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Progressivism after COVID:

Experiences, Impulses, Ideas

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NEXT LEFT

PROGRESSIVISM AFTER COVID:
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NEXT LEFT

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Economic growth in post-COVID-19 European Union

FOUNDATION FOR EUROPEAN PROGRESSIVE STUDIES
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Stability and Growth Pact, Fiscal Rules, Growth Regime, Social Classes

Abstract

With the response to the COVID-19, we finally saw a European Union based on cooperation rather than competition, flexibility and pragmatism rather than one-size-fits-all rules, and willing to sustain the economy. However, with the health crisis now over, the chances that we will face a return of the "austerity + structural reforms" economic policy mix are high, because there has not yet been a rethinking of Europe's long-term growth strategy. The Next Generation EU program alone will not produce the growth in aggregate demand necessary to switch to an investment-led growth model, and with stagnant salaries in many countries, a consumption-led growth model does not seem too plausible either. Overcoming austerity (or structural reforms) without changing our long-term growth strategy is an illusion.

After almost a decade of criticising Frankfurt-Bruxelles orthodoxy in matters of economic policy, with the response to the COVID-19 pandemic social democrats can finally see a European Union closer to what we fight for. A Union based on cooperation rather than competition, flexibility and pragmatism rather than one-size-fits-all rules, and willing to sustain the economy rather than chasing the monsters of expansionary austerity.

However when the health crisis, hopefully, is over, Europe will be at a crossroads. The chances that then we will face a return of the "austerity + structural reforms" economic policy package are high. This is because there has not yet been a rethinking of Europe's long-term growth strategy. As we debated many times in the previous rounds of our Next Left Focus Group, all European countries have engaged in (or have been forced to adopt) an export-led growth strategy that, in the absence of sufficiently large investments in innovation and efficiency (especially in the "peripheral" Member States), has made wage compression and fiscal austerity the necessary measures to achieve the Holy Grail of international competitiveness.

The Next Generation EU program alone will not produce the growth in aggregate demand necessary to switch to an investment-led growth model, and with stagnant salaries due to several global and European reasons, a consumption-led growth model does not seem too plausible either.

The problem is both political and of economic culture (which itself is a very political issue). At the political level, COVID-19 has caught many European countries, and the EU as a whole, still in the midst of a reorientation of the debate from the traditional left-right cleavage to a "new" establishment-vs-populists struggle. This newish form of cleavage has proved electorally successful for its main proponents (the populist movements themselves, but also mainstream politicians trying to reframe themselves as neither left or right, or simply "technicians" in charge of administering well). It has, however, proved a very shaky basis on which to build effective coalitions to govern.

The underestimation of the left-right cleavage testifies to the problems at the economic culture level. On the one hand, the Member States' long term growth strategy and that of the EU as a whole are never thoroughly discussed and are assumed to be a matter of broad consensus among both experts and (mainstream) political parties. On the other hand, in-depth discussion and a radical change of course in these matters are hindered by the inherent technical difficulty of the topic (and sometimes the unnecessary recourse to jargon and mathematics among those who do not wish to be understood), and by some little debated institutional constraints. A major institutional constraint in the determination of economic policy in the EU is the use of econometric models for forecasting and policy evaluation, which embed unscientific and frankly conservative assumptions in their inner working. To make one, significant, example, the Commission does not foresee a long-term impact of the NGEU program, because its forecasting model assumes that in the long-term growth is supply determined, and aggregate demand measures such as public investments can only support the economy in the short run. Notice that, significantly, this crucial assumption is made necessary to estimate the model every time, and is never updated or discussed in light of the evidence, quarter after quarter.

