

# The financial pandemic response of the EU – a step towards fiscal federalism?

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Second Intermediate Workshop

# The financial pandemic response of the EU

## Initial/Immediate Response

- Providing the Member States with more fiscal room for maneuver to respond to the lockdown, demand, and reallocation shock:
  - Relaxation of State Aid Rules (cf. Art. 107 (2) (b), (3) (b) and (c) TFEU)
  - Activation of the general escape clause of the Stability and Growth Pact
  - Redirecting of previously unspent funds to cover pandemic relief measures
  - ESM Pandemic Crisis Support Credit Line (available until end of 2022, but not used yet)
  - The ECB's Pandemic Emergency Purchase Program (PEPP) as well as continuation of enhanced credit support (e.g. TLTRO III)

# The financial pandemic response of the EU

## Next Generation EU

*“COVID-19 crisis presents Europe with a challenge of historic proportions (...) This requires an unprecedented effort and an innovative approach, fostering convergence, resilience and transformation in the European Union.”*

*(Meeting of European Council Conclusions, July 2020)*

# The financial pandemic response of the EU

## Next Generation EU

### A budget for European recovery and resilience

SURE / ESM Pandemic Crisis Support / EIB Guarantee Fund for Workers and Businesses	EUR 540 billion
Next Generation EU	<b>Temporary reinforcement</b> EUR 750 billion
Multiannual Financial Framework	EUR 1100 billion

# The financial pandemic response of the EU

## Next Generation EU

- Next Generation EU: financial and policy recovery effort, which is significant, focused and limited in time
- Own Resources Decision 2020 empowers Commission to borrow funds on the capital markets on behalf of the EU up to the amount of EUR 750 bn.
- New net borrowing activity will stop at the latest at the end of 2026
- The additional funds generated by the EU's borrowing will be disbursed as grants (EUR 390 bn.) and loans (EUR 360 bn.) via the instruments and programmes of the RRF and MFF (existing and new ones)
- For the sole purpose of addressing the consequences of the COVID-19 crisis, but: RRF manifold policy goals: Six pillars (green transition; digital transformation; smart, sustainable and inclusive growth; social and territorial cohesion; health, economic, social and institutional resilience; policies for the next generation)

# The financial pandemic response of the EU

## Next Generation EU

- The NGEU amounts constitute external assigned revenues to Union programs, i.e. not part of the general budget
- Demand driven, but only 30% of the maximum grant portion for each member state is calculated on the basis of changes in real GDP in 2020-21. The rest is calculated on the basis of 2019 population, GDP, and average unemployment rate 2015-2019
- Maximum volume of loans for each Member State: 6.8% of its GNI
- The RRF application process will be embedded in the European Semester
- Plan to work towards reforming the own resources system and introduce new own resources (see already new tax on plastic packaging waste)
- The proceeds of the new own resources introduced after 2021 will be used for early repayment of NGEU borrowing

# The financial pandemic response of the EU

## Next Generation EU



EU support will be anchored in national **Recovery and Resilience Plans**, which should be submitted to the Commission.

If the assessment criteria are fulfilled, Member States will be able to **receive grants with the possibility to complement with loans:**



### Grants:

Maximum allocation for each EU country, depending on population, GDP per capita and unemployment rate.



### Loans:

- Maximum volume of the loan for each Member State of up to 4.7% of its Gross National Income.
- Loans can be requested together with the plan, or at a different moment in time accompanied by a revised plan.



