CENTRE FOR EUROPEAN REFORM
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Press release

Three ways COVID-19 will cause economic divergence in Europe

by Christian Odendahl and John Springford

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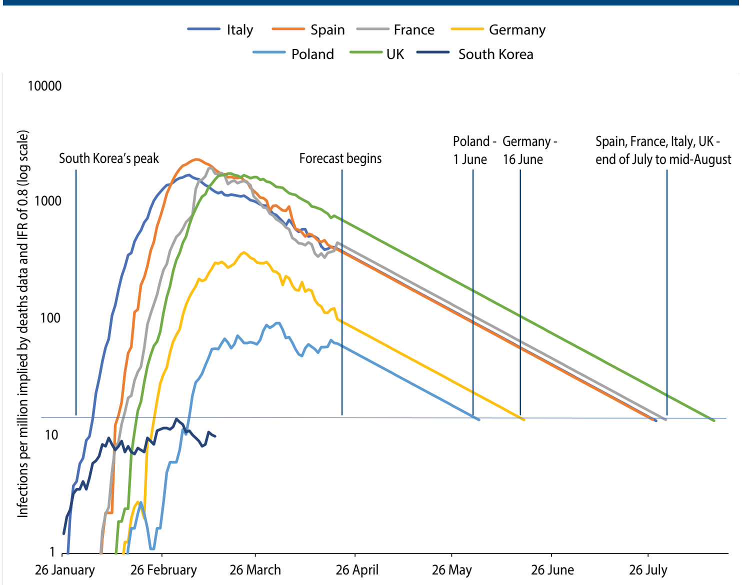
The COVID-19 crisis is threatening to widen the gap between the European Union's heavily indebted southern countries and the more prosperous northern member-states. The Franco-German proposal for a €500 billion recovery fund has potential, but if reluctant Northern and Central European member-states balk at sizeable transfers to Southern Europe, the virus will create fertile ground for more extreme and destabilising politics. That's the key conclusion in a new Centre for European Reform research paper, 'Three ways COVID-19 will cause economic divergence in Europe', which takes an in-depth look at the dynamics of this dangerous trend and recommends policies to address it.

Although the whole of the EU has been hit by the coronavirus pandemic, the economic costs of lockdowns – and the social distancing measures that follow them – are different across countries and regions. The new CER research shows how the asymmetric shock of the COVID-19 crisis is exacerbating economic divergence in three ways. First, lockdowns in southern countries with larger outbreaks, such as Italy and Spain, but also France and non-EU member the UK, will last many weeks longer than in Poland and Germany – illustrated by Chart 1 below which sets out forecasts for countries based on estimates of infection rates. Even an extra month of lockdown will result in much bigger recessions for these countries.

Chart 1: Countries with larger outbreaks will be in lockdown longer



Source: CER analysis of European Centre for Disease Prevention and Control data.

Second, regions that depend more heavily on the hardest-hit sectors like tourism and manufacturing, many of which are in Southern Europe, will be hit harder by lockdowns. And third, the more heavily indebted southern countries have less firepower to support their economies through the lockdowns and subsequent recovery, and they will also face higher borrowing costs and greater pressure to reduce deficits.

The new CER paper makes clear that the EU's high degree of economic integration means that member-states have a strong interest in each others' recovery from the pandemic. This is an external shock that affects euro members and non-members. But a debt crisis in Italy may spread to other eurozone member-states, so the single currency needs some form of common fiscal stabilisation tool. France and Germany should be willing for transfers within the recovery fund to largely take place within the eurozone.

"*Austerity and diverging living standards over the last decade have laid fertile ground for the far right and left. The EU must avoid the same fate in the 2020s*," said John Springford, deputy director of the CER, and co-author of the report.

"*The Franco-German proposal is a unique opportunity for the EU to become a 'convergence machine' again, and it is in the interest of richer countries to seize it*," said Christian Odendahl, chief economist at the CER, and co-author of the report.

Note for editors:
For further information on the new research and to request an interview with Christian Odendahl or John Springford, please contact Nick Winning in the CER press office on pressoffice@cer.eu or +44 (207) 976 3429 and +44 (0) 7714 256241.

'Three ways COVID-19 will cause economic divergence in Europe' is the second in a series of in-depth CER reports examining divergence in Europe's economy. The first, 'The big European sort? The diverging fortunes of Europe's regions' was published in May, 2019 – subsequent papers will examine how technological changes and globalisation might affect growth and inequality across regions, and their impact on politics.

The Centre for European Reform is a think-tank devoted to making the EU work better and strengthening its role in the world. The CER is pro-European but not uncritical. Follow us on Twitter: @CER_EU @COdendahl @JohnSpringford