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CETERIS PARIBUS

CORONABONDS

A SYMPTOM OF A CHANGING EUROPE?

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Economics Club
CATÓLICA

LETTER FROM THE CLUB

Dear Reader,

Welcome to **Ceteris Paribus**, the CATÓLICA-LISBON Economics Club's quarterly Magazine.

Let us start by introducing our club.

The CATÓLICA-LISBON Economics Club was created in 2017.

Our team took over in September 2020, our focus is to promote the economic science amongst our student community, for this purpose, we have created this magazine and a podcast, called *Défice de Atenção*, available on Spotify and Apple Podcasts. From our magazine you can expect articles written by our members, interviews with specialists in the Field and a lot more.

This club is committed to develop and deploy economic reasoning to all our readers and listeners so, we hope you enjoy this magazine as much as we loved making it!

See you next time,

Católica Economics Club

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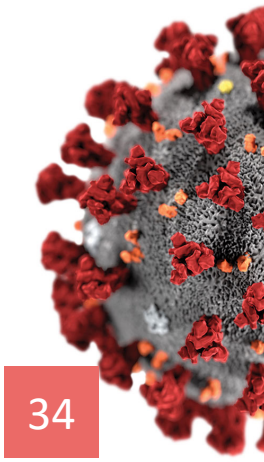

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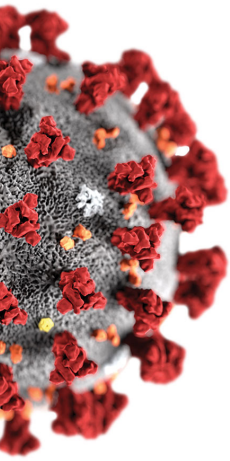

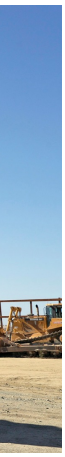

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CETERIS PARIBUS

PODCAST

DÉFICE DE ATENÇÃO

Défice de Atenção is our new Podcast. Here we are going to talk about all types of interesting topics related to the economics field. This is going to be a place where we can share our thoughts, debate different points of view or simply talk about what is happening in the world. This is the first time that our club is creating a project like this, so we hope you enjoy listening to the episodes as much as we enjoy creating them.

All episodes are available on our Spotify account CATÓLICA-LISBON ECONOMICS CLUB or on our website www.economicsclubclsbe.com.

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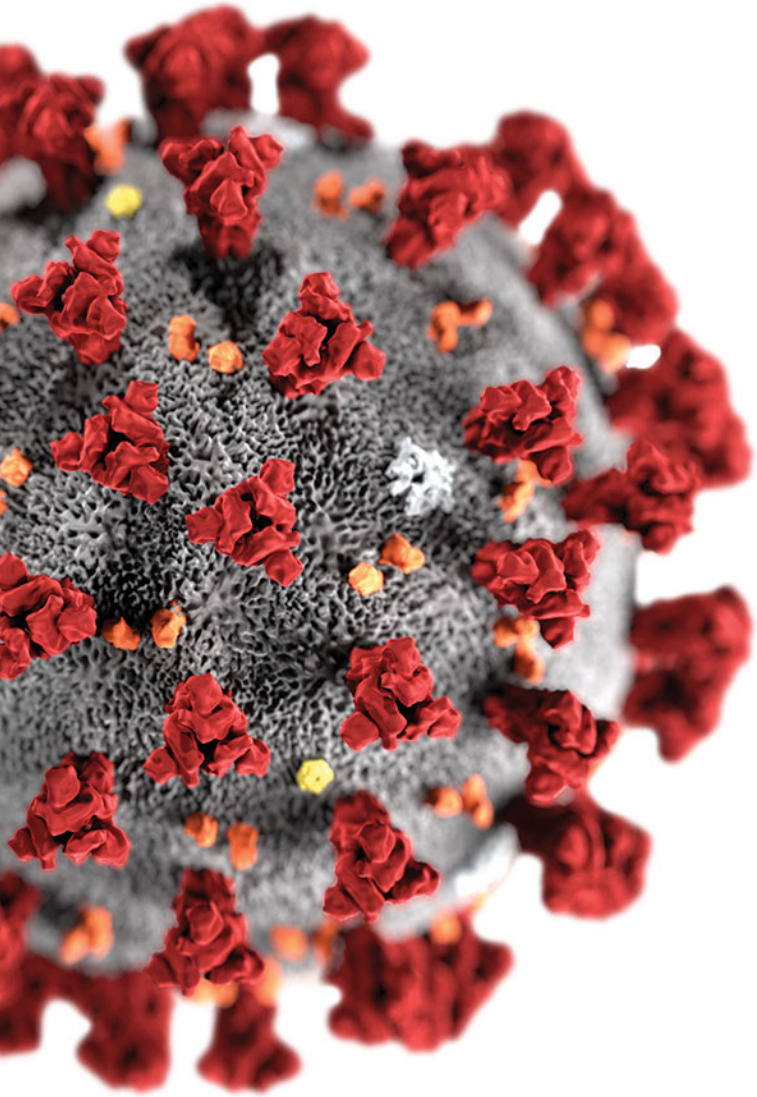
Coronabonds,

a symptom of a changing Europe?



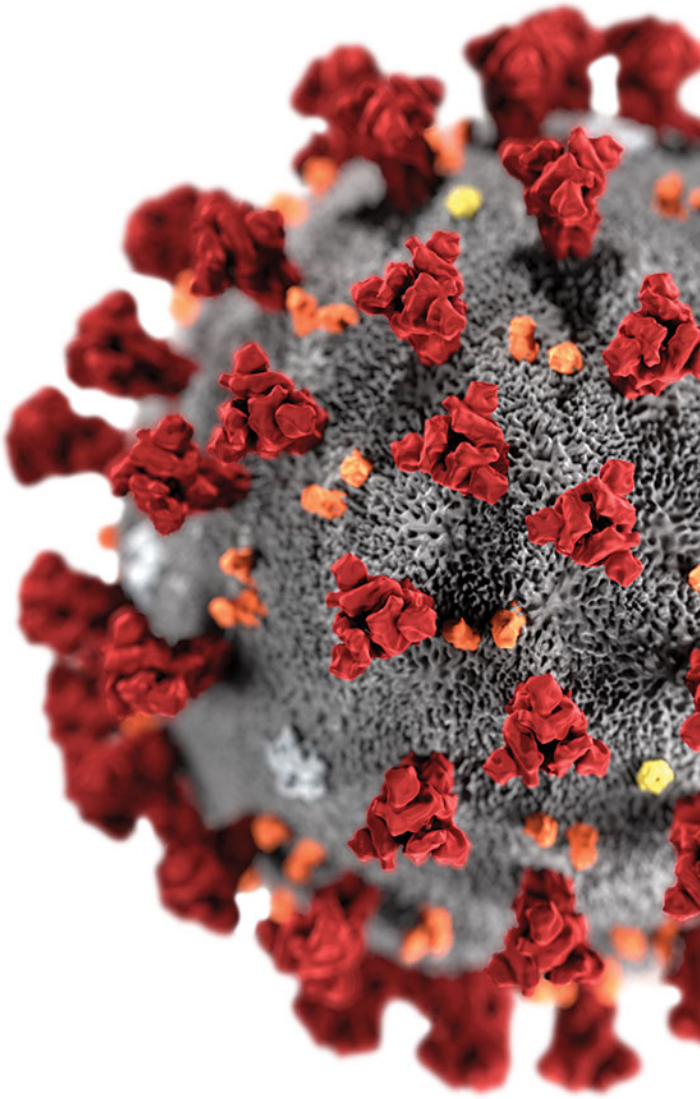
July 21st, 2020: This is the date of the historical agreement between "the 27" European countries for approving a common debt instrument equivalent to 750 billion euros, at par, which are referred to as Coronabonds. The name alludes to the problem that caused the crisis we are facing: the coronavirus pandemic. The archives acknowledge that the idea of common borrowing, in Europe, was firstly introduced to the public debate by Jacques Delors in 1993, at the time, to finance huge public projects such as telecommunication, transport, and energy. The idea was brought up several times, especially during periods of crisis. For instance, in the awakening of the European Debt Crisis, the Barroso Commission proposed an "EU Project Bond". However, after almost 30 years, Europe may be living what experts love to define as a Hamiltonian

moment, as specialists love to say, referring to Alexander Hamilton's proposition for common debt issuance in the USA in 1790. Starting first with a formal letter signed by nine countries including France, Italy, Portugal, in spite of tough bargaining and within an 80-hour marathon negotiation, the step was taken and the COVID-19 crisis pushed all members to agree on an historical issuance of 750 billion euros in common bonds.

For a decade now, the European Union has broken many taboos such as the Maastricht criteria, the purchase of public debt above the 33% normally allowed, and now common borrowing. It could be said that all of these easing policies emerged during this crisis and are temporary. However, history has shown us that most of the changes introduced during crises are long-lasting if not permanent.

Is this last agreement a new step in a changing Europe that is moving in a new kind of regime?

This question will be answered in three parts. Firstly, the question of the similitude between the US in 1790 and Europe in 2020 will be approached. Secondly, we will highlight that even if this kind of agreement was found, there is still a nationalist protection of interest toward the European level. We conclude by further analysing how Coronabonds will impact the near future.



1) Hamiltonian moment and similarities between the agreement of shared debt in the USA and Coronabonds in Europe.

The establishment of an analogy between this agreement and an European "Hamilton moment" didn't happen by chance. However, there are some differences. For instance, the Eurozone is indebting itself directly, while U.S. States were already indebted on a state-level and they decided to federalize all the debt. But there are also many similarities, which we shall now discuss:

Both the US and the EU have chosen to put forward this solution of gathering and sharing the debt burden for a common reason: war. In 1783, after the end of the Independence War, the different U.S. States were facing a huge burden of debts held for 20% by foreigners. On the 17th of March of this year, President Macron publicly declared to the French citizens: "Nous sommes en guerre" (We are at war – against COVID-19). Indeed, more people have died from the coronavirus than in battle throughout several recent major military conflicts. Just like everywhere else in the world, Europe has taken decisive steps to tackle the disease, from massive lockdowns and restrictions to a spending spree on unemployment subsidies, company support, hospital expenditure, research for a vaccine, among others. The European Union is trying to spend its way out of a recession, backing this fight with a tremendous amount of money made available to the state members, including the issuance of common debt, namely Coronabonds.

Focusing on the debate side, the underlying issues were quite similar. In America, some states were doing well and had already refunded all their debt, while other states were highly indebted. The states which were already done with their debts were worried to pay for the states that were in difficulty. It is surprisingly similar to the current European situation, where a couple of northern countries were absolutely against the Coronabonds agreement and the shared debt for the same reasons of moral hazard.

Eventually, in both situations, the agreement led to some consensus. In what it is now well known as the United States of America, the negotiations were about the capital of the United States. They finally settled on Washington. In Europe, the consensus was found in economics terms. The original idea was to give €500 billion in subsidies, distributed among countries. After tough negotiation between frugal countries and the others, the package was reduced to €390 billion. The contribution of these countries for the European budget was also reviewed and lowered.

The situations of the two regions in their respective eras seem similar. It could be said that while the United States has succeeded in building federalism, Europeans may be taking the same path. However, it is essential to not forget that at the time, the states of America had a very young history. Europe at the opposite has built a history of thousands of years, leading to a national spirit in each country, very different cultures, language, habits etc. It seems very difficult to unleash that national spirit and turn it into a cohesive European group.

2) Debates and disagreements that confirm the lack of confidence

between members and the national interest that prevails over European ones.

The main technical purpose of the Eurobonds is the idea of saying "the 27 countries are borrowing together and sharing risk together, if one of the countries is failing to refund the money, the 26 others will help it". The signal sent to the investors is that even if these countries seem weaker among others, since the risk is shared, the default payment is almost null. Then, the countries will be able to borrow money at a rate like the German bond one which is considered by investors as one of the safest assets in Europe. It will also strengthen economies subject to speculation attacks as it has been seen in Greece during the Great Depression or more recently at a lower scale with Italy during the Covid-19 crisis when the country was harshly hit by the disease.

Politically speaking, the Coronabonds agreement is an outstretched hand to all countries and citizens associated with them that have suffered since a decade now of stigmatization and restrictive policies. Among others, António Costa's reaction concerning the behaviour of the "frugal countries" that he describes as "RE-PUG-NAN-TE" is a great summary of the feeling and the resentment of a part of the EU.

Finally, and as Angela Merkel understood, it is a win-win situation. The European economies are interdependent, and the wellbeing of some pull the others up and vice-versa.

António Costa's reaction concerning the behaviour of the "frugal countries" that he describes as "RE-PUG-NAN-TE"

However, the Northern countries don't share that point of view. They are mainly afraid about the free riding risk and moral hazard. In fact, they did not forget the great depression and the issues associated with PIIGS (Portugal, Ireland, Italy, Greece, and Spain). They have accused them to not be able to manage their expenditures, leading to big deficits that became uncontrollable during the 2010 crisis. They also question their obligation to help and trust countries that did not respect the original European Rules and were almost bankrupt 2 or 3 times during the last decades, when they were themselves careful as much as it was possible.

