IW-Kurzbericht 71/2020

Next Generation Solidarity: EU growth package instead of business cycle stimulus

Matthias Diermeier / Florian Güldner / Markos Jung

The EU-27 suffered a hard, economic hit by the Covid-19 crisis. The EU Commission is now primarily trying to support Southern and Eastern European countries. The proposed 750 billion euro stimulus is not so much aimed at counteracting the economic corona crisis but should rather be understood as a long-term growth package – coinciding with the EU's sluggish nature and supranational purpose.

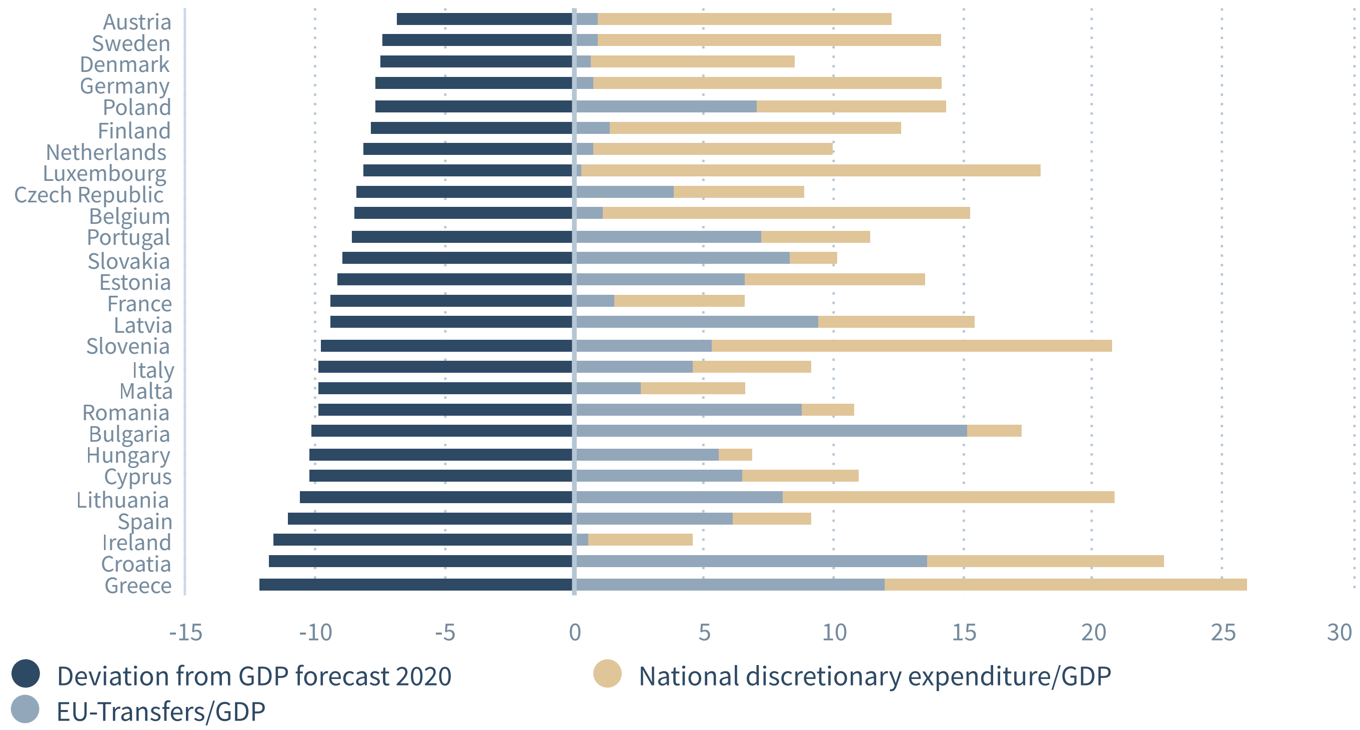
For weeks, the EU Commission, the European Parliament and the member states have been struggling to bring forward a major Corona aid package. At the end of April, after extensive negotiations, an initial 540 billion euros safety net has been agreed upon. However, this only provides for guarantees and favourable credit lines via the European Stability Mechanism and the European Investment Bank, which are available, for example, for corporate loans, the financing of expenditures in the health sector or the funding of short-time labour schemes (European Council, 2020).

The current proposals for a European crisis response go beyond this. Germany and France have presented plans for a growth programme of 500 billion euros, which is to support particularly affected states by means of transfer payments. Future EU budgets would then have to be used for the corresponding repayments (Matthes, 2020). However, such a sign of European solidarity is off limits for some member states. The "Frugal Four" (Austria, the Netherlands, Denmark and Sweden) would like to rely exclusively on loans. As of today, transfers are not an option for them. Moreover, aid should only be granted subject to strict verifiable conditionality (Frugal Four, 2020).

