Distributional Conflicts and Social Capital

The coronavirus pandemic is still unfolding, and most countries are in a serious second wave with an increasing number of infections and Covid-19 related deaths. The economic consequences are dire as reflected in a deep recession, increasing unemployment, and deteriorating public finances (see Chapter 1).

While the coronavirus pandemic is a common or aggregate shock, there are large differences in both the health and economic consequences across and within countries. Some countries have been particularly hard hit in terms of the number of people infected and mortality, and often this cannot be readily explained by differences in containment strategies. The economic consequences also differ, and they are not related one-to-one to the magnitude of the health shock. Economic structures, dependence on international trade, and the initial situation, among others, play a role. Within countries, the health fallout severely affects the elderly,[1] while the direct economic consequences are largely borne by particular sectors (services) and workers, while families have also been affected by school closure and working from home.

The present situation is thus very problematic in all European countries. However, significant progress in developing effective vaccines makes it a realistic scenario that vaccines can be produced and distributed during 2021. Although this is obviously an important and critical first step, the economic consequences will not disappear once an effective vaccine is rolled out. It takes time to recover from a deep recession, and the crisis is also associated with structural changes. The post-coronavirus world will in many ways be different from the pre-coronavirus world.

As a first economic policy response, emergency packages were launched to mitigate the consequences of lockdown restrictions for both firms and workers. These are temporary measures to cope with the immediate effects, and while still relevant, they suffer from a status-quo bias. We are now in a second phase where a more forward-looking perspective should be taken in economic policies.

The economic possibilities at any point in time depend on the available capital stocks, including not only business investment but also social and human capital. These are crucial conditioning variables that determine a country's or regions' level of prosperity, and economic opportunities depend critically on how these different capital stocks are affected by the coronavirus crisis. From an economic policy perspective, the challenge is to prevent further erosion of capital stocks, seeking to re-build them in order to recover from the crisis while also adapting them to cope with structural problems and challenges, including aging and the climate.

The following chapters deal with the three capital stocks in order, starting in this chapter with social capital.

2.1 SOCIAL CAPITAL

The pandemic, its economic consequences, and the policy responses have wide ranging ramifications across different groups in society, affecting social cohesion and capital. Social capital denotes the networks of relationships among people who live and work in a particular society, enabling that society to function effectively.[2] Social capital allows a group of people to work together effectively to achieve a common purpose or goal. It allows a society (or organization) to function together as a whole through trust and shared identity, norms and values. Concepts such as social cohesion, social capital, trust, or social inclusion/exclusion are related and are often used interchangeably. The notion of social capital explicitly builds on the recognition that individuals are interdependent in a way that goes beyond the (non-personal) interaction in economic markets. The core of the concept is thus a two-way interaction: social capital affects individuals and policies, and individual behavior and policies influence social capital. Social capital is thus of direct importance for economic performance (e.g., trust reduces transactions costs) as well as of political importance in the sense that low levels of social capital reduce the scope for mutually beneficial cooperation.

Social capital consequently determines how to cope with societal changes and shocks. This revolves around notions of "equal and fair burden sharing" and "winners compensating losers". The ability to navigate societal changes in a way considered fair is thus closely related to the notion of social cohesion. A society with little cohesion is likely to be more segregated and conflict-ridden, whereas more cohesion is conducive to a more consensus-driven approach. Eroding social capital fuels fragmentation, populist tendencies and impairs political decision-making and thus reform capacity.

[1] As we explain in the next chapter, although Covid-19 is particularly hard on the elderly, the proportional increase in death rates is roughly evenly distributed across age groups for those over 30.

[2] See https://www.lexico.com/definition/social_capital.

Social capital is, as indicated by the term, a stock that can be accumulated and depreciated, yet it is characterized by a strong asymmetry in the sense that it takes a long time to build up, but it can diminish quickly. A crisis can thus have persistent effects if social capital and cohesion depreciate.

Historically, pandemics have often been associated with loss of social cohesion. The available evidence has identified several factors that increase the likelihood that pandemics lead to social conflict, notably high lethality, high child mortality, having an "intermediary" level of knowledge of the mechanisms by which the disease transmits,[3] and pre-existing intergroup tensions; see Jedwab et al. (2020) for a review. The coronavirus pandemic exhibits several of these features. Moreover, the health and economic consequences have very different effects both across and within countries. While lockdowns and containment restrictions as well as economic policy interventions aim at addressing the common goal of reducing the negative externalities from contagious behavior, the costs and benefits are not equally shared. But can these societal goals be achieved without the costs falling on specific groups, particularly when several of the above correlates with social conflict are present in the current crisis? Who is affected by the pandemic? Who is affected by the lockdown and containment restrictions? How is all of this financed?

This chapter identifies how tensions that may erode social capital in the European Union are likely to appear. These tensions can occur not only across countries but also within. They have both inter- and intragenerational dimensions, as costs affect in a different way those with different income or education levels, migrants and nationals, men and women.