It is important to recall that even if it is not that true anymore, due to the low interest rate policies everywhere in the world, there is a

little part of the borrowing cost that is subject to the level of risk incurred by the investor. Common borrowing will erase this risk premium, which may lead to overspending in unnecessary things. The argument advanced by the Northern Countries is that it is avoidable to borrow together since some tools are already existing such as the European Stability Mechanism (ESM), a fund created during the last crisis with a capacity of about 500B€, financed by the 27 according to their means, and usable in time of crisis. In exchange, some policies are imposed or strongly advised to encourage these countries to better manage their expenditures.

The common debt could eventually require a right of review by the partner countries when it is a matter of ensuring full repayment and avoiding any issues of moral hazard and free riding risk from European Countries to the borrowing nations.

A huge gap needs to be filled if an "American-style" federalism is the EU's ultimate goal.

This is a similar situation to ESM, and the partner countries may give advice in terms of retirement age or expenditure management they may give advice on fiscal policies and expenditure management to enforce the repayment of the loan, which could be viewed as interference both by citizens and politicians of the concerned countries.

Even if an agreement was found, the divergence in the countries' approach and the European history that had exacerbated those differences show that there is still a lack of confidence among states. A huge gap needs to be filled if an "American-style" federalism is the EU's ultimate goal.

3) Will this agreement lead to irremediable rapprochement? Review of the challenges and involvement behind it.

It is important to insist on one point: Coronabonds is common debt that will benefit everyone in the European Union. The 390 billion euros will be used as subsidies: countries will get the money according to a key distribution that is taking into account many criteria, such as each country's population concentration, GDP per capita, unemployment rate before crisis and GDP loss during the crisis, such that the most affected economies have help in accordance to their losses during the crisis. Even if the countries will not have to refund it directly by themselves, they are linked by this bond because they somehow borrowed it all together as if they were a single country.

The nations are usually refunding

their bonds by collecting taxes which are their main source of revenue. However, at the moment Europe is not raising any taxes and is financed directly by each state according to their means and their willingness to pay for the functioning of the European Union. That is why, from 2021 onwards, new tariffs on plastic will be implemented by the European Union. Other solutions such as taxing digital giants or carbon at the continent's borders are on the table. Taxation is a very sensitive subject because it is seen as an instrument of national sovereignty, which may call into question a possible change of dimension towards a more political Europe, with greater centralization of power and a parallel loss of each member state's sovereignty. It will raise many problems especially for countries such as Ireland, Luxembourg or Malta, that are taking advantage of easing fiscal policies for the digital companies to attract them to their territory.

For the moment, issuing European debt is just a tool to overcome the crisis and seize the opportunity to invest in new ambitious projects that turn towards sustainable development and modernisation of infrastructures. The main goal is that the economy recovers as fast as possible and to create a virtuous cycle. However, this one-time bond experiment may be the early stage of an "Euro bond". Issuing European debt instead of individual debt can give many advantages to the Euro in the financial markets. Currently, the fragmentation of debt among European states makes some assets undesirable by investment funds that are buying them because the amount is not important enough, or the debt is not liquid enough. Issuing a big amount of debt for the 27 will overtake this issue, make the debt more desirable and more liquid, which may reinforce the Euro as one of the leading currencies in the world.

Politically, this agreement is incredible. Admittedly, "frugal countries" had obtained some counterparties as it has been seen previously in the article. They have also been often described as selfish. However, before the Covid-19 crisis, and even at the start of it, it was not even possible to imagine this idea being implemented as the northern countries were against the debt sharing. Today, we can't find anywhere else a group of 27 countries with different political and economic orientations that are capable of finding a consensus for a common policy so quickly, even if opinions diverge. It is at least an improvement compared to the subprime crisis and the long time reaction. It is also an outstretched hand to the southern countries: "we will not leave you alone a second time, and we will go beyond this crisis together".

When we retrace the history of Europe, starting with the creation of the European Community of Coal

and Steel in 1952, then the treaty of Rome in 1956 and an extension of the union, following by a single currency implemented in 2002, and finally a common loan in 2020 that will lead to questions about common taxes and tax harmonization... All those events can be seen either as an extension of Europe's power over the individual states or as an equalization of all the state situations. In any case, uniformization is one of the important steps to move toward federalism.

All the historical events European Union went through have helped to define it. Every time, the politician has had mainly 2 choices. To go for further help and integration, or to stop the development, staying with their own benefits and sovereignty, facing the risk that European citizens feel abandoned and an increasing share wanting to leave it. Every time, even if it leads to bitter negotiations and some disagreements, the decision was made to go for further integration, with the idea that together we are stronger.

And... Why isn't the European Union already a federal state? That is what Sylvain Kahn suggested in the French newspaper "Le Monde" on the 22nd of July, one day after the Coronabonds agreement, with a provocative column title: "The European Union is now a state". Behind this provocative title, there is the following idea: the European Union has its own currency and it will also borrow as a state. Furthermore, the nations are now linked between them with this loan and the EU will raise taxes as a state to refund it. The Union has a lot of state attributes and is getting more as time goes by. The European countries may be in the process of creating a new form of federalism.

Théotime Noël

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Reviewed by: Maria Ribeiro, Pedro Batista and Pedro Cruz

CULTURAL SUGGESTION

Considerations on income distribution

Economic policy in general and social policy, in particular, find justification on behalf of improving the distribution of welfare in a society. The solution that the market gives to the distribution of the results of economic activity is influenced[1] by factors that are strange to the market itself. The ownership structure of productive factors, natural gifts (intelligence, determination, and sympathy are examples), the ability to exercise political influence, the social and geographic context of the individuals; all of these have a saying in the process.

Therefore, the justification for policy on these matters relies on the objective of reducing the dispersion of these results and approximate the final outcome to what society sees as fair. In other words, the aim, the majority of the time, is to reduce inequality.

Notice that in the first paragraph we referred to the distribution of welfare. The question is: how do we measure welfare? Welfare is not directly quantifiable (that is, we cannot attribute a value to how much welfare a certain individual or society has). Thus, a question that arises relates to how to find an equivalent measure of welfare, something that allows for empirical analysis when addressing these issues. Most of the analysis conducted with real data emphasizes the measurement and distribution of variables such as income, consumption, expenditure, or wealth.

Throughout this article, the focus will be on the distribution of income[2]. That is, we are going to use income as a proxy for welfare. Income is made essentially[3] of earnings, rents on capital, transfers, and others. Perhaps the most comprehensive definition is the *Haig–Simons income*[4]: it defines income as consumption plus the change in net worth over a period of time (a year for example). In practice, however, measured income falls short of this definition.

Furthermore, in order to correctly access this matter, two notes must be made before we proceed:

One is that we should be careful when comparing incomes across individuals, regions, or countries, in the sense that there are going to be geographic and social differences in prices. Throughout this article, comparisons will be made mostly based on one of the most relevant aspects of distribution: dispersion[5].

[1] How land, capital and labor are distributed across a society.

[2] Throughout this article, by income distribution we mean personal income distribution.

[3] Self–production and lotteries are examples of other incomes.

[4] The definition was developed by the American economists Robert M. Haig and Henry C. Simons in the 1920s and 1930s. Although some may argue that the definition is tautological, it fits our illustrative purpose.

[5] Dispersion is a reflection of inequality.

Secondly, it is important to adjust income for the household size. Think of two households: one household has two working adults and the other household also has two working adults (earning the same income as the first two) but with two children.

This last household will not have individuals with the same welfare as the first household (although they have the same income), since there are *more mouths to feed*. Therefore, most of the statistics here will refer to equivalised income[6] (by using what is called equivalence scales), in order to take this into account.

But if we are interested in how unequal the income distribution may be, it is also interesting to perceive the extent to which there is income mobility within an economy. That is, to what extent there is a "social elevator" that allows individuals to achieve other levels of income. Furthermore, another way to approach this question is to look for drivers of this same mobility[7].

Regarding the comparison between inequality across countries, the statistics presented here are *recent* and refer to Portugal and other EU countries.

However, as we approach the other mentioned topics, a broader geographic perspective will be taken, the main reason being to make the analysis more interesting. The drawback from this is that the data will not always be the most recent. This is mainly due to the fact that the idea here is not so much to compile statistics on these matters, but to enlighten some of the ideas around these topics and to stir up the intellectual curiosity of the reader to look up the mentioned references.

We'll start with the numbers and the comparisons, as mentioned. The distribution of income may be portrayed and summarized in a number of ways. One way of doing it is by using an index of inequality.

The index that is presented here is the Gini index, in particular, the *Gini coefficient* of equivalised disposable income[8]. The Gini coefficient measures the inequality among values of a frequency distribution (the scale goes from 0 to 1). A value of 0 expresses perfect equality, an economy where all individuals have the same income. A value of 1 expresses maximum inequality.

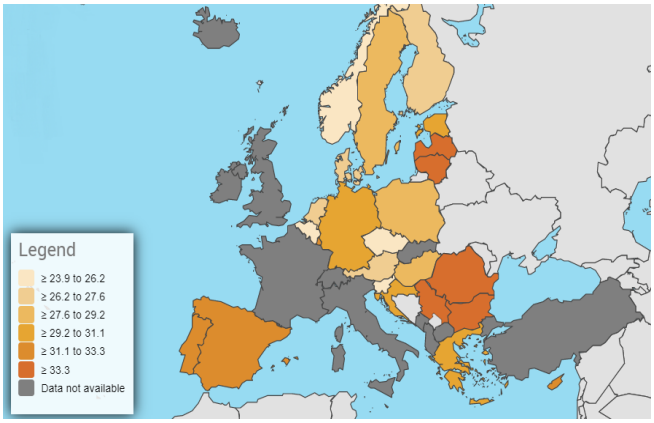
The map on the next page gives colors for different classes of values of the Gini coefficient (in %) for

[6] Each household type in the population is assigned a value in proportion to its needs. The factors commonly taken into account to assign these values are the size of the household and the age of its members (whether they are adults or children).

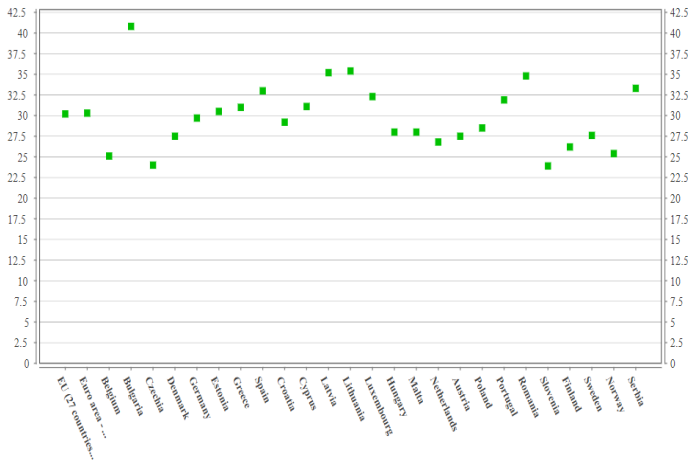
[7] To what degree does our parents' income or our parents' education play a role? What about biological factors such as genetic heritability or assortative mating?

[8] The amount of income that households have available for spending and saving after income-taxes have been accounted for.

2019 for all EU countries from which data was available[9]. On the other hand, the scatter plot specifies what these values are.



The value for Portugal is 0.319, slightly higher than the EU (27 countries) average (0.302) and the Euro area average (0.303). The lowest value is from Slovenia (0.239), with the highest being from Bulgaria (0.408).



Although other criteria could have been used, it can be interesting to select values for other EU countries with close[10] GDP *per capita* in *Purchase Power Standards* (PPS) to Portugal and see where they sit relatively. The selected countries were: Estonia, Lithuania, Hungary, and Poland. Their Gini coefficients are: 0.305, 0.354, 0.28 and 0.285, respectively.

This puts Portugal in a relatively more unequal position, in terms of the distribution of income, when compared to these countries, with the exception of Lithuania.

Following our discussion, in particular, the aspects referred to in the first paragraphs, one thing that is interesting is to try to capture the effect of social transfers on these values.

From the same data source and for the same year, the value for the Gini coefficient for Portugal before taking into account social transfers (pensions included) was actually 0.55. This discrepancy clearly reveals the impact of redistribution on reducing inequality.

The value for the EU (27 countries) average was 0.503, which confirms the effect. The table below shows the values for the countries that served as examples.

Portugal	55.0
Lithuania	50.3
Hungary	47.9
Poland	46.5
Estonia	44.5

The largest observed difference was actually in Portugal. Notice that, if we did not take transfers into

[9] Source: Eurostat.
[10] The data is from 2020. The adjustment for PPS is made in order to correct for differences in purchasing power across the EU countries (EU-27). Source: Eurostat.

account, Portugal would be sitting in last, meaning that it would be the country with the most inequality in terms of income. It is also interesting that Estonia is surpassed both by Poland and Hungary when we take these into account.

One point is worth mentioning: it is important to understand the extent to which this dispersion in incomes is due to factors under the control of the individuals or to factors the individuals have no control over. Of course, here we are not looking into a relative perspective (comparison across countries dispersions), but to explain inequality within each country.