**Grants and loans will be paid in instalments**, following the fulfilment of milestones and targets.

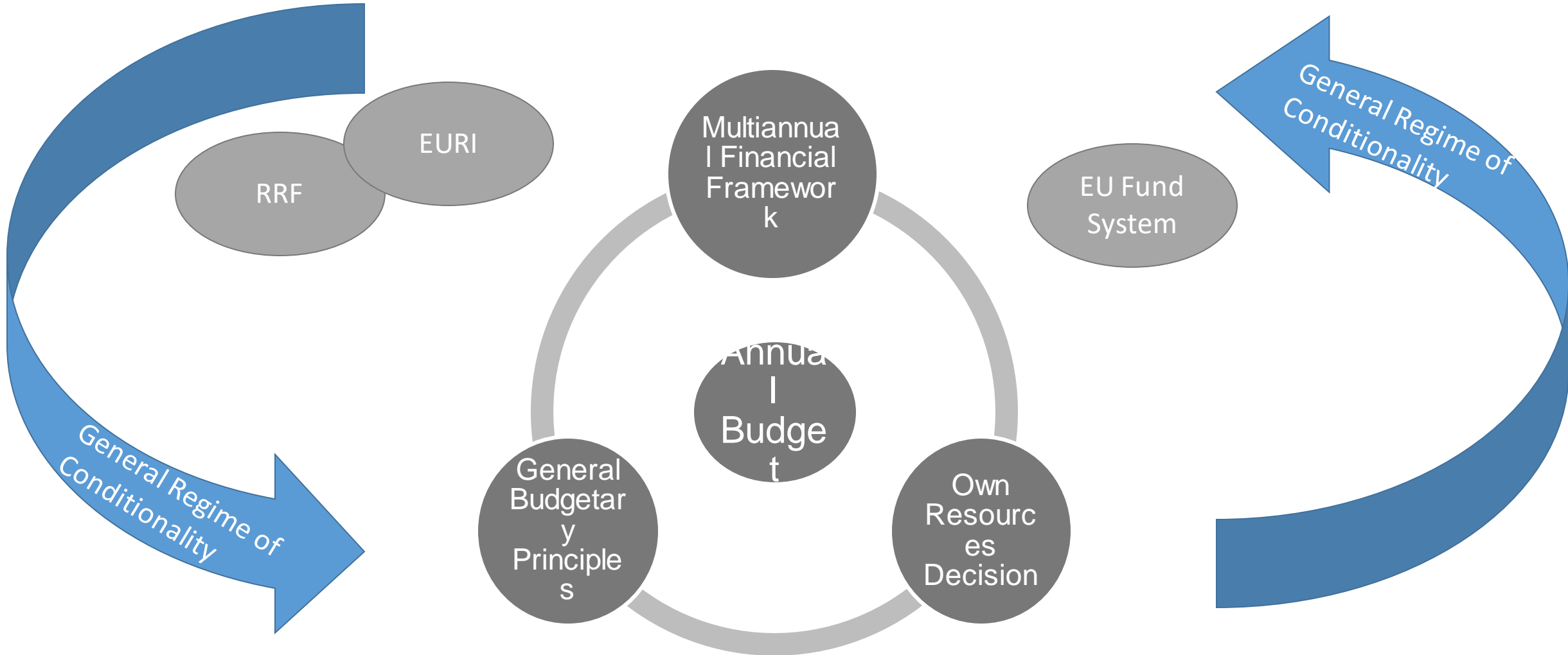


**Technical support** can be requested for the preparation and implementation of the recovery and resilience plans through the Technical Support Instrument.