2.2 INTERGENERATIONAL CONFLICT

Intergenerational linkages are an important element of social capital. A very tangible sign of social capital and cohesion is the intergenerational contract embedded in tax-financed welfare arrangements. Provision of education, health, child- and old-age care financed by taxation implies a clear age gradient. The young and the old tend to be net beneficiaries, whereas those of working age are net contributors. This implicit contract relies on the net contributors being willing to support the arrangement.[4] This contract embeds both a conflict between generations (should more be allocated to the young than the old?) and also a mutual dependence. The current net contributors have an interest in the scheme since they will be net beneficiaries when they become old. Investing in education for the current young is not only to the benefit of the young but also older cohorts, since it increases future incomes and thus future tax bases.

The intergenerational contract depends fundamentally on social capital and trust across generations. This can be challenged if there is unequal burden sharing across generations. The coronavirus crisis has important intergenerational implications. While the health risk can be argued to be equivalent across generations (see next chapter for details of why this is so), the costs of the policies put in place to fight the pandemic are not evenly distributed. The costs of social distancing, which fall across all generations, are probably largest for younger cohorts. Business and employment interruption losses (a market closure shock) fall primarily on the working-age population, while adapting to working from home and reduced possibilities for child-care also fall on the younger generations. Interruptions in education and lower educational quality due to virtual teaching—see Chapter 3 on human capital—have costs for the very young. As a consequence, inequality of opportunity occurs across generations.

Simultaneously, the income of pensioners is not affected by the economic crisis.[5] The pension challenge is primarily related to the pensions the current workforce can expect: many public pension schemes are not financially viable, and a low real rate of return environment reduces the value of defined contribution schemes. Hence, the pension risk falls mainly on the shoulders of future pensioners, that is, younger cohorts.

The economic costs of the lockdown restrictions are being collectively shared via various types of emergency packages, and the intragenerational implications are discussed in the next section. While public debt increases are entirely appropriate in a crisis situation, there is a need to ensure that their repayment does not break intergenerational social cohesion. Is increasing debt a burden on future cohorts?

Some debt may be repaid within the lifetime of individuals currently alive, and the use of appropriate tax instruments can ensure that revenue is raised efficiently and equitably, that is, from those individuals who benefited from spending and tax reductions during the crisis. Most public debt, however, will undoubtedly be passed on to the yet unborn, raising frustrating issues concerning equity considerations. Parents may adjust bequests, which will in many cases consist of public-debt assets. And productivity growth at moderate and realistic rates imply that future generations will in any case be better off than generations currently alive, and better able to service debt as long as interest rates are not too high (for

[3] By an "intermediary" level of knowledge, the literature means that the disease is neither attributed to supernatural causes nor yet fully understood by the medical community, authorities or populations.

[4] For a discussion see EEAG (2016). There is a large amount of literature on both the economic implications of the intergenerational contracts and its political support, see e.g., Andersen and Bhattacharya (2017) and de Walque (2005).

[5] This is clearly the case in defined benefit schemes. Funded defined contribution schemes incurred large losses at the onset of the crisis, but later developments in financial markets have implied a strong rebound.

a discussion of dynamic efficiency concerns about public debt, see Blanchard 2019).

Current government bond rates are low, lower than plausible economic growth rates, indeed negative at 10ys maturity in most countries (though not in some of the countries most affected by the coronavirus crisis). A downward trend in rates of returns is also reflected in government bond yields.[6] Yet using current low rates of returns as an argument for dismissing the role of debt is tantamount to saying that the current situation is permanent. If not, then building up large debt levels can become a burden when returns normalize. This is a huge risk. Moreover, high debt levels reduce fiscal space and the ability to cope with negative economic events, and during the coronavirus crisis, countries with lower debt levels have been able to pursue more aggressive fiscal policies, see Alerbarola et al. (2020). Moreover, the increase in debt due to the coronavirus crisis comes on top of looming fiscal sustainability problems and insufficient reforms in the past. The countries facing the largest increases in debt in most cases had initially high debt levels and sustainability problems.

In these circumstances, the perception that the costs of the policies implemented for dealing with the pandemic fall disproportionately on younger cohorts can affect adherence to the social contract. This can take many forms, from social unrest and support for populist politics to migration of young workers to countries with weaker welfare states. Avoiding such erosion of social capital calls for policies that imply a more even burden across generations.

2.3 SHARING RISKS AND DAMAGES

While the health challenge has the same origin, both the health and the economic consequences of the coronavirus pandemic vary significantly across countries, and there is no strong correlation between measures of the economic impact like the decline in economic activity and health consequences in terms of e.g., Covid-19-related mortality, see Figure 2.1. As discussed in Chapter 1, the economic consequences depend, among other things, on the health shock, containment restrictions, and the economic policy responses. Moreover, the initial position of countries also differs, and for some countries, the coronavirus crisis comes on top of other problems. Notably, there is a tendency for countries entering the crisis with high public debt levels to have experienced the largest public finance consequence during the crisis, see Figure 2.1.

Social capital is often understood as the norms of trust and reciprocity that arise among individuals or groups. Consequently, sharing risks is a fundamental way of investing in social capital, since it requires both an ex ante commitment to reciprocity and sufficient trust in the fact that such reciprocity will materialize ex post. Providing insurance and redistributing incomes are both ways of sharing the economic risks associated with a crisis. As these figures and the evidence presented in Chapter 1 indicate, the economic implications of the health shock vary considerably across countries, testing the strength of European cohesion. The next subsection examines how to share the resulting costs across EU countries. The coronavirus crisis has also had different effects across groups of individuals, both across income groups that have different possibilities for smoothing consumption, or across categories of workers whose capacity to work or entitlement to receive welfare support varies. Sections 2.3.2 and 2.3.3 consider how these sources of heterogeneity may affect social capital during the crisis.