Things being what they are, and barring dramatic negative evolutions of the health and sanitary situation, it is only a matter of time until we will have to discuss – again – how the economy supposedly needs "structural reforms" and how high public debts (that in many countries remain below the level of private debt) are unsustainable and a burden on the future generations. There is still hope that this time these voices will not be heard: at least in the short term the policy course had indeed changed, and this opens the chance to debate new fiscal rules for the future with the overcoming of the Stability and Growth Pact as a *fait accompli*. But thinking of overcoming austerity (or structural reforms) without changing our long-term growth strategy would be an illusion.

The EU economic policy stance up to the pandemic

In several prior rounds of our Next Left reflections, many of us have exposed the economic and political problems of the European growth strategy. All Member States (MSs) have agreed, and then they have been asked by the EU Commission and Council to follow the same overall strategy. Public sector austerity – in the loose sense of reduction and containment of general government deficits in all countries simultaneously, and independently both of economic conditions and at the level and composition of revenues and expenditures – is the most visible and openly debated ingredient of this strategy. But not less relevant are the so-called structural reforms, typically labour market reforms aimed at reducing workers' bargaining power and/or to increase labour supply, and privatizations and other reforms (eg of pension systems) aimed at increasing the reach of markets at the expense of the public provision of goods and services, in particular financial markets.

In some countries, these policies have had some relatively positive side effects, mainly a reduction of external debt and/or an increase in employment (though this is mostly low-wage and precarious employment, stimulated by the reduction of labour costs rather than by an increase in the demand for goods and services).[1] However, these are side effects in the sense that they are not what these policies primarily aim at. Except for financialization and privatizations (which are more clearly neoliberal than ordoliberal policies, see below), the common overarching goal of austerity and structural (counter-) reforms is consolidating the EU as a whole as an export-led economy.

Within this strategy, all MSs simultaneously are expected to grow by exporting more and importing less, copying the growth strategy that several of MSs had successfully implemented when they were small independent economies. Austerity works almost automatically to fix current accounts deficits, through its negative impact on imports; structural reforms reduce labour costs in the hope of reducing (export) prices too, thus making Europe the "most competitive" region in the world.[2] If austerity created some unemployment, and structural reforms increased unemployment by reducing inactivity, this was only thought by the proponents of this strategy as a bitter pill: a temporary evil that is necessary as a means to an end, which again is to produce downward pressure on wages and therefore increase firms' cost competitiveness. Conveniently, welfare state retrenchment is an example of how the two policies can go hand in hand.

There are other negative side effects of this strategy – increasing inequality and in-work poverty, decreasing wage share of income, worsening public services, etc. – but from the point of view of our overall growth strategy, one is crucial. The EU as a whole is the first or second largest economic bloc globally, and the rest of the world does

1 This observation is perfectly compatible even with mainstream economic theory, which predicts a growth in employment and wages if there is an increase in firms' demand for labour, and an increase in employment but a decrease in wages if there is an increase in workers' supply of labour.

2 It must be a minor detail, then, that advanced economies typically compete on innovation rather than on costs, and that competition has probably taken place more among MSs than between the EU and the rest of the world.

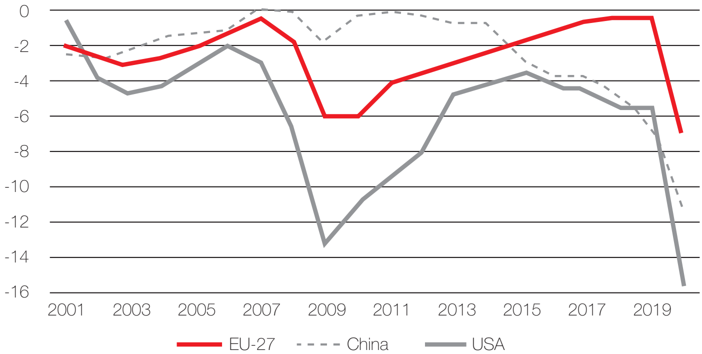
not have the capacity to create all the additional aggregate demand required to grow both the EU's economy and that of the rest of the world. This way, the EU is a drag on global growth and a threat for global financial stability (therefore tensions with the USA were bound to erupt independently of Trump's election); as well as that the US is a low performer in its own terms, given that the growth that can be produced by its exports has proved to be feeble and erratic.