The idea is basically to differentiate the outcomes of inequality driven by the individual life choices from the inequality that is caused by the individual's circumstances, like the place of birth, sex, race, and many other aspects. The inequality that is due to factors beyond the control of individuals can be thought of as inequality of opportunities.

In this sense, if inequality of opportunities is largely correlated with inequality of results, then there is certainly room for finding policies to try to dissipate these discrepancies in opportunities. It is largely thought that, for example, promoting equal access to quality education is a starting point[11], but there are many other ideas here.

There has actually been some progress in trying to measure it[12]. The evidence seems to suggest that an important portion of income inequality observed in the world today cannot be attributed to differences in individual efforts or responsibility. On the contrary, it can be directly ascribed to exogenous factors. In addition, the data seems to point out a positive correlation between inequality of opportunities and income inequality.

This point is intrinsically related to the idea of labor mobility that we've talked about in the beginning of the article. We are actually going to address income mobility from two perspectives: income mobility over a certain period or the life course and intergenerational mobility[13].

Going back to the analysis with the index of inequality, notice that the degree and form of labor mobility have major implications for our assessment of income inequality within and across countries.

People's incomes are constantly changing over time. Inequality measures observed only in a certain point in time (such as the Gini coefficient) reflect only a snapshot of levels of inequality among individuals. It is in this sense that it is

[11] See for example: Shields, Liam, Anne Newman, and Debra Satz, "Equality of Educational Opportunity", The Stanford Encyclopedia of Philosophy (2017).

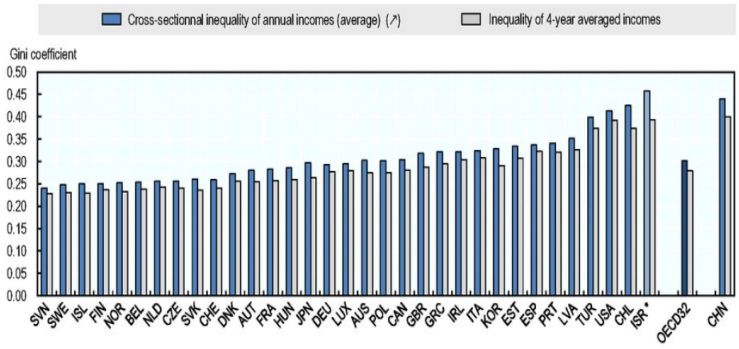
[12] See for example: Brunori, Paolo; Ferreira, Francisco H.G.; Peragine, Vito. 2013. Inequality of Opportunity, Income Inequality and Economic Mobility: Some International Comparisons. Ferreira et al.

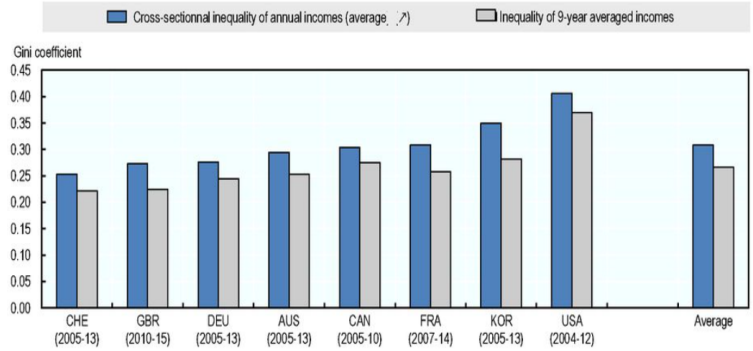
[13] For these ideas, we will follow closely the OECD report: A Broken Social Elevator? How to Promote Social Mobility (2018).

worth talking about intergenerational labor mobility.

As Milton Friedman put it: "Consider two societies that have the same distribution of annual income. In one there is great mobility and change so that the position of particular families in the income hierarchy varies widely from year to year. On the other, there is great rigidity so that each family stays in the same position year after year. Clearly, in any meaningful sense, the second would be the more unequal society."[14].

Following this reasoning, we may comprehensively state that a measure of average incomes over a longer period is better reflecting the welfare of individuals, capturing the persistent inequality (*Shorrocks*[15], *A.*; *Gary S. Fields*[16]).





With this being said, the two graphs above report cross-sectional data on the inequality of annual incomes (average inequality of a 4-year and 9-year period) and, inequality of 4-year and 9-year averaged incomes, respectively. On the first graph, data refers to 2011-14 for all selected countries except Australia, , Germany, Ireland, Korea, Switzerland and Turkey (2010-13), Canada (2007-10), and Chile (2006-09).

On the second graph, data refers to 2007-14 for France, to 2005-13 for Australia, Germany, Korea, and Switzerland, 2004-12 for the United States, and 2005-10 for Canada.

Although the ranking among countries does not change when incomes are assessed over a four-year span, some differences between countries can be observed. The estimates for a long duration (over ten years) suggest that inequality declines further as the reference period is extended.

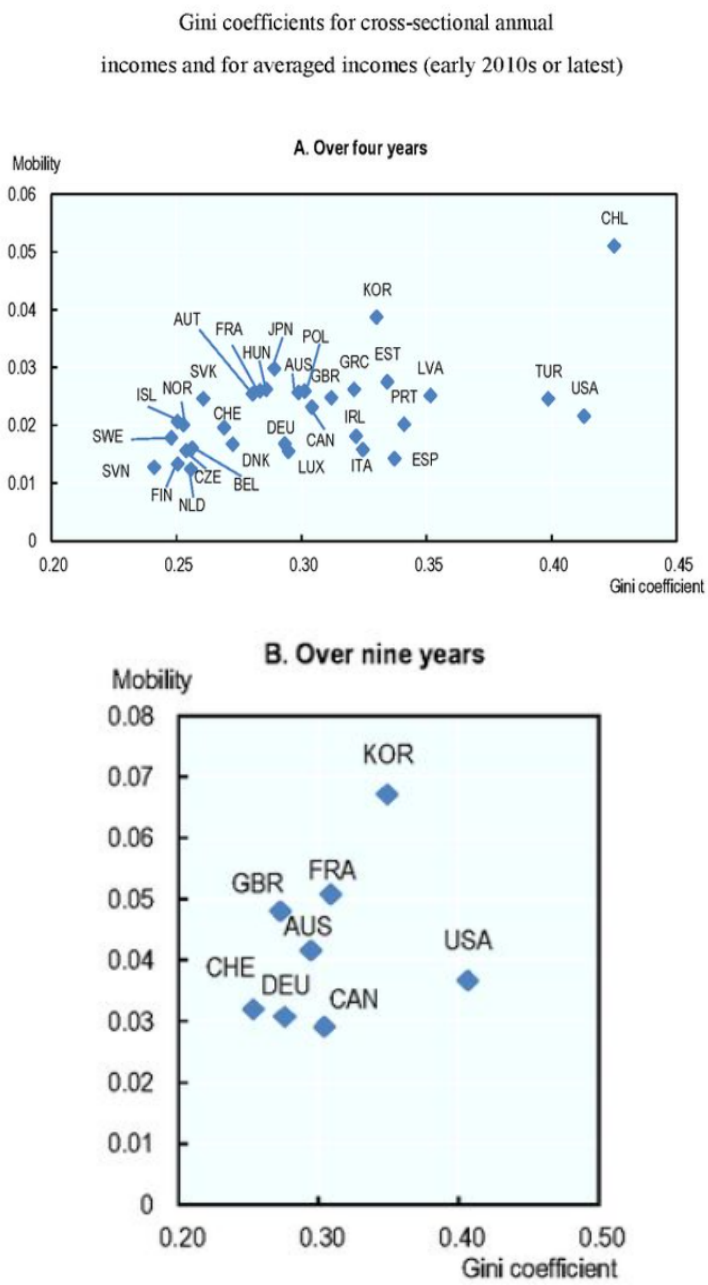
Notice that, in the OECD, on average, the Gini index for the working-age population (18-65 years old) stood at 0.302 on average between 2011 and 2014. The Gini index of averaged 4-year incomes was slightly lower, at 0.279, indicating that income mobility decreased the level of inequality by 2.2 points.

[14]Milton Friedman (1962), Capitalism and Freedom.
[15]Shorrocks, A (1978), Income inequality and income mobility, Journal of Economic Theory.
[16]Gary S. Field (2009), Does income mobility equalize longer-term incomes? New measures of an old concept.

Income mobility lowers long-term inequality more in countries like China, the United Kingdom, Chile, Korea, and Japan, and in the Central Eastern and Baltic European countries, for instance, when compared to Slovenia, the Netherlands, Finland, and Spain.

Therefore, it seems that the reduction of inequality due to income mobility is somehow greater in more unequal countries. However, although this is true, it is not to an extent that changes their relative position to other countries (in terms of index ranking). Consequently, it gives us a weak correlation sense between this indicator of mobility and inequality in the distribution of income, as the next figure[17] suggests.

The literature on this topic does not point us in a clear direction. On one hand, it is argued that wider inequality is the result of larger scale mobility processes. In this sense, inequality would not represent a problem for as long as the large mobility compensates for it (e.g. *Friedman*, 1962). On the other hand, other authors seem to suggest that a more unequal income distribution implies bigger steps to climb up in such a way that labor mobility isn't enough to compensate for (e.g. *Paul Krugman*, 1992).



Several researchers looked into this[18]. For example, Alves and Martins (2012) focused on European countries in the period going from 2005 to 2009 and concluded that income mobility does not substantially alter the income inequality ranking of EU countries. Burkhauser and Couch (2009), comparing the United States and Europe, concluded that greater inequality is weakly linked to greater intra-generational mobility.

[17] The data for this figure is the same.

[18] Besides the mentioned, see also: Aaberge and Mogstad (2014), for comparison between the US and the Nordic countries; Chen (2009) who compares the US, Canada, Great Britain and Germany (during the 1990s); Chan et. al (for China); Clement (2016) for comparison between US, Germany and Great Britain.

In the next part of the article, we're going to address the perspective of intergenerational mobility. Finally, we will finish with a look at some particular out-of-the-box interesting factors that may influence the distribution of income and that can be added to this discussion.

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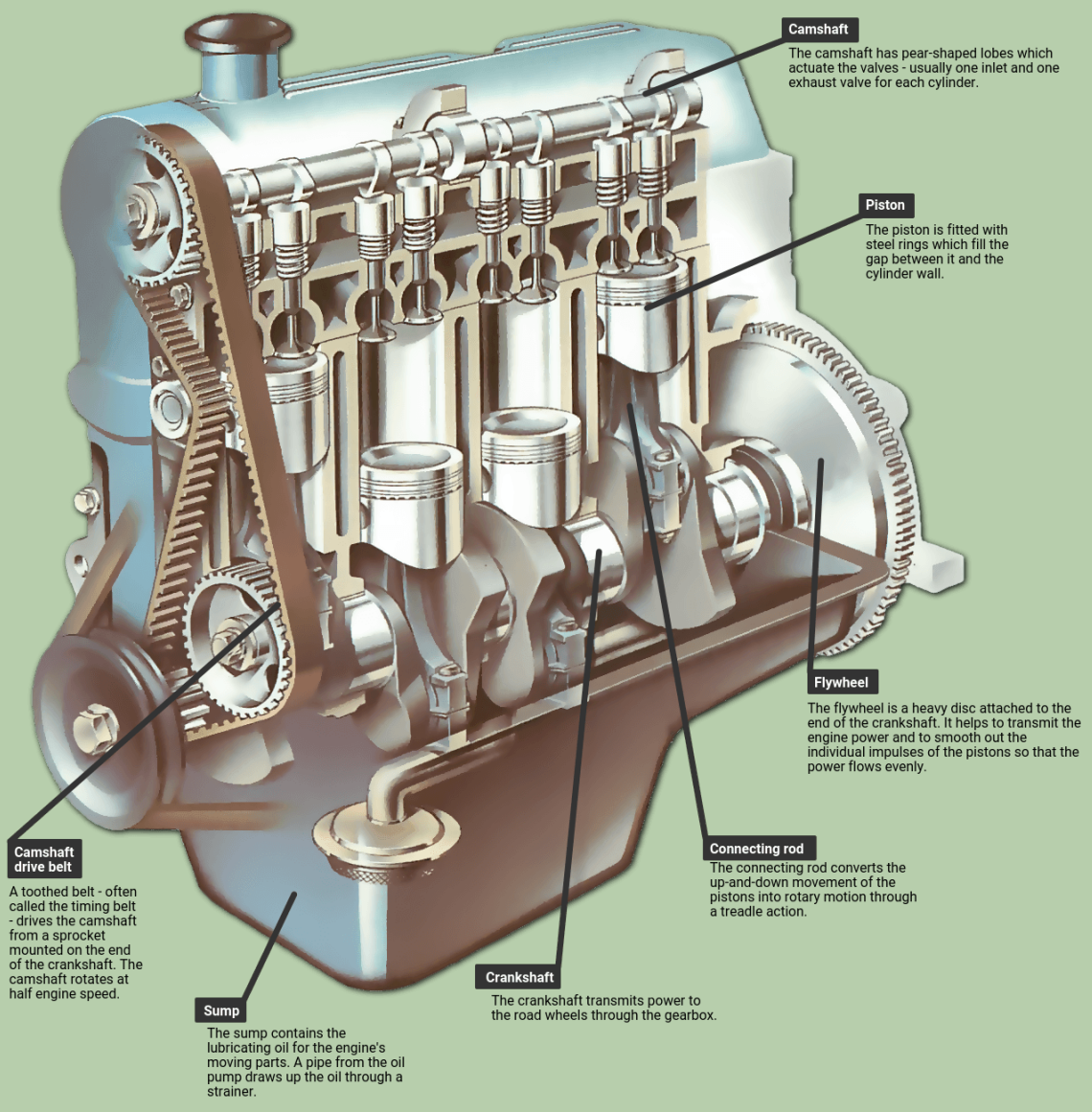
Reviewed by: Rita Pinho and Maria Henriques



Why Germany is Europe's Double Motor

Germany, as we know it today, is only this way since 1989, when the Berlin Wall fell, and the two sides of Germany reunified. This makes us think. The biggest European economy and the 4th in the world, according to the World Bank, has only been stable for the past 31 years. How could this have happened? What can account for this great success?