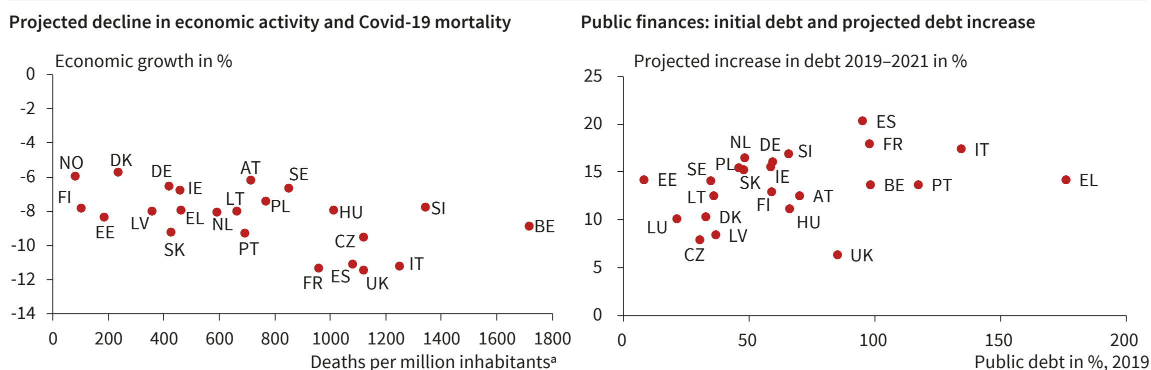
2.3.1 Sharing Across the European Union

Economic crises affect social capital. After the financial crisis, trust in the European Union declined, and although it has since recovered, it has not reached the level that was present before the onset of the crisis; see European Commission (2020a). In the current context, the same may occur. In fact, trust in the

[6] Changing demographics is one of the explanations of this trend, and it is not expected to change in the foreseeable future.

Figure 2.1

The Corona Crisis: Mortality, Economic Activity and Public Finances, European Countries



[a] As of January 4, 2021.

Source: OECD Economic Outlook, September 2020 (single hit scenario); Statista.

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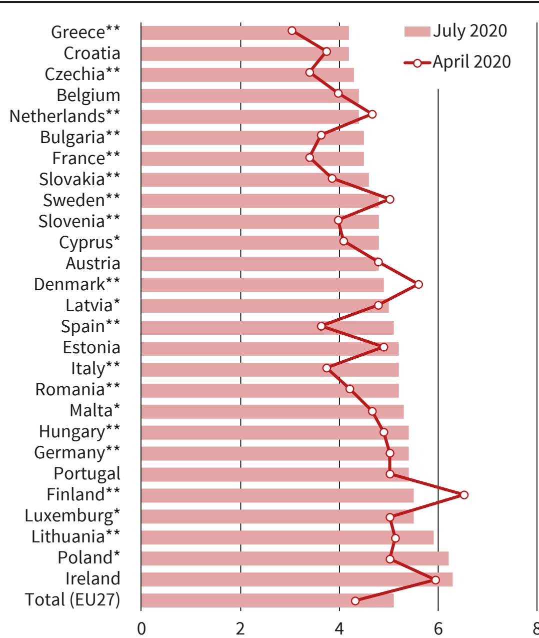
Figure 2.2

Trust in the European Union

Mean scores by country



Notes: The data show the mean for respondents in the EU27 when asked: Please tell me how much you personally trust each of the following institutions? The European Union. Trust is measured on a scale of 1 to 10, where 1 means that you do not trust at all, and 10 means that you trust completely.
* Low reliability in July in Cyprus, Latvia, Luxemburg, Malta and Poland.
**Statistically significant change (p=0.05.)
Source: Eurofound (2020).

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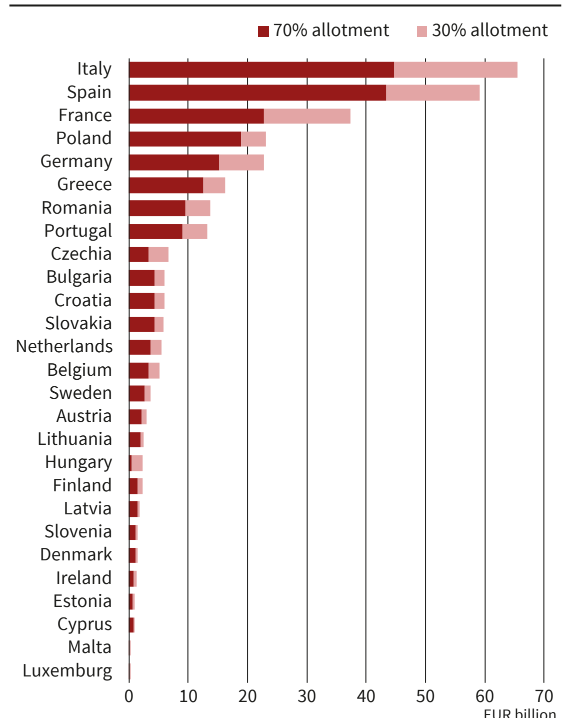
Figure 2.3

Allocation of the Grant-Part of the Recovery and Resilience Facility



Note: The grant allocation depends on two keys: (I) 70% depends on the population size, the inverse of its GDP per capita, and its average unemployment rate over the past 5 years (2015–2019), all measured relative to the EU average. (II) 30% are allocated based on population size, the inverse of GDP per capita, the observed loss in real GDP over 2020 and the observed cumulative loss in real GDP over the period 2020–2021, also relative to EU averages.
Source: European Commission (2020b).