In conclusion, we can characterize the EU's policy stance in the runup to the 2020 economic crisis as based on a structurally lower fiscal deficit than the USA (figure 1), slowly converging labour markets towards lower levels of employment protection (especially for workers on temporary contracts, figure 2), and a monetary policy that many perceived as having exhausted the levers at its disposal as well as, according to some observers, having exceeded its mandate in the quest to save the euro.

Then COVID-19 brought about a crisis of unseen proportions: first through a reduction of exports (due to the obstructions to global trade and international supply chains) and a collapse in investments due to the sudden uncertainty; then via a fall in consumption too, due to the necessary social distancing measures. Facing this challenge, Europe responded more quickly than many would have thought, and mostly in the right direction.

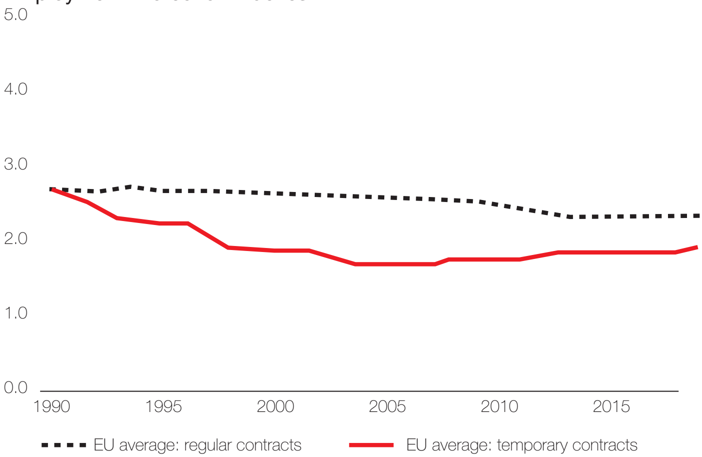
Facing a dramatic social and economic crisis due to the health crisis, this time Europe has reacted in a totally opposite way to the previous eurozone crisis. First, fiscal austerity has been quickly forgotten, with the suspension of the Stability and Growth Pact, now extended until 2022, and above all with the strong and effective backing of the European Central Bank (though after a little gaffe by its President). Where there was public sector retrenchment there is now a boost to aggregate demand, in all EU countries and, significantly, an even larger deficit has been allowed in the traditionally weaker countries

Figure 1. Fiscal policy up to the pandemic: general government deficit



Source: Eurostat.

Figure 2. Labour market policy up to the pandemic: OECD Strictness of Employment Protection indexes



Note: single Member States in grey, simple EU average in black (unweighted, data only available for 20 EU countries).

than in the stronger ones – though overall the fiscal policy stance has once again proven less expansionary than in the USA and, this time, even China (figure 1).

Second, this expansionary response has been coordinated and partly centralized, with the creation of (sort of) Eurobonds and the protection of all Member States from the risks of financial markets tensions and speculation. The bulk of the fiscal answer still resides with the MSs, but at least now the EU is a help and not a hindrance to national policies – the ECB is here to close the spreads.

Third, the EU answer aspires to have a forward-looking character and to extend beyond the short term, with plans on the "digital revolution", social cohesion, and green and climate-friendly policies.

However, it would be premature for us to declare victory in the economic policy field. Member States still do not fully trust that a new course has indeed begun. No MS has applied for the health emergency program created within the European Stability Mechanism, despite formal assurances that its conditionality would not lead again to austerity.

What is even more worrying, for the moment most MSs, even among those who would possibly save in terms of debt service costs, do not plan to use the loans part of the "Next Generation EU" (NGEU) program. As shown in table 1, only Romania and Italy have requested 100% of the loans they would be entitled to, and Greece slightly exceeded the maximum. Cyprus, Portugal, Slovenia, and Poland have requested between 13% and 35%. All others, *schwarz null*. Moreover, most Member States plan to use these loans, and sometimes even the grants, to replace the source of funding of already planned expenditures, rather than to increase their planned expenditure.

