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## **EU economic governance and Covid-19: policy learning and windows of opportunity**

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### ABSTRACT

This paper analyses the extent to which the Covid-19 pandemic crisis represents a window of opportunity towards fundamental change in the economic governance of the European Union (EU). Adopting a historical institutionalist (HI) perspective and drawing insights from the policy learning literature, we argue that contingent learning immediately took place and policy entrepreneurs took important decisions recognising the new crisis as an existential threat for the EU. Further, the pandemic crisis support fund and the ECB pandemic emergency purchase programme represent instances of single loop learning that leave the fundamentals of economic governance untouched. However, and in contrast to the Euro area crisis response, the adoption of the Resilience and Recovery Fund (RRF) represents a bold decision and suggests double-loop learning. It is argued that the Covid-19 crisis is a critical juncture for the EU. As a result, EU economic governance ceases to be limited to its regulatory function and is now complemented by a redistributive function as well.

## Introduction

*The exceptional nature of the economic and social situation due to the Covid-19 crisis requires exceptional measures to support the recovery and resilience of the economies of the Member States.*

(Special Meeting of the European Council, Conclusions, 21 July 2020, Article A1)

Until the Covid-19 pandemic hit, the European Union (EU) could claim that the economic crisis was a thing of the past. In mid-2019 unemployment fell to its lowest levels since 2008 for the Euro area and since 2000 for the Union as a whole (Eurostat 2019). With employment growth, GDP levels and other indicators pointing to a similarly positive direction, debate on the future economic governance regime had subsided. Nevertheless, major challenges remained: rampant inequality between and across member states threatened the sustainability of the European Social Model, while disgruntlement with the rules imposed during the Euro area crisis continued to plague the politics and economics of countries, especially in Southern Europe. This, in turn, strengthened the Eurosceptic message, implicit or explicit, that several parties had been using throughout the past decade and which had brought the Euro area to the brink of collapse. Most importantly, the Union's political integration remained elusive: 'governing by numbers' (Schmidt, 2019), relying on orthodox economic policies and on regulatory instead of redistributive elements had become the Union's default function.

The Covid-19 pandemic hit Europe in March 2020. By April, IMF calculations suggested that the EU was faced with the biggest economic slump since the Great Depression of the 1930s. The pandemic was expected to have, and is indeed having, an asymmetric impact on member states, both because of their differing debt levels (making borrowing disproportionately expensive for some) as well as the ability of their health systems to cope with it. However, given that the pandemic hit all states without discrimination meant that *all* member states stared at record-high GDP contraction levels for 2020 and sky-rocketing unemployment. The EU's attempt to reinvigorate integration by focusing on climate change and the digitalization of the economy suddenly appeared secondary to the imperative of safeguarding jobs and welfare of a more traditional kind. Although the provisions of the Stability and Growth Pact (SGP) were relaxed quickly for the 2020 financial year to allow governments to spend their way out of the immediate crisis (European Council 2020a), this was not a sustainable option. Several member states, such as Spain or Italy, burdened with unprecedented debt amounts that they would be unable to repay and with rising unemployment, could see their fragile economic and political stability threatened. 'Business as usual' was no longer an option: Covid-19 called for a response that would safeguard the Union's cohesion in the years to come.

Adopting a historical institutionalist (HI) perspective and drawing insights from the policy learning literature, we argue that key policy actors recognized the existentialist threat that the pandemic posed. Contingent learning immediately took place and shrewd policy entrepreneurs, some of whom had been present during the Euro area crisis as well, took important decisions.

Intercrisis and intracrisis learning took place simultaneously, with the EU linking its existing policy agenda for economic governance to the recovery effort to tackle the new economic crisis caused by Covid-19. The pandemic crisis support fund and the European Central Bank (ECB) pandemic emergency purchase programme represent instances of single loop learning that leave the fundamentals of economic governance untouched. However, and in contrast to the Euro area crisis response, which was characterized mainly by incremental change, double-loop learning has also occurred. As the consequences of the crisis started to become clearer, the EU faced a critical juncture in its economic governance framework, in that multiple options suddenly became viable and possible within a short period of time. The Recovery and Resilience Facility (RRF) provisions on joint debt issuance and generous grant allocations to states mostly affected seem to suggest that economic governance ceases to be limited to its orthodox, regulatory premises and is now complemented by a redistributive function as well. In that important respect, it opens the possibility of adopting alternative economic policies at Union level.

