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The European Recovery Fund: An Effective Policy Measure to Deal with Covid-19 Consequences?

Antonia Díaz, Universidad Carlos III de Madrid

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The COVID-19 Shock

A very unlikely and tricky shock

- The COVID-19 reduces labor productivity in technologies that need team production...
  - In technologies that do not need of customer time ⇒ supply shock (manufacturing).
  - In technologies that do need customer time (a restaurant) ⇒ supply and demand shock.
- ... in plants/shops with limited space or limited labor shifts (important in unlocking phase).
- It is an negative externality ⇒ private agents do not internalize social cost of the shock ⇒ Prisoner's Dilemma.

Macroeconomics of COVID-19

Targeted policies to keep the economy alive while in hibernation

- The effect of the shock is not symmetric: movie theaters vs. Netflix. Some sectors gain, some services cannot be provided with inmune technologies.

- (I) Phase of shutdown:
  1. **Risk sharing among firms**: public guarantees to postpone payments.
  2. **State aid temporary framework:** e.g., in Spain we have ERTEs: workers stay at job, idle and covered by UI (also for self-employed).
  3. **Social protection**: help families to postpone mortgage payments, income assistance to poor families.

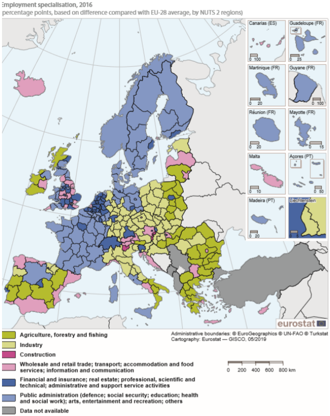
- (II) Further assistance after shutdown – because size of structures limits safe activity.

Discussion of Spain measures in Díaz & Puch: Nada es Gratis (I) (II) (III)

Macroeconomics of COVID-19

Paths of recovery

- Ricardian specialization across Europe ⇒ regions specialized in not inmune technologies will recover later. EC forecast
- Countries with lower fiscal capacity face losses of productive tissue – a transitory shock may become permanent.
- ⇒ Huge increase in public debt across Europe.



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The costs of COVID-19

Why should EU act? (I)

- Lack of policy coordination across Europe threatens the Common Market:
  - The past attempts to ban exports of face masks by some EU countries.
  - Direct state aid to firms depend on countries' fiscal capacity $\Rightarrow$ competition will be distorted.[1,2]
- We need to enhance risk sharing across EU members.

	Fiscal Imp	Defer	Guarant
France	2.4	9.4	14.0
Germany	10.1	14.6	27.2
Italy	0.9	13.2	29.8
Spain	1.1	1.5	9.1

Fiscal measures adopted in response to coronavirus by 16 April 2020*, % of 2019 GDP[3]

[1] Motta & Peitz (Voxeu.org, April 18th)

[2] Commission Statement April 9th 2020

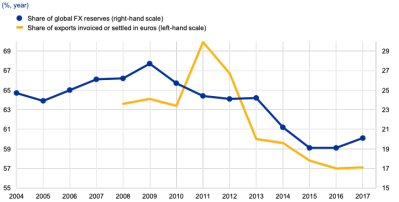
[3] Bruegel May 6th 2020

The costs of COVID-19

Why should EU act? (II)

- Instability of public finances affects the EZ as a whole.
- This effect comes from the fact that we do not have a European Treasury (uncoordinated fiscal policies, again).
- The lack of a safe asset in € hinders its use as a global currency and capital market integration.[4]
- We cannot rip the full benefits of being a global currency.[5]

Chart 3
The international use of the Euro in invoicing and reserves



Sources: ECB (2018) "The international role of the euro" statistical appendix.

[4] Reis in "20 Years of European Economic and Monetary Union"

[5] The international role of the Euro, June 2019

The costs of COVID-19

How should EU act? (I) Eurobonds?

- There are already mutualized bonds (EMS, EIB, EC) – backed by EU, not sovereign countries.
- Issuing “new” bonds (Euro/Corona bonds) jointly by various independent fiscal authorities creates a lot of moral hazard $\Rightarrow$ the details about seniority of debt are key.
- If the Spanish share of new debt is considered as ”subordinated” by the market, the new instrument will not have great advantage. If older Spanish debt is subordinated (difficult implementation), Spain will have difficulties in rising debt on its own. (See Cooley & Marimón, voxeu 2011)
- In my view, new forms of mutualized debt should not arrive in the middle of a crisis. They should come after the fiscal capacity of the EU members is improved.