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European Union in April 2020 remained low, averaging just over 5 points on a scale of 1 to 10, according to a survey conducted by Eurofound (2020); see Figure 2.2. Interestingly, trust in the European Union has increased during the Covid-19 crisis, and Figure 2.2 indicates that between April and July, this level of trust has generally increased across member states, with the exception of Northern European countries.

These different patterns are likely due to national perceptions of recent EU initiatives that were welcomed by many member countries but opposed by the Northern European economies. In a hypothetical ex ante situation, there would be an incentive to enter risk-sharing arrangements across EU countries to face health shocks like the coronavirus pandemic, see discussion in EEAG (2020a). In reality, there is no such arrangement, since the European Union was not set up to offer automatic responses for such purposes. The question has been whether ex post, there is sufficient solidarity among member states to establish such arrangements.

The European Union has launched the groundbreaking *Next Generation EU* (NGEU) program, which involves common burden sharing and explicitly aims to strengthen social cohesion within the European Union. Labeling the initiative also signals a forward-looking perspective where intergenerational aspects are key. The initiative seeks to show that the European Union takes responsibility and can be part of the solution, rather than a part of the problem, as under the financial crisis. But will the program be successful in strengthening social capital and cohesion within the European Union?

The key element is the Recovery and Resilience Facility, which includes both a grants and a loan facility (grants: EUR 313 billion; loans: EUR 360 billion) financed by EU borrowing and is intended to be operative in early 2021. This is an unusual initiative to support recovery and resilience of member states, creating jobs and repairing the immediate consequences of the pandemic, while promoting the green and digital transitions. The grants are allocated based both on the economic situation prior to the coronavirus crisis and the economic effects of the crisis. The allocation of the grant portion of the initiative is shown in Figure 2.3. Support under the scheme is conditional on reform initiatives, and funding depends on meeting explicit milestones and targets. The scheme has been vividly discussed and modified in the process, and approval was uncertain until the very end.

The initiative is a high-risk stake for the European Union. If it succeeds, it can strengthen the role of the European Union and cohesion within the European Union, if it fails, it will be another example of a promising project on paper without much actual effect, thus eroding social capital in the European Union. The ultimate test is whether the funds are used for the intended purposes and a critical aspect is the reform contingency. Making support contingent on

reform plans and implementation is an appropriate mechanism designed to deal with moral hazard. But enforcing this in practice is far from simple, starting with the difficulty of defining what is meant by a structural reform. Moreover, the track record for enforcement in the European Union is not strong as seen from e.g., the Stability and Growth Pact, rule of law and human rights issues.

Two aspects are essential in terms of the effectiveness of the initiative. On the one hand, the funds need to be well invested with an overall aim of overcoming market failures. This can encompass new technologies, for example, the digital transition, as well as key aspects of social capital, such as an efficient public sector. On the other, it is important that the investments are visible and that they do not end up financing activities that would be undertaken in any case. The NGEU relies on membership initiatives, which strengthens country-ownership to the specific initiatives but does not ensure that policy interdependencies are taken sufficiently into account.[7] Focusing on cross-national high-profile projects would highlight the role played by the Union. Last, monitoring should be strengthened to ensure that both the designs and the effects of the projects can be properly assessed, hence, avoiding wasteful use of resources. Not only would waste be economically costly, but it would also jeopardize social capital and cohesion.

2.3.2 Tensions Across Income Groups

A shock of the magnitude of the current one will have distributional consequences and existing evidence on other pandemics indicates that such consequences tend to persist.[8] Moreover, growing income inequality over the past few decades has been associated with declining social capital, and it is likely that the former affects the latter.[9] Identifying the distributional conflicts that have emerged in the wake of the coronavirus crisis is hence essential for designing policies that prevent further erosion of social cohesion.

Data on income changes during the pandemic is not yet available, but the information that exists points toward important distributional effects. First, while the crisis has affected the labor market generally, there is a clear social gradient, as indicated by Figure 2.4, since low-income groups face the largest risk of both temporary lay-off/shorter working hours and job loss.

Figure 2.4
Risk of Temporary Lay-off/Reduced Hours and Job Loss
EU 2020, Q2

Source: Eurostat (2020). © CESifo

Second, bank data has allowed the analysis of changes in savings and consumption for French households during the pandemic (Bounie et al. 2020). Average consumption dropped during the spring and rebounded over the summer, a pattern that was accompanied by a substantial increase in household savings. But the data show vast heterogeneity across income groups (measured by total expenditure in 2019), as seen in Figure 2.5. Compared to the previous year, households at the top of the distribution reduced their consumption and increased their savings, with half of the "excess" increase in wealth being in the hands of the top decile. In contrast, households in the bottom deciles decreased both their consumption and their savings, while increasing their debt, observations that can only be explained by a drop in revenue.