The paper's structure is as follows. We begin with a theoretical discussion centred on HI and policy change to discuss previous EU responses to crises, especially the Euro area crisis. We complement this framework by focusing on the policy learning literature. The next section deals with empirical developments during the pandemic emergency, namely the Union's initial response to the crisis as well as the 17-21 July Summit. The third section analyses the EU response in terms of economic governance and substantiates our main argument with reference to concrete policy and institutional innovation adopted by the Union. Our concluding section recaps and rings a note of caution: while steps forward have undoubtedly been taken, the concrete implementation of the new tools and policies is yet to be determined.

### Historical Institutionalism, Policy Learning and Change in times of crisis

How does the EU react to crises, and what are the consequences of crisis events in terms of the Union's economic governance trajectory? At a general level, integration is shaped, and even fuelled, by crises (Monnet, 1978; D'Erman and Verdun, 2018: 2). Such episodes force the hand of reluctant policy actors and often produce policy results that become difficult to reverse later on. Necessity carries with it an integration dynamic that few can foresee but many end up accepting as the least bad choice. Article 8's (this issue) definition of crisis, as a situation which threatens the high priority goals of the decision-making (i.e. the EU), restricts the amount of time available for response and surprises the members of the decision making unit by its occurrence, is adopted here (Hermann 1969; Degner 2019). In the relevant literature (Jones and Baumgartner, 2002; Falkner, 2016), there is widespread consensus that crises can, under certain conditions, enable change. The pace and direction of change and its relationship with learning mechanisms, however, is less easy to detect. In this section we combine tools from HI and from the literature on EU policy learning to explain why such a dynamic and fast economic response has been offered by EU leaders in the current crisis. This contrasts with the slower and more

incremental response that we have seen in previous crises and especially during the Euro area crisis.

New institutionalism's rational choice, sociological and historical variants (Hall and Taylor 1996) are regarded as particularly pertinent in explaining and analysing the evolution of EU integration (Pierson 1996; Pollack 2009). For historical institutionalists in particular, it is crucial to show how institutions structure the choices open to political decision-making and how the institutional setup affects political contests (Meunier and McNamara 2007). In such a setting, change is the result of the interaction between actors and the context in which they operate. The literature identifies four 'modal types' of change (Mahoney and Thelen 2010: 15-16). *Displacement*, whereby new rules come to replace old ones; *layering*, in which new institutions are added or placed alongside existing ones; *conversion*, which means no new rules but rather redeploying existing ones; and finally *drift*, whereby institutional, formal rules remain intact but policy and institutional outcomes are altered as a result of new policy conditions.

Critical junctures are central to HI in EU studies (Verdun, 2015: 222). These are 'relatively short periods of time during which there is a substantially heightened probability that agents' choices will affect the outcome of interest' (Cappoccia and Kelemen, 2007: 348). Prior choices made at critical junctures lead to the formation of new institutions that generate self-reinforcing path-dependent processes' (Ibid., p. 341). Gocaj and Meunier (2013) point to the Euro area crisis as an example of such a dynamic, arguing that decisions made at the crisis' initial stages, including institutional formation, shaped the path, and the options available, to policy-makers in the later phases of the crisis. In a similar vein, Verdun (2015) identifies the formation of the European Monetary Union (EMU), the sovereign debt crisis as well as the Euro area financial crisis as critical junctures. Policy-makers were sufficiently determined to defend EMU that they opted for institutional choices such as the European Stability Mechanism (ESM), the European Financial Stability Facility (EFSF) or the Fiscal Compact that would preserve it going forward by use of layering, or as Verdun puts it, 'copying'. Further, and although institutions like the ESM were originally set up on a temporary basis, they eventually took a concrete and lasting institutional structure (Verdun, 2015: 232), albeit in the shadow of the intergovernmental constraints imposed by governments' unwillingness or inability to consent to treaty change.

Previous crises have led to incremental change, with the EU relying on existing structures and tools or forming new ones to respond to contemporary challenges. The Euro area crisis is the most recent and fitting example. The EMU governance framework remained intact, and new tools, such as the European Semester or the Fiscal Compact, were added to reinforce pre-existing policy mechanisms, such as the Stability and Growth Pact. From a historical institutionalist perspective, the institutional mechanisms put in place provided continuity with the existing EMU governance framework and strengthened existing policy mechanisms centred on fiscal prudence and macroeconomic policy coordination. What emerged at the end was a combination of intergovernmental coordination and supranational hierarchy (Börzel, 2016). To avoid the further

politicization of the crisis, however, member states chose to hide the political nature of implemented reforms under the regulatory rubric of depoliticized, technocratic governance (Genschel and Jachtenfuchs 2016). The distributional effects of the Euro area could not be addressed, at least explicitly, for fear of exacerbating tensions between northern and southern member states. Therefore, although further integration was achieved (Ioannou *et al.*, 2015) this was done by stealth and in the absence of an explicit political debate as to the future direction of integration.