First of all, to understand the Germans, we need to know the **history of their country** so we can comprehend the present.

In 1517, when Germany was still called Holy Roman Empire, the monk Martin Luther published a pamphlet with 95 Theses that he posted in the town square of Wittenberg and handed copies to feudal lords. The list detailed 95 assertions, he argued, represented the corrupt practice of the Christian faith and misconduct within the Catholic Church. This was the **beginning of the Protestant Reformation.** The ideas of the Reformation spread rapidly, as the new technology of the modern printing press ensured cheap mass copies and distribution of the theses and helped by Emperor Charles

V's wars with France and the Turks. So, the Germans converted to the Protestant religion which had great results in their development.

In the Catholic religion, the Bible was written in Latin and, at the time, translations weren't allowed, but Martin Luther translated the Bible to German to encourage the people to read It individually and to meditate on It. Therefore, the literacy rates increased as well as the primary school enrolment. The gender gap in school enrolment decreased. As a consequence, there was a higher capability in reading, numeracy, essay writing, and history which led to a higher human capital formation, so the workers were more skilled. Hence, with this new asset, the labor force increased its productivity. According to Becker and Woessmann, they suggest that the bettereconomic performance of Protestant regions should be linked to their higher human capital generated by the ability to read the Bible.

We could also say that The Lutheran religion is against spending lots of time and money money on leisure. With this new Protestant ethic, the religious worked more hours and they were less satisfied when unemployed. In conclusion, at the time, they were almost Puritans. With all these changes, and **working more hours more productive**, the Protestant cities grew a lot, and these cities ended up being **industrialized.**

Therefore, the regions where Protestantism rooted **increased their** GDP *per capita*, all thanks to the way they started viewing life and its multiple parts. According to Deirdre McCloskey, there are only evolutions when people start to think differently, and we can see with clarity this happening at the time. When the population started to think that working more and investing in education was not wrong, they started to grow and with this new philosophy, these regions augmented their wealth, although they did not spend it. Instead, they saved a lot because they had a sparing lifestyle.

After the reformation, Germany continued with its multiple changes. In 1871, the German Empire was formed, and, as we know, in 1914, it joined World War I to support Austria-Hungary. After 4 years of war, in 1918, the Allied won and the German empire lost the war. Afterward, the empire was dissolved, and the Weimar Republic was formed.

The humiliating peace terms in the Treaty of Versailles provoked bitter indignation throughout Germany, and seriously weakened the new democratic regime. In 1929, with the Wall Street Crash, began the Great Depression, which hit Germany as hard as any other nation. In July 1931, the Darmstätter und Nationalbank, one of the biggest German banks, went bankrupt. On top of the collapsing economy came a political crisis. As a consequence, in 1933, the Nazi party won the elections and Adolf Hitler gained the power to rule Germany.

On 1 September 1939, Germany invaded Poland. On 3 September, France and Great Britain declared war on Germany and the Second World War began. At first, Germany was very successful in its military operations but, in the course of the war, Hitler started to lose his advantage in December 1941, when the invasion of the Soviet Union hit determined resistance in the Battle of Moscow. By April 1945, Soviet and Polish forces stormed and captured Berlin. On 30 April, the Reichstag was captured, signaling the military defeat of Nazi Germany. Hitler committed suicide on 30 April 1945. World War II destroyed Germany's political and economic infrastructure and led directly to its partition, considerable loss of territory (especially in the East), and historical legacy of guilt and shame.

“The humiliating peace terms in the Treaty of Versailles provoked bitter indignation throughout Germany, ..”

As a consequence of the defeat of Nazi Germany, the country was divided into two blocks, the East and West Germany. East Germany was a totalitarian Communist dictatorship controlled by the Soviet Union that was a satellite of Moscow. West Germany was a parliamentary democracy, a NATO member and, a founding member of what since became the European Union.

East Germany didn’t grow much because of its system. West Germany, on the contrary, grew a lot and we are going to focus there.

In 1949, the three western occupation zones (American, British, and

French) were combined into the Federal Republic of Germany (FRG). At that time, we cannot forget that FRG had a skilled workforce and a high technological level, but its capital stock had largely been destroyed during and after the war. Allied Forces had attacked or bombed large parts of its infrastructure. In short, Germany was a ruined state facing an incredible bleak future. Although, we know that when the Berlin Wall fell, Germany was already the third biggest economy in the world, only behind the USA and Japan, in terms of GDP. How could this have happened?

After the war, industrial production was down by a third, and food production was half the level it was before the start of the war. Many of the nation's men between the ages of 18 and 35, the demographic which could do the heavy lifting to rebuild the country, had either been killed or injured. During the war, the civilian population was limited to no more than 2000 calories *per day* because of food. After the war, the Allies continued this food rationing policy and limited the population to between 1,000 to 1,500 calories *per day*. Price controls on other goods and services led to shortages and a massive black market. Germany's currency, the Reichsmark, had become completely worthless.

Perhaps the person who made the difference in this miracle was **Walter Eucken**. He was an economist and a teacher at theUniversity of Freiburg after World War I. Eucken gained followers at the school because it was where he began to develop his economic theories, which became known as the Freiburg School, ordoliberalism, or the **"social free market"**. His ideas were firmly rooted in the camp of **free-market capitalism** while also allowing a role for **government involvement** to ensure that this system worked for as many people as possible. For example, strong regulations would be put in place to prevent cartels or monopolies from forming. Another measure would be to have a large social welfare system that would serve as a safety net for those who were found struggling. He also supported having a strong central bank, independent from the government, which focused on using monetary policies to keep prices stable. This type of economic system was completely different from those which were seen at the time.

As West Germany was in its beginning, they didn't know what the new state's fiscal policy should be.

Lots of people wanted to have a system that still maintained government control. But a disciple of Eucken, **Ludwig Erhard**, who became known as the "father of the German Economic Miracle", was appointed to the position of the finance minister of Bavaria and then climbed to the director of the

economic council of the FRG.

Once he gained political influence, Erhard formulated a plan to improve West Germany's economy. First, he played a large role in formulating a **new currency** issued by the Allies to replace the worthless Reichsmark. This project would reduce the amount of currency available to the Germans by 93%, a decision that would reduce the already little wealth that German individuals and companies held. Besides, large tax cuts were also instituted in an attempt to promote spending and investment. In an extremely criticized move, Erhard decided to remove price controls on the same day that he introduced the new currency. This decision was considered to be crazy. He was even called to the presence of the commanding officer, the US General Lucius Clay, due to his advisors informing him that his plan would be a mistake. Erhard responded: "Don't listen to them, General. My advisers tell me the same thing". Extraordinarily, he proved everyone wrong.

With spectacular speed, West Germany regenerated. Shops immediately became stocked with goods as people realized that the new currency had value. As a consequence, the black market ended. At the time, the commercial marketplace took hold and people were encouraged again to work, their sense of diligence returned. The results were amazing. In May of 1948, Germans missed around 9.5 hours of work a week to look for food and other necessities but in October, after the new currency was introduced and price controls were lifted, that number lowered to 4.2 hours. By the end of the year, industrial production was close to 80% of the 1936 level.

Germany also had the support of the European Recovery Program, better known as the **Marshall Plan.** This plan was only extended to Western Germany after it was realized the suppression of its economy was holding back the recovery of other European countries. It was implemented in 1948-1950 and it was seen as a way to modernize business procedures and utilize the best practices. It was crafted by U.S. Secretary of State George Marshall and the United States would give more than $15 billion (around $173 billion in 2020 prices) to European nations affected by World War II, with a large part of this money going to Germany.

Nevertheless, the success of the Marshall Plan has been debated by economic historians and some have estimated that aid from the **Marshall Plan contributed less than 5% to Germany's national income during this period.** In conclusion, we can say that this money was not the main force behind the Economic Miracle. This plan had a large part of *laissez-faire* which was criticized by Wilhelm Röpke, who influenced Erhard in his economic recovery

program. He said that the Marshall Plan for forestalling the transition to the free market by subsidizing the current, failing systems. As we already know, Erhard followed the ideas of Walter Eucken, ideas with which Röpke also agreed, and we know that Germany had a fantastic recovery. West Germany's growth continued over the years. By 1958, its industrial output was four times than it was in 1948. We call this economic miracle *Wirtschaftswunder.*

During this period, Germany was caught in the middle of the Cold War. Side by side, these two nations offered a perfect way to compare the two major economic systems in the world. There wasn't a lot to compare. While the West part improved, the east part got behind. Thanks to the struggling economy and lack of political freedoms, East Germany's residents protested and tried to leave the country. In November of 1989, the East German regime allowed members of its country to members of its country to travel directly to the other side of the Iron Curtain for the first time in decades. This led to the collapse of East Germany and the two nations reunited. But it would be a long time before the two sides would be on the same level. When the reunification began, the eastern parts of the country had only 30% of the GDP per capita of the western half.

This is a part of German history that explains why the country is so successful. They have lots of other reasons to explain their success. According to the OECD, only the

Dutch **work** fewer **hours** among the 34 members of the OECD because those few hours they work are productive ones. They also have **strong employment protection** legislation so the workers are willing to work fewer hours because they know that they will keep their jobs because of it. They were all the more willing to do so due to the stronger bond that exists between workers and employers compared with many other countries.

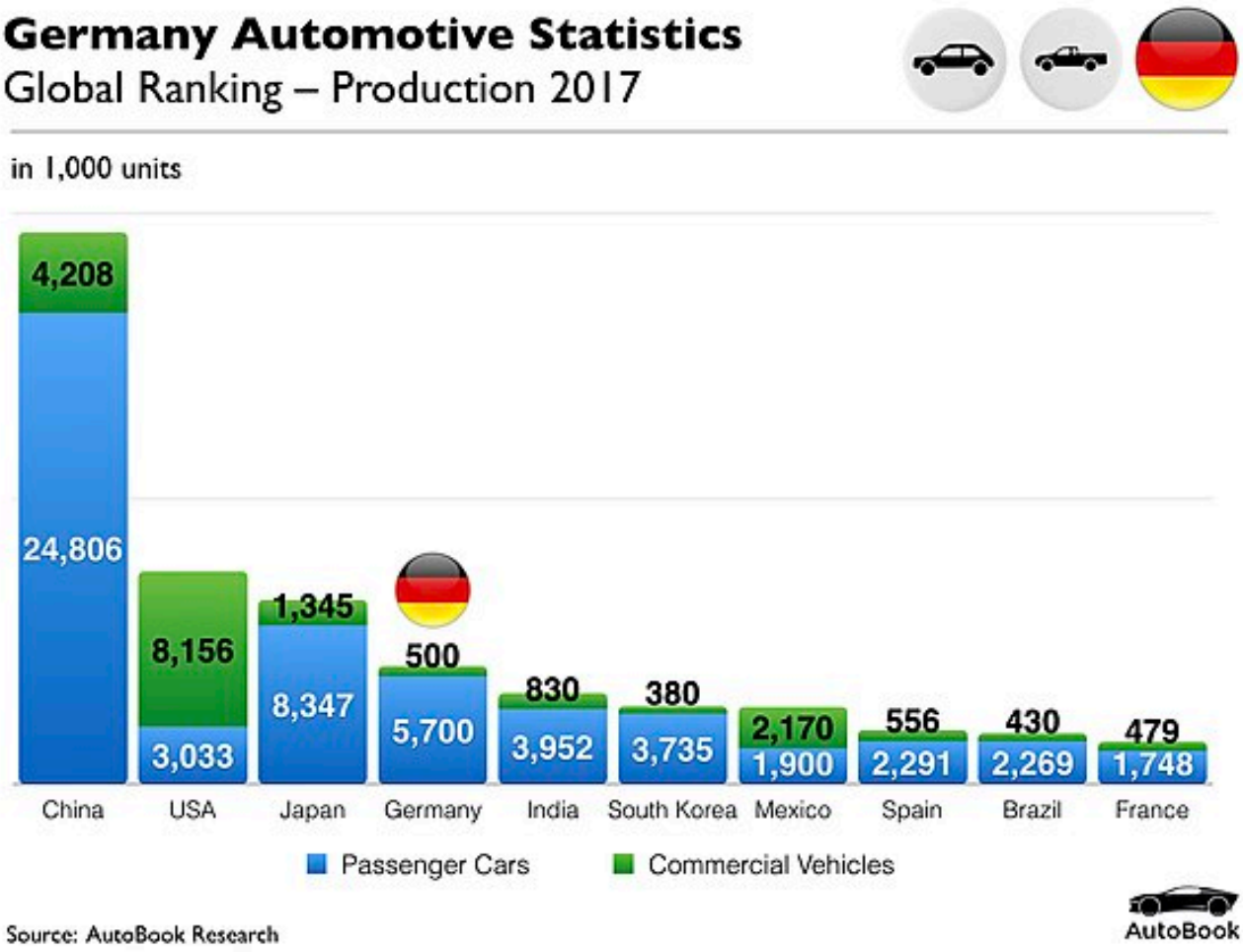
> "More Important still to Germany's industrial strength is the country's education system…"

More important still to Germany's industrial strength is the country's **education system.** The German model stands apart in the later years of schooling. Half of all the students in secondary school are in **vocational training** and half of these are in **apprenticeships.** Apprentices aged 15 to 16 spend more time in the workplace receiving on-the-job training than they do in classes and after some years they have almost guaranteed a full-time job. In Germany, there is less stigma

associated with vocational training. This education system provides a lot of skilled workers to meet the needs of the country's manufacturing base, which is rooted in the stable and small family businesses that are the backbone of the economy.