Before the pandemic, much of Europe witnessed surges of populist sentiment as a response to increased polarization in earnings and access to jobs, and the differential way in which the health, employment and earnings shocks have affected different income groups risks further eroding social capital. In this context, policy should target both pre-tax and post-tax inequality. The former is largely determined by the distribution of human capital, which we discuss in detail in the next chapter. In the short term, redistribution plays an important role, and the concept of fair taxation is an essential policy element if the fiscal costs of supporting the recovery are to be widely accepted and not engender further social fracture (see EEAG 2020a).

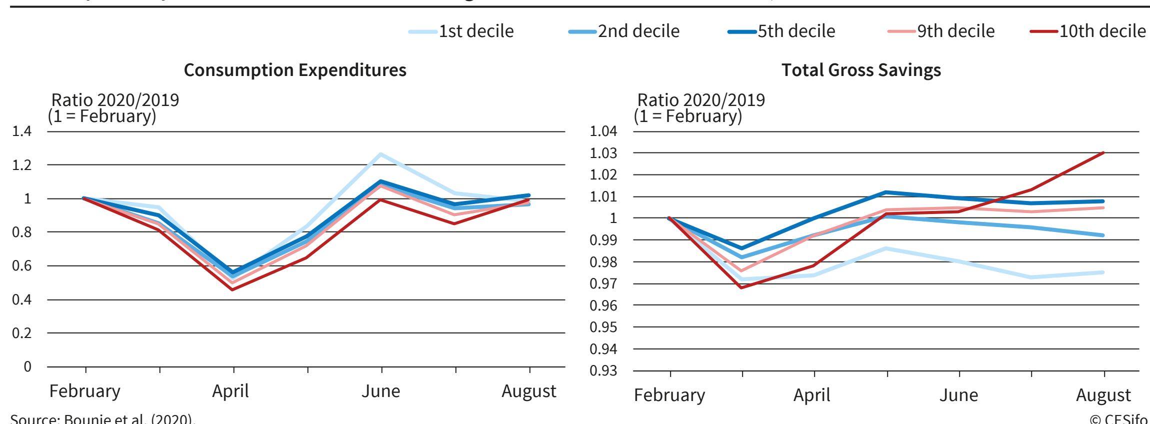
Two elements are key. The first concerns how to support jobs when individuals are forced to stop working because of government-imposed restrictions. Emergency packages were an essential part of social insurance at the start of the health crisis. Yet, after generous benefits in (most) EU countries during the first wave, governments need to think about the design of such packages during the second (or any future) wave since the perception of overly generous

[7] As discussed in the EEAG 2020 Policy Brief (EEAG 2020b), to enhance the efficiency of the investment part of NGEU, it is important that it focuses on investments that are productive, but which are not, or not sufficiently, undertaken by member states. Examples of such investments are cross-border transport, energy and communication networks, data networks or power lines, cyber security, and research and innovation programs. The challenges are that they are not specifically targeted at the countries, regions or sectors that have been particularly hard hit by the coronavirus crisis.

[8] For example, data for Italian municipalities on the effects of the 1918 influenza indicate that, after 5 years, income inequality was higher in municipalities more affected by the influenza and that these differences persisted for a century; see Galletta and Giommoni (2020).

[9] See Gould and Hijzen (2016) and the references therein. It is also likely that causality goes both ways, with weakened social capital resulting in higher inequality.

Figure 2.5
Consumption Expenditures and Total Gross Savings across the Income Distribution, France 2020



Source: Bounie et al. (2020).

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subsidies could reduce support for the policy and incite calls for a reduction in the extent of redistribution (as well as dampen incentive to return to work, as we discuss in the next chapter). A second important aspect for ensuring support for welfare policies for those temporarily out of work is to prevent individuals from exploiting the system. Incidental evidence (Le Monde, 10 and 13 July 2020; The New York Times, September 10, 2020) seems to indicate that there has been a large increase in welfare fraud in several countries, which may make support for welfare and emergency packages wane. It is thus essential that governments implement sufficient monitoring to prevent fraud.[10]

2.3.3 Insiders and Outsiders

Fractured labor markets reduce trust and incite social exclusion; consequently, the markedly different fortunes of insiders and outsiders during the pandemic risk eroding the social tissue of European economies. The contrast between insiders and outsiders can appear along multiple dimensions—whether the individual has or does not have a job, the quality of employment (formal versus informal), or the characteristics of the individual, notably domestic versus foreign workers. By making these differences more salient, the pandemic risks making social networks less connected and increasing the feeling of entitlement of certain groups, thus reducing trust across the various communities and hence the willingness to share the costs of the shock.

