

A conversation with Paolo Gentiloni, Commissioner for Economy, European Commission

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with Gian Maria Milesi-Ferretti and Thomas Wright

moderated by David Wessel

(this transcript is lightly edited)

Milesi-Ferretti : Now, the recovery is underway, and I was wondering Commissioner, whether you can share with us your views on how did the policy response work, both at the national level and the EU level? So what role has it played in fostering this recovery? And how do you see the recovery going forward? Thank you.

Commissioner: If we look behind us, I think we had, in the European Union, a quite fast and strong reaction. I have to say completely different from the one we had in the previous crisis, the financial crisis. You know that the main decisions, at least three very important decisions were taken in mid-March. So after one week of the declaration of the pandemic, we had the European Central Bank deciding for its purchase program and the Commission deciding to suspend the stability and growth pact, and to suspend our state aid rules. These three decisions allowed a tremendous effort from member states, putting a lot of money in the table to avoid bankruptcies, crisis in labor market and to face the pandemic.

Then we had the second period where unprecedented common initiatives based on common issuance of European debts were taken, first, for a support to short term work schemes, 100 billion, and then for the recovery program, around 800 billion Euro. So overall, we delivered, a part of the European budget, something around 1 trillion euro in extraordinary supportive measures. Results, I think we have a deep, deep recession in 2020, a GDP contraction of 6.4% in the euro area. We had a difficult beginning of the vaccination campaign in January, February this year. But then, now we can say at least two optimistic things.

First, vaccination campaign is quite strong, we are now over 75% of fully vaccinated. And after a difficult beginning, we are now probably the more advanced area in the developed world for vaccination. And second, the outlook for our growth is quite coherent with the one that the IMF published a couple of days ago, as you may remember they had for the Euro area, a 5% growth for this year, slightly higher than the one that they had in their July forecast. This of course is the

positive part of the story, so big success in vaccination. I say big success because we had common procurement of vaccine, which is completely unprecedented. So vaccines were acquired by Brussels and distributed to member states, and good figures for growth. Of course, we all know that we have increasing risks in this very positive outlook, but maybe Gian Maria, we can enter in these risks with your following questions.

0:05:12.9 Milesi-Ferretti: Maybe we can dive into these issues in two stages. It would be great to hear your views on the risks that you see, the prospects and the risks for the recovery, say over the next year, year and a half or so, but then later also your views on how this policy response could help shape the medium term outlook for the Euro area. And I have in mind in particular, the prospects for reducing divergence, increasing convergence across countries, given the very asymmetric impact of the pandemic across Europe and across the Eurozone, thank you.

0:06:19.3 Commissioner: Yes. Well, risks, we had several discussions, in these days, in the IMF meetings about these risks. And well, broadly we can say that we have three kind of risks among others, first risks in our supply chains that are particularly important in the European Union in some industrial sectors, and namely in motor vehicles, machinery, plastic, wood, these are among sectors more affected by the bottlenecks in their supply chains. An, some risks also in the construction sector, of course, not so high risks of bottlenecks, and on supply chains in the services sector until now, this is the first one. I mean, still in a framework of industrial production, rebounding very strong, not so strongly in September as in July, but still very, very high level.

Second are risks are connected to this, and to the spike in energy prices, risks of inflation. I think these risks are for the moment in Europe, lower than in the United States. You know that we had a 3.4 inflation level in the last September, and this should continue to remain high this year, and probably is next year going down. For the moment, we don't see a secondary effects of this increase of inflation, referring to wages, labor market. So this is what the mainstream opinion in Europe define mostly as a temporary phenomenon, but for sure we have also some structural elements that we have to look at. And the spike in energy prices is politically difficult to manage. It's the first big hurdle in the path of the climate transition. And of course, we should not downsize our ambition for the climate transition in this very first hurdle that we have to face it to manage it, to respond.

Then we have the third range of risks connected to the fact that a lot of spending is going on, and the level of the debt is higher. We have now in the Euro area debt of 100 percent of GDP on average, which is 10 to 15 points higher than before the crisis.

I repeat all these risks are the downside part of a still positive outlook. We should not, in my opinion, shift from maybe excessive enthusiasm to pessimism, because the many of these phenomena are connected to the strong recovery, which is underway. And this is I think, a reality. These risks are not shadowing the big opportunities we can enter on the subject in the following question, but that's just to summarize with one word, I think that the challenge for the European Union is how to find ways that what we are experiencing is not only a rebound, bringing us to the previous situation, but it's something that gives to the European Union, a more durable and sustainable growth. And a way out from the period that we define as the low for a long period of the European economy. This opportunity is there, and I think the challenge is to seize it.

