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The new European dynamic

« Their rivalries and debates sharpened intelligences » Hume

This analysis of the reasons for the success of Ancient Greece is enlightening. According to ***Hume***, the autonomy of each city, the competition between Athens, Sparta and the others, stimulated the whole. In "Of the Rise and Progress of the Arts and Sciences", Hume (1742) wrote about Europe as being the division which makes the force. A counter-intuitive statement to emphasize that the advantage of plurality is to promote freedom of thought and judgment of each person, to encourage critical thinking.

Over the past year, with the new Commission led by Ursula Van der Leyen and the determination shown by Angela Merkel and Emmanuel Macron, rivalries and debates have led to concrete results and progress has multiplied on a few fronts: *Economic* - with the €750 billion recovery plan, or 5% of European GDP; *Financial* - with the extension of the role of the European Stability Mechanism (ESM) to defend banks in case of need; *Monetary* - with the action of the ECB; *Commercial* - with the declared union with China; *Digital* - with the preparation of the Digital Services Act intended to regulate the GAFAM; and finally, *Political* - by bringing Hungary and Poland into line, they will no longer be able to dodge, deflect or even trample on democracy. To all these initiatives, we should add the launch of the Europe of batteries, the debate on the Europe of defence, the Europe of energy, and we are forgetting about others.

Europe, a great economic power but a political dwarf, is asserting itself, between or alongside the United States and China and, as we noted in Letter 14 of July 6, we can speak of a tripolar world. It can be written that Europeans have come together to try to remain in control of their destiny.

So let us consider the economic, monetary and political dimensions of this new dynamic.

From an economic standpoint, it is important to note the scale, speed and scope of this plan.

The recovery plan means more debt but above all an opportunity to be seized to boost the Union because real growth over the last ten years has barely exceeded 1%.

- *The scale* :

€750 billion is the equivalent of 5% of European GDP, five times the annual budget of the European Union. It includes €312 billion in subsidies, €360 billion in loans that the Member States can decide whether or not to take up and €78 billion to support European programs for the future between 2021 and 2027 to increase productivity and improve macroeconomic stability. A plan demanded by France, accepted by Germany, which until now has been resistant to a Keynesian revival and hostile to debt pooling.

Italy will receive €65 billion in grants, Spain €59 billion, France €40 billion, Poland €23 billion, Hungary €7 billion and Greece €16 billion. The amounts of subsidies received must not exceed 6.8% of the income of each member state.

Of the €360 billion in loans, the rate for each borrower will be more attractive than a direct loan because the Union has an AAA rating and there will be no trusteeship for these states, even if structural reforms are desired. After the debt to finance the SURE unemployment compensation plan (which is small in relation to GDP), there is a second issue of Community debt, which will be of great interest to investors.

It was difficult to understand the reticence of the four "frugal" countries of the North. If their public debt/GDP ratio was low at 33% in Denmark, 35% in Sweden, 49% in the Netherlands according to Eurostat, their private debt is not exemplary, 280% of net disposable income in Denmark, 240% in the Netherlands compared to 87% in Italy. Moreover, the 4 frugal countries had an interest in the compromise because they export a lot to these countries. Sweden, for example, makes 2/3 of its exports to European countries. As a reminder, it should be remembered that these countries have 42 million inhabitants, i.e. less than 10% of the European population and produce less than 50% of the German GDP.

One understands the abandonment of the veto by Poland and Hungary, their fear of a substitution plan for the other 25 members, because their dependence on Community manna is high: nearly 5% of GDP/year for Hungary in recent years and 3.5% for Poland. The Polish Ministry of Economy acknowledged that ¼ of the country's growth in recent years was the result of this aid and with the necessary investments in energy conversion, European subsidies will be welcome. Let's bet that respect for the rule of law will eventually prevail in both countries.

- *The speed* :

The avoidance of the mistake of a delayed stimulus in 2010 and the imposed austerity policy that almost proved fatal to Greece is very well described by Obama in his memoirs, where he described his inability at the time to get a global stimulus package adopted.

This time is different and, to the sorrowful minds, quick to denounce the slowness of the Brussels administration, one will answer with the objection of a rapid release of funds. 70% of the payments will be made in 2021 and 2022, the balance in 2023. Speed is key because the recession is strong, -7.3% this year, +3.9% in 2021 and +5% in 2022, according to ECB estimates.

