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The European Union's response to the coronavirus emergency: an early assessment

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Abstract

This article provides an assessment of the EU institutions' response to the coronavirus pandemic. It contends that it followed the new intergovernmental tendency to empower *de novo* bodies like the European Stability Mechanism, the European Investment Bank and the European Central Bank. The European Central Bank's early and unconstrained action structured European politics. Its pandemic emergency purchase programme ensured that euro area member states were able to maintain market access and lowered the financial attractiveness of the subsequently created instruments to tackle the corona crisis. The European Commission was relegated to the role of 'cheerleader of European solidarity'. It partially redeemed itself by creating a new temporary loan-based instrument to support national short-term work schemes and by proposing a large-scale recovery instrument termed 'Next Generation EU'.

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Keywords: Coronavirus crisis, pandemic emergency politics, COVID-19, euro area, EU

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Table of Contents

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Tobias Tesche

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1. Introduction

The coronavirus pandemic hit the European Union in early 2020. The COVID-19 outbreak gave rise to an initial reflex to retreat behind the confines of the national borders before any coordination took place at the European level. The lack of European solidarity at display fueled the perception that this was an existential crisis for the EU even though it had limited competences in the policy area of public health. Consequently, the Commission focused on the temporary untying of member states from any institutional constraints that could hinder their fiscal responses to the corona crisis before proposing its own emergency schemes. Generally, there was broad consensus about the appropriate economic measures to deal with the socio-economic fallout of 'the great lockdown'. National approaches to flatten the curve of infections differed in their timing and stringency. From an economic perspective, the looming danger was that the strongest economies would emerge even stronger from the shock, whereas the weaker ones would get even weaker. The concern was not unjustified given that Germany single-handedly accounted for half of the state aid approved by the Commission.

With the Commission relegated to 'cheerleader of European solidarity' and the European Parliament missing in action, it was again the European Central Bank (ECB) that saved the day – a role it had already played during the euro area crisis. This time it fulfilled its lender of last resort function through the announcement of its 'pandemic emergency purchase programme' (PEPP) on 18 March and its 'pandemic emergency longer-term refinancing operations' (PELTROs) on 30 April 2020. It is noteworthy that the ECB diverged from its established pattern of prodding fiscal authorities into action before announcing any monetary stimulus. Like her predecessor Mario Draghi, who famously declared that the ECB would do 'whatever it takes' to safe the euro, Lagarde's 'whatever it takes' moment came only a few months after taking office and fundamentally changed the dynamics of pandemic politics. After the February Eurogroup and European Council meetings did not yield any tangible results, in March 2020 the discussion turned to the crucial question how to finance the economic recovery after the corona lockdown. The Eurogroup agreed on a three-pronged approach to help sovereigns through the European Stability Mechanism (ESM), companies through the European Investment Bank (EIB), and workers through the Commission's temporary loan instrument to support short-time working schemes (SURE). In May 2020, a French-German compromise paved the way towards the Commission's Next Generation EU recovery instrument that proposed €500 billion in grants and €250 billion in loans to aid the recovery on top of a revamped EU budget.

The EU's recent history has generated new ways to understand and explain European integration. Two important theories are the new intergovernmentalism approach as well as White's account of 'emergency politics' (Bickerton, Hodson, and Puetter 2015; White 2019). Taking the European response to the coronavirus pandemic as a case study, this article asks what these theories can offer beyond their home turf. This article argues that European pandemic politics largely followed the theoretical expectations of the new intergovernmental theory. Rather than delegating new competences to the Commission as the traditional engine of European integration, the European response to the corona crisis relied largely on *de novo* bodies like the ECB, the ESM and the EIB (Bickerton, Hodson, and Puetter 2015).

This article relies on a qualitative assessment of newspaper coverage, press releases, press conferences, and official documents from EU institutions (Commission Communications, ECB decisions and minutes, Eurogroup and European Council Conclusions and letters). The structure of the article is as follows. First, it outlines a theoretical framework to enhance our understanding of the European response to the corona crisis drawing on the new intergovernmentalism and the concept of 'governing by emergency' as proposed by White (2019). Subsequently, the article details the measures taken by EU institutions to tackle the corona crisis. It traces the policy response by the European Commission and the ECB. The article then discusses the deliberations and intergovernmental bargaining at the European level about the instruments to shape of the European recovery. Finally, it concludes by assessing the consequences of the pandemic for European integration.

2. Pandemic politics and the coronavirus emergency

European politics has been dominated by the EU's 'polycrisis' (Zeitlin, Nicoli, and Laffan 2019). In many respects the corona crisis looked like a replay of the eurozone crisis politics. The rift between creditor and debtor countries returned with a vengeance. With intergovernmental negotiations proceeding slowly, the responsibility was shifted on to the ECB which did most of the heavy lifting. Seen from this perspective, the European response to the corona crisis broadly followed the pre-existing tendencies in the EU that were identified by new intergovernmentalist (NI) theory. NI argues that member states demand a deepening of European integration but without delegating competences to the traditional engines of European integration like the Commission (Bickerton, Hodson, and Puetter 2015). Rather member states seek to empower institutions like the ESM and the EIB that possess intergovernmental governance structures but also more autonomous institutions like the ECB (Hodson 2019). Moreover, NI emphasizes the importance of deliberation and consensus-seeking as guiding norms of EU decision-making (Bickerton, Hodson, and Puetter 2015, 711). From the very beginning of the corona outbreak, there was constant deliberation at the European level about the adequate common response. Without strong consensus-seeking behavior among governments, the April 9 Eurogroup package could not have been agreed. However, governments deliberately used rhetorical strategies to cater to domestic public opinion. These strategies might have distracted from the fact that consensus-seeking among EU governments was the guiding norm. Afterall, even the 'frugal four' agreed that a recovery initiative was urgently needed.