Milesi-Ferretti: We can really see the recovery under two lenses. I think the first one which is more short term is the reopening, restarting activities that had to be curtailed and that aspect clearly

goes hand in hand with the successful vaccination campaign that you highlighted, that's how you allow these activities to restart, and clearly policy can help in supporting sectors throughout this period and easing their restart, but then there is a second aspect which has to do with the need for resource reallocation. This is something we actually don't know that well but that it's clearly important in a number of dimensions. Some may be pandemic-induced, the remote work aspect, digitalization more generally, certainly accelerating that trend. The second is the greening of the economy and the big policy effort in that direction, so maybe you can tell us a bit how you see the role of the EU policy initiatives in fostering this second leg of the recovery more into the medium term, which is the resource re-allocation, the fostering convergence across countries.

Commissioner: Yes indeed, I think the crisis response went overall well as we said until now. Situation is quite different from what we expected, we, for example, expected wave of bankruptcies and massive unemployment and the crisis response avoided these things but now we have labor market with different problems, unemployment in some areas and shortage of labors in other areas. And we had the need to go out of support to companies, we had in Europe the lowest level of bankruptcies since 10 years, but this support should be now of course, should become more selective etcetera, this for the crisis response. For the medium term, I think we have clearly indicated, at least for the Common European money, the number one priority is the green transition and more or less 40% of these national plans are dedicated to investments on the greening of the economies.

Second, the digital transition, and third, what we call the resilience of the society, the Healthcare Assistant, etcetera, etcetera. This, I think, is a very good outcome of this unprecedented fact that European fiscal policy has some fire power, not only many rules but also money. And this money of course, is given to member states if some priorities and criteria are fully respected. Implementation will be a challenge, especially for countries receiving larger amounts of money, and what happens after this extraordinary supportive period also will be a challenge because indeed we will have this year, 3.5% to GDP of public investment, which is the highest level since years in Europe, but this is connected to this extraordinary problems. What will happen in the next 10 to 20 years, how will we face the need of investment of the green transition, all this is more open to debate and brings us to a classic of the European discussion, which is the fiscal rules that we will, of course discuss in the next months.

Wessel: There's a relevant question to that from Lorenzo Forni. He asks: Commissioner, the latest Italian government plan foresees a fiscal deficit of 3.3% of GDP in 2024, does this point to a reduced need for reform of the stability and growth pact and how do you think about changing the stability of growth pact going forward?

Commissioner: Well as you know, we suspended the Stability and Growth Pact with something that we call the general escape clause in March 2020. And this general escape clause will remain into force until the end of next year. Then the Commission will re-launch the public consultation on the review of the pact in the next days, and with the intention to table our ideas and proposal, of course, before the expiring of this general escape clause so to steer the transition period. Of course, these proposals are not yet in our pockets, they are strongly dependent from the possibility to build consensus among different point of views in the European Union. What I can say is that we have clear in mind the three issues that we should deal with. One is, if possible, simplification of these fiscal rules that are quite complicated and not always enforceable. Second, how we can be able to facilitate public investment. We can't repeat what happened with the previous crisis. With the

previous crisis at the end of the previous decade, the net public investment in the EU was zero.

If you have net public investment at zero, you will not crowd private investment and you will not have the climate transition, so how to facilitate investment is the second chapter, and the third chapter is how to deal with this higher level of debt, of course, because we know that we have a 60% debt-to-GDP threshold in our treaties. The treaties were decided at the time when 60% was the average debt of the European countries, and now in the Euro area, the average is not 60 but 100. This doesn't mean that we will, as Commission, propose to change the treaties, not at all. By the way, we are defined the guardian, of the treaties. If someone wants to change the treaties, this is not for the European Commission to propose, but we can deal in a gradual and flexible way with these rules, otherwise if we go, so to say back to normal, either we will not be able to enforce these rules or we will find very difficult situations having this higher debt after the funding.

Milesi-Ferretti: Maybe for the last question, I would quickly stretch beyond the boundaries of the European Union to ask you about the agreement on international taxation that was reached recently, could it be an important milestone? There is a range of countries in the European Union --.. Luxembu0rg, Ireland, Netherlands -- that have been heavy recipients of flows driven by regulatory taxation reasons. How do you see this agreement playing out? Clearly, a lot has still to be done, ratifications in individual countries and the like, but do you see it potentially as an important milestone in strengthening international corporation on this front or do you fear that this may just get lost in the sea of ratifications that would be needed to have it binding?