As we also have found above, Germany has a lot of manufacturing which is due to its **automotive industry**. This industry represents 24% of the total domestic industry revenue of Germany and is one of the largest employers in the world and has the third-highest car production in the world. With an annual output of close to six million (2017) German-designed cars won in the European Car of the Year, the International Car of the Year, and World Car of the Year annual awards (2017). As we can see, cars are of high quality and play an important role in the economy. They also have their history.

Motor-car pioneers Karl Benz (who later started Mercedes-Benz) and Nicolaus Otto developed four-stroke internal combustion engines which led to the design of the modern-day motor car and by 1901, Germany was producing about 900 cars a year. The collapse of the global economy during the Great



Depression led the German auto industry to a severe crisis. Barely twelve companies survived. The turnaround for the German motor industry came about in the mid-1930s following the election of the Nazi Party to power. The Nazis instituted a policy known as *Motorisierung* (motorization), a transport policy which Adolf Hitler himself considered a key element of attempts to legitimize the Nazi government by raising the people's standard of living. It was also conceived the *Volkswagen* project whose main objective was to design and construct a "people's car", the product of which was the *Volkswagen Beetle*, launched in 1937. When World War II finished, a great part of the auto factories had been damaged. The *Volkswagen* production facility in Wolfsburg continued making the *Beetle* in 1945. By 1955 they had built 1 million and in 1965 the number increased to 10 million. This is often why this car is associated with *Wirtschaftwunder*. Thereafter, the automotive industry increased once again in lots of brands Germany had and has lots of car types, going from the family vans to the luxurious cars so it is not a surprise that vehicle construction is the strongest sector.

After seeing the bigger assets that Germany has, we can understand why one of the three largest exporting nations is this country and why it is called Europe's Double Motor and Europe's biggest economy. Their economic system, on the one hand, is based on capitalist competition, but on the other hand, it still allows the state to provide social correctives. Along with this system and the institutions that came with their turbulent history we can easily realize their success and explain it. Although these measures could not work in other countries, we have seen that in Germany they had excellent results. For a country that lost two world wars, no one was expecting this outcome but here we are today, with a country of which's economy is enviable across Europe.

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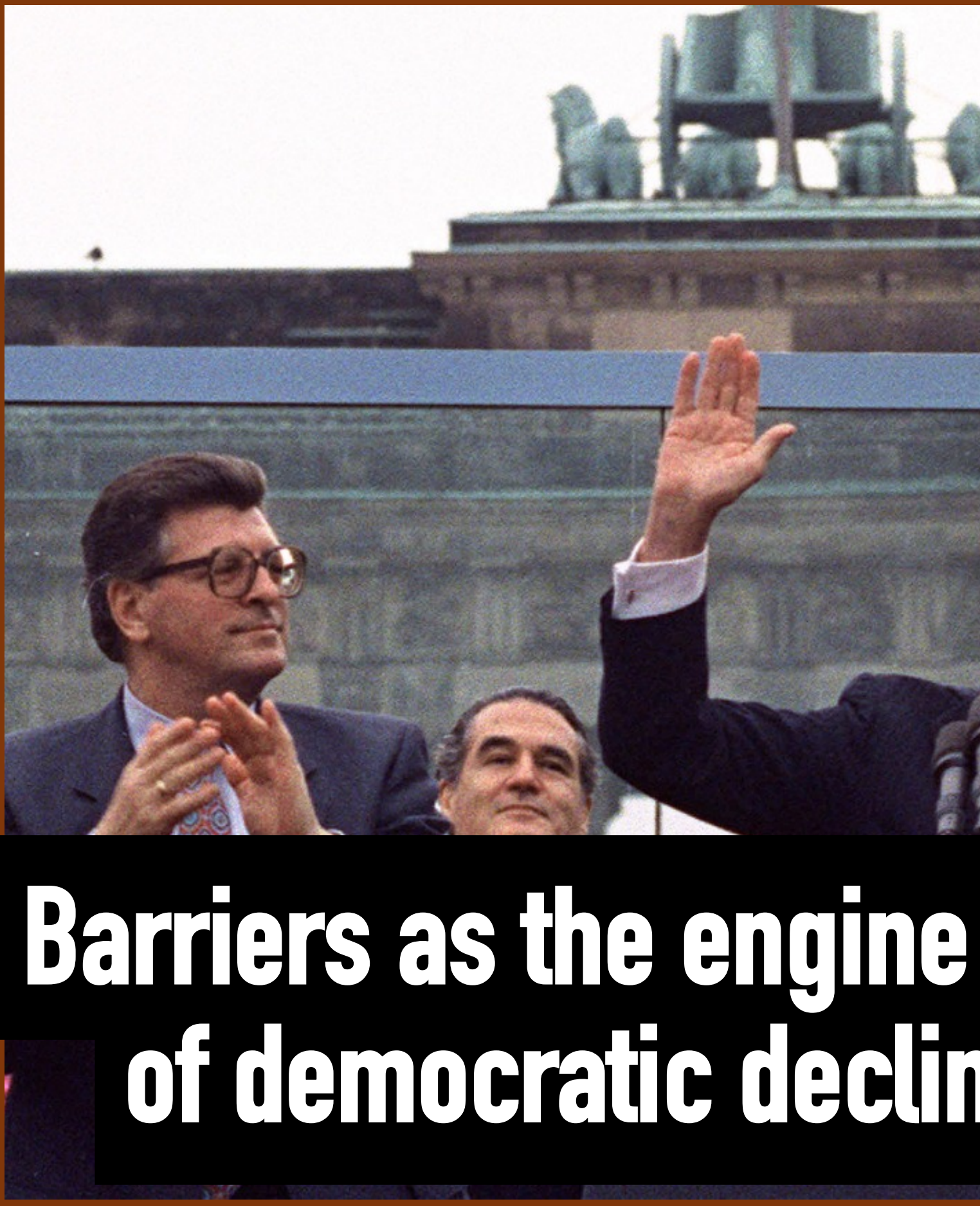
Reviewed by: Mariana Santos and Joana Severino



Barriers as the engine of democratic declin

Thirty-one years ago, a wall fell, ushering in what appeared to be a new era of openness and internationalism, where Berlin, Germany, and then Europe were increasingly united. Two years before Berlin's wall was overthrown, President Ronald Reagan said to his homologous in the Union of Soviet Socialist Republics (USSR), in 1987, "Mr. Gorbachev, tear down this wall!".

However, we may say that lately, the meaningful call "tear down the wall" has been replaced by the call "build the wall", a fortress mentality that seems to earn more and more strength in the face of the frightening escalation of mass migration, the reactions against globalization, the resurgence of Nationalism, the collapse of Communism and the 9/11 attacks and their consequences.

The construction of walls on borders around the world without many people realizing it is now a worldwide phenomenon. Thousands of kilometers of *walls* have been erected around the world throughout the 20th century. At least 65 countries, more than a third of the world's Nation-States, have built barriers along their borders. Half of the walls built between WWII and today, have been built after the year 2000. In Europe alone, in a few years, there may exist more *walls* than those at the time of the Cold War.

If, on the one hand, globalization has brought us closer to each other, allowing the increase of

1- Professor at the Faculty of Ecomics of the University of Coimbra, where he teaches in the area of European Economic Integration.

international trade and the reduction of barriers to the movement of people and capital – important achievements that have cemented a long period of peace and prosperity – on the other hand, it also has inspired us to build barriers, especially after the 2008 financial crisis. With the perception of additional threats, such as terrorism, violent conflicts, refugees and immigration, the widening gap between rich and poor, people have clung more tightly to their groups. In this sense, the concept of globalization has therefore become a synonym of instability for some countries in recent years due to the inability to control the capital and wealth system, which has been marked by volatility, uncertainty, and speed in the transfer of financial flows, posing a threat to national unity, economic progress and power.

Protectionism often arises from the instability and insecurity that many countries feel about international trade. The word "protectionism" itself presupposes that there is a weaker group that must be defended from a stronger one and, if not, it will be harmed by this alleged unfair competition. Thus, many countries end up adopting protectionist measures to protect, at first, their economies through the search for, at the limit, self-sufficiency that in all stages is not sustainable.

According to Alfredo Marques[1],

protectionism is "the existence of obstacles to the penetration of foreign goods, services or factors of production in a country's domestic market. However, the measures adopted by national governments to facilitate the penetration of national products or factors of production in foreign markets are also ways of protecting the national economy.". Therefore, protectionism is a way of government intervention by limiting trade with the outside through the collection of tariffs/customs duties and the imposition of quotas that fix maximum import quantities, allocating subsidies to production, and manipulating the value of the currency.

Protectionism can be justified by the *Infant Industry* argument, or as the support for High-Tech Industries and Externalities, or even in cases of imperfect competition and strategic commercial policy; the ultimate goal of these policies are, according to protectionism advocates , to help create domestic jobs, increase Gross Domestic Product (GDP) and make the country's Economy globally more competitive. However, it should be noted that, in the long run, protectionism brings disadvantages to the countries' domestic economies and, ultimately, it ends up causing a slowdown in GDP *per capita* growth or even a stagnation: protectionism not only generates inefficiency, as it increases prices for consumers but also leads to the accommodation of national companies and consequent technological backwardness, since companies have no incentive to innovate, thus not encouraging progress; it is biased, benefiting mainly private interests, with no adequate social cost-benefit analysis.

A relevant example is the case of the two edified Germanies. In 1945, Germany was in ruins. No-one – not even the occupying powers – was, at this time, certain what the future would hold. Yet, during the next four decades, two very different Germanies emerged. In the west side, the Federal Republic of Germany developed into a politically stable and economically prosperous capitalist democracy – it established a booming economy due to cheap labor costs and the increase of demand for goods after the Second World War, which quickly propelled them to become one of the strongest economies around the world; in the east side, even though the German Democratic Republic had proven to be economically be the most productive state in the communist bloc, it turned out to be less developed than their western brother: it had lower levels of education and higher unemployment rates. Additionally, East Germany relied on heavy industry and public employment, similar to many Soviet countries, at the time. As a result of its centrally planned Communist Economy,

there was little innovation and entrepreneurship, and the uncompetitive industries that existed were not financially feasible after the reunification. This meant that the new German government had to provide welfare for those who lost their jobs, adding this way further costs to the state.

The subsequent economic restructuring and reconstruction of eastern Germany resulted in significant costs, especially for Western Germany, which spent large sums of money, to rebuild eastern Germany's infrastructures. Peer Steinbrück[2] said during an interview in 2011, "20 years of German reunification has cost 2 trillion euros or an average of 100 billion euros a year.".

Another relevant example is the case of North and South Korea, which shared the same history and cultural roots, such as language, ethnicity, disease environment, *per capita* income, etc... When the Korean peninsula was divided into two, we were left with a highly protectionist North Korea very different from capitalist South Korea.

In 1998, South Korea's GDP *per capita* was about seven times greater than North Korea's. These substantial differences arise from democratic and institution deficiency of North Korea and, a closed economy with very little opening to international trade and high demand for self-sufficiency, while South Korea flourishes from an opening to international trade. This resulted in a minimal growth and minimal economic development, marked, at the limit, by economic stagnation, regarding North Korea, and, on the other hand, high economic growth in South Korea.

