EUROPE

Europe needs to avoid a ‘decade of forbearance’

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Each time the eurozone is hit by crisis it has ended up one notch weaker. The financial crash of 2008 hit the banking sector. The eurozone debt crisis impaired the sovereign debtors of southern Europe. The pandemic lock-downs will hit private companies and employees hardest. Whereas previous crises were mainly macro, this one is predominantly micro. Corporate insolvencies and higher unemployment will be its lasting legacies.

Eurozone policymakers, to their credit, managed to avoid some of the more egregious mistakes made in the past. They were right to support companies through credit guarantees, and workers through subsistence payments. The European Central Bank was also right to widen its credit support and to extend asset purchases. So far, nobody has committed any catastrophic mistakes. But this may be about to change.

The biggest danger now is that governments do in 2021 as they did in 2020. They are right to maintain a high level of discretionary fiscal support, but the emphasis needs to switch from protection towards productivity growth.

For example, Germany’s decision last week to extend short-time work schemes until the end of 2021 was wrong. Exemptions for corporate insolvency have also been extended. Companies will now be spared the obligation to declare insolvency simply on the grounds that they have too much debt. This will be the decade of forbearance.

The politics behind this are clear enough: 2021 is an election year in Germany, and nobody in the governing coalition wants to risk voters’ wrath. Even so, it makes no economic sense to protect jobs in sectors that were already under threat before the crisis — coal mining, car components suppliers and some parts of the chemical and mechanical engineering industries. Germany should instead support private and public investment in mobile telecommunications, artificial intelligence and green technologies.

The consequences of faltering productivity are apparent across the euro-zone, especially in Italy. Ex-ECB chief Mario Draghi was never more right than in his recent comment that it is important to focus public spending on helping the young get through the crisis and on high-tech research. Sadly, Italy suffers from a triple misfortune: a particularly steep decline in productivity growth; being locked into monetary union; and an overdependence on tourism, which accounts for around 13 per cent of gross domestic product, or around €200bn a year.

I spent a couple of weeks in various north Italian cities this summer and never saw Bologna and Venice so empty. Anecdotal estimates from local hotel owners suggested turnover had fallen by 80 per cent. Even if that turns out to be too pessimistic, it is still reasonable to assume an aggregate loss of tourism revenues this year that is over €100bn. One hotel owner said he expected no meaningful recovery in tourism next year either.

So Italy's longer-term economic policy challenge is how to become less dependent on tourism and more productive overall. Unfortunately, there is little debate about reforms, beyond legislation to reduce bureaucratic complexity. There is a good chance that the coalition between the Five Star Movement and centre-left Democratic party will muddle through this crisis with the help of money from the recently agreed European recovery fund. But there is no overarching strategy.

Germany and Italy differ, of course, in how their economies are managed, their resilience and their respective specialisations. Yet they both enter this decade with a similar mindset, and little support for entrepreneurship and free markets.

Economic reform in Europe has been discussed for decades. Unfortunately the debate has focused too much on labour markets and not enough on innovation. Italy needs to downsize its state sector and reform its inefficient judiciary, both of which obstruct business. No one from outside will ever think of launching a start-up in Italy, knowing it can take years for a civil court case to be heard. Other priorities, and for Germany too, include tax cuts to encourage private investment, public sector support for strategic high-tech sectors, and gradual withdrawal of crisis support.

But this is not going to happen. The eurozone is switching from a long period of austerity and abstention and going straight back to the bottle. Once fiscal emergency measures are extended into 2021, it will be increasingly hard to remove them. It may well be that the eurozone emerges from this crisis the weakest of the large advanced economies. ***munchau@eurointelligence.com***

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