Commissioner: Well, I am confident that we will implement [the agreement.] The OECD is committed to deliver in November the so-called model rules for the implementation of this agreement, and for the Commission, I can say that we will swiftly adopt a proposal of directive to transpose this agreement in the EU legislation with the target of doing so in the first semester of next year. This is referred, of course, to what is called the pillar two over the agreement on the 15% minimal corporate taxation. [Regarding] pillar one, we are legally scrutinizing if a European directive is needed or if it is only something that members states could join separately as an international agreement. All in all, I think this is, well, everyone used the word historic. We could refrain from using it, but at least extraordinarily important, and I think we should recognize that this would not have been possible without the new US Administration, and Janet Yellen role in particular, because this story was going on since 6-7 years without any agreement, and then in the last 6 months, 7 months, we were able to reach the agreement.

I'm quite proud of the fact that all 27 member states of the Union are in the agreement, and you know that for some countries, it was not easy at all, especially for example, Ireland, to join this agreement. Of course, this will not mean that we will have the same minimal corporate taxation in Europe, because many countries have much higher than 15% corporate [rate] but we will limit the unfair competition. We will limit the tendency, what we call the race to the bottom, and we will have a better level playing field among all the players in the world, so I think very, very important step. And also the other pillar, the fact that you re-allocate taxing rights, based on where profits are done and not based on where headquarters are established is also a such an important principle. So without exaggeration, I think that this was really a turning point. And citizens are expecting from us that we have not only a political agreement but we implement it, and we are committed to do this by 2023, it will be a rush to get there, but I think we will get there by 2023.

Wessel: Great, thank you Gian Maria and thank you Commissioner, right now I want to turn it

over to the foreign policy part of our discussion with Tom Wright, Tom is the Director of our Center in United States and Europe and I'm in the book promotion business myself, so I want to call attention to his new book, Aftershocks: Pandemic Politics and the End of the Old International Order, which was published recently and has been getting very favorable reviews, so Tom, the floor is yours.

Wright: We're at an interesting moment in Transatlantic relationship. Your colleague, Thierry Breton, said, there's a growing feeling that something is broken in Transatlantic relations and recently called for a pause and reset. And Charles Michel, the President of the EU Council, said in reference to President Biden's catchphrase, what does it mean, America is back? Is America back in America or someplace else? We don't know, we are observing a pure lack of transparency and loyalty, and that was all said after AUKUS, but since Afghanistan, AUKUS, the Travel Ban, which has an announced it will be lifted, but still isn't lifted. There does seem to be some frustration in Europe and in the EU in particular at the United States, so, how does this look from your perspective? How do you assess where we are and if there needs to be a reset platform, what form should it take?

Commissioner: I think we should look to this issue with a little bit longer view, and the longer view is clearly that from the European Union position, the new Biden administration is an extraordinary change for good, especially because of the clear commitment and message on multilateralism, multilateralism appeared to be old-fashioned, if not dead, in some political messages, now, I would say multilateralism is back, and what we were just commenting with Gian Maria, this agreement from the taxation is a good example from this point of view. Then, of course, we know that we experienced two different episodes. One particularly difficult to accept from France, the deal on submarine and the AUKUS story, but also in general, perceived in Europe as a lack of good communication among partners this story, and then more importantly, I think also the conclusion of the Afghan missions reinforced an awareness in the European Union of the need to try to play a more important geopolitical role. The point is, is this a problem, a difficulty, or a concern for our American friends, or is it an opportunity also for United States? My view is that being clear, at least since 10 years, that America is strongly committed in NATO and concentrated in the pacific area, the fact that....

The EU could acquire some geopolitical weight in some areas that are very important for Europe, like Mediterranean, North Africa, the Balkans. This should be considered good new for NATO and for the US-EU partnership. The problem is will we be able, we the Europeans to deliver and to take these decisions? Because as you know, we are talking of European defense since maybe 20 years and the progress are still very limited, but I think this is not something that should create difficulties but that we should look as a mutual reinforcement, we are on the same page in addressing the China challenge, we are strongly committed in the function of NATO, especially towards Russia, we develop an autonomous geopolitical weight in some areas around Europe, also because I think the American idea is not to be concentrated in this.

Wright: You mentioned China at the end, the EU, as of a few years ago had a China strategy, that sort of divided relations with China into partnership, competition and rivalry, and EU officials have been pretty clear that they want to continue to work and engage with China on shared transnational problems like climate change and pandemics and also, of course the global economy but in recent months, the Chinese leadership have made it pretty clear that they don't believe, and that the West should be able to fit different issues into different compartments, and that if we wanted to cooperate

with China on shared challenges, we in their terms need to create the conditions for cooperation, which means a polling of relations or an easing of pressure on Hong Kong, Xinjiang and other sort of contentious issues, how do you and how does the EU see this message from China and how worried are you that there will be a breakdown in cooperation because China's making it conditional on geopolitical concessions?

