Jérémie Cohen-Setton and Shahin Vallée

Measuring the European Fiscal Stance After Covid-19 from National and European Budget Plans[1]

After the panic of early March 2020, when the pandemic morphed first into a financial and then economic crisis, European governments were pressed to respond to the speed and magnitude of the Covid-19 shock. With national governments necessarily providing the bulk of the economic response, the European Union (EU) agreed to suspend the European fiscal rules and to modify State Aid rules.[2]

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After some costly hesitation the European Central Bank (ECB) announced an important Pandemic Emergency Purchase Program (PEPP), which had the effect of ensuring that all member states could expand fiscal policy as much as required by the circumstances. This program, and its subsequent extension and expansion have played a considerable role in loosening financial conditions and enabling fiscal expansions by national governments.

After weeks of European debates at the Eurogroup, the European Council complemented national emergency packages with an important European agreement for a new recovery facility rooted in the EU budget (called NextGenerationEU, NGEU) on 21 July 2020. The agreement provided a strong signal of coordination and mutual support through large common borrowing and the establishment of significant transfers, thus breaking two important past European taboos.

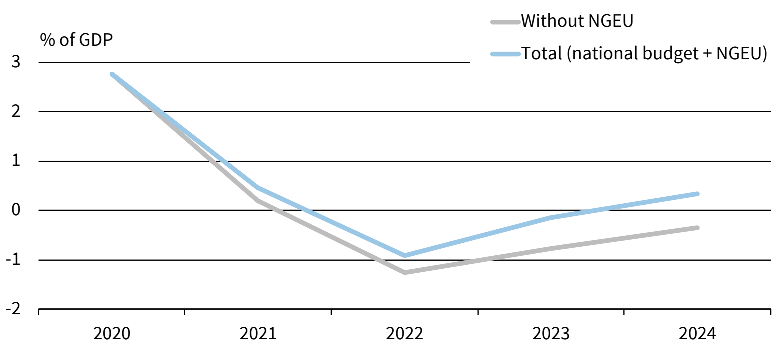
Despite these important breakthroughs, whether an adequate fiscal response will be delivered beyond 2020 remains an open question. According to our calculations based on national and European fiscal plans – the results of which are summarized in Figure 1 and explained in the remainder of the text – the strong expansionary European fiscal stance of 2020 will quickly dissipate and turn contractionary. Already in 2021, the almost complete withdrawal of emergency measures risk dwarfing the positive impulse from national and European recovery packages, whose expenditures are for the most part backloaded. After 2021, the positive contribution from NGEU will grow but is expected to remain insufficient to compensate for the large fiscal drag induced by a return to national and European fiscal rules.

These calculations are tentative. Estimating the overall euro area fiscal impulse from national budgets and from NGEU requires a number of assumptions, some of which may be disputed.

For 2020 and 2021, we for instance agree with the European Commission that an expenditure benchmark methodology is better than the structural balance methodology to obtain an estimate of the fiscal impulse from national budget plans.[3] But we disagree with the Commission's choice to fully remove emergency income support measures from the calculation of the fiscal stance because some of these measures do not simply substitute for already existing automatic stabilizers but also reinforce the level of support for a given level of output loss. In our view, adding and removing these enhancements in the social safety net thus constitutes a discretionary action, which should at least to some extent be reflected in fiscal stance indicators. Similarly, we disagree with the European Commission's choice to remove emergency medical

Figure 2

An Estimate of the Euro Area Aggregate Fiscal Stance



Note: Negative figures indicate a contractionary stance.
Source: European Commission (2020f); European Commission's assessment of national draft budgetary plans; Darvas (2020b) for NGEU amounts; IMF WEO.

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[1] The authors would like to thank Dominik Buhl and Tarin Karzai for remarkable research assistance. They thank Xavier Debrun, Anne-Laure Delatte, and Lukasz Rawdanowicz for useful comments. All remaining errors are ours.