As a consequence, NGEU as a whole will be smaller than the €750 bn agreed upon, and it will not add significant fiscal firepower on top of national fiscal policies. At the very least, one would hope that the

Commission could raise all the funds originally planned, and use the part not requested from the MSs for EU-wide investment projects.

Finally, the Eurobonds issued under this plan are – for the moment, at least – conceived as a one-off exceptional measure: without plans to roll over this debt indefinitely, the problem of who to pay it back emerges already from day one.

All in all, it seems fair to assume that the EU response to the COVID-19 crisis has been a small step in the right direction, but also that dark clouds are already appearing on the horizon. Even though the pandemic is not finally over yet, it is already time to discuss what the future of the EU economic policy will be. This requires considering both the political and the economic dimension. To consider the former, in the next section I discuss the recent political crisis in Italy from a European perspective, as a relevant example of a wider trend. The following section will then be devoted to the political economy side of the issue.

Table 1. Member States' proposed take-up of NGEU (€ bn)

	Grants	Loans requested	Loans requested (% of max)
Austria	4.5	0.0	0%
Belgium	5.9	0.0	0%
Croatia	6.4	0.0	0%
Cyprus	1	0.2	13%
Czech Rep.	7.1	0.0	0%
Denmark	1.6	0.0	0%
Finland	2.1	0.0	0%
France	40.9	0.0	0%
Germany	27.9	0.0	0%
Greece	17.8	12.7	102%
Hungary	7.2	0.0	0%

Ireland	1	0.0	0%
Italy	68.9	122.6	100%
Latvia	1.8	0.0	0%
Lithuania	2.2	0.0	0%
Luxembourg	0.1	0.0	0%
Poland	23.9	12.1	35%
Portugal	13.9	2.7	19%
Romania	14.3	15.0	100%
Slovakia	6.6	0.0	0%
Slovenia	1.8	0.7	22%
Spain	69.5	0.0	0%
Sweden	3.3	0.0	0%
Total	**329.7**	**166**	

The political consequences of COVID-19: the case of Italy's political crisis in a European perspective

With a government crisis in the midst of a global pandemic, last winter the Italian case seemed very special – and characteristically irresponsible – to many European partners. But those developments, only facilitated by a more fragile Constitutional framework than in other Member States, reflect similar trends ongoing in several other MSs and in the EU as a whole. The pandemic struck while the political system was/is in a fluid state in many countries, torn between traditional party competition of the left-vs-right kind and the attempts to reframe the debate in terms of new-vs-old movements – this is true in many corners of our Continent, it only became more visible in Italy.

During the 2010s, years of failures of austerity policies have produced a gradual realignment of both economic thinking and politics. Across much of Europe, these two developments reflect similar trends going on, for partly different reasons, in the USA.

Concerning economic policy, the so-called "new Keynesian" economists regained prominence in the public debate, claiming that – although they agree with the proponents of "expansionary austerity", that market forces and in particular international competitiveness are the main determinants of a country's growth in the long term – there is a positive role for government action, including expansionary fiscal policy, when needed in the short term (the exact reach of "short" and "long" term is never clear in this debate). Soon the Brussels-Frankfurt consensus shifted from the urge to frontload fiscal consolidation and reduce public deficits at all costs, to the promotion of structural reforms. This more nuanced position even recognized that these reforms might entail a cost (again, supposedly only in the short term, of course). Top EU officials said increasingly loudly that countries may have to compensate those who stand to lose something when they enact reforms; instead of the "stick logic" of the Stability and Growth Pact, the "carrot" idea gained prominence, of allowing a little extra deficit spending when member states enacted these reforms (or, as was perceived by several national governments, *in exchange* for these reforms).

