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The European economy in the time of Covid-19: Towards a new dawn?

This special issue of *International Economics* aims at providing some theoretical and empirical perspectives on the European economy from a macroeconomic viewpoint. The contributions have been selected after the fourth international workshop on European Macroeconomics (Strasbourg, France, 3rd December 2021) entitled “The European Economy in the Time of Covid-19: Towards a New Dawn?” organized by the research team in European Macroeconomics of the Bureau of Economic Theory and Applications (BETA, CNRS, INRAE, Agro Paris Tech) at the University of Strasbourg. Twenty-four papers were selected from forty submissions from sixteen countries and international institutions.

First of all, we would like to thank the University of Strasbourg, the Bureau of Economic Theory and Applications (BETA, UMR CNRS), and the Interdisciplinary Thematic Institute called “Making European Society” (MAKErS) for their financial and logistical support. We are also very grateful to the keynote speakers, Xavier Debrun from the National Bank of Belgium and Jérôme Creel from the French Economic Observatory (OFCE), for their invaluable contributions to the workshop. We also want to thank all the participants of the workshop for their implication during the sessions and for the quality of the debates. We thank Mario Larch and Valérie Mignon, the managing editors of *International Economics*, for providing us the opportunity to publish this special issue on the European Economy in the time of the pandemic crisis. We thank the anonymous referees for their comments and remarks. For this special issue, amongst the twenty-four communications of the workshop, we have retained six papers, and five articles were selected from outside the workshop.

This special issue entitled “The European economy in the time of Covid-19: Towards a new dawn? “is structured in two blocks. At first, papers analyzing macroeconomic issues before the pandemic crisis are gathered, dealing with the determinants of economic growth, the effects of the European Central Bank (ECB) unconventional monetary policy, the case of accessing countries to the European Monetary Union (EMU), the relation between shipping freight rates and inflation, and finally the public debt sustainability in the Eurozone. Secondly, papers considering some issues introduced by the Covid crisis are proposed, focusing either on the public action implemented to deal with the pandemic crisis (fiscal policy, firms support role of European Union (EU) cohesion policy), or on the impact of Covid on behaviors (especially on financial markets, and on carbon emissions).

In **“Are There Any Robust Determinants of Growth in Europe? A Bayesian Model Averaging Approach”**, Sarah d’Andrea provides new empirical evidence about the determinants of economic growth in the long run. First, she proceeds to a simulation exercise to test the validity of the proposed Bayesian approach. Then, she investigates the long-run determinants of the average annual GDP per capita growth rate for a sample of 19 European countries between 2002 and 2019 and 70 explanatory variables. Overall, she finds some support for the catching-up process: the most robust determinant of growth is the initial level of income, which is negatively related to economic growth.

In **“ECB unconventional monetary policy and volatile bank flows: spillover effects on emerging market economies”**, Salima Ouerk highlights a new driver of the Global Financial Cycle, namely the ECB unconventional monetary policy. She underlines the international spillovers linked to the ECB by focusing on cross-border banking flows. As suggested by the author, future research could explore portfolio flows from non-banking sectors.

In **“Inflation and Unemployment, new insights during the EMU accession”** by Jean-Louis Combes and Pierre Lesuisse, the authors focus on the impact of the EMU accession process on potential changes in the inflation/unemployment trade-off in accessing

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countries (captured by the Phillips curve coefficient) using a panel approach. Their study reveals that the Euro Area accession seems to be followed by the loss of both monetary autonomy and the significant Phillips curve. This result is robust to changes in variables' definition and is not influenced by the contemporaneous economic and sovereign debt crisis. In addition, the "leading" economies of the Euro Area still have a significant inflation/unemployment relationship. This corroborates the idea that entering a monetary union may have heterogeneous effects, given the size of such an economy.

In **"The relationship between shipping freight rates and inflation in the Euro Area"**, Nektarios A. Michail, Konstantinos D. Melas, and Lena Cleanthous examine the relationship between shipping freight rates and inflation using disaggregated monthly data between January 2009 and August 2021. The supply-side shock to freight rates affects the economy via imported goods. In their VECM analysis, they use the category of Non-Energy Industrial Goods (NEIG) with the most import content. Their analyzes show that the inflation of NEIG impacted more total inflation at the beginning of the Covid period than in the previous periods. In their threshold analyzes, they also find that the relationship between freight rates and inflation becomes positive when the freight rates rise above the $1200-$1500 levels.