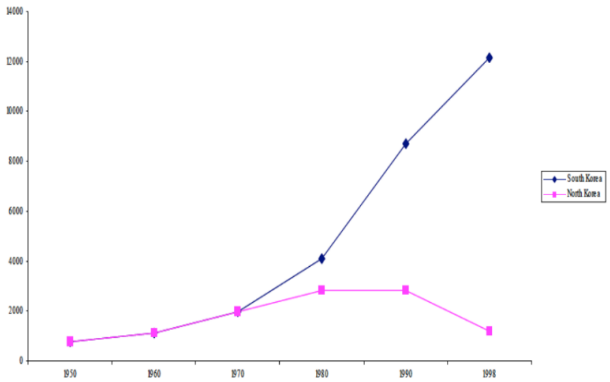


Fig. 1: GDP per capita in North and South Korea since the separation (Source: Acemoglu et al. (2005))

The first conclusion that emerges is that international trade brings advantages to economies. It allows them to increase both their welfare and income – by optimizing the allocation of their resources in production according to countries' comparative advantage, and by minimizing the incentives for unproductive activities associated with protection, such as smuggling, lobbying, and tariff evasion.

The second conclusion that emerges is that institutions, especially the economic and

2- German Politician who was Federal Minister of Finance – 2005-2009 – and was the Chancellor-candidate of the Social Democratic Party (SPD) in the 2013 Federal election.

democratic ones, have a preponderant role in economic performance and development since they are responsible for innovation, economies of scale, education (as a factor of human capital), capital accumulation, among others. Thus, economic institutions, on the one hand, influence economic results through the effect of the incentives they give to economic agents – economic performance –, and, on the other hand, they have an impact on the way the resources are distributed/divided by the parts. Knowing that institutions result from a conflict of interest between the various groups of society, the winners of this conflict are the ones who will have great political power and, therefore, define the institutions. In a situation of protectionism, in which producers are benefited to the detriment of consumers, who are worse off than in a situation of free trade, and, ultimately, to the detriment of the benefit that would result for society, the institutions that are selected are not exactly chosen to maximize the size of the "pie", i.e., the objective of maximizing efficiency, but rather, in favor of their private interests, consecutively generating a problem in the distribution of the resources. It must be taken into account that the more economic resources an organized group can muster, the greater the influence in the redistribution of political power they will have.

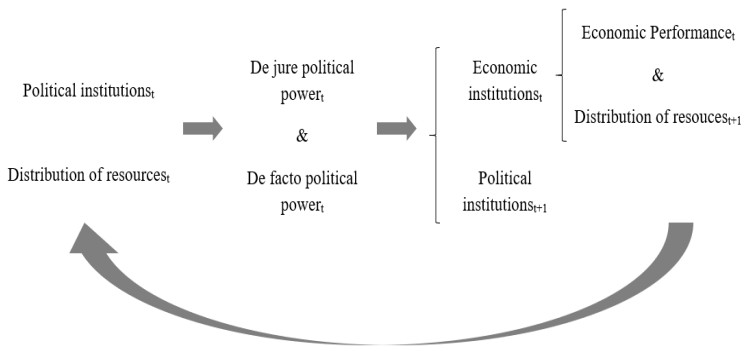


Fig.2: Endogenous dynamics of institutions. (Source: Acemoglu et al. (2005).)

The institutions that result from the type of political power above described are extractive institutions, which are not only biased in the economic "game", given the lack of law, the property rights, the insecurities, the extreme market regulations, the barriers to economic activity, etc., but also, tend to absolutism, i.e., to concentration and to grow the power they seek. Therefore, when, in a country, institutions are extractive, the economy tends to stagnate, because those who have political/economic power (those who are adverse to change) do not want to lose their privileged incomes/positions.

In contrast, the institutions that result from an opening to international trade are inclusive institutions that are related to the encouragement of investment, to the smooth functioning of markets (even with state intervention), to the access to education, to economic opportunities for all, etc., and, therefore, it allows a broad base of participation and limits power to some effective rules. Besides, there is

also an incentive for technological investment, even if the old technological resources have to be destroyed.

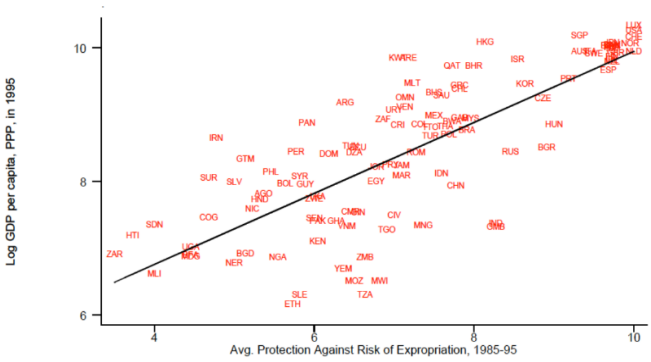


Fig.3: Average protection against the risk of expropriation 1985–95 and log GDP per capita 1995 (Source: Acemoglu et al. (2005))

This figure shows there is a linear relationship between log of GDP *per capita* and the protection against the risk of expropriation. On average, the more inclusive the institutions are, the higher the country's GDP *per capita* is, and vice versa. Therefore, protectionism, in the long run, contributes to even more divergence between countries – Sachs and Warner (1995) estimated that open economies grew about 2.5% faster than closed economies –, contradicting a natural convergence that should arise, according to Solow. In this economists' opinion, in the long run, the economies not only tend to the equilibrium but also converge.

Following the growing trend of building walls on borders and increasing protectionist measures in recent years, "in every region of the world, democracy is under attack by populist leaders and groups that reject pluralism and demand unchecked power to advance the particular interests of their supporters, usually at the expense of minorities and other perceived foes", according to Freedom House.

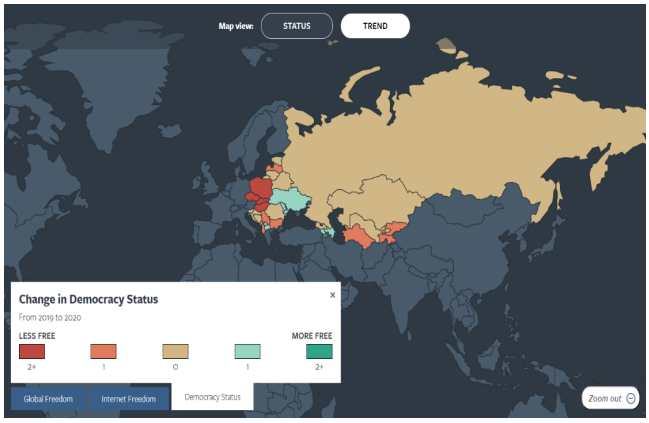


Fig.4: Change in Democracy Status between 2019 and 2020 (Source: Freedom House)

With the increase in migratory escalation in Europe, which reached its peak in 2015, countries like Bulgaria, Hungary, or Poland erected barriers on their borders, to prevent the entry of these migratory flows into their territories. But the isolation of these countries has not proved to be purely physical: over the past few years, these countries have been also a reflection of economic and commercial isolation, with the rise of protectionist measures and trade barriers imposed by them. Furthermore, in these countries, as well as around the world, there has been an increase in the power nationalist parties, through growth in the number of extractive institutions that to an absolutist tendency: according to Freedom House[3] Bulgaria's

3– Freedom House assesses democracies, assigning a score that incorporates separate classifications on national and local governance, electoral process, independent media, civil society, judicial structure, and independence and corruption.

democratic score decreased from 4.71 to 4.54 in a total of 7.00, from 2015 for 2020; Hungary's democratic score decreased from 4.82 to 3.96 in a total of 7.00, between 2015 and 2020 – in these 5 years, Hungary ceased to be considered a semi-consolidated democracy and started to be considered as a hybrid system or regime in transition –, and Poland's democratic score decreased from 5.79 to 4.93 in a total of 7.00, between 2015 and 2019 – in these 5 years, Poland ceased to be considered a consolidated democratic regime, becoming a semi-democratic, according to Freedom House.

Also, the atypical circumstances that have been experienced due to the Covid-19 pandemic, have, according to Carlos Gaspar[4], accelerated the trend of regionalist protectionism initiated in the 2008 financial crisis. According to this researcher, "interdependence, which was considered a crucial factor for cooperation in international political and economic relations, has become a factor of risk, conflict, and tension. The value chains, the international division of labor that makes things start to be produced in China, India, or Bangladesh and end up being finished in California or England or Germany", allowing cost-effectiveness, now represents risks. Therefore, the tendency is to continue to close borders. At the same time, the emergency measures taken all over the world to contain the Covid-19 pandemic, which allowed the States to face exceptional situations, temporarily limiting civil liberties and rights, and concentrating power in governments, increased the worsening of the situation, leading to the decline of democracies in at least 82 countries.

With the perception of threats, people cling more tightly to their groups.

To sum it all up, it is possible to conclude that there is a close relationship between the level of physical openness of the country on its borders, the level of openness of economies to international trade, the type of political and economic institutions, and the type of political power that governs a given country. Thus, the more physically closed a country is and the more protectionist its economy is, the more extractive its institutions are, the lower will be its democratic index and GDP *per capita.*

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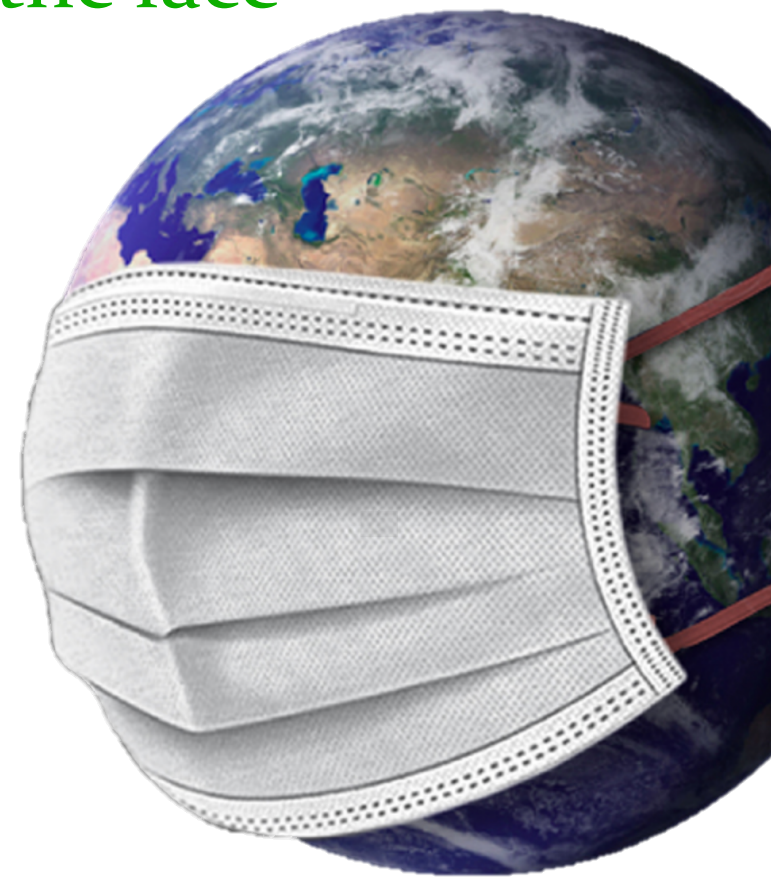
climate change in the face of the pandemic



2020 was a year of accumulating crisis. When promising agreements and commitments were achieved on the issue of climate change, a new emergent crisis burst onto our lives. The COVID-19 pandemic has resulted in widespread social and economic disruption, including the largest recession since the Great Depression. The impacts have been large and broad. On the environment, the closure of the world economy because of lockdown measures has caused an unprecedented drop in greenhouse gas emissions. On the opposite side, the pandemic has also put constraints on climate action, with some countries calling for climate measures and targets to be scrapped as long as the economic downturn isn't resolved. The climate emergency, however, will not momentarily dissipate. To that end, the fights against the COVID-19-induced recession and climate change must be juxtaposed into a single framework: a green recovery for eradicating transformation.

The Current Stance

Global fossil CO_2 emissions have been growing since the Industrial Revolution, with some sudden shocks caused by economic, social, and health disruptions like the pandemic itself. For several years, climate data analysts have demonstrated that CO_2 concentrations and temperature are procyclical: when the level of CO_2 in the atmosphere increases, so does the global average temperature.

This is caused by the greenhouse gas (GHG) effect, which, to a certain degree, guarantees that the Earth is survivable to humans.

The problem arises from anthropogenic interference in this system, that is, from human-caused emissions that enhance this GHG effect beyond what is optimal. While the resulting temperature anomalies are small, they cause defining changes in the climate system, increasing the likelihood of severe phenomenons such as heat waves and large storms, with irreversible impacts on human life and ecosystems.

Over the recent years, thanks to the international press and environmental activism, more and more people have diverted their attention to the global of climate change. This new public consciousness has pushed for a united commitment by over 190 countries to significantly reduce their GHG emissions in the coming years while investing in climate change mitigation and adaptation. The 2016 Paris Agreement is emblematic of that joint effort, aiming at keeping the increase in global average temperature below 2ºC above pre-industrial levels while making efforts to stay within the 1.5ºC boundary. This agreement left climate activists particularly hopeful because, contrary to the previous Kyoto Protocol, all signatory countries are required to prepare nationally determined contributions to the overall GHG emission reduction, take measures to achieve their targets, and report.

That being said, recent projections have demonstrated that even if all nationally determined contributions are met, that is, if all countries manage to reduce their GHG emissions according to their individually-set targets, the world would still find itself with 3.5ºC of warming, well above the Paris pledge.