In the Italian case, this happened for example with the "Jobs Act" enacted by the centre-left government led in 2014. This was a typical set of measures aimed at reducing dualism in the labour market by reducing the job protection for the "insiders" rather than by increasing the protection for the outsiders. Upon approving this law, the government was immediately allowed some more decimal points of GDP in terms of deficit spending, which allowed then PM Matteo Renzi to enact a small but very popular reduction in earned income tax rates for the middle class. Fast forward, the logic of money in exchange for reforms is exactly the deal the Commission is now pushing within the NGEU, with its informal criticisms of several draft national recovery and resilience plans for their lack of effort and detail on the future reforms.

The shift from belt-tightening to structural reforms does not reflect a change in the economists' minds only. It arises from the repeated electoral failures of the two main parties that sealed the "Grand Coalition" at the EU level, in particular the social democrats. Coalitions had to grow in several member states, coming to include in some countries the whole spectrum of mainstream pro-EU parties. On the positive side, grander coalitions softened some policy extremes; on the negative side, criticizing EU policies became practically impossible if not by criticizing the EU itself.

As a consequence, and this is the political realignment I mentioned above, attempts emerged such as Macron's in France, to merge all mainstream parties in a new movement (the *bloc bourgeois*, to use Bruno Amable's, 2019, term) to counter the growing radical right. Significantly, La Republic en Marche claimed to be beyond left and right just as much as the populist parties' claim to be neither left or right. In fact, it would be more correct to say that both sorts of coalitions contain both a right and a left wing. They both tried to reorient the political debate from the traditional left-right cleavage, which admittedly had lost salience due to the social democrat's role of junior partners in most Grand Coalitions, and therefore the overall imbalance at the EU level, to a "new" cleavage: that between the centrist, pro-EU segments of society versus the anti-EU radicals.

In practice, this new agenda led to some electoral gain – notably the centrist bloc in France, and the populists in Italy, but also to some extent the expansion of the Große Koalition in Germany now to include the Greens, and the growth of populist movements in Spain. But both of the extremes, the establishment and the anti-establishment poles, had very little success when in government. Macron, as is well known, quickly became one of the least popular presidents of modern France in the wake of widespread resentment against (higher) pollution and (lower) wealth taxes. The populists, in Italy, quickly began infighting both to attract the attention of the media, which had always been a prime ingredient of their strategy when in opposition, and because of real differences in terms of policy preferences.

When in government, these players had to make divisive choices and it became impossible for them to remain beyond or neither left or right. The bloc bourgeois quickly came to represent the interests of "the establishment" (a mixed bag by which I mean mostly the upper class and the variegated middle classes), and the populists in Italy just could not agree on an agenda that could satisfy both the League's (richer) northern constituency and the 5-Stars Movement's (poorer) southern voters. The French semi-presidential system allowed Macron to survive, though he had to reshuffle his government, and the epidemic is now giving him a tragic chance to show his administrative skills and possibly keep his post by showcasing administrative efficiency. Italy's more fragile system, due to its dictatorship past and the subsequent decision to make the government stand in a weaker role vis-à-vis parliament, made the country a barometer of wider trends.

At first, the League seemed to have the upper hand on the inexperienced leaders of the 5-Stars Movement (M5S) and their government (PM Conte) ostensibly implemented a number of radical right policies, eg in the management of migration flows, or in its open favour in its tax policy towards the higher income strata of the self-employed. M5S, the party that had won a relative majority at the previous elections and controlled an absolute majority in the lower House, began bleeding votes in the polls, losing support in the country, and even facing an increasing number of departures of MPs from its parliamentary group. Its crisis became so evident that after one year, assuming its right-wing voters had by now flown to the League (which nearly doubled its support in the polls), the M5S did what had been unconceivable up to a few months before: it formed a new alliance, this time with a pro-EU mainstream party, the Democratic Party (PD).