Since the Euro area crisis is the most recent precedent to the ongoing economic crisis due to the Covid-19 pandemic, the looming question is whether lessons have been learned from the recent past and the response to the Euro area crisis. We argue that learning has indeed taken place and it can explain the quicker and more decisive answers that the EU has provided to this economic crisis.

Kamkhaji and Radaelli (2017), in their exploration of learning mechanisms during the Euro area crisis, assert that when a crisis occurs, it is very likely that change will take place quite quickly, especially when the crisis is existential for the EU or for domestic structures. This is reversing the sequence of events that public policy analysis expects to observe. Crisis is normally seen as an opportunity for learning, which would lead to reforms and policy change (e.g. Sabatier and Jenkins-Smith, 1993; Kington, 2002). Building on behavioural economics and psychology, Kamkhaji and Radaelli (2017) show that contingent learning (and not policy learning) takes place as a result of surprise caused by a crisis. Contingent learning happens when ‘accidental (policy) heroes’ (as they call them) perform real-time changes, which only later lead to reflection and to what has been described as policy learning by political scientists. We use the more established term ‘policy entrepreneurs’ since political real time is much longer than a life emergency crisis, even when it is short, and thus political actors’ decisions are rarely accidental. Political ideology, political compromises and calculations as well as the experience of handling previous crises play a major role in the final decision.

What is significant in the current economic crisis is that it started only a few years after the end of the Euro area crisis. It can be claimed that this time proximity has enabled quicker and deeper learning. The timing of change has repeatedly been emphasised by historical institutionalists to be of paramount importance in understanding the outcome of change (e.g. Pierson, 2004). In this instance, the time proximity of the two crises is key in understanding the development of events. At a minimum, it has allowed for intercrisis learning, defined as ‘learning from one crisis and making changes to prepare for another’ as well as intracrisis learning, which refers to ‘learning that seeks to improve response during a single crisis episode’, to co-exist (Moynihan, 2008). This has been enabled by the existence of an important number of the same actors that have acted as policy entrepreneurs during the two crises. For example, Christine Lagarde and Angela Merkel had both experienced the Euro area crisis and were both responsible in their

respective roles for some of the decisions and institutional changes that paved the way for the current response.

One of the most common distinctions in the literature is between single or double-loop learning. Single-loop learning refers to corrections of divergences and flows in an organisation without touching upon its fundamental normative assumptions. Through single loop learning, actors and organizations modify procedures in order to achieve the objectives and policies already set out. Double-loop learning, on the other hand, represents a deeper learning form. To double-loop learn, actors inquire and, if need be, modify the norms, policies and objectives of the organisation (Deverell, 2009). Further, double-loop learning usually occurs at a time of rapid change (Argyris and Schoen, 1978). Deverell (2009) rightly points out that more attention should be paid to single-loop learning since it can often pave the way for double-loop learning in a second instance. It can be argued that this is what happened with the two crises under discussion here. A lot of single and some double-loop learning took place during the Euro area crisis leading to more learning of both types during the current crisis. For example, the six-pack and two-pack Regulations represented examples of single-loop learning to smoothen EMU governance, while the asset purchasing programme initiated by the ECB and especially the creation of the ESM constituted instances of double-loop learning. To take the argument a step further and following a historical institutionalist logic, the change and institutional arrangement of the Euro area crisis, whether we categorise them as ‘muddling-through’ or as non-incremental change, led to double-loop learning and to more radical decisions during the initial tackling of the Covid-19 economic crisis.

### The Covid-19 emergency and the EU’s initial reaction

The sudden spread of Covid-19 in Europe, a public health problem unrestrained by borders, quickly turned into another economic crisis for the EU. Only two years after Greece, the last country still in a bail-out agreement, exited its Third Economic Adjustment Programme, the EU was called to tackle a new economic crisis which could prove to be even bigger and more unpredictable than the Euro area crisis. Although the cause of the crisis is exogenous and symmetric for all member states (Celi, *etal* 2020), highly indebted member states are particularly vulnerable to its consequences as they can hardly afford to spend their way out of the crisis. The predominant discourse in Europe one decade ago was that of a ‘morality tale’ that juxtaposed the Northern virtues of ‘hard work, prudent savings, moderate consumption, wage restraint, and fiscal stability’ to the ‘Southern vices of low competitiveness, meagre savings, undeserved consumption, inflated wages, and fiscal profligacy’ (Matthijs and McNamara 2015:135). Today, this discourse has lost its strength. It is unfair to blame individual countries for a pandemic (Moury, *et al* 2020). This context has made agreement to an EU wide solution easier than the tackling of the Euro area crisis. In this section, we outline the EU’s initial reaction to the crisis

which has been characterised by immediate change and contingent learning. We observe that single-loop learning, which took place during the Euro area crisis, enabled second-loop learning to occur much faster this time.