**Conditionality!**

# The financial pandemic response of the EU

## Legal Framework





# The financial pandemic response of the EU

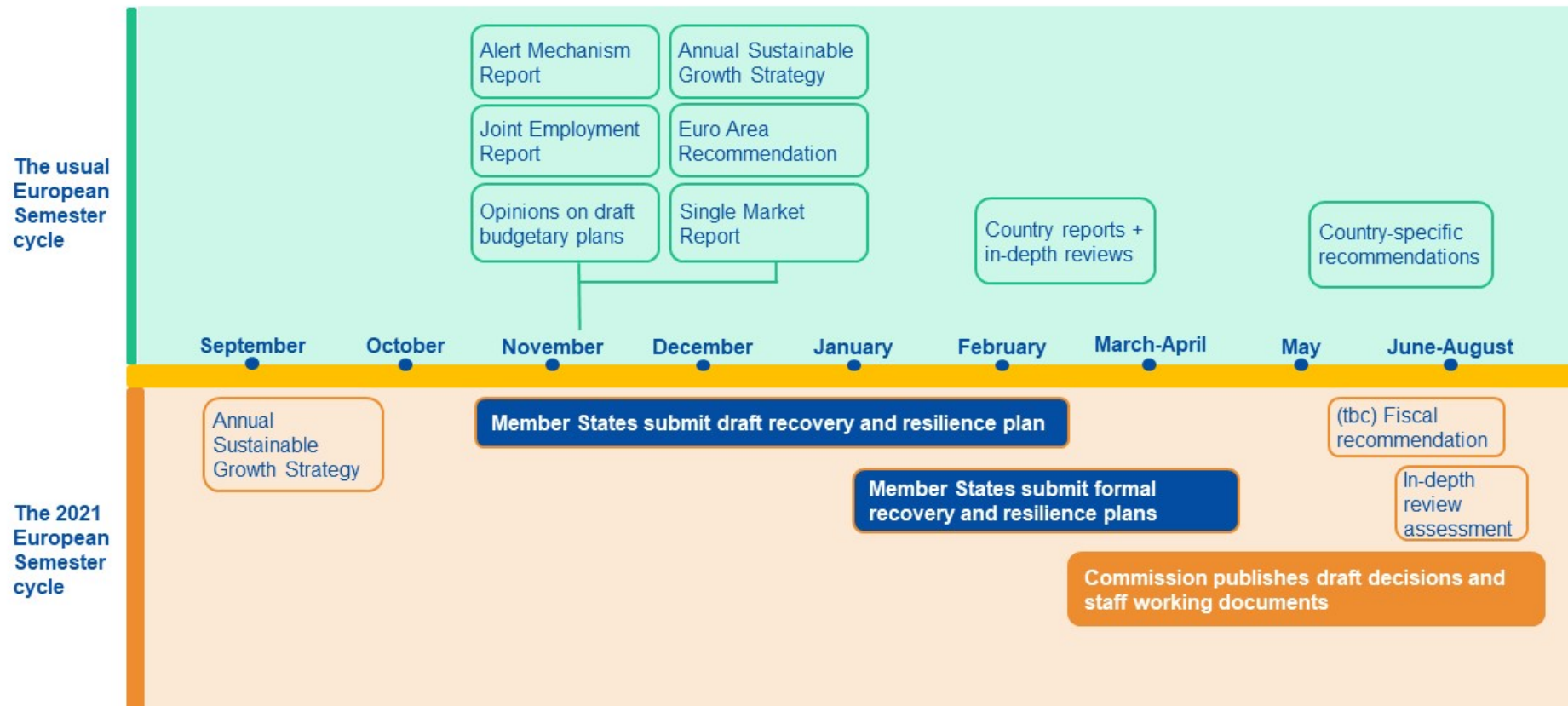
## Legal Framework – points of contention

- A subsidiary budget of significant volume: Violation of the budgetary principles of unity and universality?
- Authorization to borrow without clear qualification as own resource in ORD legal?
- Introducing new taxes (plastic packaging waste) with policy goals other than funding the EU in ORD legal?
- Budgetary power shift away from the European Parliament (to the Commission and the Council) respecting institutional balance?
- Is the general regime of conditionality compatible with Art. 7 TEU?
- EURI and RRF on tenuous legal ground?
- Distributive effects through the back door? (calculation methods for support; decision on financing the repayment of the borrowed funds remains to be seen.)
- No bail-out rule (Art. 125 TFEU) and joint borrowing – compatible?

# EU economic policy coordination

## Exceptional 2021 European Semester cycle

## Aligning timing: 2021 European Semester cycle



# 2021 European Semester cycle

## Emerging results

## National programmes/plans: current state of affairs

National Recovery and Resilience Plans (RRPs)	National Reform Programmes (NRPs)	Stability/Convergence Programmes (S/CPs)
24 RRP submitted to the COM (9 RRP submitted by 30 April deadline)  COM endorsed 18 RRP - Council approved and pre-financing authorised for 12 MS	9 MS submitted their NRPs as a separate document  Other MS have integrated these in their RRP	All MS submitted their Stability/Convergence Programmes  COM issued recommendation for a Council opinion on 2021 S/CPs (2 June 2021)