Internal developments within the PD facilitated this outcome. Agreeing with Macron's vision of realigning the political cleavage along a centrist vs a populist field, Matteo Renzi left the PD to create a new pro-establishment party, leaving free rein to those within the PD who had been hoping for an alliance with the M5S all along. This way, the "Conte 2" government, supported by the PD and the left wing of the M5S (or what remained of it), constituted a second experiment, after Sanchez's government in Spain, of a progressive alliance between the mainstream and the populist left.

Without indulging in a "post-hoc ergo propter hoc" logic, it is noteworthy that the League has been the main winner in all this, in electoral terms, while remaining focused on its trademark policies geared to its northern, relatively well-off constituency and now turning back to its traditional alliance with the radical and the mainstream right. When, prompted by the PD, the M5S finally embraced a critical pro-EU stance (eg by rejecting 'sovranism' and excluding the option to leave the Euro) and it embraced a more clearly progressive stance, eg defending a more inclusive welfare state and regional convergence, the M5S finally stabilized in the polls. It then seemed the old left-right cleavage still matters after all.

This is when the pandemic struck. The relatively successful management of the health and economic crisis has indeed been a boon for the PM Conte and its M5S, even though the PD did not seem to fare badly in the polls. However, forces remained strong, both in the Parliament and within society at large, for a reconfiguration along the new pro- vs anti-establishment cleavage. Matteo Renzi's new-formed party, though very small, managed to induce a government crisis that very quickly resulted in a new great-grand-coalition government, supported by all parties except the radical right. We are now facing a rethinking of its main stance within the League, which is gradually approaching a critical pro-EU position, which reproduces the establishment vs populists divide, this time with only one party among the populists (Fratelli d'Italia, which not by chance is quickly growing in the polls). This sort of outcome is not too different, after all, from Macron's attempt three years before.

To understand how the difficulties of the "populist bloc" are not a unique Italian phenomenon, let us consider the composition of its electorate by distinguishing between "left-wing" and "right-wing" populist movements, following Krouwel et al (2021). Using European Social Survey data (2019 wave), both similarities and differences emerge in the composition of this electorate.

Table 2. Populist movements' voters by educational attainment

	Lower secondary	Upper second.	Tertiary
Populist/far right	18%	13%	8%
Populist centrist	8%	5%	2%
Populist/far left	4%	5%	6%
Mainstream party	71%	77%	84%

Table 3. Populist movements' voters by income quintile

	Bottom 20%	2nd quintile	3rd quintile	4th quintile	Top 20%
Populist/far right	14%	14%	14%	11%	8%
Populist centrist	6%	5%	5%	3%	1%
Populist/far left	6%	6%	6%	6%	4%
Mainstream party	75%	74%	74%	80%	86%

Table 4. Populist movements' voters by activity status

	Em-ployed	Unem-ployed	Retired	Inactive	In edu-cation
Populist/far right	13%	13%	13%	12%	6%
Populist centrist	5%	16%	3%	6%	9%
Populist/far left	5%	9%	3%	5%	13%
Mainstream party	77%	62%	81%	77%	73%

Table 5. Populist movements' voters by main source of household income

	Wages	Self-em-ployment	Social benefits	Other (rents, profits)
Populist/far right	12%	16%	13%	9%
Populist centrist	5%	8%	4%	6%
Populist/far left	6%	3%	4%	6%
Mainstream party	77%	73%	80%	79%

As shown in table 2, support for radical right and populist far right parties decreases with voters' educational attainment, and the same for centrist or nonaligned populist movements, but the opposite holds for radical left and far left populist parties. Similarly, support for populist movements decreases with voters' income, but less strongly so for the left populists (table 3). This evidence could partly be explained by the radical right parties' ability to attract unemployed voters and those whose primary income source is wages, than the left populist movements. Overall, it seems that populist movements partly reflect what Piketty (2019) has noted for mainstream parties, that is, the left attracts more often the more educated voters, and the right the relatively richer – except that in the case of the populist far right, it effectively attracts relatively poorer and less well-off voters too, notably those in the bottom quintiles of the income distribution and the unemployed.