A first reaction, similarly to what happened at the beginning of the Euro area crisis, was an increased initial public spending at the EU member-states level. From March 2020 onwards, just as in 2008-9, in a ‘neo-Keynesian’ spirit, many European countries increased their spending to tackle the public health emergency and to compensate for the economic losses of the lockdown (Ladi and Tsarouhas, 2014). The EU institutions backed up this effort in two ways. First, the European Commission adopted a Temporary Framework enabling Member States to use the full flexibility foreseen under state aid rules to support the economy and businesses (European Commission, 19 March 2020). Second, as happened twelve years ago, flexibility on fiscal rules was permitted by the Council on the 23<sup>rd</sup> of March by initiating the general escape clause of the Stability and Growth Pact (European Council, 23 March 2020). Both measures can be described as contingent learning (i.e. real time changes) and were received with relief by member states. However, these initial measures if not followed up by policy learning leading to more ambitious cooperation could have unintended multiplier effects. To illustrate, the suspension of state aid rules could lead to more divergence and threaten to unravel the single market and, possibly, the EU too since it offers countries with large fiscal space and capacity more of a chance to offset the crisis with help to consumers and business (Buti, 2020).

However, the rise in public spending, together with the foreseen recession, is already leading to a rise in public debt. The debt-to GDP ratio of the euro area is projected to rise substantially, reaching a new peak of around 103% in 2020. It is projected to increase significantly in all member-states. More specifically, it is expected to stay above 100% in seven member-states (Belgium, Greece, Spain, France, Italy, Cyprus and Portugal) while seven more member-states are forecast to show a debt ratio above 60% of GDP in 2021 (Germany, Ireland, Croatia, Austria, Slovenia, Finland and Hungary), (European Commission, 2020). An important problem associated with this rising debt ratio is that investors can sell the bonds of a given country to buy bonds of a more credible country (e.g. Germany) denominated in the same currency (De Grauwe and Yuemei 2012). This happened during the Euro area crisis and signified the skyrocketing of borrowing costs in the bailed-out countries and their rapid decline in Germany and other countries (Moury *et.al*, 2020). During the current crisis this has been avoided because this time the ECB, after a brief hesitation, has acted quickly. This is clearly an instance of policy learning from the Euro area crisis. After all, Lagarde was a key figure during the Euro area crisis, albeit in a different capacity and she has now been acting as a key policy entrepreneur. In doing so, she has followed on the footsteps of her predecessor Mario Draghi. The latter’s ability to act as a bridge-builder within the ECB’s Governing Board during the Euro area crisis facilitated the ECB’s reinterpretation of rules to ‘save the Euro’ (Schmidt, 2016: 1043). A ‘Pandemic Emergency Purchase Programme’ (PEPP) was created in mid-March. This is a temporary purchase programme of €750 billion euros involving both government and private debt. It aims

at reassuring financial markets by directly purchasing assets at countries on the periphery of the Euro area, which are subject to high pressure by financial markets. Doing so without imposing policy preconditions has made the PEPP a helpful policy instrument in the attempt to overcome the crisis with the Euro area intact. The ECB decided on 4 June 2020 to increase the initial €750 billion envelope by €600 billion to a total of €1,350 billion euros (ECB, undated). Further, it now seems likely that the programme will not cease in mid-2021 but extend to the end of 2021 instead (*Bloomberg* 2021).

The European institutions, although with some initial delay, have also been active in the creation of mechanisms and instruments for the support of EU governments and businesses drawing on the Euro area crisis experience. The ESM, that was created as a response to the Euro area crisis, is responsible for the ‘Pandemic Crisis Support’ which was made operational on 15 May 2020. The fund has been created to provide cheap loans to Euro area member states of up to 2% of their GDP, but solely to support direct and indirect healthcare costs related to Covid-19. Its capacity is 240 billion euros (ESM, undated). The Council in April 2020 also approved the creation of a temporary recovery fund (SURE), that could distribute loans for aid to employers that would otherwise lay off workers, but also to the self-employed. Its capacity is 100 billion euros (European Commission, undated). Finally, the European Investment Bank (EIB) in May 2020 created a safety net for small and medium enterprises that could mobilise up to €200 billion in resources for viable firms affected by the crisis (EIB, undated).