NI observes that the border between what pertains to 'high' and 'low politics' has become increasingly blurred. In this regard, NI points out that 'existential concerns are often posed in relationship to a country's *isolation* or *withdrawal* from the logic of European integration' (Bickerton, Hodson, and Puetter 2015, 715). An illustrative example is the unilateral national border closures in the EU during the coronavirus emergency. These measures were controversial in the context of European integration because they violated the principle of free movement, whereas border closures in third countries outside of the EU were much less controversial. The pandemic blurred the distinction between 'high' and 'low politics' because seemingly mundane decisions such as the reopening of schools, suddenly turned into an existential question. However, in certain respects the corona crisis also pronounced the differences between low and high politics. The 'low politics' of promoting economic growth was sacrificed to ensure the survival of the citizens ('high politics').[1] In an FT interview Emmanuel Macron described this dynamic as a 'profound anthropological shock' and stated that 'we have stopped half the planet to save lives' (Mallet and Khalaf 2020). Finally, NI controversially argues that the EU finds itself in a permanent state of disequilibrium characterized by 'the EU's tendency to produce policy outputs that polarise politics in ways that cast doubt on the future of the Union' (Hodson and Puetter 2019, 1157). The tension between integration-minded leaders and eurosceptic mass publics can fuel a 'destructive dissensus' (Hodson and Puetter 2019, 1154). In Italy an integration-minded prime minister Conte struggled to convince an increasingly eurosceptic mass publics to support his EU-level efforts to negotiate a grant-based deal.

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[1] I would like to thank the anonymous reviewer for making this excellent point.

The COVID-19 pandemic has led to the return of 'emergency politics' experienced during the migration and eurozone crisis (Dyson 2013; Kreuder-Sonnen 2019; White 2015, 2019). Building on White's analysis of emergency rule, a couple of recurring patterns and characteristics can be identified. First, there is a tendency towards executive politics benefitting incumbents at the national and the European Council and the Eurogroup at the EU level (Puetter and Fabbrini 2016; Hodson and Puetter 2019). Second, a reliance on the indispensable technocratic actor – the ECB. It is the only supranational institution that has the capacity to rapidly mutualize risks via its balance sheet and forms 'a core component of EMU's emergency regime' (Scicluna 2018, 1885). Instead of creating new *ad hoc* solutions, the European Council and the Eurogroup were able to tackle the corona crisis largely within the existing institutional framework. To be sure: new temporary emergency instruments like SURE and the recovery fund were created but *ad hoc* arrangements like the troika that featured prominently in 2012 were explicitly rejected (Maas and Scholz 2020).

Third, the logic of the '*self-cancelling* prophecy' as a rhetorical strategy was used by different actors, i.e. 'credibly raising the prospect of further chaos as a way to reassert control' (White 2019, 22-4). The *self-cancelling* prophecy was invoked by the two opposing camps regarding the issue of 'coronabonds'. Italy, Spain and France argued that without a mutualized debt instrument the EU would face the prospect of nothing less than rising populism and complete disintegration (Mallet and Khalaf 2020), whereas the northern camp was adamant that 'coronabonds' would cause moral hazard and undermine the proper functioning of the euro area. Macron himself reverted to the *self-cancelling* prophecy in his FT interview when he cautioned that 'failure to support the EU members hit hardest by the pandemic will help populists to victory in Italy, Spain and perhaps France and elsewhere' (Mallet and Khalaf 2020). Fourth, learning effects from previous crises also came into play. Member states were cognizant that temporary emergency arrangements are likely to become institutionalized over time. They can set a precedent that can normalize emergency arrangements. White (2019, 6) convincingly argued that 'emergency rule marks the radicalization of existing tendencies, but it also leaves its own distinct traces. It points not just to a set of institutional transformations but to a potentially enduring recalibration of authority. Despite the emphasis on exceptionality, emergency rule sets precedents for what follows. Hence, the expectation was that the pandemic would reinforce the pre-existing tendencies and underlying structural divergences within the EU. The rhetorical radicalization of existing tendencies was openly at play in the debate about the potential issuance of mutualized debt. The Dutch finance minister Hoekstra insinuated that southern fiscal profligacy precluded an adequate fiscal response to the public health emergency (Khan 2020). The morality tale of 'southern sinners vs. northern saints' came to dominate the policy discourse once again (Matthijs and McNamara 2015). However, the symmetric nature of the shock made mass audience more receptive to arguments framed in terms of solidarity. Reinvigorating the morality tale was a rhetorical strategy catered to domestic audiences, but it didn't preclude deliberation and consensus-seeking at the EU level.

