The Eurogroup at the epicentre of crisis responses

One of the most powerful bodies which, along with the ECB, will determine the extent to which Europe will overcome the economic crisis which erupted as a result of the Covid-19 pandemics is not a well-established institution, but an informal club, namely the Eurogroup. Though it functions as a discussion forum, this gathering of Economic and Finance Ministers, which also includes the central bank and the Commission, exerts considerable influence over the lives of 350 million Europeans. It does so by paving the ground for the decisions which are adopted by the European Council, where policy-making power lies.

And the challenges that lie ahead are monumental, if not existential. To see this, it is important to note that Europe is once again on the verge of becoming one of the main economic victims of the crisis. According to the latest IMF projections, the Eurozone will shrink by over 10% in 2020, two percentage points more than the US. Meanwhile China, the epicentre of the pandemics, would register a modest but positive growth rate. The economic vulnerability of Europe is not new. The impact of the global financial crisis had been significantly more severe in the Eurozone than in all other major economies.

A first reason for this under-performance in the face of *shocks* is that Europe still lacks a budget specifically devoted to the fight against recessions. During the financial crisis, the Eurogroup neglected this issue, preferring to leave the task to individual member countries. If need be, governments could have access to rescue programmes through the European Stability Mechanism or in the form of loans from the IMF, as happened with Cyprus, Greece, Ireland and Portugal. Those programmes came with all sorts of conditionalities attached to them –so recipient countries had limited room for manoeuvre to negotiate them. This resulted in traumatic social effects, and in some cases expeditious democratic processes. In Greece, for instance, some of the most comprehensive reforms negotiated with the Troika were presented to Parliament for urgent approval.

Under the presidency of Mário Centeno, the Eurogroup shifted the approach and recommended greater reliance on European-wide action. For the first time, consideration was given to the possibility of establishing some form of fiscal stabilizer for the group of countries as a whole. This was a game changer, which found its way through the Commission's proposal for a recovery fund. Though a much-needed step which still needs to be approved by the Council, however, it is doubtful whether this will be up to the immense task of the ongoing crisis. In addition, the Eurogroup will have to determine how the funds will be disbursed so that they play an effective anti-recession role.

A second source of vulnerability –one on which the Eurogroup has also played a role--lies with the incomplete architecture of the Euro. This became apparent with the financial crisis, especially in 2011-2012, when suddenly markets realized that the ECB was not acting as a lender of last resort, so governments were borrowing in a currency on which they did not control. The result was an escalation of risk premia, and a double-deep into recession.

Ever since, the reform of the Euro has been at the top of the Eurogroup agenda. And it still is. Indeed, despite some progress –such as the set-up of a single supervisory body aimed at preventing bank failures— the architecture remains fragile. In particular, at times of crises, and in the absence of common deposit insurance, there is an inherent risk that bank deposits move away from the most affected countries to safer locations, thus destabilising the economy.

The Eurogroup has repeatedly tried to remedy this by proposing a European deposit insurance mechanism. The idea is that all bank savings in all member countries are guaranteed, thereby reducing the risk of capital flight. However, country disagreements, fuelled by lack of trust regarding the financial health of banks in certain countries, have prevented any significant action on this front. The high incidence of non-performing loans which saddle Italian banks has been one of the stumbling blocks.

Finally, there is an issue of governance. The Eurogroup is sometimes criticised for its opacity. Though its conclusions are made public and discussed with the media, little is known about the content of the proposals and background papers. Given its composition, the Eurogroup has suffered from a certain gap between its agenda and areas which are of paramount importance to Europeans, such as the digital revolution, the environment and social issues of macroeconomic significance.

The new Commission has put significant emphasis on those areas as part of the proposed recovery plan. However, without a closer involvement of the Eurogroup, there may be a disconnect with mainstream economic policies. Likewise, taxation should receive closer attention in the Eurogroup, especially as countries emerge from the crisis with significant public debt burdens, and harmful tax practices, including within the Eurozone itself, continue to undermine public revenues.

The biggest challenge for the president of the Eurogroup which will be selected shortly will be to accelerate the move to European-wide policy making, thus relaxing the pressure on individual member countries, and making the economic response to the pandemics more effective. The risk of not moving in this direction is further cross-country divergence, thereby threatening the sustainability of the Euro as a single currency. But the opportunities are no less significant in terms of a stronger and more inclusive European economy.