- *The scope* :

Stimulus plan money should not be used to finance wage increases or partial unemployment. Some like ***Xavier Timbeau*** denounce "a recovery plan without recovery" but the aim is to increase the Union's competitiveness. In particular, 37% of the spending will be dedicated to the energy transition (thermal renovation, etc.) and 20% to the digitalization of the economy (industrial cloud capacity to offer healthcare services, to promote urban mobility, etc.). In parallel with the recovery plan, the structural funds will no longer finance fossil fuel energy production after 2025. It should be remembered that the "Airbus of batteries" is taking shape with the opening of the first plant in France in 2023 and in Germany in 2024, but by 2030, production will only cover 10% of European demand.

Among the ambitions of the various measures is the relocation of certain industries with the aim of slightly increasing the weight of industrial added value in GDP, which, according to the OECD, has fallen to 29% in the Czech Republic, 24% in Germany, 15.8% in Spain, 14.8% in Greece and 13.5% in France.

For a long time, a simple incantation of the most fervent Europeans, this plan, which was still unexpected at the beginning of the year, constitutes a step forward that would have been impossible with the English. To the critics, it is the first example of the mutualization of debts within the Union, it is a milestone on the road to integration that will disarm the opponents of Europe. It is like the signing of the Treaty of Rome in 1957, the successive enlargements, the Maastricht agreements, one of the strongest moments in the affirmation of this power.

This European revival plan corresponds to Community financing. The plastic tax comes into force at the beginning of 2021. A carbon tax, a GAFAM tax, all the more logical since these actors have benefited from the crisis, and perhaps a tax on financial transactions are then expected.

From a monetary point of view, the Euro zone's debt ratio, which has been reduced from 95% of GDP in 2013 to 85% in 2019, will worsen by around 20 points. In 2019, according to the IMF, the ECB held 21% of Spanish debt, 19% of German and Italian debt, 16% of French government debt, 5% of Greek debt and, by way of comparison, the Fed held 17% of the Treasuries. In 2020, this percentage will increase rapidly. From January to September, the States have been indebted by €1 trillion and companies by €500 billion.

The inflation rate in recent months has been negative and in 2020 is not expected to exceed 0.2%, a figure far from the 2% target set by the ECB. The appreciation of the Euro, against the dollar, already 8.4% this year, will further reduce inflation and the ECB therefore has full latitude to conduct an aggressive policy of monetary support.

The PEPP, a program to repurchase public and private debt, will run until March 2022. €2.4 trillion will thus be disbursed by the ECB. The LTRO, Long-Term Negative Interest Rate Financing Program for Banks at -1%, is extended until June 2022 and allows banks to earn money on their loans. These various actions of the ECB have 4 objectives: to revive growth, to absorb debts (70% of issues this year according to the IMF, compared to 75% in Japan, 57% in the United States and 50% in Great Britain), to bring inflation to 2%, (-0.3 in November) and to curb the appreciation of the €.

The ECB's rapid reaction contrasts with the management of the 2012 crisis. The markets are not mistaken because despite high public debt, the 10-year debts of Greece, Italy, Spain and Portugal are trading at 0.6%, 0.55%, 0 and -0.1% respectively. Nothing to do with the year 2012 when the Greek 10-year debt was at 37%, the Portuguese debt at 17%... The amount of debt is substantially higher but states do not face threats of solvency crisis as rates are very low as compared to 2012. In 2012, for Portugal, issuing debt at 17% was blocking growth. In 2020, issuing debt at zero is an opportunity to raise growth potential, invest in infrastructure and gain competitiveness.

Of the outstanding negative-rate bonds estimated at nearly $18 trillion by Bloomberg, a significant portion is in Europe, and this is an asset. By way of example, in 2020, France financed itself at an average rate of -0.14% for 11 years, compared with 2008, which was characterized by an average 8-year debt at a rate of 4.10%. If public debt at the end of 2020 reaches 120% of GDP, financial costs will not exceed 1.4% of GDP, whereas in 2005, a debt at 67% of GDP cost 2.7% of GDP.