3. The European Commission: Cheerleader of European solidarity

The corona crisis tried the Commission on multiple fronts. First, the Commission had to ensure that the protectionist measures of member states would not permanently undermine the single market. Early on Germany had issued a temporary export ban on critical medical equipment which was only lifted once the Commission threatened to open an infringement procedure. Ultimately, the Commission imposed an EU-wide ban for exports of critical medical equipment to the rest of the world. Temporary border closures posed a threat to the continuous flow of goods across the union and violated the Schengen Borders Code (Carrera and Chun Luk 2020). To prevent the EU-wide supply chains from unravelling the Commission issued guidance for border management (European Commission 2020a). It entailed the creation of 'green lane' border crossings open to all freight vehicles with limited controls. An attempt by the Commission to coordinate the national exit strategies from the lockdown via a *Joint Roadmap towards lifting COVID-19 containment measures* failed. Second, the Commission had to counter the perception of a lack of European solidarity. The unilateralism that dominated during the early phase of the coronavirus outbreak further decreased the already low levels of trust in the EU in Italy and increased the risk of disintegration (Moschella and Quaglia 2020; Johnson, Fleming, and Chazan 2020). However, member states set the agenda and relegated the Commission to the role of 'cheerleader of European solidarity'. The Commission's communication strategy focused on highlighting the limited incidences of European solidarity on display through the cross-border transfer of intensive care patients, the provision of face masks or the dispatch of medical teams via the EU civil protection mechanism. Third, the Commission was constrained in its capacity to act because it only possesses limited competences in the area of public health. Article 168 TFEU limits the Commission to complement the policies of the member states by promoting research, exchanging best practice and 'monitoring, early warning of and combating serious cross-border threats to health'. However, within the boundaries of its existing powers it operated effectively. It used the EU public procurement framework to buy medical equipment on the world market under extreme urgency. It *de facto* suspended the SGP by triggering the general escape clause for severe economic downturns to enable member states to deviate from their fiscal targets. The corona outbreak also severely affected the European Semester. The deep uncertainty made it impossible to quantify fiscal targets so that the Commission had to accept qualitative stability and convergence programmes. In addition, it pledged to interpret the state aid provision in a flexible manner during the pandemic (European Commission 2020b). Unbound from their European obligations, member states were in the position to respond to the corona outbreak unconstrained. However, the decision was criticized for accentuating the divergence of the national fiscal responses. Finally, the Commission had to ensure that national emergency measures would not undermine democracy and the rule of law and exacerbate the authoritarian tendencies in some member states. Hungary's prime minster Orban used the pandemic to usurp emergency powers that allowed him to govern by decree for an indefinite period.

On 13 March, the Commission proposed a 'Coronavirus Response Investment Initiative (CRII)' that entered into force on 1 April. The CRII redirected €37 billion under the existing cohesion policy for tackling the COVID-19 outbreak. As a result, unspent pre-financing for European structural and investment funds did not have to be repaid (approx. €8 billion from the EU budget) and existing structural funds to the amount of €29 billion could be used. In addition, the Commission waived the national co-financing requirement for the remaining unallocated €28 billion in structural funds to use them for providing support to health care systems, liquidity to SMEs and to fund national short-term schemes. However, the CRII funds were disbursed according to the pre-existing rules. This meant that Hungary - despite having used the pandemic emergency to move closer towards authoritarian rule – would receive €5.6 billion (3.9% of GDP), whereas Italy would only receive €2.3 billion (0.1% of GDP) (European Stability Initiative 2020). Furthermore, the Commission extended the scope of the EU Solidarity Fund to cover the public health crisis freeing up €800 million for 2020 and mobilized €179 million for 2020 from the European Globalisation Adjustment Fund to support laid-off workers. On 2 April, the Commission proposed to reactivate the Emergency Support Instrument to provide another €2.7 billion from EU budget resources.

The European Commission also created a loan-based European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) (European Commission 2020c). SURE would leverage €25 billion of financial guarantees voluntarily committed by member states to the EU budget in line with their respective share of the gross national income of the EU (i.e. no paid-in capital required). This would amount to a financial capacity to issue loans of up to €100 billion subject to qualified majority voting in the European Council based on a Commission proposal. All EU Member states can use these debt-increasing loans to finance short-term working schemes to stabilize the existing employment level and avoid potential hysteresis effects. The instrument follows the same technique previously used to create the European Financial Stabilisation Mechanism (EFSM) (Vandenbroucke et al. 2020). It makes use of Article 122(2) TFEU that enables member states to channel financial assistance on a temporary *ad hoc* basis to a member state in severe difficulties due to exceptional circumstances. Given that SURE is a repayable loan-based instrument it falls short of facilitating true burden-sharing even though it might generate a small net financial benefit for countries with very high borrowing costs. However, the ECB's PEPP had lowered the spreads of Italy, Spain and Portugal to such an extent that the relative financial attractiveness of a SURE loan was reduced. A long-term SURE loan repayment schedule would prevent medium-term rollover risks. Its temporary nature and targeted purpose ensured that it did not contain the nucleus for a permanent automatic European unemployment (re-)insurance scheme which made it acceptable to northern member states. The Eurogroup April 9 statement explicitly mentioned that the introduction of SURE does not pre-judge member states' position-taking on a potential European unemployment (re-)insurance scheme. In sum, SURE provided merely a 'second line of defense' in case the situation would worsen considerably. Its efficiency largely hinged on the respective national design features of the short-term working schemes. The fact that SURE is a temporary loan-based vehicle based on member states' guarantees reduced its scalability because new guarantees would be required if many member states would make use of the instrument simultaneously. The Eurogroup approved the SURE loan instrument stating that it should build 'on the EU budget as much as possible, while ensuring sufficient capacity for Balance of Payment support, and on guarantees provided by Member States to the EU budget' (Eurogroup 2020b).

The Eurogroup's proposal to create a recovery fund opened a window of opportunity for the Commission to reassert itself. Thus, it tried to coopt the proposed corona recovery fund citing the experience gained in managing the 'Juncker fund' as evidence that it was in a prime position to manage the recovery fund. Linking the issue of the economic recovery to the EU budget enabled the Commission to push for lifting the own resources ceiling to 2% of GNI. The European Parliament also supported a solution based on the multiannual financial framework (MFF) 2021-2027 because it would give MEPs the chance to influence the process. In February 2020, a special summit convened by European Council President Charles Michel had failed to reach an agreement on the MFF. The corona crisis offered an opportunity for the Commission to use part of the MFF to finance the post-corona recovery but also to channel substantial funds into the Von der Leyen Commission's flagship policy priorities such as the European green deal and digitalization. The previously held position of the 'frugal four' became untenable. The still limited size of the EU budget would make it necessary to frontload investments to the early years of the new MFF to have a sizable economic impact. The Commissioner for the EU budget Johannes Hahn proposed to lift temporarily the maximum cap of the EU budget to 2% of EU GNI in order to increase the Commission's borrowing capacity in the financial markets (Fleming 2020). This could then be leveraged to generate an estimated €1.5 trillion in spending and investments. It is important to point out that the increase of the own resources ceiling would have to remain for the indicated borrowing period (at least until 2058).