To summarise, the Union’s initial response represents an instance of contingent learning. Reacting to the pandemic meant putting in place emergency policy measures to offset the immediate effects of the crisis. Evoking the flexibility and general escape clauses on the deficit and state aid rules or the launch of SURE represent such an instance. Further, the ECB’s PEPP was premised on similar activism during the Euro area crisis, aiming at stabilizing financial markets and the economic outlook of the Euro area. Yet all these measures were time-limited responses to the shock caused by the pandemic and are, at least in principle, meant to expire as soon as the relevant authorities have identified the end of the crisis.

Nevertheless, it soon became evident that the challenge was huge and that a more ambitious EU reaction would be necessary to tackle the pandemic but also to secure the EU’s viability. For Europe as a whole, the economic shock was the biggest following the Second World War, with Euro area output falling in two quarters as much as it had risen over the last 15 years (Lagarde, 2020a). Borrowing the sorts of sums necessary to protect employment and recovery under such conditions was, from day one, a non-sustainable option. ‘Faced with a *common* shock, it was appropriate for Europe to deploy its collective weight through its *common* institutions to ensure that all members could react to the crisis adequately. The *next phase* of Europe’s response to the crisis was about putting this into action’ (Lagarde, 2020a, emphasis added).

At the European Council of 24 April, EU leaders asked the European Commission’s President Ursula von der Leyen to go further and prepare a proposal for growth, mixing grants and loans

and outlining the linkage of this Fund to the Multiannual Financial Framework (MFF) (European Council, 23 March 2020). It was thought that the EU strategy for the economic recovery from the pandemic and the MFF discussion should take place simultaneously to enhance the fiscal capacity of member states to respond to the crisis. The ECB was a key actor, engaging in PEPP and other measures but also pushing for a more ambitious approach. On 9 April 2020, Christine Lagarde wrote: ‘if not all countries are cured, all will suffer. Solidarity is in fact self-interest’ (Lagarde, 2020b).

The game changer was the Franco-German proposal to distribute grants of 500 billion euros to member-states in need (*Politico*, 18 May 2020). The demonstration of unity from Germany and France confirmed the importance of the Franco-German cooperation in times of crises which was in short demand during the Euro area crisis. Chancellor Merkel and President Macron’s quick reaction was building on single loop learning and institutions building that took place during the management of the Euro area crisis. In contrast to what happened during the Euro area crisis, this move opened avenues for compromise and for an ambitious Commission proposal. A few days after the Franco-German proposal, the Commission unveiled a recovery instrument named ‘Next Generation EU’ (NGEU) worth 750 billion euros (European Commission, 27 May 2020). Central to NGEU was the proposed Recovery and Resilience Facility (RRF), with €310 billion in grants envisaged to be dispersed to member states.

Despite a first unsuccessful attempt to reach a compromise the 17 July European Council was a success. At the heart of the negotiation stood the RRF (Fleming and Khan, 2020). The Commission suggested three main measures through which to allocate funds: a country’s population, its gross domestic product per capita, and a five-year average rate of unemployment between 2015 and 2019.

Several issues remained unresolved and preoccupied the Summit. First and foremost was the grants/loans ratio of the RRF. The ‘Frugal Four’ (Austria, Denmark, Netherlands and Sweden) had made it clear that the Franco-German proposal went too far, and that financial assistance should be tied to loans (and the concomitant conditionality these come with) instead of grants. In an echo of earlier debates, the Frugal Four insisted on conditionality to secure that EU money would be spent by member states such as Italy, Spain or Greece in the way intended by the Commission proposals. Second was the actual size of the total NGEU funds available: €750 billion was seen by some as too high an amount. Third was the question of rebates, which had dogged EU budgetary negotiations ever since Mrs. Thatcher asked for her ‘money back’. Brexit meant that northern European states bargained hard to increase their rebate and reduce their net contribution to the Community budget. Finally, there was also the issue of which programmes to fund: the ‘frugals’ were keen on R&D, digital and green investment at the expense of cohesion funds, whereas the so-called Friends of Cohesion (Southern and East European members) wanted the earmarked allocation for cohesion unchanged (*Euronews*, 21 July 2020).

