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Keynes And Schumpeter Are What The European Economy Needs Right Now*

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Key takeaways

- *Keynesian and Schumpeterian dynamics may well help the European economy's tricky transition out of the COVID-19 crisis.*
- *The fiscal space that Europe has finally found is the Keynesian element of expected demand at work, incentivizing economic agents to convert their excess savings into consumption and investment decisions.*
- *The strong increase in business starts, like those we are seeing in France and Germany, is the Schumpeterian process of value creation following the economic shock.*

"Glass-half-empty" observers of the European economy see the better-than-expected third-quarter economic rebound as just a mechanical bounce-back from the pandemic-related lockdown. That was the easiest part of the recovery, they say. From now on, we are in for a tougher, slower climb.

* This policy brief does not constitute a rating action.

The pessimists are right to point out that the European economy is clearly entering a tricky transition period--phase 3, as some say. Government support measures will gradually end at the turn of the year, but it won't be until mid-2021 at the earliest that European recovery plans will kick in. Meanwhile, dangers are looming that could derail the economy during this delicate phase:

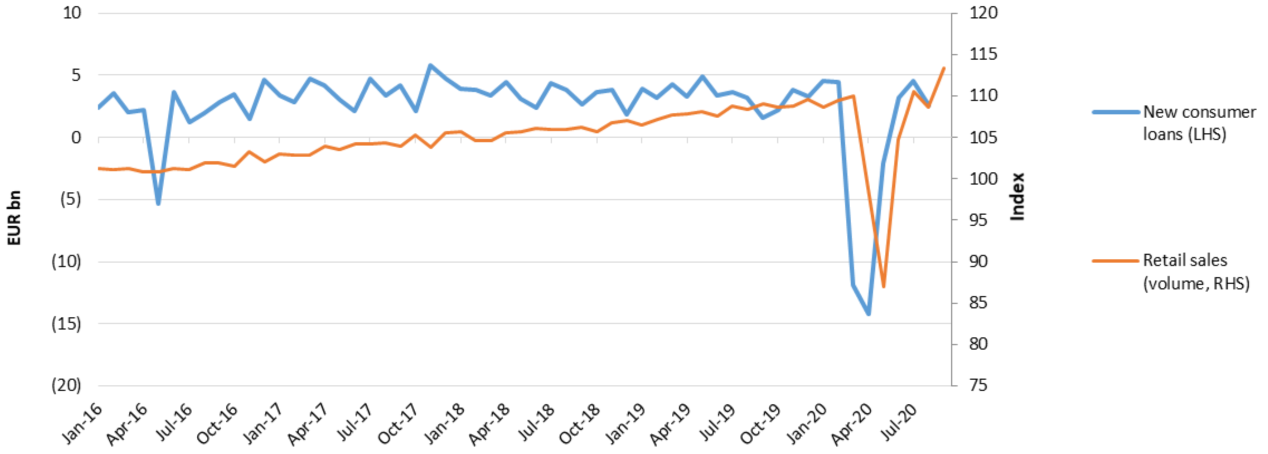
- The withdrawal of government support--short-time work, guaranteed loans, and exemptions from the bankruptcy register--could tip the economy, leading to an abrupt surge in unemployment and insolvencies.
- Banks, which helped economic agents avoid cash crunches during the lockdowns, might turn off the money tap this time.
- If the second wave of COVID-19 again leads to lockdowns, the economic fabric may not recover as quickly as it did in the third quarter and one month of second lockdowns might cost more than 4 percentage points of GDP as it has been the case during the first lockdowns.
- European households may consume only a small part of the whopping 24% of income they saved during confinement because of economic uncertainty and slack in the labor market. Online job openings are 46% lower than last year in the U.K. and down 36% in France and 20% in Germany.
- And then there are Brexit negotiations, which could turn sour.

All of these arguments are perfectly valid. However, they overlook some Keynesian and Schumpeterian economic forces that are at work today that might help the European economy fully recover from COVID-19.

The British economist John Maynard Keynes would have spotted the shortage of demand and the overabundance of savings. Putting aside negative interest rates--a "hypothesis" he rejected in his "General Theory" of the 1930s–-he would have pointed to excruciatingly low financing costs and advocated for strong public investment to reflate the economy. Before even asking himself whether French, German, and European recovery plans were well designed or not, he would have interpreted them as an element of "expected demand", needed to provide incentives to economic agents to convert their savings into consumption and investment decisions. In addition, he would have stressed that the positive "multiplier effects" of investment in green and digital infrastructure, part of the European recovery plan, might strengthen the European economy's long-term path. In other words, Keynes would have applauded the fact that Europe had found more fiscal space. Let's face it: Without this pandemic, the European Commission's "Green Deal" would probably not have been endowed with €750 billion or so.