4. The ECB with PEPP and PELTRO: 'Whatever it takes 2'

The ECB's corona response was accompanied by botched central bank communication. But after a remarkable volte-face the Governing Council acted forcefully with the announcement of its €750 billion Pandemic Emergency Purchase Programme (PEPP) on 18 March 2020 (Randow and Skolimowski 2020), which was later expanded in size and duration. The ECB's supranational discretionary authority enabled it to act in 'supreme emergency' (Dyson 2013). Its emergency powers had *de facto* been normalized (Kreuder-Sonnen 2019, 135-51). Yet, the Governing Council had been reshuffled since the ECB's OMT announcement. There was uncertainty about the balance between hawks and doves in the Governing Council. Overall, the symmetric nature of the economic shock seemed to have appeased monetary hawks. This was not a shock related to fiscal profligacy but due to exceptional circumstances outside the control of national governments. Thus, the ECB did not allow the spreads to reach the same levels observed during the euro area crisis and guaranteed member states' market access. This had far-reaching implications for European pandemic politics because it reduced the relative financial attractiveness of European loan facilities offered via ESM and SURE. Paradoxically, the improved crisis management architecture enabled Europe's politicians to prefer responsiveness to domestic audiences over European solidarity at least in their public rhetoric. Former President of the Eurogroup Working Group Thomas Wieser caustically summed up this paradox stating that 'the more Europe we have, the more provincial our politicians become' (de Gruyter 2020).

During the eurozone crisis the ECB had played a repeated 'game of chicken' with the Eurogroup's fiscal authorities (Henning 2016). Before announcing its first limited bond purchasing programme the ECB had written letters asking for structural reforms as a *quid pro quo* for bond purchases. When Draghi announced the ECB's first long-term refinancing operations (LTROs), the fiscal compact provided the institutional safeguard for the ECB's monetary dominance. Finally, OMT overlapped with the creation of the banking union. It is remarkable that the ECB diverged from this well-established pattern of prodding fiscal authorities into action by holding out the 'monetary carrot'. It would have been in line with the ECB's past approach to secure a (fiscal) pre-commitment by the Eurogroup in exchange for PEPP. However, it is not for a lack of trying. On 12 March 2020, Lagarde had urged the fiscal authorities to come up with an ambitious coordinated fiscal response (Arnold and Stubbington 2020). During a Eurogroup videoconference on 24 March, Lagarde tried to encourage finance ministers to embrace the concept of 'coronabonds' (Dombey, Chazan, and Brunsden 2020). Arguably, this would have made the job for the ECB easier because it would have enabled the ECB to put aside the self-imposed issuer and issue share limits for its public sector purchase programme (PSPP). The 33% issuer and issue share limits were originally imposed to exclude that the ECB would obtain a blocking minority in case of the activation of collective action clauses. In such a scenario, the Governing Council would find itself in the uncomfortable position that it would have to agree to a potential haircut which could equate to monetary financing.

Why did the ECB fail to leverage its capacity to act as a lender of last resort to elicit some concessions from fiscal authorities this time around? First, the symmetric nature of the shock certainly forms a large part of the answer. In addition, rising spreads of Italy, Spain and Portugal signaled that the corona shock could spiral into another sovereign debt crisis in the absence of immediate ECB intervention. Italy's debt to GDP level was projected to increase above 150% inevitably raising questions about its debt sustainability, which could entail a downgrading of its credit rating to 'junk' status. A reaffirmed commitment by President Lagarde to the ECB's lender of last resort function became necessary. But the activation of OMT was not the appropriate instrument because it hinged on two preconditions: cut-off market access and an ESM programme. However, an ESM programme was not immediately forthcoming and all member states still enjoyed market access. Hence, the activation of OMT was not an option in the very short term. While it had worked during the euro crisis when there was a big question mark looming over the ECB's willingness to act as a lender of last resort, the corona emergency demanded a different kind of response (European Central Bank 2020e).

On 12 March, the ECB President presented the first monetary policy package to tackle the corona crisis which left financial markets disappointed. The package consisted of three pillars. First, the Governing Council decided to conduct additional temporary LTROs 'to provide immediate liquidity support to the euro area financial system' (Lagarde 2020b). Second, it announced that the targeted-LTRO III would be conducted on more favorable terms to support cheap bank lending especially to SMEs for a period of one year. The ECB chief economist Philip Lane explained that 'by setting the minimum borrowing rate at 25 basis points below the average interest rate on the deposit facility, we are effectively lowering the funding costs in the economy without a generalised reduction in the main traditional policy rates' (Lane 2020). Third, it temporarily boosted its net asset purchases by €120 billion until the end of 2020 as part of its existing asset purchasing programme. During the Q&A session, Lagarde distanced herself from Draghi's legacy rather than using the opportunity to reaffirm her commitment to OMT. Instead, she argued that 'we are not here to close spreads. This is not the function or the mission of the ECB. There are other tools for that, and there are other actors to actually deal with those issues' (Arnold and Stubbington 2020). These remarks were clearly aimed at the Eurogroup but were construed by the markets as an abandonment of the ECB's commitment to do 'whatever it takes'. Subsequently, the markets reacted swiftly to Lagarde's gaffe and the spreads of southern member states increased dramatically.