Commissioner: I think we are perfectly aware of the challenging risks that are there, the model of a, so to say an authoritarian model where economic success is not coupled with democracy as we know it. This challenge is a challenge that Europe has to face, and we know that this challenge is also a challenge that could have some impact also in some aspects of our European political landscape, the model of a capitalism without full respect of rule of law and democratic rules, so this is for sure something we are in the same page with our American friends and allies.

The effort of the EU is to try to support at the same time, the potentiality of an open economy, open trade, avoiding negative economic consequences of a decoupling or a closure of this international economic relations. This double track is challenging, not easy of course. For example, if we look to the supply chains that are now very important in the crisis we are facing, of course we need as Europeans, to address our dependency from other players, not only China, but in some cases Russia, and take care of our autonomy in some strategic supply chains, without this meaning a break in international trade relation and without this meaning the impossibility to cooperate on the climate transition, it's a big challenge as you said before but what alternatives do we have? We are, I think obliged to stay and defend our values, and at the same time we have to cooperate to tackle climate change, and we are interested in trade and open economy. Could these things go on together? This is a challenge, but I don't think we can accept the idea that no cooperation is possible on climate change, and that defending our autonomy means disrupting all the global trade economy.

Wright: The United States, obviously has had a tougher approach to China over the last few years, but on the business side, investment has been actually dramatically increasing when people have noticed this sort of twin track between the political, military, diplomatic side on the one hand and the business wall street side on the other hand, but in parallel with that, over the last year or so, there's been a very notable crackdown on business and in particularly big tech inside China on major companies sort of transforming the landscape. Are you sort of worried by those developments in China, what do you think the implications of them are, and do you still sort of think it's senior officials here said their job is still to get access for US companies in China, how do you see that sort of economic financial interdependency between the EU and China at the moment, given what's happening on the regulatory and sort of political side in Beijing?

Commissioner: Things have changed in the last four or five years, maybe five years ago, the message from Europe was, well, doing business, asking for level playing field, supporting our companies in China. Then I think the lesson of the reality showed us that we need to strengthen our political position if we want to keep, open the doors for trade and investment. I don't know if we were too open or too weak in the past years, or if the situation has changed also in China, but for sure now, we still pursue economic relation, investments, but we pretend a different attitude from the Chinese authorities.

Wright: We have a question from Julia Friedlander. Julia served in the Trump administration and in the National Security Council and then in the Treasury Department. She asked, how much do you assess the supply chains problems and trade tensions will force EU member states to reconsider

export dependencies, especially as countries implement this year the fierce fiscal assistance, so and basically with these supply chain problems, does that encourage more self-reliance or even protectionism how do you think this is gonna play out, especially as we head into the winter?

Commissioner: I think we need to strike a, not easy balance, but this is what we have to do from one side without disrupting the EU economic model, the single market, the open economy, the competition, blah, blah, blah. But on the other side, we need to, and this is for the first time in the EU experience, to adopt industrial policies looking to supply chains and making EU more independent from the supply chains point of view. And this is related to, of course, gas supply, you know that we are importing 90% of our gas from in the EU this means semi-conductors, this means other raw materials, this means also the pharma and healthcare supply chains. So there are some strategic sectors where the Commission is finally working after years of difficulty even in mentioning the industrial policy word, to defend our autonomy, but this in balance with the fact that the single market remain an open economy based on competition. And we have to do this, of course, with our trade partners all over the world, but especially with like-minded friends.

Wright: On Brexit, I'm not going to ask you about the details of the negotiations this week, because I know you won't be able to discuss it that much. But the overall picture is really of a deteriorating relationship between the EU and the UK. There's a possibility this all ends up in an all-out trade war, even without that, We'll have to settle for a very protracted period of difficult sort of exchange with distrust on both sides, not just over the interpretation of the agreement, but also just over other political and diplomatic issues. How worried are you about EU/UK relations at the moment and where it's headed?

Commissioner: Well, I'm worried, but I would not exaggerate this concern. Providing one thing, I would not exaggerate because we all knew, and our British friends knew much more than us. That a decision was taken, and that this decision would have caused difficulties. It was not our decision. It was the British people decision. But of course, after decades in a single market if you leave it you will have to face problems. These problems are manageable, I think. With goodwill from both parts, with good words also from our American partners that, of course, are very interested to avoid these tensions. I will say provided that we avoid to use in a negative way the Northern Ireland situation. Because this is a problem of different nature.