[2] In March 2020, the Commission adopted a Communication on the Activation of the General Escape Clause of the Stability and Growth Pact (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX-%3A52020DC0112). In a 12 March 2020 decision, the European Commission concluded that the Covid-19 outbreak qualifies as an "exceptional occurrence" for the purpose of Article 107(2)(b), which foresees exceptions to the general prohibition of state aid.

[3] The expenditure benchmark methodology obtains the fiscal impulse by calculating the growth of spending (net of discretionary tax measures) in excess to potential growth. For 2020-21, it has several advantages over the structural balance methodology that obtains the fiscal impulse by calculating the change in the cyclically adjusted primary balance, net of one-offs. First, because the expenditure benchmark methodology is not affected by large shifts in tax elasticities. Second, because the expenditure benchmark methodology uses a medium-term reference rate of potential GDP growth in its calculations rather than the actual series of potential output for a given year, which has been shown to be very procyclical (Cohen-Setton and Valla 2010).

measures from the calculation of the fiscal stance. The fact that the rationale for these expenditures will cease to exist as the pandemic recedes does not annul their impact on the fiscal impulse.

Obtaining an impulse from European policies also requires that we make specific assumptions about the speed of disbursements of NGEU grants and loans and their respective contributions to the fiscal stance. Some of the assumptions that we make may be disputed, but they're presented explicitly in the remainder of the text.

These calculations are also limited in scope. To fully assess whether the size of the fiscal support is adequate, one would have to also assess the efficiency of various stimulus measures and whether fiscal policy is adequately complemented by monetary support. While important, these considerations are beyond the scope of this paper.

THE FISCAL SUPPORT FROM NATIONAL BUDGETS AFTER 2020

The European Commission Likely Underestimates the Fiscal Drag Induced by the Removal of Emergency Measures

European governments have submitted their fiscal plans for 2021 on October 15th and the European Commission has offered its assessment in November. As part of its recommendations to the Eurogroup, it will also issue a formal recommendation with a possible specific target for the aggregate fiscal stance of the euro area (European Commission 2020f).

Based on these Draft Budgetary Plans, the Commission estimates that fiscal policy in the euro area will remain broadly supportive in 2021. Yet, as can be seen in Figure 2, this assessment depends critically on whether conventional indicators of the fiscal stance—here the impulse obtained using the expenditure benchmark methodology—are corrected for the introduction in 2020 and subsequent withdrawal in 2021 of sizable temporary emergency measures.

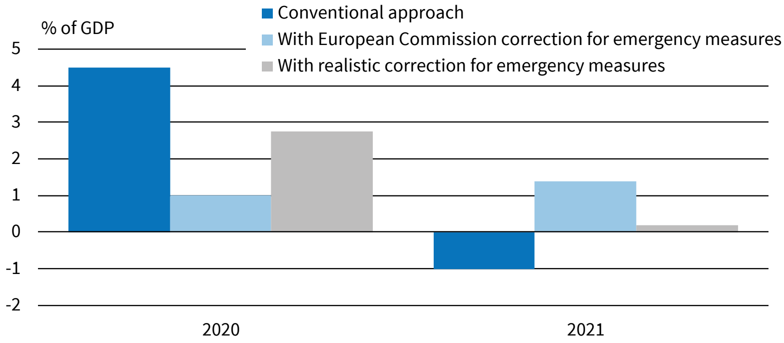
Indeed, without this technical adjustment for the planned unwinding of temporary emergency measures, conventional indicators of the fiscal stance would not point to a fiscal expansion of 1.4% of GDP in 2021 but to a fiscal consolidation of 1% of GDP.

The European Commission approach has the merit to provide a standardized way for measuring the different national fiscal policies. Prior to the European Commission's assessment and computation, member states had each accounted for emergency measures differently, with the French Treasury classifying them as "ad hoc and temporary measures" and excluding them from the calculation of conventional indicators of the fiscal stance, while other countries followed a more conventional approach and included them.