However, it did not take long for the ECB to reverse course and correct Lagarde's costly mistake. During the euro area crisis, it took the ECB several years until Draghi's 'whatever it takes' announcement put an end to the crisis. Now, it took the ECB only a few months to act and Lagarde's 'whatever it takes 2' moment came sooner than expected. On 18 March, the Governing Council announced its 'Pandemic Emergency Purchase Programme (PEPP)' a temporary €750 billion asset purchase programme of private and public sector securities to guarantee a smooth functioning of the monetary transmission mechanism until the end of 2020 or as long as necessary. The ECB committed to conduct the purchases 'in a flexible manner' and allowed 'for fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions' (European Central Bank 2020b). This meant that purchases could temporarily diverge from the ECB's capital key to prevent Italian and Spanish spreads from rising. Article 5 of the PEPP decision delegated the implementation of PEPP to the ECB Executive Board which enjoyed complete leeway in setting the appropriate pace and composition of the monthly purchases (European Central Bank 2020a). PEPP was complemented by an expansion of the range of eligible assets under the ECB's corporate sector purchase programme (CSPP) in which the ECB also actively purchases in the primary market and by lowering the quality standards of its collateral framework (European Central Bank 2020d). It also granted a waiver to allow purchases of Greek bonds which signaled the ECB's concern about a renewed sovereign debt crisis. Like Draghi's OMT announcement, the impact of PEPP on the spreads was immediate. But there was an important difference that distinguished PEPP from OMT. In contrast to OMT, which has remained nothing more than a press release and was never activated, the ECB published PEPP's accompanying legal decision act on 25 March and immediately started asset purchases.

In a *Financial Times* op-ed published on the day after the PEPP announcement, Lagarde mentioned that self-imposed limits would be reconsidered if they would hamper the ECB's ability to fulfil its mandate (Lagarde 2020a). This was later confirmed in the PEPP decision in which the ECB noted that 'on 18 March 2020, the Governing Council also decided that to the extent some self-imposed limits might hamper action that the Eurosystem is required to take in order to fulfil its mandate, the Governing Council will consider revising them to the extent necessary to make its action proportionate to the risks faced' (European Central Bank 2020a). The Governing Council was divided on the issue of whether a lifting of the self-imposed issuer and issue share limits was warranted (Arnold 2020c; European Central Bank 2020e). In the past, these self-imposed limits had repeatedly casted doubts over the ECB's ability to provide further monetary stimulus due to a potential shortage of eligible assets. Thus, the potential removal of these limits additionally reassured markets.

Due to repeated legal challenges, the ECB knew how to design an asset purchase programme without entering into uncharted legal territory or so it thought until 5 May 2020. On this day, the German Federal Constitutional Court (GCC) ruled on the ECB's PSPP. The GCC harshly attacked the CJEU and argued that it acted outside its treaty-based powers ('*ultra vires*') (German Federal Constitutional Court 2020). It issued an ultimatum that if the ECB would not carry out a proper proportionality assessment within the next 3 months, the Bundesbank would have to withdraw from the PSPP. The GCC's ruling encompassed a list of criteria supposed to ensure that an asset purchasing programme does not violate the monetary financing prohibition (among them was the 33% issue limit). This created a significant degree of legal uncertainty for

PEPP. Even though the ruling did not have any immediate effect on the ongoing asset purchases, it made a legal challenge against PEPP more likely. However, a majority of Governing Council member refused to give in to the GCC's demands because it would undermine its independence creating a constitutional stand-off (Arnold 2020a). The ECB feels bound by EU law only and feared that other constitutional courts could follow suit to develop their own criteria for a proportionality assessment. Even if it were to be ruled in the future that PEPP was in violation of the treaty, it would arrive only after it had achieved already the desired calming effects on financial markets.

On 30 April, the ECB Governing Council decided to conduct a new series of seven additional longer-term refinancing operations termed 'pandemic emergency longer-term refinancing operations' (PELTROs) (European Central Bank 2020c). The major innovation of the PELTROs was that their interest rate was negative (i.e. 25 basis points below the average rate applied in the Eurosystem's main refinancing operations). The ECB also further eased the lending conditions for its TLTRO-III by lowering the interest rate to 50 basis points below the average main refinancing rate. In effect, the ECB subsidizes banks if they extend credit to the real economy, while at the same time allowing them to benefit from the looser collateral requirements. PELTROs introduced a system of dual interest rates. This gives the ECB another powerful tool to stimulate lending and to control its redistributive implications. A rate cut usually implies benefitting debtors at the expense of savers. A dualization of interest rates dissolves this trade-off by enabling the ECB to raise the deposit rate to avoid the savers' grudge, while simultaneously benefitting debtors by cutting the borrowing rate (Greene 2019). By differentiating its interest rate regime during the pandemic emergency, the ECB *de facto* suspended its one-size-fits-all monetary policy. The longer the lockdown measures lasted, the more monetary taboos were lifted such as considerations by the French central bank governor to engage in outright monetary financing via 'helicopter money' for companies (Arnold 2020b). On 4 June, the Governing Council followed up on Lagarde's promise that the ECB would remain 'undeterred' despite the GCC's ruling. It expanded PEPP by another €600 billion to a total of €1.35 trillion until at least end June 2021 and pledged to reinvest PEPP's proceeds until at least the end of 2022. With a sense of déjà vu, the ECB again pushed the limits of its mandate during supreme emergency even if this might come at the expense of increasing threats to its independence (Tesche 2019).

