems to pivot around *a priori* standpoints, for or against its use. Instead, as it often happens, what matters are the details, clarified only on May 8: conditionality is only related to the object of the expenses (medical and health), the duration of the loans will be ten year, and the rate 0.1%. Compared to a rate on Italian 10-year public bonds, currently at 1.83%, the deployment of the ESM new scheme would imply a reduction in the cost of financing of 1.73% per year. That is, on a loan of up to € 36 billion, up to more than 600 million euros per year, which accumulated over the ten years, represent too large an advantage to renounce.

5. Prospects for strengthening the European Union

As noticed, the creation of the single currency had to be complemented with a strengthening of the Union in terms of coordination of macroeconomic policies and revenue systems. An enlargement of the Union’s budget would go towards this direction, along with its application for the purposes of counter-cyclical control of the economy, and the formation of a sufficiently large market for European public debt securities. Difficulties are substantial. However, it must be clear *that if steps forward are not made towards the development of instruments for the federal management of economic policy, the single currency itself is likely to collapse*.

The collapse of the euro would open a huge financial and economic crisis. The political consequences would be even worse: the abandonment of the single currency – with the formation of a group of ‘strong euro’ countries in central Europe – would constitute the reaffirmation of the hegemonic design that Germany, under Kohl’s lead, had instead openly given up in exchange for a green light to the German unification. In the long run, the international strains that this would ensue would be extremely dangerous.

In the field of industrial policy, the temporary lifting of the ban on State aid can be an opportunity to revise competition policies, an issue often raised before the current crisis. Last year’s ban on the merger between Siemens and Alstom in the field of railway equipment, and the controversies that followed, stands out as an emblematic case. It made it clear that Europe’s reference market, in several sectors, must be the world market, where the competition is with the USA and China (and in perspective, with India and other countries), and where the size of European companies today is medium if not small, like for instance in the shipbuilding industry. Overcoming some competition dogmas would allow industrial policies to be innovated in a coordinated, and often unified, system, on a European scale. We have already recalled the need for an investment plan for the real economy, for macroeconomic reasons. From an industrial point of view, energy, the web, telecommunications, hyper-engineering of humanoids and bio-genetics could represent crucial sectors in which to invest and prompt mergers between European companies. In these, as in other areas, the consolidation of large companies would benefit from the contribution of "patient capital" (which forgoes immediate returns in anticipation of more substantial profits in the long run, considering also the externalities). Therefore, the contribution of public shareholdings is not to be discarded *a priori*.

A second package of interventions should strengthen the European research platforms, on the model of the CERN, ESA, and EMBO, which innovative, medium-sized companies and highly advanced start-ups are at the same time supplying and benefiting from.

A third area of interventions, still in the field of industrial policy, should involve trans-European infrastructure and its national branches (for example the Euro-Italian port system) which would require European funding, regulations and standardized design models, as well as executive supervision. Here, in fact, national barriers are raised, mostly by bureaucracy or by protectionism.

In terms of fiscal policies, it will be appropriate to check that the current expansion of public deficits and debts does not become a new excuse, as soon as the emergency stage is over, to propose or impose drastic austerity policies again. This calls for an open debate on how and who will bear the costs of the present interventions, and carry the weight of the necessary recovery measures. After 2008, the separation process between more and less competitive regions (especially within the euro area) has accelerated in the European Union. A new, long period of this kind (a slow decline of the periphery countries, against a corresponding growth of the central regions) – and if the pursuit of solidarity is given up – would create, especially in the southern countries, an amount of distress that could be otherwise avoided, and the EU itself would be deprived of substantial legitimacy (*output legitimacy*).

A tool that can be used whether some countries were reluctant to accelerate cooperation on some areas is *enhanced cooperation*, provided for by the Treaties on the European Union. While it does not permit to step beyond the competences allowed by the EU treaties, this tool still has a strong potential. In cases in which enhanced cooperation is not feasible, there will still be the possibility of signing cooperation agreements formally beyond the Treaties' rules.