The European Commission disagreed with the French Treasury's accounting convention of classifying

Figure 2

The Euro Area Fiscal Impulse from National Policies, 2020–2021



Note: The graph shows the discretionary fiscal impulse based on the expenditure benchmark methodology. The conventional approach does not exclude emergency measures. The "European Commission correction" removes all emergency measures from the calculation of the fiscal stance. The "realistic correction" removes only 75% of Income-support measures and does not remove emergency health spending. See text for explanations. In this graph, positive figures indicate an expansionary stance.
Source: European Commission (2020f). © ifo Institute

emergency measures as "ad hoc and temporary."[4] But in arguing that "excluding the temporary emergency measures from the calculation of the fiscal stance indicators leads to a more representative assessment of the underlying fiscal support to economic activity," the European Commission effectively adopted the French convention for calculating the fiscal impulse.[5]

Saying that conventional indicators of the fiscal stance require some form of adjustment to reflect the nature of emergency measures is reasonable. After all, many emergency measures have simply replaced traditional automatic stabilizers like unemployment. But excluding all emergency measures from the calculation of the fiscal stance appears extreme.

To see why, it is useful to note that two relatively distinctive types of fiscal measures are included in the emergency measures category:

(1) Measures aimed at providing income support,
(2) Measures aimed at addressing the public health situation.

Income support emergency measures

Fiscal measures aimed at compensating workers and firms for income losses behave to a large extent like automatic stabilizers: spending increases when output declines and decreases when output recovers. And clearly, some of these measures have substituted for traditional automatic stabilizers like unemployment benefits (Cohen-Setton and Pisani-Ferry 2020). But like the extra unemployment benefits under the CARES Act in the United States, they also correspond to a discretionary and temporary improvement in

[4] The Commission has a well-developed set of principles for defining what is a one-off measure for the purpose of fiscal surveillance, which "excludes compensatory payments to households or businesses not directly triggered by the pandemic and for which the government has a larger degree of discretion." In addition, given uncertainties about the duration of these measures, most would not qualify as one-off in an ex-ante assessment – see https://ec.europa.eu/info/sites/info/files/economy-finance/opinion_on_dbp_france_analysis.pdf.

[5] European Commission (2020f).

the safety net. And they are not automatic and could fail to be reactivated if a form of stimulus fatigue settles in.

Introducing and then withdrawing that improvement in the safety net affects the fiscal impulse. At a given level of slack in the labor market, the amount of support that individuals receive to compensate them from reduced hours of work is clearly not the same under the new and the old parameters of partial unemployment schemes. For some of these emergency measures like the *Fonds de Solidarité* in France for the self-employed and microentrepreneurs, the discretionary nature of the improvement in the safety net is even starker as the pre-pandemic safety net was essentially non-existent for this category of individuals.

Because the unwinding of work-sharing schemes for regular workers or the unwinding of grants to self-employed and very small enterprises will generate a decrease in support for a given level of economic activity, at least some proportion of these measures should be included in the calculation of the fiscal stance. What that exact proportion should be is open to debate. And it goes beyond the scope of this paper to provide a definitive number. But it should not be zero. Given the size of these emergency measures (Figure 3 shows that the removal of income support measures amount to almost 2% of GDP in France and Germany), considering that even a small share of these emergency income support measures correspond to discretionary changes in fiscal policy can have a meaningful impact on the overall size of the fiscal stance. In fact, assuming that only 25% of the total amount of income-support measures correspond to discretionary changes in fiscal policy would reduce the 2021 euro area fiscal stance estimated by the European Commission by almost one-third.

Medical emergency measures

What about emergency medical measures? Should they also to some extent be included in the calculation of the fiscal stance? That choice also matters since France and Germany currently plan to withdraw emergency medical measures worth respectively 0.9% and 0.5% of GDP in 2021 (Figure 3).