Given EU-wide heterogeneity in the support for left and right populism, as well as for centre-left and centre-right mainstream parties, difficulties to agree on an economic policy agenda appear only natural.

Post-COVID-19 economic policy choices for the European Union

In this section I will describe the main options in terms of growth strategies and the associated economic policy prescriptions, along the lines summarized in the table below. I will highlight how "structural reforms" are clearly linked to the export-led-strategy only.

Defining national income as aggregate demand, we can decompose it into the sum private (C) and public (G) consumption, investment (I), and net exports (exports minus imports, NX). We can thus distinguish different growth models for the three largest economic areas of the world, depending on which component of aggregate demand drives income growth and what the conditions and policies are that support (or not) such growth.

Further, we can try and connect growth models with the income sources that they benefit most. Simplifying and rationalizing on the more complex scheme of table 6, in table 7 such exercise is proposed for the main philosophies of economic policy. Export-led and investment-led models benefit profits, though the former more than the latter because export-led models typically entail wage compression and thus an increase in the profit share. These growth models are characteristically sought by scholars and policymakers who are (consciously or not) influenced by Ordoliberalism. Debt-fuelled growth typically benefits financial rents, is supported by neoliberal orientations, and it manifests

Table 6. Main sources of growth in the three largest economic areas

	Anglo-Saxon model	Chinese model	EU model
Main sources of demand growth	Individual and collective consumption	Investment	Net exports
Main beneficiary sources of income	Mostly wages, and rents	Mostly profits, and wages	Mostly profits, and rents
Main sources of supply growth	Employment, often imports	Productivity and employment	Productivity, and employment
Main stimulus/ support policies	Expansionary fiscal policy, generous lending policies	Targeted fiscal and lending expansionary policies, incentives for FDIs	Expansionary monetary policy (currency depreciation), labour market reforms
Frequent obstacles	If productivity does not increase: unsustainable private and/ or public debt, and assets price inflation	If not enough investment opportunities: wasteful capital accumulation, and non-self-sustaining growth	If competitiveness does not increase: imports grow in line with exports (stagnation)
Political con-sequences	Moderate growth. Debt overburden (personal income inequality), financial fragility	High growth. Stagnant living standards	Low growth. Unemployment, functional income inequality (in-work poverty)

itself through a debt-induced growth of consumption (in the USA) or of the expenditure of any sector other than the private sector. Wage earners will typically prefer an investment-led or at most consumption-led growth model, of the sort advocated by Keynesianism. And finally, those whose primary income source are public transfers will naturally favour the expansion of public expenditure, as implied by Beveridge-type welfare states.

Table 7. Growth models and income sources in the main economic policy approaches

	Profits	Fin. Rents	Wages	Fisc. Transf.
Public sector (state)			Keynesian	Beveridgian
Private sector (market)	Ordoliberal	Neoliberal	Keynesian	
Preferred growth model	*Export-led*	*Consumption-led (C)*	*Investment-led*	*Consumption-led (G)*
Second choice	*Investment-led*	*Export-led*	*Consumption-led (C)*	*Consumption-led (C)*
Third choice		*Consumption-led (G)*	*Consumption-led (G)*	

However, moving from economic philosophy to political families is tricky, because there is no one-to-one relation, and because party families could be inconsistent or change their economic ideology over time and/or between countries. Table 8 is my first attempt at a synthesis, that I very much look forward to discussing with you at our next meeting.

Table 8. Growth models and party family preferences

Export-led	Conservative*	Liberal*		
Investment-led	Conservative		Socialdemocratic*	
Consumption-led (C)			Socialdemocratic	Radical left
Consumption-led (G)		Liberal		Radical left *

* : first choice

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