An important feature of many emergency support packages in Europe (and elsewhere) has been protecting existing jobs. Income support packages for those temporarily unable to work have implied that there has been little incentive for workers to search for employment in other sectors or for firms to create new positions. As a result, emergency policies have had a different impact on insiders and outsiders in the labor market, with both those that were unemployed before the health crisis and those about to enter the labor force having been particularly badly hit. Such a situation implies both inefficiency and unfairness. Inefficiency stems from the fact that jobs that existed before the pandemic are being protected irrespective of their viability in the medium term, a viability that may be in jeopardy due to the health crisis or to pre-existing structural shocks. Unfairness is particularly salient when we compare two successive cohorts finishing their studies/training in the summer of 2019 and the summer of 2020, and thus facing very different labor-market entry conditions.

A second group of workers that has been badly hit by the pandemic are informal workers. These individuals pay a double penalty in terms of health and financial costs. There has been a high willingness to work among the informal workforce during and after the lockdowns as many of these individuals fail to qualify for any government schemes to support their incomes. Moreover, these workers are likely to be particularly unlikely to be able to maintain social distancing, at work because employers willing to hire informally are probably also cavalier about respecting distancing/safety norms, and at home because many such workers live in intergenerational housing or in crowded employer-provided accommodation. As a result, areas with a prevalence of informal work have often been hotspots of Covid-19 transmission.

Migrants are often employed in the informal sector and as a result, they are a particularly vulnerable population.[11] Yet, as it is often the case in a climate of economic insecurity, an anti-migrant backlash is possible since when people feel they are competing for scarce resources—whether jobs or hospital beds—

[10] Fraud can occur at the individual level and at the corporate level. In some countries the emergency relief packages are contingent on a certain amount of revenue loss, and this can lead to fraudulent accounting in order for the firm to benefit from wage support. Hence, similar concerns arise for firms. In the case of firms, the question concerns whether firm support should be related to attitudes toward taxes in the past, in particular for firms that were in "gray zones" in terms of tax compliance. We return to this question in Chapter 4.

[11] Work for the United States indicates that county-level measures of the ability to work at home are negatively correlated with the employment share of low-skilled immigrants, many of whom are performing essential jobs (Rahman 2020).

they tend to turn against those supposedly taking away those resources. The contribution of migrants to the economic performance of high-income economies over the past few decades has been notable,[12] hence, closing down borders in response to populist pressures could slow down the recovery by depriving certain sectors, notably agriculture and the business services sector, of categories of workers for which national supply is lacking. Moreover, migrant workers help lower dependency ratios and hence share the burden of public debt. Acknowledging the contribution made by these individuals during the pandemic, since notably they are often key workers, could help increase tolerance toward this population.[13]

To avoid an increase in social fracture, policies should seek to be encompassing. Status quo biases–whether toward those already employed or domestic workers–can lead to inefficiencies and hamper social cohesion if certain groups, such as young entrants into the labor market or migrants, feel that they are being unfairly treated. The first wave of the pandemic required immediate action, now more thought needs to be devoted to how to let the labor market adjust while protecting *all* individuals and not only those already in formal employment when the pandemic hit.

2.4 WHAT KIND OF RECESSION?

2.4.1 A Pink Recession

Social capital is increased by building and strengthening the norms that underpin reciprocity, co-operation and trust, and the most basic sphere in which these norms operate is the household. Just as an uneven sharing of the costs of the coronavirus crisis across age or income groups risks reducing cohesion, the feeling that gains in terms of gender equality are being reversed by the pandemic can diminish social capital. And the data so far indicates that the coronavirus crisis is affecting women more than men.

Traditionally, recessions have tended to have the largest impact on male employment, with, for example, the 2008-09 crisis being termed as a "mancession." In contrast, a number of indicators point toward the current crisis as having hit women particularly hard. There are two reasons for this. First, women are more likely than men to work in sectors with a high level of social interaction[14] and while in some cases this implies that they are essential workers (e.g., nursing), most of these jobs are in sectors that have been badly hit by the lockdown measures. Second, the closure of schools, the need to provide support for isolating older relatives, and the medical consequences of either Covid-19 itself or delayed treatment, have vastly increased the need for home-production, raising the question of who bears this burden.

The evidence indicates that generally—but not universally—women have been particularly badly hit. Larger employment losses for women than for men have been documented for the United States as well as for United Kingdom households with dependent children, but when all UK households are considered, there seems to be no difference between men and women in the extent of job loss and reduction in hours. Within households, the increased childcare needs have been mainly met by women, although, at least in the UK, the share of childcare performed by men has risen (see Hupkau and Petrongolo 2020 for a discussion and sources). In the United States, women are dropping out of both employment and the labor force, and local decisions on school closures predict well where this is occurring; see Heggeness (2020).

These patterns raise concerns about a potential reversal of the gains in gender equality made over the past decades since they seem to imply a return to traditional gender roles. Moreover, as the health shock prolongs, changing attitudes toward work at home and in the market can have important consequences. On the one hand, current generations of working-age women can be hurt as women who "choose" to exit the labor force for a prolonged period of time are likely to incur costs for their future careers due to a loss of skills and experience. On the other, a return to traditional gender roles at home can affect the perception of roles and identity, resulting in increased biases in the workplace, diminished aspirations for girls and greater gender gaps for future generations.