## Commission assessments of compliance with deficit and debt criteria in 2020

Deficit criterion	Debt Criterion	*Macroeconomic Imbalances
Fulfilled by 3 MS (BG, DK, SE); not fulfilled by 23 MS  <i>*excludes RO which is currently the only MS that is subject to an excessive deficit procedure</i>	Not fulfilled by 13 MS (BE, DE, HE, ES, FR, HR, IT, CY, HU, AT, PT, SI and FI)	Identified for 12 MS *3 excessive imbalances (CY, HE, IT) *9 imbalances (HR, FR, DE, IE, NL, PT, RO, ES, SE)

# Democratic legitimacy

## Issues in the RRF governance

### ➤ Increased powers of the Commission and the Council

- focus on output legitimacy; politicization of responses - temporary suspension of the rules, various degrees of conditionality (SURE, ESM, NGEU), rules and numbers after the crisis; the impact of *national* political cycles - slowing down the decision-making process, new priorities

### ➤ Sidelining of the European Parliament and national parliaments:

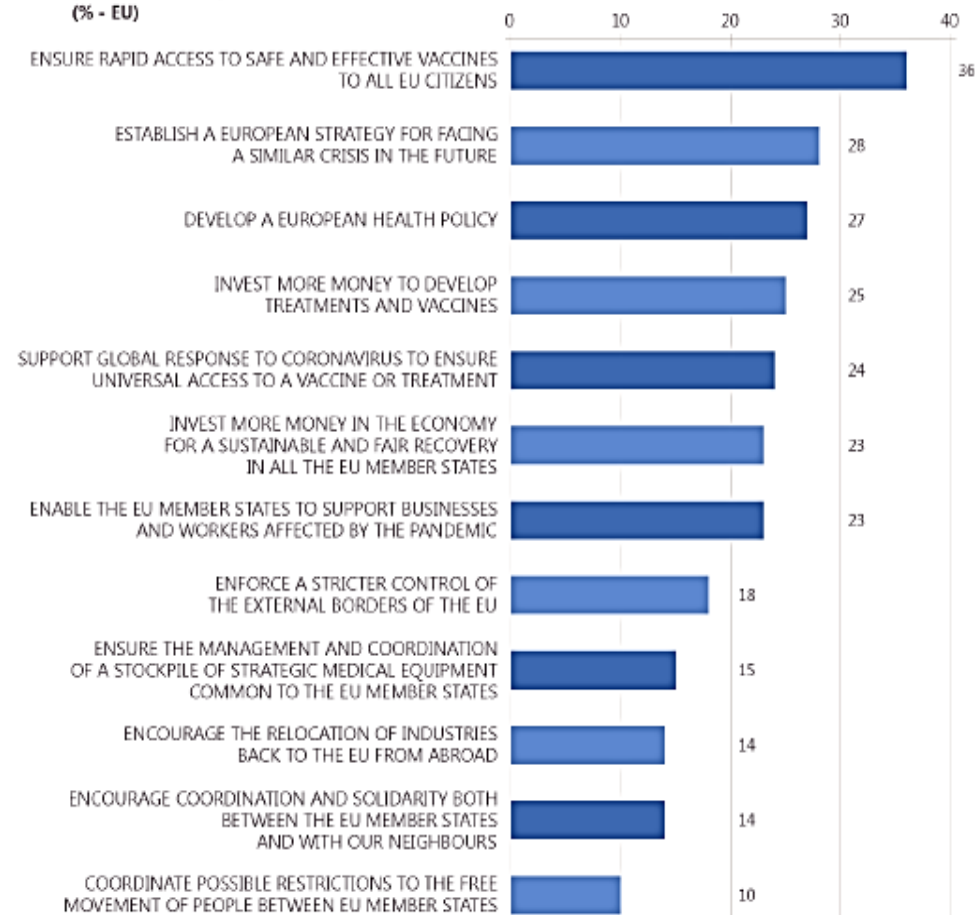
- Powers of the EP were not enhanced (information and consultation only)
- NP not mentioned in the RRF Regulation, their role and participation depends on national legal framework (COM guidelines require a summary of the national consultation process in preparation of the RRFs)