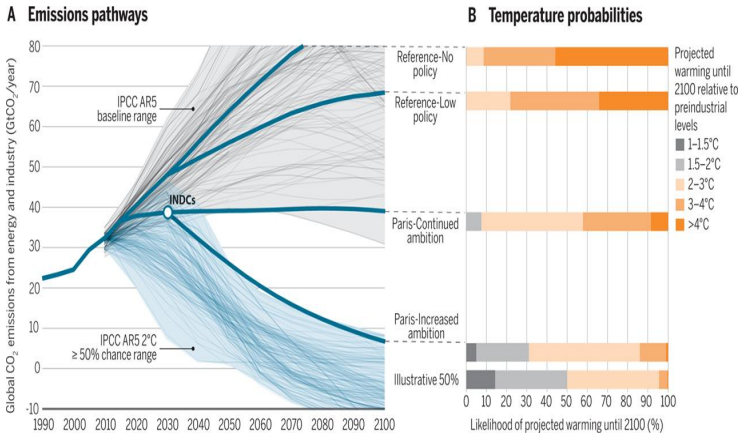


Figure 1: Global CO2 emissions and probabilistic outcomes of the Paris Agreement. Science (2018)

The pandemic, which one can see as a negative shock on the economy, resulted in an unpredictable decline in global emissions. Based on the duration of governmental restrictions and the magnitude of the recession, the Global Carbon Project suggests that global CO_2 emissions from fossil fuel and industry have declined by 7% in 2020, which would be the largest relative fall since WW2[1].

Particularly, the study estimates

1 – https://www.carbonbrief.org/global-carbon-project-coronavirus-causes-record-fall-in-fossil-fuel-emissions-in-2020

great contractions in some of the world's biggest emitters, including the US (12%), the EU (11%), and India (9%). The reduction in emissions in China, however, is expected to be much more modest. Indeed, as the Chinese economy's rebound quickly gathered steam, the epicenter of the pandemic is expected to reduce emissions only by 1.7%, slowing down global emission reduction.

The example of China shows how a quick and CO_2-based economic rebound can quickly bring emissions back to pre-pandemic levels. History tells us that this reduction in GHG emissions will be short-lived. After a significant drop in global emissions driven by the 2008 economic crisis, a quick rebound was registered in the early 2010s, suggesting that the way countries stimulate their economies after the pandemic crisis will shape future emissions.

In that regard, while a sudden drop in emissions will hardly slow down the pace of global warming, the post-corona world is a unique opportunity to combine an economic recovery with wide decarbonization progress.

The European Effort

This goal, however, is not unprecedented in the political debate.

To lead by example, the Von Der Leyen Commission presented the European Green Deal, a set of regulations and directives aimed at containing the effects of climate change. The EU Commission President called it "Europe's man-on-the-moon-moment", as it aimed to make the EU carbon neutral by 2050 while delivering on the Paris Agreement's targets. It was the 11th of December 2019, exactly when the first reports of a mysterious new illness were coming out of China.

At that time, no one could have foreseen the consequent shockwaves of these early signs of a pandemic.

The European Green Deal represents a further step in the process of integration within the EU and it is destined to shape the Union as much as other important reforms, such as the CAP (Common Agricultural Policy) and the monetary union. Analogous to FDR's New Deal, created in response to the Great Depression, the European Green Deal was designed to tackle climate change,

that the UN has called "the defining crisis of our time".

The reform acts on many issues, starting from a more ambitious emission target. Beyond the Paris EU pledge, the Commission has proposed to increase the 2030 target for emission reduction to 55 percent, compared to 1990 levels. Considering that between 1990 and 2018 the EU reduced GHG emissions by 23%, this new target will require EU members to reduce their combined emissions over the next decade by around as much as they did over the past 25 years. The recent revision proposed on the EU Emissions Trade System (ETS) has reflected this new goal.

The ETS is a typical cap-and-trade system, through which annual marketable pollution permits are distributed or auctioned among firms. Once a cap on carbon emissions is defined at the EU-level, companies receive or buy allowances that they can freely trade in the market. Scarcity produces the price: the fact that these allowances are limited gives them a value. This pricing on carbon is what internalizes the externality of climate change.

The ETS is anticyclical: as the economic activity and, subsequently, the demand for allowances go down, so does the price on carbon, which prevents it from becoming an additional burden to carbon-intensive sectors. Additionally, there is the threat of an increase in supply as many companies could find themselves selling allowances to raise cash, increasingly dropping the ETS price, which would enhance the major challenge that the system already faces: the surplus of allowances. Indeed, as lockdowns began to be imposed on many European countries, the price of allowances dropped from around €25 to €16. Nevertheless, after only one month in decline, the ETS price quickly bounced back, even surpassing pre-pandemic levels.

Figure 2: Daily EU ETS price in Euros. Ember Climate (2020)

This was a direct result of the market stability reserve (MSR) scheme, which aims to neutralize the impacts of existing and growing surpluses. As soon as a significant surplus built up in the market, threatening a price decline, the MRS acted immediately, absorbing it into a reserve. By taking out the additional allowances in the market created by the pandemic, the MRS was able to stabilize the carbon price by guaranteeing that scarcity remained an issue. As the European Cap keeps shrinking to meet

emission reduction targets, it is expected that the ETS price will continue to rise, therefore increasing the costs of firms to pollute which provides an incentive for decarbonization[2].

A Green Recovery

It is unequivocal that climate change cannot be the priority for any world government shortly: the pandemic crisis has raised more acute challenges beyond the disease itself, from mental health to rising inequality and mass unemployment. That being said, climate change will not dissipate as countries enter the phase of recovery.

Countries may feel inclined to pursue a high-carbon recovery pathway, which would be a heavy blow to previous efforts and the goals of the Paris Agreement.

In that regard, some have pointed out that the ECB, the Fed and the Bank of England's asset purchase programs have been skewed towards high-carbon sectors[3]. Furtherly, some governments are studying the possibility to temporarily reduce tax and regulatory levels to stimulate the economy. These measures have taken many forms, such as giving tax reliefs to fossil fuel companies[4] and moving to ease environmental protection in the name of stimulus[5].

Within the European Union, there were clear early calls for the temporary discontinuation of the EU ETS and the abandonment of the European Green Deal[6], which were promptly rebutted by the Von Der Leyen Commission. Frans Timmermans, one of the Commission's Vice-Presidents, reiterated that the Green Deal was and would remain at the core of its agenda. While acknowledging that "as uncertainty grows, so does the pressure on governments to provide quick fixes" that neglect climate action, Timmermans reiterated that the Green Deal was the "roadmap out of this crisis", from which the

2 - https://www.europarl.europa.eu/doceo/document/E-9-2020-001835-ASW_EN.html
3 - https://reclaimfinance.org/site/wp-content/uploads/2020/05/Report-Quantitative-easing-the-ECBs-dirty-secret-RF.pdf
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6-ttps://www.rechargenews.com/transition/eastern-european-leaders-use-covid-19-to-attack-eu-climate-policies/2-1-776128

Commission would not deviate[7].

In that regard, many governments question how to ensure that an effective and urgent response to the COVID-19-induced economic crisis can accommodate climate efforts.

The financial stress in which many companies plunged may postpone a lot of investments that could be aligned with tackling climate change. However, as world governments and institutions are responding to the pandemic crisis with record-breaking stimulus packages (including the European bazooka), there is a unique opportunity to set these support schemes strategically to fast-track a decarbonized economy.

Accordingly, measures such as supporting zero-emission technologies (for instance, renewable energy) and geoengineering (particularly direct air capture), reducing fossil fuel subsidies, and investing in green infrastructure must be prioritized.

These stimulus packages will shape the world economy for years, or even decades to come. One must however make sure that they lead to a greener and more sustainable future.

Climate diplomacy will be of pivotal importance to ensure an inclusive and cohesive green recovery, not only amongst the world's most developed countries.

Climate diplomacy will be of pivotal importance to ensure an inclusive and cohesive green recovery

Next year, COP26 will be held in Glasgow, Scotland, where financial support for low-income countries to cope with climate change will be discussed along with new emission reduction targets, which the 189 Paris Agreement parties must submit by the end of the year. In that sphere, particularly, some recent developments may leave us optimistic.

7-https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_20_1551
8-https://www.theguardian.com/environment/2021/jan/20/paris-climate-accord-joe-biden-returns-us

To start with, 2021 has seen the United States back in the Paris Agreement, which was a campaign promise of the newly sworn-in President Joseph Biden. Additionally, last September Xi Jinping surprised the world by announcing a carbon neutrality target of 2060 and the pledge to peak carbon emissions before 2030[9]. As the world's largest emitter (greater than the EU and US combined), this Chinese commitment could prevent 0.2 to 0.4 degrees Celsius of further global warming.

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Conclusion

Speedy economic recovery and strong climate action can be jointly achieved in a post-pandemic world. On the flip side of the economic downturn, if the recovery is implemented properly, it may be able to redefine what adds value to the economy, shifting towards a "degrowth" in carbon-intensive sectors and rapid growth in more eco-friendly alternatives. For the EU, the European Green Deal means that it can still live up to its promise of economic development while meeting the Paris targets. If there is anything that this pandemic has shown is that acting early prevents far greater costs down the line: so, why not apply this lesson to climate change?

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Pedro Baptista

9-https://apnews.com/article/climate-climate-change-paris-xi-jinping-emissions-reduction-7a4216ad4026090adb8d600fab210406

INTERVIEW

PROFESSOR LUÍS CABRAL

BIO

One of Portugal's most renowned and cited economists, Luís Cabral is a graduate of Stanford University (PhD, Economics, 1989). He taught at the London Business School, Berkeley, Yale, NYU and IESE. He is currently the Paganelli-Bull Professor of Economics, as well as Chair of the Economics Department, both at NYU's Stern School of Business. He graduated from Católica Lisbon School of Business & Economics, our beloved faculty, in 1983.

Cabral's research is focused on the dynamics of firm competition, both from the antitrust and from the strategy perspectives. His research topics include networks and network effects; corporate reputation; and a focus on media and entertainment industries. In addition to numerous journal articles, he is the author of *Introduction to Industrial Organization*, a textbook translated and adopted by universities in dozens of countries worldwide.

He consulted with a variety of organizations (firms, universities, governments, tax and law enforcement agencies, even sports teams) on a variety of economic issues. He was a leading expert witness in the Airbus-Boeing WTO disputes. From 2004-2009, he was a member of European Commission President Barroso's Group of Economic Policy Analysis (a group of 12 members).

THE INTERVIEW

Did Economics choose you, or did you choose Economics, when and how did you know this would be your path?

Largely, Economics chose me. When I was in high school (Pedro Nunes), the choices I was considering were Mathematics or Architecture. There were already four architects in my family (dad, mom, two siblings) and I thought that was enough, so I dropped the idea of Architecture and began focusing on Math. However, during the post-1974 period most Portuguese universities were not functioning very well (to put it mildly). Amid the revolutionary chaos, Católica was a bit of an oasis: a university where things actually functioned. So, when two classmates at Pedro Nunes talked to me about Católica I decided to go along with them.

Following António and René's lead, I enrolled in the Business degree (Gestão). When we started taking actual Business courses (basically during the second and third years) it became clear to me that Business was not my thing. Meanwhile, I greatly enjoyed the Economics, Math, Stats and Coding courses. Also, in 1979 (second year at Católica) I was hired as a Fortran programming Teaching Assistant. It was fun. Then one day I was in the library and stumbled upon a book

by James Buchanan (who years later would be awarded the Economics Nobel), I believe "Demand and Supply of Public Goods" (which had been published just a few years before) was the first book I read in school without anyone telling me to do so. I absolutely loved it. Since then, I've read many other Economics books that I liked better, but that one turned out to be the turning point: I switched from Business to Economics, took a bunch of extra courses to catch up with my new colleagues … and here I am.

In 1985, as I was starting my PhD program in Economics, I was offered a place in the UC Berkeley Math PhD program, but by then my interest in Economics was too deep for me to switch back to the initial plan.

In your opinion, what are the most important qualities of an Economist?

First, a very solid command of the methodology of Economics (e.g., knowing how to make the logical connection between assumptions and results, distinguish correlation from causality, etc).

Second, a good economist must understand that, equations and statistical regressions notwithstanding, Economics is essentially about people, not models.

> **“ Economics is essentially about people, not models. ”**

What fields of Economics you consider have had a tremendous development in recent years, are the undergraduate degrees lagging with respect to the kind of new research being conducted? What new disciplines should be in the programs?

The two fields where we've seen the most action are (a) 'behavioral economics'(essentially, the combination of psychology and economics); and (b) digital economics, by which I mean the economics of 'digital' industries. In terms of economics methodology, we've seen a significant increase in experimental methods (both lab experiments and field experiments). These changes are gradually (maybe too slowly) being reflected in undergraduate programs.

I might also add that there is a greater interest by researchers and teachers in issues of social justice (broadly understood), especially issues related to economic inequality. Not enough interest, in my opinion, but more interest than 20 or 30 years ago.

Which global trends do you believe will shape the world in the upcoming years?

It's a bit of a cliché, but I think Artificial Intelligence will spark a small or not-so-small economics revolution. I also expect that the current pandemic will accelerate a series of pre-pandemic trends related to the relation between economic activity and space (of which remote work is one, but not the only one).