It was very difficult to reach this Northern Ireland protocol. It was reached on the basis of a UK proposal that the Commission accepted. Of course, we can ease, make things flexible. I know perfectly well the problem because I'm also responsible for customs. And you can imagine how difficult is the customs issue in Northern Ireland. But we recently proposed easing of customs control in a very, very high and ambitious way. So we have a lot of things that we can address. But we can't cancel and attack this Northern Ireland protocol without causing dangerous political consequences more than with EU in Ireland. And I think this is not the right thing to do.

Wright: So I'd like to move to COVID, which we haven't mentioned yet. And of course, the EU has been exporting vaccines to the rest of the world, and the United States and the EU are now working closely together on trying to vaccinate the world. There's obviously at least a two-track or two-speed approach over the course of the last year. Much of the world remains unvaccinated. The EU has committed previous to September, I think, to donate 450 million doses. They committed again to commit another 500 billion. United States has committed to about the same, I think, about a billion doses of the vaccine, but only 28 million doses as of September were shipped from the EU

and a tiny fraction of the percentage that was committed has been distributed. So how should we sort of think about this? How salient an issue is this in the EU? And how much more do you think the United States and the EU need to do together to actually ensure that there are vaccines that go into the arms of billions of people around the world? Keeping in mind that the WHO estimates that we need 11 billion vaccine doses to get to 70%. Even what we've jointly committed comes to about 20% of the total and then only a fraction of that so far has actually gone out to the people who need it.

Commissioner: Yes, I think this is probably and incredibly the more urgent need for the global economy. And also, in theory, the easiest to be addressed because we are no more in the situation we were a few months ago of shortage of doses all around the world. We introduced a mechanism of authorization of export from the European Union in last March, if I remember well, and up to now, we authorized export from the EU of 800 million doses. Which is more than the 700 million doses, that's have been distributed in this period to European citizens. The problem is that's these doses are not reaching especially the low-income countries, and here, I think that we need to multiply our efforts. Also in these very days, and I hope the next G-20 in Rome at the end of this month will be a turning point and increase commitments from different advanced economies. We should be, I think, more ambitious, and we can do that. We are not talking of hundreds of billions, we are talking of dozens of billions, but I have to say that's the EU Commission and member states after a difficult beginning are not lagging behind up, they are active.

Wright: We're looking at the global vaccination effort in sort of two ways, one is this development assistance, are we doing more we used to, and also relative to each other, is EU doing as much as the United States and vice versa? But this is, in some ways, just the latest front, in an existential struggle against this pandemic. And I'm wondering, do you think it's possible for senior officials in Europe or the United States, to make the case to the populations of their countries that we need to be spending potentially hundreds of billions of dollars on this, at least 10 of billions, in order to avert an economic cost which is estimated in the trillions of dollars over the next sort of five or 10 years, if we don't contain and defeat the pandemic. And how do we shift from seeing this is a matter of development assistance, to actually seeing it as something that is sort of existential for us?

Commissioner: Well, I think the message that nobody is safe until everybody's safe, is not so difficult to understand. We are now in a quite good situation in Europe, and also in the US, more recently, the new wave of the pandemic is slowing down very seriously, vaccination is working, and the cost at least based on the estimates on the IMF to give a strong contribution to solving these problems are not of hundreds of billions.

So, they are affordable for our economies if it is clear that it is not only for reason of solidarity, but it is also for reason of the well-being of our economies. So for the well-being of our economies, we need to address globally the vaccination campaign. And also, if I may say this, we need to accelerate our effort to ease traveling rules. And this kind of thing, we have it in the EU. A great story with this Green Certificate, I have one in my pocket. And this thing is used by more than 400 million European citizen, I have a Belgium one, I'm Italian, and I travel all over Europe, and I go to restaurants and theaters all over Europe with the same QR code, I think we should among not only help emerging and low income countries, but we should increase and facilitate exchanges and travel among developing countries. It is the time now, I think.

Wright: That's a great note to end on we're out of time, I think David. So I will turn it back over to

you.

Wessel: I just want to thank the Commissioner for joining us this morning and glad that you're European passport, your COVID passport allowed you to come to Washington in-person. I look forward to more in-person events in the not too distant future. I want to thank Gian Maria and Tom for such excellent questions. And for everybody for dialing in, as I mentioned in the chat, this was on the record, and we have a recording which we'll post the link to it, at some point when we have it rendered properly. So with that stay healthy, stay safe, and have a productive day.

Commissioner: Thank you very much.