5. Virtual intergovernmental bargaining in the EU during the pandemic

The corona pandemic prevented the heads of state and government and finance ministers to meet physically. The videoconference format changed the negotiation dynamics in that breaking up temporarily into smaller groups became more challenging. After several failed videoconferences of the Eurogroup and the European Council, there was intense pressure on Germany, the Netherlands, Austria and Finland to abandon some of their red lines before the Eurogroup meeting on 7 April 2020. France threatened that it would not give consent to any of the three proposed options (ESM, EIB, SURE) if there was no agreement on a temporary 'corona fund' to finance targeted expenditures related to COVID-19. Italy's Conte categorically excluded an ESM programme and continued to demand the introduction of 'coronabonds' together with Spain. However, the Eurogroup after an intense 16-hour round of discussions failed to agree on the three-pronged approach to tackle the corona crisis largely due to Dutch and Italian resistance. Three stumbling blocks in the negotiations remained. First, Italy was adamant that the conditionality for an ESM programme should be dropped completely (Khan and Fleming 2020). The Netherlands insisted that the ESM credit line should cover only coronavirus health care and economic costs and encompass a commitment to sound public finances in the medium term (Smith-Meyer 2020). Second, the Dutch government would only agree to the Commission's new SURE instrument to finance short-term working schemes if there were safeguards in place that it would remain temporary. Third, the most controversial measure was the potential introduction of temporary one-off 'coronabonds'. A Germany-led coalition encompassing the Netherlands, Austria and

Finland rejected 'coronabonds'. Despite the intense lobbying efforts of the coalition of 14 euro area member states under the tutelage of France, Italy and Spain, a mutualized debt instrument to minimize roll-over risks and to finance targeted investments to tackle the corona crisis was not acceptable for the northern camp (Dombey, Chazan, and Brunsden 2020; Ciriaco and D'Argenio 2020). It didn't change even though a small minority of europhile members in Merkel's Christian Democratic Party called for the issuance of temporary 'coronabonds' invoking a historical precedent of debt mutualization during the oil price shock (Schuller 2020). In the end, Merkel's dictum that 'there will be no eurobonds as long as I live' prevailed as the red line even in pandemic times.

When the Eurogroup reconvened on 9 April the final compromise solution entailed that the ESM would create a new Pandemic Crisis Support (PCS) credit line. In effect, the new temporary ESM credit line is based on the ESM's Enhanced Conditions Credit Line (ECCL) but with only 'symbolic conditionality' attached, namely, a commitment to use the funds for 'direct and indirect healthcare, cure and prevention related costs due to COVID-19 crisis' (Eurogroup 2020b). The negotiation outcome largely followed the preferences of the countries with fiscal space (Schimmelfennig 2015). They ultimately displayed financial solidarity with highly indebted member states but shaped the conditions of the deal in exchange. Thus, the outcome followed the German preference to use the ESM to provide fresh capital injections for Italy and Spain if needed. Germany had softened its position on ESM conditionality. The social democratic German finance minister and foreign minister argued that 'we don't need a troika, inspectors, and a reform programme for each country drawn up by the Commission. What we need is quick and targeted relief. The ESM can provide precisely that if we adjust it sensibly' (Maas and Scholz 2020). Consequently, southern member states achieved a suspension of the politically toxic conditionality. However, the ESM's limited involvement of up to €240billon (or 2% of each country's respective GDP as of end-2019) would not lower the debt servicing costs substantially (Claeys and Wolff 2020). The ECB's PEPP kept spreads at such a low level that tapping the PCS was relatively unattractive. Yet, the PCS could generate a net financial benefit for 11 euro area countries because the interest rate on 7-year bonds was negative and the ESM reduced its one-off service fee to 0.25% (Anev Janse 2020). But an ESM credit line has the disadvantage that it counts directly to the debt-to-GDP ratio and subordinates the existing debt because ESM debt enjoys a senior creditor status. However, an agreed ESM programme even if only with symbolic conditionality attached would enable the ECB to activate OMT. This explains why the Italian coalition government (in particular, the *Partito Democratico*) gradually warmed to the idea of using the ESM despite the political pressures from Italian right-wing populists not to do so. On 8 May, the Eurogroup decided that the PCS would entail 'a maximum average maturity of 10 years for the loans and favourable pricing modalities to the exceptional nature of the crisis' (Eurogroup 2020a). A preliminary assessment found that all ESM members were able to access the new facility, which was set to run until 31 December 2022. Due to national sensitivities, it was decided that the Commission instead of the ESM would monitor whether the PCS funds would be used to cover 'direct and indirect healthcare costs'. The dispute about the use of the ESM showed how domestic politicization can undermine a *de novo* body's legitimacy. In fact, the ESM was not designed to provide 'supranational executive discretion' in supreme emergency (Dyson 2013, 216). If the ECB acts in an unconstrained manner and guarantees market access, Europe's sovereign bailout fund is superfluous because member states can afford to disregard debt-increasing ESM loans. On the other hand, proponents of the ESM argue that its mere existence as an insurance mechanism builds confidence and contributes to maintaining market access during periods of financial stress.