Presumably, the rationale for removing emergency medical expenditures from the fiscal stance is that they fluctuate with the intensity of epidemy. And since the state of the economy is highly correlated with the public health situation, they too are countercyclical and almost automatic. Another reason for excluding these measures appears to be that "the appropriateness of their deployment should be gauged not in connection with the state of the economy but the state of public health and the restrictions it demands" (European Commission 2020f).

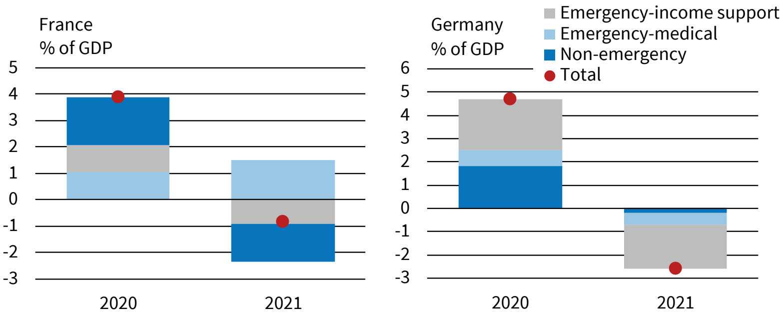
None of these reasons are convincing. The fact that extra expenditures on ICU beds and nurses were required to deal effectively with the health crisis did not make them automatic. Deploying them required new executive and legislative action. And the fact that the rationale for these expenditures ceases to exist as the pandemic recedes does not remove their effects on the fiscal stance. Like military buildups and drawdowns in the past, the introduction and withdrawal of medical emergency measures affect aggregate demand. Finally, the expenditures related to vaccination will be significant and are liable to come with an improvement in underlying economic conditions.

Altogether, the adjustment applied by the European Commission is thus likely to overestimate the actual fiscal support planned for 2021. In Figure 1, we adjust the conventional fiscal stance with what we consider to be a more realistic correction for emergency measures. More specifically and in line with the argumentation developed above, we keep all health-related expenditures and only exclude 75% of income-support measures from the calculation of the fiscal stance.

Doing this points to a much smaller fiscal impulse for 2021 at 0.2% of GDP. More fundamentally, it emphasizes the risk that recovery measures, namely in the form of extra investment expenditures and lower taxes, may not be enough to compensate for the drag associated with the unwinding of emergency measures.

Figure 3

Main Discretionary Measures Reported in the French and German Draft Budgetary Plans, 2020–2021



Note: The graph shows the budgetary impact of new discretionary measures (% of GDP-change from previous year - positive sign for deficit increasing measures).
Source: European Commission's assessment of national draft budgetary plans. © ifo Institute

The Return to Fiscal Rules in 2022 Implies a Large Fiscal Contraction

The fiscal stance after 2021 also weighs on the strength of the recovery through the expectations channel. As this point, national budgetary plans appear consistent with a return to the pre-crisis fiscal framework starting in 2022. It is not clear to us that this is a realistic proposition but we attempt to measure the fiscal impulse that such a policy would produce.

With the general escape clause activated in both 2020 and 2021, no euro-area country would start 2022 under the corrective arm of the Stability and Growth Pact (SGP), also known as the Excessive Deficit Pro-

Figure 4

Matrix for Specifying the Annual Fiscal Adjustment towards the Medium-Term Objective (MTO) under the Preventive of the Pact

	Condition	Required annual fiscal adjustment*	
		Debt below 60% and no sustainability risk	Debt above 60% or sustainability risk
Exceptionally bad times	real growth <0 or output gap <–4	No adjustment needed	
Very bad times	–4 ≤ output gap < –3	0	0.25
Bad times	–3 ≤ output gap < –1.5	0 if growth below potential. 0.25 if growth above potential	0.25 if growth below potential. 0.5 if growth above potential
Normal times	–1.5 ≤ output gap <1.5	0.5	> 0.5
Good times	output gap ≥ 1.5	> 0.5 if growth below potential. ≥ 0.75 if growth above potential	≥ 0.75 if growth below potential. ≥ 1 if growth above potential

*All figures in percentage points of GDP.