Nonetheless, the virtue of maintaining a low public debt is an advantage for Germany. By the end of 2020, its public debt ratio will only be 75% of GDP after having mobilized infinitely more money than other countries and this will reflect on its future growth potential. At the end of September, Germany's GDP was still 4.2% below the level of the same period in 2019 (France still 4.3% lower, Italy 4.7% lower and Spain 8.7% lower) but the recovery will be faster.

From a stock market point of view, the European market is cheaper than the American market. The lower percentage of technology stocks in the indexes is one reason, but the recent attractiveness of investors for cyclical and financial stocks has allowed the European markets to outperform the US market in November and this trend is expected to continue in 2021.

Even from a technology point of view, we have the satisfaction of seeing an increase in the number of "unicorns" in Europe, these wealthy start-ups with a stock market value in excess of €1 billion. In France, there were none, and there are now about ten of them. Snowflake is valued at 70 billion.

From a political point of view, it is necessary to avoid the "ghost of freedom" in Hungary and Poland and thus, following the agreement of November 5, a qualified majority in the Council will be sufficient, with 55% of the countries, representing 65% of the population, to suspend the payment of aid to a State guilty of illiberal drift and of not respecting the independence of the justice system. Poland and Hungary will no longer be able to block such a decision, or at most defer it by appealing to the European Court of Justice. In the run-up to the elections in Hungary in the spring of 2022, we can be sure that the focus will be on the corruption of the Orban clan and the misappropriation of European funds for its benefit. As criticizable as Kazcynski in Poland and Orban in Hungary may be, let us not forget that their coalition lost the local elections in Poland's major cities and represents barely more than half of the population. Nothing is set in stone. As the Czech writer ***Milan Kundera*** reminds us, these countries have for centuries participated in the great adventure of Western civilization, the Gothic, Renaissance, Reformation, and they must deserve their place in Europe.

Conclusion

The late ***Steiner*** wrote that "***Europe lives in the serenity of memory***". This image is outdated and Europe, thanks to Germany's abandonment of budgetary orthodoxy and its acceptance of European mutualization, can finally project itself into the future.

- ***Europe, the leading commercial power :***

With a market of 440 million consumers (after the United Kingdom exit) who are more open to the outside world than the United States and China, the European market with its 27 member states (EU-27) is a coveted market since exports account for 47% of GDP against 12% in the United States and 18% in China. The European Union has a GDP of €14 trillion, of which Germany has €3.4 trillion, France has €2.4 trillion, Italy has €1.8 trillion and Spain has €1.25 trillion. Europe must also direct its savings surplus, its current account surplus, 3.5% of GDP against 1.1% in China and -3% in the United States, towards the financing of sectors of the future.

- ***Europe, an original economic model :***

Between the United States and China, the Euro zone is characterized by a level of public spending, 47% of GDP on average, higher than the 35% observed in the United States and China. Europe has successfully developed a generous social model, a model that is less obsessed with short-term profit, a model that is more concerned about the climate issues that it must defend and promote, and it must extend the use of the Euro as an alternative to the $. At a time when neo-liberalism, in vogue under Thatcher and Reagan, is denounced as a generator of growing inequalities, Europe can make its music heard and reduce the social divide by seeking more inclusive growth, by investing more in education and health and by drawing inspiration from the success of the Swiss model in professional education.

- ***Europe, a powerful player on the global political stage :***

What ambition for Europe? To be a diplomatic player as France would like it to be, or just a commercial power as others would like it to be? Should it be a player between the United States and China on the international stage or should it be neutral on major issues? Europe was formed with the sole ambition of avoiding new conflicts and creating a large market. From this project, the ambition to play a political and diplomatic role on the international scene did not emerge, and the Union struggles to adopt common positions, often makes discordant voices heard, and has many members who are not very concerned about making their voice heard on the international scene.

Today, between the American retreat and the Chinese offensive, which has invested €150 billion in Europe since 2010, between a certain isolationism and Xi Jinping's desire to strengthen the public sector in order to form leading groups on an international scale, between the customs duties imposed by the American administration and the sometimes unfair Chinese competition, a change is needed.

The creation of a European Defence, the definition of a migration policy at the borders of the Union, the affirmation of Europe in the fight against global warming, are all work in progress. Europe must not be on the defensive but involved as an actor.

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Geneva, December 14, 2020

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