If one would conduct a SWOT analysis of the current century, from an economist's perspective, what would be the main conclusions?

I have recently completed a new introductory textbook. I think the book's motto best summarizes the SWOT analysis you ask for: "Technology and the market economy got us into the present mess, but technology and the market economy are the only hope of getting us out of the present mess."

> **"(...) I would expect the sectors with greater growth prospects to be wellbeing, education and entertainment."**

What kind of recommendations would you have for a country like Portugal in the context of the SWOT analysis previously described. The industrialization has commonly been proposed as the effective way forward is that true?

I like to remind people that I can hardly predict the past, let alone the future. That said, I would expect the sectors with greater growth prospects to be wellbeing, education and entertainment (notice industry is not one of them). Portugal is very well positioned in all three, which makes me very optimistic about the country's prospects.

How beneficial was an international career, would Luis Cabral still be such a renowned economist if he would have stayed in Portugal? How have times changed?

In 1982 or 1983, when I started to think seriously about a PhD in Economics, there were less than 200 PhDs in Portugal (in all fields). Currently, there are more than 2000. The conditions for initiating a productive academic career in Portugal have changed enormously in the past 40 years!

If you could give one piece of advice for our students, that will enter the job market in a few years, what would it be?

Early in one's professional career, it is common to experience enormous swings in one's self-esteem: one day

you think you are greatest of all time (GOAT), the next day you think you are totally useless. Get used to the idea that you are neither one nor the other.

Tell us about a project you are currently working on.

I have just finished the first draft of a new textbook, *"Introduction to Microeconomics".* It was my "COVID project", so to speak. It's an eBook and it's available for free.

http://luiscabral.net/economics/books/micro.

There is no shortage of economics textbooks, but my experience is that current issues such as climate change or the power of high tech or rising inequality levels do not get as much attention as they should.

Apart from Economics, what are your passions?

Painting (watercolor, acrylic, oil) and plying jazz saxophone.

What is your top 5 list of favorite books? Why?

This is the one question I will not answer.

I have done it in the past and then came to regret it. (Also, the question assumes I actually read more than 5 books.) I am constantly changing my top 5 lists. Right now, as I look at my bookshelf, I would say "The Complete Calvin & Hobbes" (4 volumes) tops my list, but tomorrow I might write something different.

Do you consider coming back to Portugal one day?

As a possibility, yes.

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Mariana Felizardo

Thomas Constantino is a second year student of Economics at Católica Lisbon School of Business and Economics and he's the President of our club.

Thomas Constantino

CATÓLICA-LISBON Economics Club

FEBRUARY EDITION

BREXIT DEAL

On 23rd, June of 2016, the Brexit Referendum took place in order to ask British people whether the country should remain a member of the EU or leave it. In what consists this deal and what were the reasons behind its creation?

Looking back, the idea of a European Union was always a chronic theme in the long and often fierce history of the continent. From the Holy Roman Emperors, passing through Napoleon, to Hitler and others sought, they all aimed to achieve a continental unity based on generous alliances, ethnic cohesion, ideology, or raw power, sometimes in horrifying ways.

Nowadays we have finally our great European Union (EU), which has its roots in the *European Coal and Steel Community* (ECSC) and on the *European Economic Community* (EEC) established, respectively, by the 1951 *Treaty of Paris* and the 1957 *Treaty of Rome*. Only on November 1st, by the *Maastricht Treaty*, the EU became effective, with its pillar system, including foreign and home affairs alongside the European Community.

Both in 1963 and 1967 UK applied to join EEC, however, these were vetoed by the President of France, Charles de Gaulle. It is important to state that besides the struggle UK was facing to recover from WWII, De Gaulle had also personal reasons for not wanting the British around the table – French and British farming economies were very different – "How could we maintain on our territory more than two million farms, three-quarters of which were too small and too poor to be profitable, but on which, nonetheless, nearly one-fifth of the French population live?" His solution was the Common Agricultural Policy (CAP), which is a partnership between agriculture and society, and between Europe and its farmers, which provides a single market for agricultural goods at guaranteed prices[1]. Finally, in 1973, the Conservative Prime Minister Edward Heath led the UK into the EEC, after De Gaulle had left office. However, Britain went from enthusiastic commitment to the EU to an acrimonious departure on unfavourable terms. And this leads us to 2020, exactly the year the UK leaves the EU, the so-called ***Brexit Deal***. As a matter of fact, Britain then becomes the first and only country to ever leave the EU. Napoleon, Britain's old archnemesis once said "Geography is destiny" and indeed, now the UK is not only physically separated from mainland Europe, but now it is also economically, politically and ideologically.

WHAT IS THE STORY OF THIS DIVORCE?

Back on 23rd June of 2016, the United Kingdom European Union Membership Referendum, commonly referred to as Brexit Referendum, took place in order to ask British people whether the country should remain a member of the EU or leave it. This resulted in 51,9% of the voters being in favour

1 https://ec.europa.eu/info/food-farming-fisheries/key-policies/common-agricultural-policy/cap-glance_en

of leaving the EU. As expected, immediately after the result, financial markets reacted negatively worldwide, and the Prime Minister and Leader of the Conservative Party at the time, David Cameron, announced his resignation (he defended unsuccessfully that the UK should remain in the EU).

It is commonly known Europe's creation was a reaction to the horrors lived in the WWII and Britain, unlike the rest of Europe, was the only member that felt no need to escape from its past: Germans were escaping Nazism, the French defeat and collaboration, the Italians dictatorship, the eastern Europeans, when they eventually joined, Soviet domination.[2] This allied to Britain's imperial history, lead to the known result.

According to *Forbes Magazine*[3] (23rd July 2016 – the referendum day), there are **three reasons** why the British voted to leave the European Union: **Economics**, **Sovereignty** and **Political Elitism**.

The first was easy to guess, since opponents of the EU argued that Europe as a whole is a dysfunctional economic entity, which is economically stagnated. The argument for remaining in the EU was that the alternative was economic disaster. However, staying in a stagnated organization to solve British problems seemed short-sighted and made little sense to opponents.

The second reason is the rise of nationalism across the world. There's a growing distrust of multinational financial, trade, and defence organizations created after World War II. The EU, the IMF, and NATO are good examples of this. Many who oppose the EU believe these institutions no longer serve a purpose. Not only that, but these

2 https://www.economist.com/britain/2021/01/02/how-brexit-happened
3 https://www.forbes.com/sites/johnmauldin/2016/07/05/3-reasons-brits-voted-for-brexit/

organizations also take control away from individual nations. Mistrust and fear of losing control made Brexit a reasonable solution to them. The immigration crisis in Europe was a trigger. Some EU leaders argued that aiding the refugees was a moral obligation. But some EU members saw immigration as a national issue, as it affected the internal life of the country. Steering clear of this issue was an important driver for the "leave" vote.

The last reason is due to a profound crisis faced by the political leadership of Britain. The "leave" voters rejected both the Conservative and Labour parties. Both parties had endorsed remaining with the EU and saw many of their members go into opposition on the issue.

IN WHAT CONSISTS THIS DIVORCE?

The UK-EU Trade and Cooperation Agreement was negotiated for 9 months and it may be characterized as a typical English Revolution, a backward lurch into nationalism as well as a Luddite assault on the progressive dream of globalism.

Apparently, it preserves the "four freedoms" of its cherished single market: free movement of goods, services, capital and people. According to Boris Johnson, in his official Brexit announcement, on 24th December 2020, this is a deal that will protect jobs across the country, it will allow UK goods and components to be sold without tariffs and without quotas in the EU market, a deal which will, if anything, allow their companies and our exporters to do even more business with their European friends.

The EU-UK trade agreement focuses on regulations that cover labour law, environmental standards and government subsidies for businesses. In the negotiations, while the UK was determined to assert its sovereignty (independence from EU rules), the EU was determined to protect its single market and control access to it. Thus, in the more than 1000 pages of dense legal text, which outlines how the relationship will operate, there are all the answers for the issues raised:

1. **Fishing** was the hardest and last issue to be settled in the negotiation. In what matters to fishing, over the next five-and-a-half years, the UK will gradually gain a greater share of the fish from its own waters. Translating this into numbers, the value of the fish caught by the EU in UK waters will be cut by 25%. Additionally, from 2026 onwards, the UK will fully control access to its waters, but in response, the EU would be allowed to introduce taxes on British fish.

2. The so-called **level playing field** is a trade-policy term that aims to assure fair and open competition, being an important part of the EU single market. It is a set of common

rules and standards that prevent businesses in one country from accessing unfair conditions from their national government, avoiding competitive advantage over those operating in other countries. The measures adopted commit both the UK and EU to maintain common standards on workers' rights, as well as many social and environmental regulations. They don't have to be identical in the future, meaning the UK does not have to follow EU law, but they do have to be seen to protect fair competition. The UK has also agreed to stick to common principles on how state aid regimes work, and to an independent competition agency which will assess them. But it can choose to develop a system which only makes decisions once evidence of unfair competition is presented. That is different from the EU system which assesses the likely impact of subsidies before they are handed out.

Mistrust and fear of losing control made Brexit a reasonable solution to many.

3. Dispute resolution: what actually happens if either side breaks any of the terms and conditions? The agreement incorporates a mechanism to resolve disputes via arbitration, involving officials from both sides. If the arbitration panel finds that one side violated the agreement, a dispute mechanism can be triggered, which could mean tariffs being imposed. It is based around a "rebalancing" clause which gives both the EU and the UK the right to take steps if there are significant divergences.

4. Justice: European Court of Justice (ECJ) will remain the ultimate arbiter of European law, however there will be no role in the UK for the EU's highest court. Brexit supporters said it would allow the UK to "take back control" of its laws. The ECJ could still have a role in Northern Ireland because it continues to follow some EU trade rules. Northern Ireland will preserve a special status under the terms of the Brexit withdrawal agreement. It will remain subject to EU single market and customs union rules, which means the European Court will remain the highest legal authority for some disputes in one part of the UK.

5. Travel: UK nationals will need a visa if they want to stay in the EU more than 90 days in a 180-day period. They will still be able to use their European Health Insurance Cards (EHIC) until they expire. The UK is no longer subject to the ban on additional roaming charges, although both sides will encourage operators to have "transparent and reasonable rates" for roaming. EU pet passports will no longer be valid, but people will still be able to travel with pets, following a different and a more complicated process.

6. Security & Data: what will the

data protection rules be for UK companies which deal with data from the EU? Both sides say they want data to flow across borders as smoothly as possible, but the UK will no longer have automatic access to key security databases, only when requested. Also, the UK will not be a member of the EU's law enforcement agency, Europol, but it will have a presence at its headquarters. The agreement also stresses that individuals have the right to the protection of personal data and privacy and that high standards in this regard contribute to trust in the digital economy and to the development of trade".

7. **Professional qualifications**: while the UK was still in the EU, UK workers, from accountants to chefs did not have to worry about crossing borders multiple times. What about now? Will UK professional qualifications be recognized across the EU in the future, and what restrictions will there be? In fact, no, they won't be recognized automatically. That will make it harder for UK citizens supplying any kind of service to work in the EU. They will often have to apply to individual countries to try to get their qualifications accepted, with no guarantee of success. There is a framework in the deal for the UK and EU to agree on mutually recognizing individual qualifications but that's weaker than what professionals have now.

8. **Education**: UK is definitely out of the Erasmus Exchange Programme, however, students of Northern Ireland will continue to participate in Erasmus, as part of an arrangement with the Irish Government. The good news is that a new scheme named after the mathematician Alan Turing will begin in September 2021 and the Government says it will be similar to Erasmus but will include countries across the world.

CONCLUSION

Democracy itself implies that societies comprehend conflicting interests. The parties represent these forces and mediate between them. Conflicts are managed without resorting to real fighting. However, British democracy has a subtly different mechanism.

The UK did its choice and while it is true that any deal is better than no deal, it is also true that Brexit might just be the first domino piece to fall in what eventually will be the collapse of the EU.

If we think further, it is clear that

an UK exit from the EU will bring with it huge economic and political costs. It will also reduce the UK's position in the world and its ability to influence the international events that affect it the most. It is also evident that none of the alternative relations with the EU presents itself as more advantageous compared to EU membership. For these reasons it is legitimate to conclude that leaving the EU will be a historical mistake of paramount proportions, one whose effects will be felt sharply in the short-run and having a lasting impact on the long-run.

Nevertheless, Britain certainly did not start to feel all these effects, since apart from Brexit, it is also facing the Covid-19 pandemic crisis. These two are clearly interconnected, but very different economic shocks: the first one is likely to bring mostly more predictable and permanent changes to the way the UK trades with the EU, while the second's impacts will eventually prove temporary, even if they may also be hard-to- predict.

The spread of Covid-19 has hit businesses across the world. It has caused a shrinking of aggregate demand, supply chain difficulties, and massive uncertainty. This effect will be exacerbated when combined with the UK-EU Deal, so business leaders will need to consider the interplay between the two.

While in a time of a deep crisis the EU remains together to defeat CoronaVirus, the UK finds itself more and more isolated, which in turn may weaken their fight.

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