Source: European Commission (2015).

cedure (EDP).[6] The preventive arm of the SGP will thus determine the size of the required fiscal adjustment. When assessing compliance with the adjustment path, the European Commission can, in theory, consider several indicators. In practice, however, the change in the structural balance has been the indicator privileged.[7]

With the structural balance lower than the Medium-Term Objective for virtually all euro area countries in 2022, the baseline adjustment required is an increase by 0.5% of GDP per year. The required adjustment will, however, vary across economies depending on the economic cycle and the level of public debt in each country (Figure 4).

In its Autumn forecast, the European Commission (2020h) expects a negative output gap of 1.9% of potential GDP for the euro area and individual countries' output gaps ranging from -4.4 in Greece to 1% of potential GDP in Slovakia and Slovenia. In Italy, Spain, France, the Netherlands, and Germany the economy is expected to still operate below potential with negative output gaps of respectively 3.4, 2.5, 2.1, 1.8, and 1.1% of potential GDP.

Figure 5 shows the change in the structural balance as reported in Draft Budgetary Plans for the years 2022-2024. The planned fiscal paths for France, Germany, and Italy illustrate how the compliance with fiscal rules will start to shape fiscal policy choices starting in 2022.

Several features are noteworthy. First, the overall fiscal contraction planned for 2022 is large at 1.3% of GDP in 2022 for the euro area. Second, at least for Italy and Germany, the planned adjustment by their respective governments appears larger than what is strictly required by the application of European fiscal rules. For Italy, that is because the Treasury assumes a strong recovery that will bring output equal very close to potential by 2022. But for Germany, the size of adjustment appears driven by the desire to not only comply with European rules, but also with the German fiscal rules starting in 2022.

Based on its projected change in the structural balance that it reports in its DBP, Italy is planning a fiscal consolidation of 0.9% of GDP in 2022. Given Italy's debt-to-GDP ratio and the Italian Treasury forecast of an output gap of -0.1% of potential GDP in 2022, this adjustment is in line with the requirement of an annual fiscal adjustment of more than 0.5% of GDP. But the Italian Treasury forecast for the output appears quite optimistic. In its latest forecast, the European Commission for example expects that the Italian economy will operate significantly below potential in 2022 with an output gap of -3.4% of GDP. In that situation, the rules only require that Italy consolidate by 0.25% of GDP. Why the government then expects to consolidate by even more in 2023 than in 2022 is unclear.

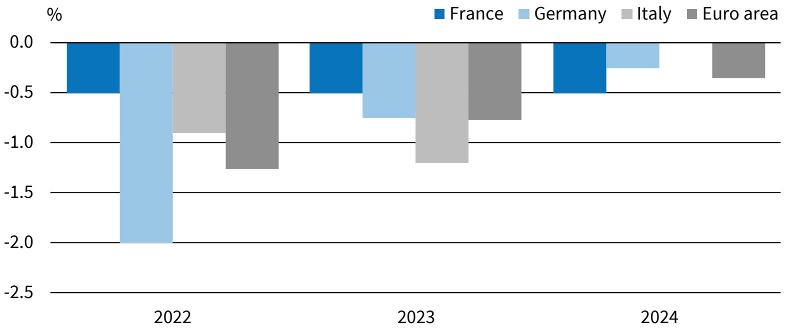
France does not directly provide information on output gaps beyond 2021 in its DBP. But the assumption that its structural balance will increase by 0.5% of GDP per year is both consistent with the fiscal adjustment specified for bad times when the economy is recovering fast, and for normal times (Figure 4). In fact, the matrix implies a 0.5% fiscal adjustment if the output gap is in line with the European Commission forecast of -2.1% of potential GDP in 2022 and the economy recovers fast. After 2022 and with normal times conditions applying, the European fiscal rules require a fiscal consolidation of at least 0.5% of GDP, which is broadly in line with what the French Treasury forecasts.