2.4.2 A Green Recovery

The climate crisis is high on the political agenda and has become a major source of social conflict. Conflict has emerged because of widespread climate skepticism, and is also due to tensions across generations with different time horizons and across income groups that disagree on who should bear the costs of climate policies. This lack of consensus has created a major split both within and across European countries, and the coronavirus crisis has brought this issue to the forefront both because of its short-term impact and because of questions regarding whether the recovery following the coronavirus crisis can be made "green" by implementing appropriate policy designs.

The NGEU has included green investments as a crucial element, and a minimum of 37 percent of the spending under NGEU should be related to climate change. This is a strong signal that the climate challenge is taken seriously and is responding to an increasing political demand to take action, thus helping social and intergenerational cohesion. However, the

[12] Existing evidence indicates that a higher presence of migrant labor has resulted in higher employment and wages for national workers as well as in increased productivity (Dustmann et al. 2013; D'Amuri and Peri 2014; Peri 2012).
[13] Data for the UK shows that migrants are overrepresented in many essential sectors, accounting for 22 percent of employment in both health and social care and in food and necessary goods, whereas they represent only 14 percent of the population (ONS 2020).
[14] For example, in the US, nearly 74 percent of women work in social sectors, compared to 48 percent of men (in 2019); see Fabrizio et al. (2020).

investment target is problematic for several reasons: setting an investment target is a top-down approach with a dubious track record; green investments are not in general targeted at the types of activity most directly affected by the crisis (e.g., services), and NGEU may finance projects that would have been undertaken anyway or that use broad definitions of green investments (green washing). All these aspects leave the net effect an open question. Targets for expenditures on climate may be more effective if focusing on network facilities and cross-border activities, as argued above, while improving perceptions about the role of the European Union in the green transition would benefit from focusing investment on highly visible projects of transnational character.

More fundamentally, subsidizing green technologies is not the best way to reach the climate target and address the associated negative externalities. A more efficient approach is to focus on price signals, such as a CO_2 price or tax. Such measures, however, raise two concerns. First, they require adjustments that would arrive at a time when economies are facing major demand shocks, yet existing predictions indicate no negative impact on growth and employment (Metcalf and Stock 2020). Moreover, Fuest and Pisani-Ferry (2020) show that the ETS could finance the entire recovery plan, freeing funds to other productivity-enhancing expenditures, notably human capital.

Second, as always, price changes have distributional implications, and these would need to be addressed so as to prevent social tensions. As recent experiences, for example in France, have shown, carbon taxes are deeply unpopular. Yet there is no good reason why a carbon tax would hurt the poor. First, while it is a burden on consumption, it also affects factor prices, with a particularly strong incidence on factors that are complements to energy, i.e., capital; second, the progressivity of a carbon price can be adjusted by indexation of tax schedules and social benefits (Metcalf 2019). The decision to pursue this avenue will test the strength of the social contract. Solidarity across groups with different incomes or lifestyles is required to ensure that the resulting distribution of consumption is acceptable, while sufficient trust in institutions is a must when households experience the increase in consumption prices daily but the reduction in their tax bill only once a year. This requires reciprocity and confidence in institutions, in which case, we would emerge from this pandemic with strong social capital across and within European nations.

2.5 POLICIES FOR PREVENTING THE EROSION OF SOCIAL CAPITAL

In the short run, halting the erosion of social capital triggered by the coronavirus crisis calls for policies that are encompassing across age, employment or income groups. Intergenerational conflict is particularly salient. In order for policy to be perceived as placing an even burden across generations, fair taxation is essential (see EEAG 2020a); for example, taxes on consumption and land are a better way to share the burden of the coronavirus crisis debt than income taxes. Another candidate policy to ease intergenerational tensions is pension reform,[15] while climate-friendly policies can also help by signaling an increased weight of the welfare of the young in the social welfare function. But above all, debt sustainability hinges on growth. Measures that enhance current and future productive capacity in European economies, such as labor market reforms, increased human capital, and innovation will generally have large effects on public budgets via increased tax revenue and reduced social spending, favoring social cohesion. We will return in more detail to these aspects in the next two chapters

A major concern are status quo biases–whether toward those already employed or domestic workers–which can lead to inefficiencies but also hamper social cohesion if certain groups, such as young entrants into the labor market or migrants, feel that they are being unfairly treated. The first wave of the pandemic required immediate action, now more thought needs to be devoted to how to let the labor market adjust while protecting *all* individuals and not only those already employed when the pandemic hit.

Countries should look for the proper balance between preserving and creating jobs so as to avoid a status quo bias. To do so, the priority should be to support individuals rather than protect jobs, as exemplified by the Danish flexicurity approach. This will require re-thinking some aspects of the welfare system, but also returning to pre-pandemic policy analyses to assess pre-crisis structural weaknesses in order to identify in which areas job preservation should not be a priority. The process of job creation and job destruction should also be smoothed by reducing existing rigidities. Indeed, firm creation and destruction is a key part of the labor reallocation process, and many EU countries suffer from barriers to both entry and exit. These barriers should be removed with urgency, yet several countries are introducing policies that head in the opposite direction.[16]

The recovery requires that the welfare system does not jeopardize incentives for job search and reallocation, hence income support should focus on encouraging people to accept new jobs. One possibility is to change benefit entitlement in such a way

[15] Whether such reforms would be contractionary in the short run is far from clear. The current situation with non-financially viable pension systems creates uncertainty, which may lead to precautionary savings. In contrast, increases in retirement ages will generally increase lifetime incomes and thus consumption.