After four days of intense and often acrimonious negotiations, Charles Michel's 'we did it!' tweet suggested that the Summit had finally reached a conclusion. The very fact that an agreement on both the Covid-19 response and the MFF worth approximately €1.8 trillion was reached is worth noting. Prior to the onset of the negotiations, Chancellor Merkel had acknowledged that negotiations would be 'very tough' and the outcome uncertain (*Deutsche Welle*, 17 July 2020). Similarly, Dutch prime Minister Rutte, the informal leader of the 'Frugal Four', declared prior to the onset of talks that he considered the chance of a successful conclusion at less than 50% (*Reuters*, 17 July 2020).

As in previous crisis meetings, compromises were made this time too. The EU budget over the next seven years has been set at €1.074 billion, an amount that the 'Frugal Four' had insisted on, despite calls from others to increase EU funding. The original Commission proposal for €1.1 billion was thus defeated. Consequently, important funding areas on research and development, education and development, which can be seen as serving as EU public goods, have seen real cuts in funding. Most prominent among them are the Horizon Europe and Erasmus programmes, which saw a cut in funding of -6% and -14% respectively compared to the original proposal. Cuts were also made to NGEU, with the cuts in the Just Transition Fund and Health programme standing out (European Parliament, 2020: 2). When it comes to the rebates, the 'Frugal Four' and Germany emerged with hefty sums from the Summit, ranging from €3.6 billion for Germany to €377 million for Denmark (European Council, 2020). To ensure that countries like Poland and Hungary would sign up to the final deal, the 'rule of law' conditionality clause that countries like the Netherlands wanted to introduce prior to funds' disbursement was substantially watered down. The final text merely mentions that the Council 'underlines the importance of the respect of the rule of law' (European Council, 2020: 15).

The compromises mentioned above are, however, overshadowed by the historic nature of this Summit's main decisions. For the first time ever, the Union committed itself to engage directly in fiscal stimulus by agreeing on setting up the RRF. The RRF presents an instance of double loop learning since a clear move from a rule-based economic governance to a mixture of rules and transfers has been decided. This is a change in the norms of the EU's economic governance framework. The total amount of that support was maintained at €750 billion, in line with the original European Commission proposal. The size of the fiscal support that the Union pledges in defence of its member states can make a macroeconomic difference (Teneo Global Advisory, 2020) offering vital support at a time of acute financial need. The total amount to be disbursed through grants was set at €390 billion and loans at €360 billion. For the first time aspirations about a transfer union seem to materialise building on a negative lesson from the Euro area crisis, which showed that loans alone were not enough to stabilise the crisis and created tensions between creditor and debtor countries (Dyson, 2017). This could not be repeated now that the crisis was hitting core member-states such as France, Italy and Spain.

The operationalization part of the recovery package breaks a major taboo of the Euro area era. The EU will fund its recovery by having the Commission borrow on international markets (until 2026), in effect realizing the Eurobond aspirations set during the previous decade (Moesen and De Grauwe 2009). The Commission will from now on play a decisive role in backing up the fiscal firepower of the Union, making it the second major institutional actor (next to the ECB) to obtain such a responsibility. To repay the borrowing generated by the recovery fund, the Council agreed to boost its own resources system with a tax on non—recycled plastic from 1 January 2021 and to consider additional resources, such as a carbon tax, digital tax and financial transactions tax (European Council, 2020).

Funds will be distributed over three years and until 2023. Reflecting the urgency of the situation, 70% of the disbursement to member states will occur in 2021 and 2022 based on the original Commission proposal, while the remaining 30% will be disbursed based on members' GDP performance in 2020 and 2021 (Colijn and Brzeski, 2020). Grants will be paid out based on the recovery and resilience plans that member states will submit to the Commission, drawing on the country specific recommendations and the jobs and growth agenda. Apart from this main criterion for assessing the efficacy of the member states' plans, grant disbursement will also rely on the compatibility of states' plans with the Union's green and digital transition (European Council, 2020). This represents intercrisis and intracrisis learning taking place simultaneously, with the Union linking its existing policy agenda with the recovery effort to improve its overall response. One or more member states will be able to call for an extraordinary Summit, should it deem another country's plan to significantly deviate from relevant milestones and targets. Nevertheless, it will have to do so within a three-month timeframe and obtain the consent of a qualified majority at Council level to stop the flow of funds.

Although the precise sums countries will be able to claim are as yet elusive, early calculations point to another major effect of the agreement: those who suffered the most from the pandemic, such as Italy, Spain and France, will also be the biggest beneficiaries (Stubbington and Szalay, 2020).