Antonio Afonso, José Alves, and Joao Tovar Jalles introduce a new database in the fiscal policy literature in their contribution **"To consolidate or not to consolidate? A multi-step analysis to assess needed fiscal sustainability"**. Using a large country-level dataset over the period 1980–2018, they examine the degree of fiscal sustainability. They assess a country's specific need (or not) to implement fiscal consolidation. This dataset provides a new area for future research.

In **"Government Debt Deleveraging in the EMU"** by Alexandre Lucas Cole, Chiara Guerello, and Guido Traficante, the authors evaluate the stabilization properties of alternative fiscal rules and instruments to reduce government debt in a currency union, like the EMU in a two-country New-Keynesian DSGE model. They find that greater stabilization is achieved when the two countries coordinate by stabilizing net exports. Moreover, they show that taxes are a better instrument for deleveraging compared to government transfers. Thus, their policy recommendations for the Euro Area are to reduce government debt less during recessions and liquidity traps, and to do so using distortionary taxes, while concentrating on reducing international demand imbalances.

In **"This time is different: Fiscal response to the Covid-19 pandemic among EU countries"**, Bettina Bokemeier and Marcin Wolski analyze fiscal policy behavior in the European Union Member States and assess how it has changed during the recent pandemic crisis compared to previous crisis periods. Based on panel estimations, they underline that fiscal policy has turned from formally procyclical design before the Covid-19 period to countercyclical in the pandemic years, on average. While this is naturally driven by the wide roll-out of fiscal support measures during the pandemic, including healthcare expenditures and spending on job security, the change in the fiscal reaction function is still visible if these effects are taken away from the budget, even though the move is less pronounced and signifies a shift from a procyclical to an a-cyclical fiscal regime.

Wouter van der Wielen, Debora Revoltella, Laurent Maurin, Rozália Pál, and Péter Harasztosi use original data, notably from the EIB Investment Survey (EIBIS), in their paper **"Firm-level policy support during the crisis"**. They distinguish the nature and intensity of the firm-level policy support deployed in EU countries, and then show their effectiveness during the Covid-19 crisis. The policy was primarily untargeted ex-ante, but they show that it does not trigger the phenomenon of "zombie firms". They find positive outcomes for investment outlook and firms' digital transformation.

In **"Stock Market Response to Covid-19, Containment Measures and Stabilization Policies - The Case of Europe"**, Jens Klose and Peter Tillman analyze the reaction of equity markets to containment and stabilization policies for a panel of 29 European economies. They rely on VAR models, using daily data during the years 2020 and 2021, and a recursive identification scheme where the variables are ordered in the following manner: cases, containment variables, stabilization variables, and stocks. The stocks react contemporaneously to all the other variables in the system. Overall, the stock prices react negatively to the cases, and positively to containment and stabilization measures. These results are not surprising since they drive market participants' expectations. Interestingly, health measures have no significant effects on stock prices.

Finally, in **"Insights on CO_2 Emission in Europe in the Context of Covid-19: A Panel Data Analysis"**, David Bourghelle, Fredj Jawadi, and Philippe Rozin investigate the dynamics of CO_2 emissions for 25 European countries over the last decade, accounting for several key commitments taken by different policymakers at major meetings related to the ambitious project of ecological transition, reduction of carbon emissions, and use of renewable energy sources (COP21, COP26, G20 meeting, etc.). They show that CO_2 emissions react significantly to shocks in oil and coal prices and vary with the industrial production cycle. Further, while a significant decrease in CO_2 emissions was observed during the Covid-19 crisis, the intensification of investment in sustainable development and renewed energy consumption has negatively impacted CO_2 emissions in the long term. This finding suggests that a key driver to reducing the risk of climate change and lowering high carbon dioxide (CO_2) emissions passes through a significant commitment to sustainable development.

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