Additional implicit liabilities were created through the backdoor with the help of the EIB. This follows a trend whereby the EIB substitutes for the lack of a supranational fiscal capacity (Mertens and Thiemann 2019). It is a conflict-minimizing solution because the EIB has not been the subject of domestic politicization but has the capacity to issue 'European debt' at low interest rates. On 16 March, the EIB announced that it would mobilize an expected €40 billion in cooperation with national promotional banks to support small and medium-sized enterprises (SMEs) through short-term bridge financing (European Investment Bank 2020b). First, the EIB launched guarantee schemes to banks to promote immediate lending to ailing businesses (€20 billion). Second, based on €5 billion EIB funding the existing multi-beneficiary intermediated lending facilities and other framework loans would be redirected to banks to channel €10 billion in funding to companies. Third, some resources from the European Fund for Strategic Investment (EFSI) would be used to set up a 'bad bank' arrangement whereby the EIB would purchase €2 billion of risky asset-backed securities from banks to free up their lending capacity. Finally, the EIB Group would provide funding for vaccine research and would amend already approved infrastructure and equipment loans to EU member states for tackling the health emergency (€5 billion in total). On 3 April, the EIB Group board had already endorsed a €25 billion 'pan-European guarantee fund' that could mobilize up to €200 billion to support SMEs, mid-caps and corporates (European Investment Bank 2020a). The funding for the €25 billion would stem from EU member states on a *pro rata* basis in line with their shareholding in the EIB. Moreover, the ECB's bond purchasing programmes would additionally support state-owned development banks.

Finally, the Eurogroup's report that would form the basis for the European Council's meeting included the option, favored by France, to create a temporary 'recovery fund' to finance the post-pandemic economic recovery through the EU budget 'to programmes designed to kick-start the economy in line with European priorities and ensuring EU solidarity with the most affected member states. Such a fund would be temporary, targeted, and commensurate with the extraordinary costs of the current crisis and help spread them over time through appropriate financing' (Eurogroup 2020b). The issue of debt mutualization to finance the recovery fund was not explicitly mentioned, but the Eurogroup President highlighted in a letter to the President of the European Council that 'some member states were of the view that it should be based on common debt issuance, while others advocated alternative solutions, in particular in the context of the multi-annual financial framework' (Centeno 2020). The corona crisis reinvigorated the Franco-German relationship that was the driving force behind the Eurogroup agreement.

6. Deliberating about the European recovery fund

Prior to the 23 April European Council videoconference, Emmanuel Macron had tried to ramp up the pressure to create mutualized debt (Mallet and Khalaf 2020). Italy's prime minister Conte also continued to demand Eurobonds. A Spanish non-paper proposed that a €1-1.5 trillion recovery fund should hand out grants to member states frontloaded to January 2021 to leave debt to GDP ratios unaltered (Fleming and Stubbington 2020). According to the Spanish proposal, the recovery fund should be financed by perpetual EU debt 'backed by existing legal mechanisms to fund the EU budget'. The interest on these non-maturing bonds (consols) should be paid via European taxes, i.e. via own resources for the EU independent of member states' contributions to the EU budget (Spanish Finance Ministry 2020). During a press conference on 20 April, German Chancellor Merkel signaled her willingness to accept a larger EU budget and to finance the recovery fund via member states' guarantees within the EU budget against which the Commission could then engage in leveraged borrowing (Nienaber and Rinke 2020). The European Council meeting did not turn out to be the breakthrough videoconference that many had expected. Instead, after a short-lived videoconference the European Council tasked the Commission with presenting a proposal for a recovery fund of 'sufficient magnitude, targeted towards the sectors and geographical parts of Europe most affected, and be dedicated to dealing with this unprecedented crisis' (European Council 2020). It endorsed the Eurogroup agreement and stated that the package should be operational by 1 June. However, the fault line now ran between those countries favoring loans (Germany, Netherlands, Austria and Finland) and other countries favoring grants (France, Spain and Italy).

To the surprise of many observers, France and Germany presented their own blueprint for a recovery fund on 18 May. Chancellor Merkel abandoned her red line that she could only agree to loans. The German volte-face was driven by various domestic and external factors (Mallet, Chazan, and Fleming 2020). First, domestic German business interests were increasingly worried about the unravelling of their supply chains if southern European economies would not recover quickly from the pandemic (Karnitschnig 2020). Second, Merkel was able to piggyback on the GCC's PSPP ruling because it gave her a welcome pretext to convince her own party that deepened fiscal integration was needed to unburden the ECB from doing the heavy lifting alone. Third, German public opinion was generally in favor of financial solidarity during a pandemic even if this solidarity should not necessarily be debt-based (Bremer and Genschel 2020). Merkel benefited from the 'rally-round-the-flag' effect and her approval ratings soared to new heights. Only a few months earlier, she had been perceived as a lame duck, but the crisis suddenly restored her authority. In addition, the Social Democratic Party-controlled finance ministry and was able to shape European policy decisively. Finally, President Macron was relentless in his determination to put forward a grand bargain to appease Italy and Spain and to push back against populist forces. Early on during the corona crisis France had proposed to set up a temporary 'corona rescue fund' for 5-10 years that could issue jointly and severally guaranteed bonds backed by EU member states (Mallet 2020).

In exchange for the German willingness to compromise, France conceded to drop its insistence on creating a separate recovery fund outside the MFF. The French-German initiative agreed to spend €500 billion in grants 'for the most affected sectors and regions on the basis of EU budget programmes and in line with European priorities' (German Government 2020). It marked a step change because it would enable the Commission to borrow in the markets on behalf of the EU. The grants would have to be repaid over future MFFs after the year 2027. However, the French-German initiative left the crucial question about the repayment plan open. Three options were envisioned to repay the EU bonds: (1) a redirection of expenditures from existing spending areas (for example, from the Common Agricultural Policy) towards the recovery effort; (2) an increase in the EU budgetary contributions (own funds) of the member states; (3) or the introduction of European taxes such as a plastics tax, digital tax or a carbon border tax that would create an (externally assigned) revenue stream. Regardless of the unresolved refinancing of the common European debt, the French-German initiative was crucial in paving the way towards an EU-level agreement. Some praised it as Europe's 'Hamiltonian moment' even though it fell short of issuing jointly and severally guaranteed debt. The so-called 'frugal four' (the Netherlands, Austria, Denmark and Sweden) rejected the French-German initiative (Brunsden and Fleming 2020). They were adamant that the EU budget expenditures should be reprioritized and frontloaded. Any topping up of the COVID-19 related expenditures should be temporary and national contributions to the EU budget should be limited. According to the 'frugals', the recovery fund should be based exclusively on favorable loans to avoid moral hazard and be conditional on a commitment to comply with the EU fiscal framework.