A final lesson learned during these first steps of managing the current crisis has to do with the institutional mix. During the Euro area crisis the EU was often accused of augmenting the democratic deficit by depoliticising the implementation of the Economic Adjustment Programmes in bailed out countries by relying on technocratic institutions such as the Troika, (Dyson, 2017). An intergovernmentalist basis that weakened the EU's common response had been chosen. This time, consensus over the origins and repercussions of the crisis as well as the experience from handling the Euro area crisis has meant that politicisation at the top, as described in the introduction of this SI, has enabled the resurrection of the 'Community method' (Buti, 2020). The Council asked the Commission to develop a recovery plan, which then led to the incorporation of the NGEU to the multiannual budget (European Commission, 2020). As a

result and given the need for the European Parliament to consent to the budget, all major institutions are genuine stakeholders in the EU's policy response.

### The Covi-19 crisis: A Critical Juncture for EU economic governance?

A critical juncture occurs when the room for policy change and policy learning by policy actors suddenly increases: more options become available to them in a short period of time, and their actions are consequential regarding future policy responses. By May 2020, key policy actors faced precisely such conditions. Policy instruments centred on loans and emergency liquidity provisions were inadequate to shield European economies, workers, households and business from the consequences of the pandemic. Piling up more debt without a change in approach led nowhere. Following the initial shock, EU policy actors were thus faced with a critical juncture regarding economic governance. The array of options was wide, ranging from the continuation of emergency assistance to an overhauling of existing policy practices. Opting for the former, as happened at the immediate onset of the crisis, represents a single-loop learning effect, with policy actors drawing from past experience, what has been called intercrisis learning, (the tools used during the Euro area crisis) to offset the economic impact.

The Franco-German proposal, followed by the Commission proposal, represents an instance of activism by policy entrepreneurs who sought to use the window of opportunity offered by the crisis. In doing so, they engaged in double-loop learning, introducing a new organisational and normative dimension to economic governance. In the words of Christine Lagarde, 'the recovery phase of the crisis will be less about preserving the status quo - which was the initial priority - and more about transforming the economy to reflect the new realities of the post-Covid-19 world' (Lagarde, 2020b). The 21 July decisions made at Council level introduce a new set of policy tools in economic governance and, at least potentially, alter the substance of the way in which EMU operated until 2020. This was made possible by emergency conditions but was premised on single-loop learning identified earlier: the one followed from the other, demonstrating the link between the two learning types (Argyris and Schoen, 1978).

The EU response to the pandemic crisis in the field of economic governance is thus characterized by *both* continuity and change. During the initial stages of the crisis, policy actors relied on single loop, intercrisis learning premised on the institutional and policy reforms introduced during the Euro area debacle. The policy response continued on the path chosen following the adoption of the ESM, which was called to task again, as well as the ECB's purchasing programme initiated by Draghi. However, change was also on display after the initial shock had subsided and economic data suggested a contraction deeper and more painful than originally envisaged. Policy entrepreneurs built on early activism to shape a more far-reaching policy response that led to the 21 July decisions, which included joint debt issuance and a policy of

intra-state financial redistribution with no modern parallel. Double-loop learning, or a change on the Union's organisational norms and policies, was thus on display.

The 21 July decisions, provided they are implemented as planned, carry significant long-term implications for EU economic governance. To start with, deficit spending will, over the next few years, become part of the EU's policy response to Covid-19. Fiscal prudence does not cease to exist, but it will now share discursive and policy space with deficit management policies that were anathema during the Euro area crisis. Second, for all the resistance put up by the group of 'frugal' states, the EU is now committed to indirect redistribution across states and direct economic support to states and regions mostly affected. The possibility of a 'transfer union' during the Euro area crisis had brought the Euro area to the brink of collapse. This time, the EU drew on lessons derived from the Euro area crisis and built on them, not least through the ECB's rapid decision-making and the pandemic crisis response fund. However, by opting for a form of redistribution through the RRF and joint debt issuance, it also engaged in double-loop learning, going beyond the incremental change paradigm that economic governance had followed until now (Verdun 2015).