Germany is planning a particularly large and front-loaded fiscal consolidation in 2022. Clearly, part of this contraction reflects the fact that several emergency fiscal measures are planned to be fully withdrawn by the end of 2021 (see Table A1 in Appendix).

[6] In 2020, only Romania, a non-euro area EU member state, is under the Excessive Deficit Procedure.

[7] The preventive arm also requires member states to abide by the expenditure benchmark. But research by the EFB (2019) shows that the European Commission has privileged the use of the structural balance change criterion than the expenditure benchmark criterion when assessing compliance with the adjustment path. With the adoption of the six-pack reform in 2011, the debt anchor of the SGP was also operationalized with the requirement that when the debt ratio is above 60% of GDP, the excess over 60% must be reduced at an average annual rate of 1/20th. In practice, however, even a partial fulfilment of the preventive arm has been deemed sufficient to establish compliance with the debt criterion (EFB 2019).

Figure 5
The Fiscal Stance from National Policies after 2021



Note: The graph shows the fiscal impulse calculated as the (negative of the) change in the structural balance. In this graph, negative figures indicate a contractionary stance.
Source: European Commission's assessment of national draft budgetary plans. © ifo Institute

But the size of the shock is also driven by Germany's own fiscal rules, which require larger adjustments than the European rules and to which Germany seems committed. In addition, the government both at the federal as well as the state level has voted on a redemption path for the new debt incurred during the Covid-19 crisis.

Starting in 2022, the German government plans to comply with the debt brake *(Schuldenbremse)*, thereby limiting the structural primary deficit of the federal government below 0.35% of GDP.[8] The German DBP does not provide a forecast for the structural primary balance of each level of government. But the decline in the structural primary balance for the general government from 2.75 to 0.75% of GDP in 2022 is consistent with complying with debt rule and maintaining the same level of structural deficits for the other levels of government.[9]

Germany's return to its *Schuldenbremse* in 2022 will therefore play a considerable role in the aggregate fiscal stance of the euro area, regardless of whether the European fiscal rules are extended. In fact, in addition to Germany's size and mechanical contribution to the overall euro area fiscal stance, it will also influence other countries' fiscal stance in setting the terms of the fiscal debate across the euro area. If Germany starts to consolidate aggressively, it is difficult to imagine that the European Commission and other member states will ignore this precedent.

With the current suspension of fiscal rules until the end of 2021, the growing intellectual consensus for reforming the current set of rules,[10] the consultation launched by the European Commission in February 2020,[11] and the macroeconomic risks entailed by a return to the pre-crisis rules, now is the right time to have a serious discussion on how to reform the SGP or at the very least when and how to restore it.

EUROPEAN MEASURES ARE MACROECONOMICALLY MODEST

The agreement regarding the Recovery and Resilience Facility on 21 July gave a strong sense of hope about a coordinated and mutual fiscal response from the EU. It clearly marked an important political breakthrough, yet behind the relatively large headline numbers our assessment is that many of the instruments will only generate a moderate fiscal impulse. It does not mean that the European dimension of the recovery plan is macroeconomically useless, but rather that its indirect political dimension, in particular in that it enables both national fiscal policy and expansionary monetary policy will matter more than its direct economic effect.

The Genesis of NextGenerationEU

After the suspension of state aid and fiscal rules as set out in the statement of the Eurogroup of 16 March, further elements of the policy response under consideration culminated in a decision by the Eurogroup on 9 April[12] that outlined what was then thought to be a comprehensive package. It was essentially built around three key building blocks:

I. The use of the European Stability Mechanism (ESM) as a safety net to ensure governments could borrow and undertake their national fiscal response without fear of losing market access. The total size of borrowing made available for this facility would be limited at 2% of each eligible country's GDP or a total of some €240 bn.
II. The mobilization of the European Investment Bank (EIB) to enhance its ability to provide guarantees to the private sector and improve its refinancing/liquidity situation. After several rounds of discussions, Eurogroup finance minister agreed to the creation of a €25 bn guarantee fund.
III. The activation of SURE, a new lending facility proposed by the Commission on 2 April, which could provide financial assistance to member states

