Will Covid19 lead to a downward reclassification of Europe, turning the old continent into a laggard that will not be able to close a lasting gap with its competitors?

Ursula Von der Leyen, the German president of the European Commission, has already been severely criticized for having botched the pooled procurement of vaccines: the decision to avoid competition between European countries in the procurement of vaccines was applauded by smaller countries that would not have had the same bargaining power, but the protracted negotiations that allowed the EU to obtain significantly lower prices may have delayed deliveries, creating the risk that Europe will emerge from the pandemic much later than the United States. Millions of euros may have been saved, but in a worst-case scenario of a protracted health crisis, the eventual economic cost would be in billions.

An even greater concern is the economic response of the European Union to the recession generated by the pandemic. The bold decision of the European Council, last summer, to take a first step towards a genuine Euro bond market – instead of a juxtaposition of national bond markets – to finance part of a recovery fund, was applauded as the possible beginning of greater European economic integration that would lead to a better balance between fiscal and monetary policies and a more dynamic macro-economic management. The European Parliament has recently approved a recovery fund of €672bn, of which €360bn will be loans. The funds will be disbursed over several years. The macro-economic impact of the European fund is however unlikely to match the impact of the support package of US$1.9trn presently being discussed in the US Congress, even if there will be proportionally more funds allocated to the countries most affected by the pandemic.

It is now widely accepted that the European macro-economic response to the 2008-2010 Global Financial Crisis was insufficient and that Europe has still not fully recovered from this crisis (Crashed, by Columbia professor Adam Tooze, Viking, 2018, is the best account of that failure). Another weak response would compound the problem. Europe has been more deeply affected by the Covid recession than other OECD countries, experiencing a 6.8% fall in GDP according to preliminary figures of Eurostat, versus 3.5% in the US.

The schemes that have been put in place to protect workers in several countries (France and Germany for example), keeping them employed but paid by the state, can have the advantage of facilitating a rapid resumption of production of existing businesses. However, they can also slow down the necessary post-Covid transformation of the economy. The Commission hopes to address this qualitative dimension by requesting member states to show that 37% of the recovery funds are allocated to the transition to a greener economy and 20% to the digitization of the economy. This will indeed help European countries in their efforts to assert a leadership position in the green economy and to catch up in their lagging digital economy, but it will not be enough if the macro-economic environment remains depressed.

For the macro-economic environment to improve, national recovery packages will have to complement the European recovery facility agreed at the European level. The size of national support packages will however be constrained by the debt position of the countries concerned, even before the Covid crisis. This is a constraint that the differentiated support of the European recovery fund (for instance €209bn of the recovery fund are allocated to Italy) will only partially alleviate.

In the end, much will depend on the size of the support packages of the two biggest economies of the EU, Germany and France, and the prospects for ambitious packages don't look very good in both countries. In Germany, the Parliament has suspended for 2020 and 2021 the socalled “debt brake” rule in the German Constitution which limits new borrowing to 0.35% of GDP, and it might extend the suspension, but there remains a strong deflationary bias in German politics. In France, which has traditionally been too relaxed with public debt, the treasury seems to be winning a battle for fiscal discipline at the wrong moment, and the French support package for 2021 may not be as big as necessary. Overall, there is little doubt that the European stimulus in 2020 and 2021 will be significantly less than the US stimulus.

This looming uncertainty over the strength of the post-Covid EU recovery may have long-term consequences if the EU finds itself incapable of catching up with its partners and competitors. Much will depend in that respect on the capacity of the EU to leverage its commitment to a greener future to give a qualitative edge to European economies. It may also have a short-term more dramatic impact on European politics.

While the German elections this fall and the retirement of Angela Merkel are unlikely to end the grip of mainstream parties on German politics, the same cannot be said of the French presidential election in the spring of 2022. The extreme fragmentation of the French political scene and the continued rejection of the extreme right candidate Marine Le Pen by a significant part of the French electorate still make it very likely that President Macron will win a second term of five years. But a botched management of the pandemic compounded by a weak economic recovery could upend that scenario, opening a narrow path for a Le Pen victory if the left does not mobilize against Le Pen on the second round of the two-round election. Another plausible scenario is a possible victory of a surprise unity candidate of the mainstream right like Michel Barnier, who negotiated Brexit, if support for Macron collapses.

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