Realizing that further divergence between the core and periphery would possibly unravel the Euro area and harm the EU's reputation, made redistribution and grants-based solidarity acceptable. The Euro area remains the single most advanced European integration project and no leader would like to be remembered for undoing it. Having a common currency since 1999 has been a catalyst for increased cross-national banking activities which was one of the key reasons why a solution was found during the Euro area crisis (Dyson, 2017). In that regard, Germany deserves special mention. As the primary beneficiary of the Euro's creation and dependent on export-driven growth, Germany acknowledged that economic collapse in countries such as Italy and Spain would not only put the Euro area project into trouble but it will also dampen German exports and therefore growth potential (*Euractiv*, 13 March 2020). The Franco-German proposal on grants reflects the acceptance that punitive austerity during the Euro area crisis brought the EMU architecture to the brink of collapse (Parker and Tsarouhas 2018). Chancellor Merkel openly acknowledged that the pandemic is deepening inequalities in the EU and that therefore solidarity and cohesion have now become more important than ever (*Tagesschau.de*, 2020). 'It is in Germany's interest that we retain a strong single market, that Europe converges and does not fall apart. What is good for Europe is good for us' (*Bundeskanzlerin.de*, 2020). Germany's change of heart as expressed by its Chancellor played a crucial role in determining the Union's crisis response.

Avoiding a north-south split became both an economic and political imperative to maintain, and even deepen, the legitimacy of the European Union. In Italy, the country first hit hard by the pandemic in Europe, the initial slow EU response to Rome's solidarity plea led to a resurgence of Euroscepticism threatening to derail the coalition government led by PM Conte. Italy, highly indebted and reluctant to use ESM support for fear of conditionality and associated austerity,

pushed hard for ‘corona bonds’ and joint debt issuance (*Politico*, 2020). Given that the Union’s positive perception in 2019 had reached its highest level since 2014 (European Commission, 2019), the pandemic became an opportunity for EU leaders to deepen the legitimacy of the European project by going beyond the already set policy practices of the previous crisis.

## Conclusion

Although crises provide fertile ground for learning and eventually for policy change, this is by no means inevitable. The nature of the crisis in question, and previous steps taken to ameliorate pre-existing problems, have an important effect in dealing with sudden shocks. In that regard, the nature of Covid-19 allowed for the swift overcoming of some of the problems that the EU had faced during the Euro area crisis, such as the debate on moral hazard and the stark contrast between the Euro area’s core and peripheral economies. Nevertheless, the fact that the consequences of the crisis would be asymmetrical, hitting some states much more than others, meant that concrete policy decisions relied on both using past lessons and being able to go beyond them.

In this paper we have argued that empirical outcomes in the handling of the crisis can be explained by use of a historical institutionalist approach and in combination with relevant insights from the policy learning literature helping us to emphasise the role of policy entrepreneurs in times of crisis. In the initial period following the pandemic’s outbreak, policy entrepreneurs reverted to standard crisis mitigation measures, drawing from the chestbook of the Euro area crisis to offset Covid-19’s effects on firms, workers and households. The pandemic fund, the suspension of the deficit rule and the evoking of the general escape clause, along with the launch of the ECB’s PEPP programme represented such moves. They form part of single-loop learning amidst conditions of uncertainty. Nevertheless, and in contrast to what occurred during the Euro area crisis, the EU did not limit itself to merely adding new policy instruments to pre-existing ones. As the pandemic took an increasing toll on future economic prospects and *all* EU states faced the prospect of unprecedented economic hardship, policy entrepreneurs at national (e.g. Macron, Merkel) and supranational (e.g. Lagarde, von der Leyen) level realized that the EU faced a critical juncture. By the spring of 2020, alternative ways of handling the impending crisis appeared quickly and unexpectedly, allowing policy actors wide room for manoeuvre.

In that instance, double-loop learning occurred as manifested in the adoption of the RRF. Breaking with the normative taboo of the EMU’s original construction, the Council broke new ground by adopting decisions on common debt issuance and the granting of generous grants to those states mostly affected by the pandemic. In that way, and if only through compromises and intergovernmental give and take, it has legitimized the principle of fiscal transfers within the Union and accepted the need to further complement the regulatory, rules-based approach to

economic governance with a distinct redistributive dimension. At least potentially, this represents a shift in the direction of EMU governance by inserting a dimension that remained a ‘no-go’ area during the Euro area crisis.

Finally, a word of caution. The close sequence of the Euro area and pandemic crises allowed for a degree of bold decision-making as described above that has no precedent in EU economic governance. Yet the Council’s historic decision is an extremely new development, untested and yet not implemented. Acrimonious debates as to the future of economic governance will continue and the more difficult part, the implementation phase of national plans to enable grants’ dispersal has yet to materialize. Further, resistance from within the EU, not least by the ‘Frugal Four’, to the prospect of genuine intra-EU solidarity remains one of the obstacles towards reconceptualizing economic governance at EU level and implementing a genuinely new approach. It is therefore unknown whether EU economic governance is transformed for good, or whether the extraordinary circumstances brought about by Covid-19 will reduce the sense of urgency once the pandemic’s effects subside.

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