The costs of COVID-19

How should EU act? (II) – The short run

- Eurogroup meeting (9/4) agreed: SURE, 100 bn €; EIB, 200 bn €; y ESM, 240 nb €. Cost of ESM funds: +45bp margin.
- What about Spain?
  Could we issue gross 300 bn €? ($\sim$ 24% of GDP 2019), (in 2011 Spain issued 249.6 bn €).

Funding of Public Treasury Spain mm €

	Debt issuance		averg cost		GDP	Deficit	Debt
Year	(gross)	(net)	stock	flow	c. p.	% GDP	
2011	249.6	96.6	4.1%	3.9%	1,064	9.7%	69.9%
2019	192.8	20.0	2.2%	0.2%	1,245	2.6%	95.5%

Díaz & Puch (2020). *Pandemic Times Economy.* In De la Fuente, Jimeno, Roldán, (eds.) *Coronaeconomics*, Penguin Random House, forthcoming.

A Recovery Plan (and beyond)

Some lessons from COVID-19

- The abrupt disruption of global supply chains rises concerns about the benefits of extreme specialization.
- In particular, the size of the industrial sector seems key to fight COVID-19.
- Robust public health systems and health related industries are essential activities.
- National responses to these challenges may endanger the Common Market and the aggregate benefits it brings.

All these considerations will make us to reconsider the costs and benefits of active industrial policies.

A Recovery Plan (and beyond)

An opportunity for coordination

Before discussing numbers and financing instruments we need to discuss coordination.

- Coordination of health measures/policies: unilateral quarantines for cross-country travelers is inefficient.
- Coordinated post-lockdown approach needed: connections between “green-light corridors” should be possible and mitigate recession in regions where tourism is the main sector.
- But first and foremost, we need to coordinate our industrial policy.

A Recovery Plan (and beyond)

An opportunity for improving fiscal capacity

- In my view, a Recovery Fund should come with a tax plan.
- It is the moment to think of a European Corporate Tax:
  - Advance in taxing digital firms, which are benefiting much from the disruption of activity during the shut-down.
  - Simplified taxation of multinational corporations.
  - Planning a unified Carbon-Tax (Dividend?).
  - Eliminating fiscal dumping among EU members.
- Much of the low fiscal capacity in Spain comes from loopholes in CIT. What if large firms pay taxes directly to a European Tax Agency?

A Recovery Plan (and beyond)

An opportunity to enhance risk sharing across EU members

- Phasing out of the GNI-based contributions to MFF and replace them with the European CIT in the long run.
- In the short run, the revenues to be used to finance the Recovery Fund
- The RF should be targeted towards sectors and regions most affected.
- I think it should be integrated within the main programs funded by the EU, which is a tested framework to allocate resources.
- We should take bold steps to invest in green technologies: since we will be issuing debt we are passing the burden of this recovery to future generations.

Thanks!

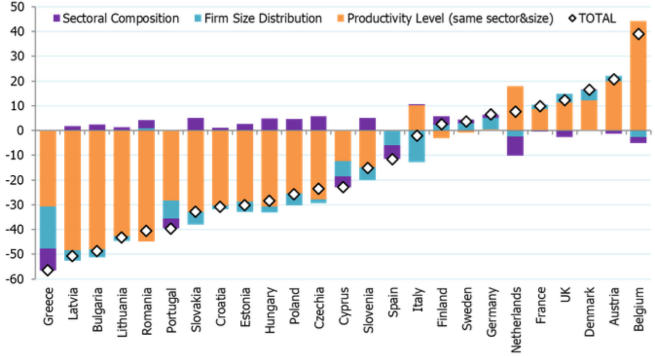
European Commission Forecast Spring 2020

Table 1:

Overview - the spring 2020 forecast

	Real GDP			Inflation			Unemployment rate			Current account			Budget balance		
	2019	**2020**	**2021**	**2019**	**2020**	**2021**	**2019**	**2020**	**2021**	**2019**	**2020**	**2021**	**2019**	**2020**	**2021**
Belgium	1.4	-7.2	6.7	1.2	0.2	1.3	5.4	7.0	6.6	-0.7	-0.1	-0.3	-1.9	-8.9	-4.2
Germany	0.6	-6.5	5.9	1.4	0.3	1.4	3.2	4.0	3.5	7.6	6.1	7.4	1.4	-7.0	-1.5
Estonia	4.3	-6.9	5.9	2.3	0.7	1.7	4.4	9.2	6.5	2.3	1.1	2.2	-0.3	-8.3	-3.4
Ireland	5.5	-7.9	6.1	0.9	-0.3	0.9	5.0	7.4	7.0	-9.4	4.6	4.4	0.4	-5.6	-2.9
Greece	1.9	-9.7	7.9	0.5	-0.6	0.5	17.3	19.9	16.8	-0.3	0.1	-1.2	1.5	-6.4	-2.1
Spain	2.0	-9.4	7.0	0.8	0.0	1.0	14.1	18.9	17.0	2.0	3.2	2.7	-2.8	-10.1	-6.7
France	1.3	-8.2	7.4	1.3	0.4	0.9	8.5	10.1	9.7	-0.1	-0.1	-0.4	-3.0	-9.9	-4.0
Italy	0.3	-9.5	6.5	0.6	-0.3	0.7	10.0	11.8	10.7	3.0	3.4	3.3	-1.6	-11.1	-5.6
Cyprus	3.2	-7.4	6.1	0.5	-0.2	1.0	7.1	8.6	7.5	-5.7	-10.9	-10.1	1.7	-7.0	-1.8
Latvia	2.2	-7.0	6.4	2.7	0.2	1.9	6.3	8.6	8.3	0.6	1.1	1.2	-0.2	-7.3	-4.5
Lithuania	3.9	-7.9	7.4	2.2	0.8	1.5	6.3	9.7	7.9	3.5	2.2	2.9	0.3	-6.9	-2.7
Luxembourg	2.3	-5.4	5.7	1.6	0.7	1.6	5.6	6.4	6.1	4.5	4.5	4.5	2.2	-4.8	0.1
Malta	4.4	-5.8	6.0	1.5	0.7	1.1	3.4	5.9	4.4	10.7	7.6	9.7	0.5	-6.7	-2.5
Netherlands	1.8	-6.8	5.0	2.7	0.8	1.3	3.4	5.9	5.3	10.2	9.0	8.4	1.7	-6.3	-3.5
Austria	1.6	-5.5	5.0	1.5	1.1	1.5	4.5	5.8	4.9	2.3	0.9	1.6	0.7	-6.1	-1.9
Portugal	2.2	-6.8	5.8	0.3	-0.2	1.2	6.5	9.7	7.4	0.0	-0.6	-0.2	0.2	-6.5	-1.8
Slovenia	2.4	-7.0	6.7	1.7	0.5	1.2	4.5	7.0	5.1	6.8	6.8	6.8	0.5	-7.2	-2.1
Slovakia	2.3	-6.7	6.6	2.8	1.9	1.1	5.8	8.8	7.1	-2.6	-2.9	-2.4	-1.3	-8.5	-4.2
Finland	1.0	-6.3	3.7	1.1	0.5	1.4	6.7	8.3	7.7	-0.8	-1.3	-1.5	-1.1	-7.4	-3.4
Euro area	**1.2**	**-7.7**	**6.3**	**1.2**	**0.2**	**1.1**	**7.5**	**9.6**	**8.6**	**3.3**	**3.4**	**3.6**	**-0.6**	**-8.5**	**-3.5**

A macro view of the size-productivity challenge in Europe

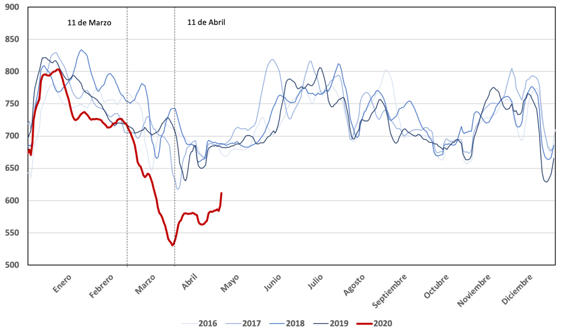


Martínez Turégano (voxeu, March 20th, 2020)

Forecasting recovery

How is activity affected by the shutdown?

Daily electricity consumption in Spain



Conde-Ruiz, García, Puch & Ruiz (Apuntes FEDEA April 2020)

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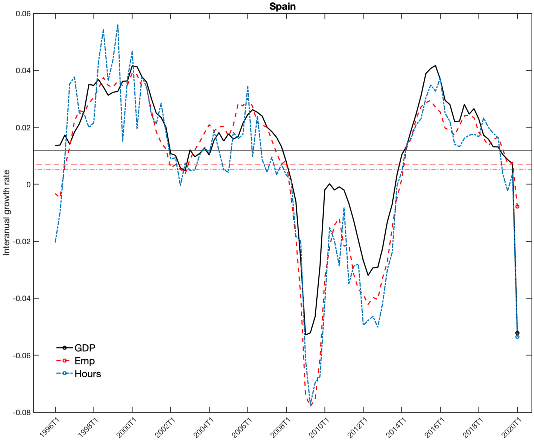
Forecasting recovery

The evolution of quarterly GDP in Spain



Own elaboration

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