On 27 May, the Commission President presented her proposal on the recovery fund - termed 'Next Generation EU' - in the European Parliament. The Commission's proposal plans to hand out €500 billion in grants and €250 billion in loans to those member states hardest hit by COVID-19 (European Commission 2020d). The grants would be frontloaded to the first four years within the next EU budget period (2021-2027). In addition, the EU budget would also be increased to a total amount of €1.1 trillion. Grants ensure that the debt to GDP ratio of member states does not rise and thus enable them to complement their national fiscal responses. This in turn prevents an increase in economic divergences within the EU. The important innovation is that the EU would borrow collectively in the markets by issuing bonds with different maturities that would fall due between 2028 and 2058 guaranteed by the headroom (0.6% of GNI) in the EU budget. Member states would be liable for the share of repayments according to their national per capita income. Article 311 TFEU (on own resources) stipulates that the EU shall provide itself with the means necessary to achieve its objectives. The Commission relies on this treaty base to argue that it is allowed to borrow in the capital markets. The proposed revenue-raising measures would take the form of externally assigned revenues earmarked for specific expenditures (not own resources) and would thus fall outside of the remit of the treaty provision requiring the EU budget to be in balance.

The key pillar of Next Generation EU is the recovery and resilience facility (RRF) with a budget of €560 billion in grants (€310 billion) and loans (€250 billion) (European Commission 2020e). The funds will be distributed conditional on the implementation of country-specific recovery and resilience plans that are based on the reform and investment priorities under the European Semester. In addition, the Commission proposes a REACT-EU (Recovery Assistance for Cohesion and the Territories of Europe) initiative to top-up the existing cohesion policy programmes between now and 2022 by €55 billion according to a new allocation key taking into account the effect of the corona crisis. Additional funding is also planned for the Just Transition Fund (additional €30 billion bringing it up to a total of €40 billion) to help with the green transition and the European Agricultural Fund for Rural Development (€15 billion) to implement structural changes related to the European Green Deal. Interestingly, the euro area budgetary instrument for convergence and competitiveness (BICC) has been superseded by the RFF and is no longer part of the EU budget plan.

The second pillar of Next Generation EU focuses on investments and entails: a solvency support instrument built into the European Fund for Strategic Investments (EFSI or 'Juncker fund') (€5 billion (existing funds from current MFF) + €26 billion (additional funds)) to enable the EIB to issue guarantees to private sector actors that invest into solvent companies in member states with limited fiscal space and sectors hardest hit by COVID-19; an upgrade of the InvestEU programme (up to a level of €15.3 billion) to foster the resilience of European supply chains; a strategic investment facility within InvestEU (€15 billion) leveraged to unlock €150 billion of investment into sectors linked to the green and digital transition.

The third pillar addresses the gaps laid bare by the corona crisis. It proposes a new EU4Health programme (€9.4 billion) to strengthen health crisis preparedness and improved procurement of critical medical equipment and medicines and more funds for the HORIZON research programme (€13.5 billion). Finally, to enhance global cooperation the plan also wants to strengthen the neighbourhood, development and international cooperation instrument and the humanitarian aid instrument (€16.5 billion). The Commission put forth a wish list that will significantly increase its capacity in various policy areas. The stumbling blocks for the negotiations are the loans to grants ratio, the allocation key for the RRF (a country's GDP, GDP per capita, average unemployment rate between 2015-19) and rebates, whether to raise more own resources via EU taxes, and what kind of conditionality will be attached to receiving funds. An agreement is expected to be reached in July 2020 during the German Council Presidency.

7. Conclusion

The coronavirus crisis is a 'human tragedy of potentially biblical proportions' (Draghi 2020). It is already clear that it will have severe implications for the European project going forward. Unforeseen events increasingly shape the European polity trumping even the effects of long-term trends (van Middelaar 2016). The debt and deficits levels in 2020 will balloon to levels exceeding those experienced during the 2008 financial crisis. The EU fiscal rules have been *de facto* suspended but given the nature of the shock, it will likely take years before they can be reinstated fully. It is hard to imagine that member states' willingness to comply with the SGP will increase. Thus, the corona crisis should give reason to engage in a comprehensive overhaul of the EU fiscal framework. The Commission's €750 billion 'Next Generation EU' proposal might reinforce the economic coordination under the European Semester and increase compliance rates with the country-specific recommendations. The ECB's balance sheet will continue to expand for years to come. Depending on the length of the pandemic shock the ECB's protection against fiscal dominance might gradually melt away. For scholars of European integration, the corona crisis offers a critical test case for various integration theories. This article has provided an early assessment of the EU's response to the corona crisis and found that it was broadly in line with the theoretical expectations of the new intergovernmentalism. The Eurogroup and the European Council relied predominantly on *de novo* bodies like the ESM, the ECB and the EIB to tackle the corona crisis. Those instruments empowering the Commission (for example, SURE) entailed sunset clauses that ensured that the Commission's gain in power would not be permanent. Finally, the pandemic revealed that a combination of the 'destructive dissensus' and politicization can have adverse effects for the legitimacy of *de novo* bodies like the ESM.

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