Should the Recovery Fund proposal be rejected or watered down, one possibility that can be immediately envisioned involves a European investment project financed with a common issuance of securities, aimed at a specific purpose, for a group of countries. Such group would of course not include the countries hostile to this line of action. These countries would however pay the cost of their fears by missing the opportunity of expansive fiscal measures financed at relatively low costs, therefore (depending on the field of the investments: for instance in bio-medical research, transport infrastructure, information technologies) impairing the prospect to increase their competitiveness.

The consortium's member countries, or a different group of countries, may adopt enhanced cooperation to create a tax level-playing field. Today, competition between tax systems within the Union appears above all through low corporate income taxation schemes, applicable without distinction to residents and non-residents, and in the failure to harmonize the determination of the tax base of groups.[9] In this regard, it is worth mentioning that the corporate income tax and self-employment taxes evaded or eluded in Italy are estimated to amount to between one third and almost two thirds of the tax due. A substantial part of these lost revenues is to be put down to the activities of companies that exploit tax competition. According to some estimates, the loss in revenue income in Italy due to tax havens alone amounts to almost 6.5 billion euros per year (equal to 15% of what is due for corporate taxes). 5.5 of these 6.5 billion of lost revenues can be ascribed to profits

[9] In this area, attempts have been repeatedly made both at the European Union level (where the best result in this field is a code of conduct for *business taxation* adopted with the resolution of the Council of the European Union of the 1st of December 1997) and internationally, through the OECD (Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting). What is missing are not the tools, but the political will to reach large-scale agreements, in order to imbue – above all in Europe – the notion of 'harmful tax competition' with substantial and effective contents, just as the already existing real limitations in State aid policies.

shifted into tax havens within the European Union (in order: Luxembourg, Ireland, the Netherlands, Belgium, Malta, and Cyprus).[10]

Despite the predictable opposition of some Member states, the adoption on part of a group of countries of a tax regime based on a taxation of sales instead of corporate profits, at least for multinational companies, can be warmly envisaged. This would also make tax havens unprofitable, thus forerunning more complex strategies for the development of shared guidelines aimed at eliminating 'harmful tax competition' policies. The possibilities of policies of this kind must be analysed in detail: some aspects are illustrated in Attachment 1. However, it is clear that a reduction in the tax revenues of the order of several billion euros over the years cannot be accepted if the countries of the Union are to maintain a balance in their public finances while preserving the *welfare state*. The Union itself has also to be allowed to create a truly integrated and competitive single market.

Finally, immediately after the current emergency, it will be necessary to reflect on proposals to reform European taxation. Interesting proposals in this regard include a financial transaction tax, already widely explored by the EU institutions, various environmental taxes, and other sources of income for the Union.

In conclusion, all considered, Europe is making progress in this crisis, towards a more communitarian and less intergovernmental institutional system. Markets and some rating agencies also exhibited some form of leniency, for example avoiding at times the downgrading of the government bonds of the member countries. Again in this crisis, for now the most "European" of the institutions, the ECB, has been crucial; but important cooperative measures on a European scale are under discussion, and in the first instance, if

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[10] It is estimated that in Germany, tax havens are responsible for a quarter of the revenue loss on corporate income tax (almost 20 billion euros of lower revenue per year), while in France is 22% (i.e. 13 billion euros). Full data are available at the web page https://missingprofits.world/ .

they do not agree on a larger scale, they could be implemented at least by a coalition of states led by France, Italy and Spain.

It is high time to start a debate that peers beyond the immediate emergency, planning the recovery and foreshadowing what type of economy and society we want to create in the medium term. In the immediate time frame, the economic and social emergency requires collective solutions based on common financing and spending instruments; but once the emergency has passed, it will be necessary to recognize the need for a new amendment to the Treaties, to increase the democracy and functionality of the common institutions. It is necessary to positively overcome, not by renouncing the principle of solidarity, the perplexities recently raised (though in an unconvincing way) by some constitutional courts of member states, on the legitimacy of the cooperative political choices adopted by European institutions, such as the ECB. *Faced with the challenges of the 21st century bipolarity between the USA and China, only the European dimension and cohesion can make the difference.*

9 may 2020