# Public opinion about NextGenerationEU and EU priorities

Q: How effective or not do you think that NGEU is to respond to the economic effects of the coronavirus pandemic?(%)

	Total 'Effective'	Win.2020/2021 - Oct.-Nov. 2020	Total 'Not effective'	Win.2020/2021 - Oct.-Nov. 2020	Don't know
EU27	55	▼13	38	▲16	7
EURO AREA	53	▼15	39	▲17	8
NON-EURO AREA	62	▼8	33	▲12	5
MT	83	▲3	11	▲7	6
SK	58	=	38	▲9	4
PL	67	▼4	28	▲10	5
BG	60	▼5	28	▲12	12
IT	66	▼7	29	▲11	5
RO	60	▼8	33	▲9	7
LV	47	▼8	52	▲23	1
HU	61	▼9	36	▲11	3
HR	68	▼10	30	▲11	2
DK	63	▼10	36	▲17	1
AT	54	▼10	35	▲9	11
FR	45	▼10	39	▲14	16
IE	77	▼11	23	▲11	0
NL	64	▼11	30	▲10	6
EE	61	▼12	39	▲12	0
SE	56	▼12	41	▲18	3
PT	50	▼14	50	▲29	0
FI	42	▼14	57	▲13	1
SI	58	▼15	41	▲15	1
EL	53	▼16	45	▲19	2
LT	53	▼17	47	▲17	0
DE	48	▼18	42	▲17	10
BE	59	▼19	40	▲19	1
CZ	55	▼19	44	▲18	1
ES	52	▼20	41	▲23	7
CY	62	▼21	33	▲18	5
LU	56	▼22	43	▲21	1

QA11 And what should the European Union now prioritise in its response to the coronavirus pandemic? (MAX. 3 ANSWERS) (% - EU)



# Possible Macroeconomic Effects of NGEU

## Evidence from EU regional structural funds

- Canova & Pappa (2021) simulate the likely effects of NGEU:
  - Dynamic nature of the analysis: Allows for discriminating between short, medium and long-run effects
  - Exploits similarities between NGEU and ERDFs and ESF
  - Focus on regional (NUTS-2) movements in production, investments and labor markets
- ERDF and ESF policies have different growth effects:
  - ERDF: Statistically and economically significant positive short-term effects on all macroeconomic variables → useful for smoothing regional business cycles
  - ESF: Often insignificant (and sometimes negative) short-run effects but positive and significant medium-run reactions of macro quantities
- Some numbers:
  - ERDF: One percent increase (which is normalized to increase regional gross value added) has effects on employment growth of around 0.9% and on investment growth of 1.3% over three years
  - ESF: A similar increase in ESF boosts GVA growth by around 5%, investment growth by around 1.6% and investment growth of around 4.3%

# Possible Macroeconomic Effects of NGEU

## Evidence from aggregate data

- Canova & Pappa (2021) consider regional data at low (i.e. yearly) frequencies
  - Potentially masks important effects that might happen within a year and could be driven by expectations
  - Aggregate (i.e. country-wide) estimates necessary to gauge the effect NGEU might have on GDP across EA economies
- Preliminary analysis based on vector autoregressions
  - We identify an EA-wide fiscal policy shock using data on spending forecasts and actual government spending
  - This identification scheme is simple and consistent with a wide range of structural models
  - A few shortcuts: Single country analysis based on a joint shock → no feedback effects across countries (see, e.g., Canova, 2005, JAE, for a similar approach to Latin American countries)
- Some numbers:
  - A one percent increase in EA-wide expenditures boosts real GDP in most countries
  - Short-run estimates range from 0.2% (in AT) to 0.8% (in FI)
  - Medium to long-run estimates: Several countries display increases in real GDP even after around 30 years
  - These estimates underestimate the true effect: Spillovers matter!
  - Next slide: IRFs which show the reactions of real GDP per quarter across countries

# Possible Macroeconomic Effects of NGEU

Evidence from aggregate data