Chart 1 - Households have started to dissave money

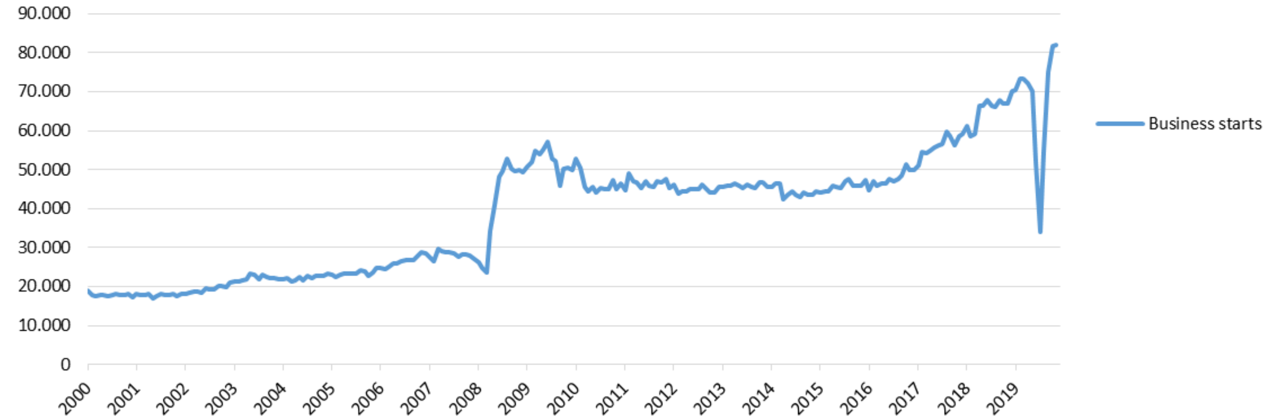
Retail sales and new consumer loans



Source: S&P Global Ratings.

As respectful as he was in his "History of Economic Analysis", it is no secret that Joseph Schumpeter was not enthusiastic about Keynes' ideas. What would the Austrian economist have said about the current situation? Certainly, he would have recognized an inexorable temporary rise in unemployment and bankruptcies in sectors most affected by COVID-19. But he would have considered this as a short-term process of destruction that will create value over the medium term. Schumpeter would have pointed out that jobs will spill over to other sectors. He would have seen that the health sector is creating jobs today. He would have noted that because of the pandemic, the number of startups created in transportation, accommodation, trade, or the property sector is skyrocketing in France. Even in Germany, the net business creation seems to have bottomed out. In other words, Schumpeter would have said that the COVID-19 pandemic is a horrible shock that is getting the European economy out of its rut and spurring it to test other, better, technological and behavioral solutions. Indeed, COVID-19 is spilling the glass so it can refill with a better fuel.

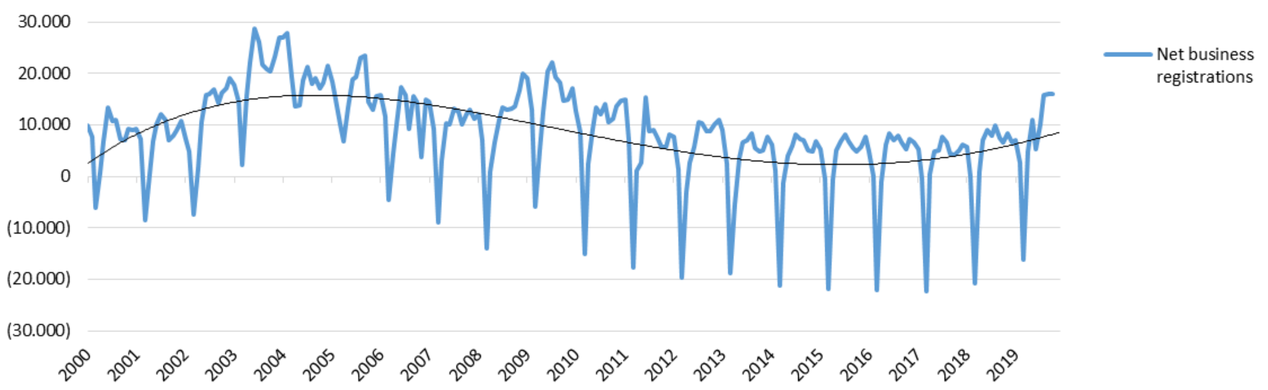
Chart 2 - The number of business starts is at record high in France after the lockdowns



Source: INSEE

Chart 3 - Net Business creation in Germany has turned up after the lockdowns

Difference between new registrations and deregistration



Source: S&P Global Ratings.

Keynesian and Schumpeterian dynamics are exactly what the European economy needs right now, right here, to successfully transition out of the COVID crisis. Both dynamics are starting to kick in as phase 3 begins. We have a combination of excess savings and strong expected demand via the European Recovery Program on one hand, and on the other, an acceleration of the digital and environmental transformations that will make the European economy more sustainable. Statistical evidence suggests that dissaving has started, and the incredibly high number of start-ups in France--and its upturn in Germany--speaks for itself. It's clear that the transition won't be smooth, but there is reason to believe the glass might be half full.

About the author

Sylvain Broyer *joined S&P Global Ratings in September 2018 as Chief EMEA Economist, based in Frankfurt. Before that, Sylvain was Head of Economics at the French investment bank Natixis and a member of the General Management of its German Branch. Sylvain has been a member of the "ECB shadow Council", a panel of leading European economists formed by German economic daily Handelsblatt since November 2012, and is a member of different public sector advisory groups (European Investment Bank, European Security Markets Authority, French Markets regulation authority). He holds doctorate degrees in Economics from the Universities of Frankfurt and of Lyon as well as a certification from the International Securities Market Association (ISMA). He teaches at the Paris Dauphine University for the Master in Banking & Finance.*