The proposal now to be negotiated at the EU Council summit on 19 June 2020 - the "Next Generation EU" programme of the EU Commission - includes both: 500 billion euros in transfers and a further 250 billion euros in loans. To this end, the Commission would like to issue its own bonds and repay them over 30 years starting 2028. The additional costs are to be financed by the contributions to the EU budget, but possibly also by new EU resources. Most payments are not to be received until 2023 (European Commission, 2020a). Therefore, the package is not going to trigger a rapid economic impulse for particularly hard-hit member states. The EU proposal rather focuses on investment-related measures. A special focus lies on countries with lower incomes and higher unemployment. Corona infection figures are apparently not included in the allocation formula: "In the Recovery and Resilience Facility, the Commission plans to take into account Member States' population, GDP per capita and unemployment figures from 2015 to

Important EU aid for Southern and Eastern Europe

Transfers & national expenditure in percent of GDP, deviation from real GDP forecast in percentage points



Deviation from GDP forecast 2020 = difference pre crisis winter forecast 2020 and spring forecast 2020 by the EU commission

Sources: Eurostat, IMF European Commission, Elgin et al. (2020), Institut der deutschen Wirtschaft

2019" (European Parliament, 2020). The resulting distribution of funds to the member states is currently discussed based on internal estimates by the Commission.

The EU Commission is thus attempting to go beyond the national aid packages with short-term economic impact to provide structural growth impulses for its poorer member states, particularly in the context of the "Green Deal" and structural change resulting from digitization (European Commission, 2020b). At first glance, this is consistent with the economic impact of the Corona crisis: with few exceptions, the deviation of the Commission's GDP growth forecast before and during the crisis is high in Western and Northern Europe, but remains significantly lower than in Southern Europe particularly. Especially the "Frugal Four" get off comparatively lightly. The average EU transfer payments to the Northern and Western European member states amount to about one percent of the GDP. However, this means that even the comparatively hard-hit Western European countries receive only moderate payments from Brussels. France, which was severely affected (Commission's GDP growth forecast revised by 9.3 percentage points), is expected to receive only 1.6 per cent of its GDP in EU transfers. Ireland, which was one of the countries most severely affected (GDP growth revised by 11.5 percentage points), is currently only allocated transfers amounting to 0.6 per cent of GDP. Western and Northern European countries are thus heavily dependent on their own, national business cycle and growth programmes. On average, these countries have initiated fiscal responses amounting to more than 10 per cent of their GDP - excluding loans and guarantees (Elgin et al., 2020).

This is contrasted by the high EU payments for Eastern and Southern Europe. On average, these countries would receive transfers amounting to 7.7 per cent of GDP: according to the current plan, Bulgaria is to receive as much as 15.2 per cent - Greece as much as 12 per cent (figure). However, Poland is also generously considered - although the economic damage here is predicted to be relatively mild. At the same time, national stimuli are much lower than in the richer West and North: In Eastern and Southern Europe, national programmes amount to only 6.1 per cent of GDP on average (Elgin et al., 2020). In Italy, national spending adds up to only 4.6

percent of its GDP.

A look at the national budgets reveals: for the distribution of EU funds, the national, mostly cyclical measures already decided upon are not taken into account. In countries such as Bulgaria, Romania, Slovakia and Hungary, more than four European Euros are added to one nationally spent Euro. In Estonia, Greece, Italy, Poland and the Czech Republic, national and European measures are balanced. And in Slovenia, as well as in Western and Northern Europe, a large share of the expenditures is paid from the national budgets. The EU is by no means compensating for a lack of national fiscal stimulus.

The findings are also reflected in corresponding regression analyses that attempt to explain the proposed European allocation formula. Neither national measures already adopted, nor the economic downturn provide a statistically significant explanation for the distribution of funds. Rather, only the structural, economic differences among member states were taken into account: Countries with a lower GDP per capita and countries with a higher unemployment rate in the long-term seem to receive higher transfers.

Brussels apparently did not intend to compensate the countries for economic distress or national fiscal restraint. This is in line with the EU's sluggish processes that prevent agile economic stimuli. Instead, the Commission is applying a strong crisis rhetoric to help the weaker member states structurally. This may not be transparent, but nevertheless appropriate. Finally, the harsh reaction of the capital markets - for example with regard to the spreads on Italian government bonds - shows that some national governments quickly find themselves in fiscal distress. In this situation, only relying on monetary policy impulses of the European Central Bank becomes a dead end. The necessary sign of Europe-wide solidarity during the crisis and the long-term growth effect of the onetime programme justify the package's size and its mutual funding. However, it must be ensured that repayment obligations are set transparently today, that the funds do not get lost in corrupt structures and that the projects are evaluated comprehensively.

Literature

Elgin, Ceyhun / Basbug, Gokce / Yamalan, Abdullah, 2020, Economic policy responses to a pandemic: Developing the Covid-19 economic stimulus index, Covid Economics: Vetted and Real Time Papers, Bd.3, S.40-54, datafile (June 7th, 2020), http://www.ceyhunelgin.com/ [16.06.2020]

European Commission, 2020a, The EU budget powering the recovery plan for Europe, COM(2020) 442 final

European Commission, 2020b, Proposal for a Council Regulation: establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 pandemic

European Parliament, 2020, Outlook for the European Council video-conference of 19 June 2020, https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/642843/EPRS_BRI(2020)642843_EN.pdf [15.06.2020]

European Council, 2020, Video conference of the members of the European Council, 23 April 2020, https://www.consilium.europa.eu/en/meetings/european-council/2020/04/23/ [15.06.2020]

Frugal Four, 2020, Non-paper EU support for efficient and sustainable COVID-19 recovery

Matthes, Jürgen, 2020, European fund for economic recovery from the Corona crisis, IW-Report 26/20