[16] For example, the 2019 OECD report on Germany already suggests that the country should "[e]ase the conditions for bankrupt entrepreneurs to be discharged of debt after three years, while maintaining adequate safeguards for creditors [and c]reate a one-stop shop to process all procedures for starting up a company online" (OECD 2019, p. 148). Yet Germany, as well as, for example, Italy, are constraining dismissals.

that acceptance of a new job—possibly in a different sector—does not reduce benefit entitlement.

At the same time, given the vast increase in coverage, it is important for the welfare system to be regarded as fair since the perception of overly generous subsidies could reduce support for the policy and incite calls for a reduction in the extent of redistribution. As a way to ensure fairness, the coverage of the social safety net could be extended by including income-contingent loan facilities as an alternative to general changes in generosity. Many countries have introduced such schemes for small firms and business owners either in the form of postponement of tax payments or outright loan facilities. For families with income loss due to the crisis and large fixed costs, a similar need exists. Income-contingent loans could be made available conditional on a sufficient drop in taxable income. The repayment would be triggered only when and if the household's income reaches a certain level, in a similar way to income-contingent loans used for financing higher education in Australia, New Zealand and the United Kingdom.

Three important considerations should be the focus of medium- and long-term policy: the implementation of the Next Generation EU plan, gender imbalances, and environmental concerns. We discuss each of these in turn.

The crisis has very different health and economic consequences across EU countries, and the Next Generation EU recovery plan aims at sharing the burden across member countries. The recovery plan and the issuance of common debt provide a much-needed signal of EU cohesion and solidarity. In the long run, they can enhance social capital, while in the short term they will keep the single market and supply chains operative, both of which are crucial for saving lives. Yet the implementation of the program is hindered by a lack of trust across countries, which is to a large extent the reason behind the conditionalities imposed in terms of how the funds can be spent. Conditionalities are, however, not an appropriate solution, both because it is not clear what an appropriate use of the funds would be—even from the perspective of countries skeptical of the scheme—and also since quantitative conditionalities are hard to monitor and enforce (notably since they can easily be met by a reclassification of expenditures and investments). As a result, the program is a high-risk venture, since poorly spent resources may turn out to be counterproductive, adding to distrust in EU initiatives. The ultimate test is the effectiveness of the initiative, making its design crucial if the program is to help build rather than erode social capital among member countries.

A more suitable approach would be to ask countries to set specific targets, leaving them discretion on how to achieve the various objectives prioritized by the Union, such as the green and digital transformations. The expenditure plans could be presented to the relevant EU authorities, which would monitor whether targets are eventually met. The result is likely to be a choice of policies that are more suited to a country's specific problems and a greater degree of accountability of the recipient that should increase the efforts made to reach targets. Specific EU-guided initiatives could nevertheless be undertaken when they focus on common infrastructure or network needs across countries.

The patterns of household division of labor observed since the start of the coronavirus crisis raise concerns both about female labor force attachment and the impact of gender roles on workplace biases and on young women's aspirations. Gender-responsive fiscal policies can and should help prevent negative outcomes by fostering female labor market participation. The decision by most European countries to avoid closing schools during the second wave is heading in the right direction and should be supported both through fiscal and health measures, as we will discuss in more detail in the next chapter, but more effort is needed.

In particular, the pandemic has identified non-resilient institutions, with child-care and primary schooling displaying critical vulnerabilities. From both a short-term and a long-term perspective, it is important to build care institutions that do not collapse in the face of a shock. Resilience requires several elements. In many EU countries, daycare centers, preschool and primary schools are characterized by short and inflexible hours as well as the impossibility for (mildly) sick children to attend. During the exit from the spring lockdowns, it would have been easier to allow for part-time attendance that allowed parents some working time if care systems had already been providing longer hours. Overall, child-care and early-school institutions should reorganize to provide more flexibility in order to adapt to parental circumstances. The example of France is noteworthy. Public daycare centers, preschool and primary schools are typically open for 11 hours per day, and although children do not spend all that time in care, it provides flexibility for parents to adapt care to their work schedules. Not surprisingly, France combines high female labor force participation with high fertility.

There is widespread debate on how to make the recovery from the pandemic consistent with a climate agenda to reduce CO_2 emissions. Quantitative investments targets, as those proposed in NGEU, are generally not an efficient way of achieving climate objectives. Cosmetic effects can distort where the funds are invested and the targets do not address aspects such as network facilities and infrastructure, where both the market and single countries may underinvest. As a result, in the short term, quantitative investment targets serve as a political signal, but its political credibility may eventually erode when it becomes clear that this approach is ineffective.

Negative externalities are most efficiently addressed via price signals, and climate objectives

should be achieved via a CO_2 price or tax. This can be accomplished by either reforming the European emissions trading system (ETS) or national CO_2 taxes respecting an EU-set minimum. As long as the measures apply generally across sectors, this ensures clear economic incentives to reduce emissions where it is most cost effective. Clear and credible price signals will also give the right up-front incentives for investments.

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