

## Will the eurozone survive this crisis?

The highly emotional debate on coronabonds, the discussion on a pan-European fiscal response and the cumbersome negotiations on a recovery fund has brought back speculation about a return of the euro crisis and a potential break-up of the eurozone



Coronavirus emergency - first day of phase 2, people in the center. Galleria Vittorio Emanuele

Source: Shutterstock

### ECB to the rescue

Even though Covid-19 is a so-called symmetric shock, its economic impact is asymmetric.

This is not just because of differences in the total number of infections or death tolls but also because of the sectors hardest hit by the crisis. The share of tourism or small and medium-sized enterprises in total economic activity varies from country to country and there has been huge disparity across the region in terms of the fiscal response. The fear of government debt increasing beyond levels that are sustainable seems to have discouraged several governments in Southern Europe from announcing bigger stimulus packages. This is despite the fact that there is a waiver for the fiscal rules, that interest rates are low due to European central bank's government bond-buying and that it is possible to get a cheap credit line with hardly any conditions attached via the European Stability Mechanism.

*Even after Covid-19, the Italian government's finances will not automatically become unsustainable and there is no guarantee that the euro debt crisis will return*

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[We have previously argued that a coronabond is not the silver bullet](#) to

all eurozone problems. There are sufficient instruments in place to tackle possible liquidity issues and a surge in debt would be better solved by debt monetisation or debt write-offs than with debt mutualisation, though a coronabond would obviously be the ultimate symbol of solidarity.

As long as the ECB keeps on purchasing bonds, even a sharp increase in government debt is manageable. Take the example of Italy, which has been running primary fiscal surpluses almost continuously since the early 1990s. Currently, the Italian government uses some 7% of its revenues for interest rate payments. With low-interest rates, a surge in debt would probably increase interest rate payments to 9% or 10% of total revenues. In the 1990s, Italy used more than 30% of its revenues for interest payments.

So even after Covid-19, the government's finances will not automatically become unsustainable and there is no guarantee that the euro debt crisis will return.

[Is this the time for a \(euro\) Coronabond?](#)

## 'Muddling through' put to the test

This does not mean that everything is all well and good.

Covid-19 will lead to further widening of economic discrepancies, at least in the first phase of the recovery. Any growing divergence bears the risk of new tensions between eurozone member states and increases the likelihood that Europe, and the euro, could once again be used as a political scapegoat. These tensions could come either from Southern European countries, which feel abandoned by their Northern peers or from Northern European countries, which want to return to normality and blame the ECB, low-interest rates and Southern Europe for undermining savings, the pension system and the financial sector.

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There is clearly a risk of strengthening centrifugal forces both in the Northern and Southern eurozone countries in the aftermath of Covid-19. This is probably the strongest argument in favour of some symbolic act of solidarity, as the ECB's debt monetisation by stealth has now been thrown into question by the German constitutional court.

The potential for the rift to widen was foreseeable given the lack of meaningful progress on deepening the monetary union's integration in the years after the financial crisis, despite numerous attempts. The right balance between the eurozone and national sovereignty, transfers

and loans hasn't been found, yet.

In the end, the eurozone is a political project. The economics and the economic risks of a possible break-up can always be tackled as long as there is the political will to do so.

However, the tried and tested practice of 'muddling through' will be challenged in the coming years.

Covid-19 will be an enhancer, not a gamechanger in this debate.

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