[8] Because the debt brake also has a cyclical component, the headline deficit will likely be higher in 2022 because output will remain below potential. This cyclical component is, however, small. In fact, it is determined by the formula $C = \eta \times (Y+a)$, where η is the budget semi-elasticity, Y is the output gap, and a is the adjustment to the federal government's current macroeconomic forecast. Using 2022 BMF estimates of Y = €-12.3 bn and $\eta = 0.203$, C will only be €2.5 bn or 0.07% of GDP. Only a planned headline deficit of 0.42% of GDP for the federal government will thus be allowed under the debt brake.

[9] The DBP forecasts no change in the headline deficit of the state and local governments and in the headline deficit of the Social Security funds between 2021 and 2022 despite the recovery in economic activity. This suggests a stable structural primary balance for these components of the general government.

[10] Blanchard et al. (2020) call for replacing fiscal rules by fiscal standards and applying a debt-sustainability test to countries' budgetary plans. Dullien et al. (2020) advocate an increase in the debt anchor to 90% of GDP and an expenditure rule for non-cyclical, non-investment expenditure coupled with a Golden Rule for public investment. EFB (2019) and calls for a simpler framework made of a debt "anchor" and a spending rule.

[11] https://ec.europa.eu/commission/presscorner/detail/en/IP_20_170.

[12] https://www.consilium.europa.eu/en/press/press-releases/2020/04/09/report-on-the-comprehensive-economic-policy-response-to-the-covid-19-pandemic/#.

in the form of loans to protect workers' unemployment benefits. The maximum amounts that could be drawn from this facility would be set at €100 bn.

While the Eurogroup celebrated this achievement as a breakthrough given the opposition of a number of member states to the use of the ESM, it was clearly understood that this package would not suffice. Already on 23 March, nine European leaders had pressed the President of the European Council to help devise a common European instrument able to issue debt and finance a significant part of the recovery effort. On 18 May, France and Germany[13] agree to the need for a €500bn Recovery Fund backed by a new borrowing capacity at the European level. This is still met with stiff resistance, and the frugal coalition[14] led by Austria and the Netherlands continues to oppose it until the adoption of the plan at the European Council of 21 July.[15]

Despite this political success, many questions remain about the European plan's true recovery potential in particular the extent to which it is drawn by member states, the use of the funds at they will be outlined in the National Recovery Plans to be submitted by April 2021 and assessed by the European Commission and the financing of the recovery plan over time, where the share of true own resources vs. national contributions will have significant impact on its intertemporal effects.[16]

Given this uncertainty over the timing and the extent of the measures surrounding the European Recovery and Resilience facility, national fiscal policy will play the central role in the recovery. In reality, the European Recovery and Resilience facility is more important politically and symbolically than economically. Indeed, by sanctioning politically common borrowing and transfers between member states, European leaders have enabled national fiscal policy to play its role fully.

[13] https://www.bundesregierung.de/resource/blob/975226/1753772/414a4b5a1ca91d4f7146eeb2b39ee72b/2020-05-18-deutsch-franzoesischer-erklaerung-eng-data.pdf?download=1.

[14] https://www.euractiv.com/section/economy-jobs/news/frugal-four-present-counter-plan-to-macron-merkel-eu-recovery-programme/.

[15] https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf.

[16] The ORD concerning the recovery plan and the budgetary framework for 2021-2027 has been approved in September 2020. It confirmed that the European Commission is allowed to borrow temporarily on capital markets in accordance with the NextGenerationEU recovery plan and the Multi-Annual Financial Framework. Furthermore, the ORD approved the new own resource ceiling to cover annual appropriations for commitment and for annual appropriations. Since 2018, the ceilings were set at 1.35% and 1.29% of the EU GNI. Both numbers were increased by 0.11 percentage in the light of Brexit. Hence, the permanent ceilings are set at 1.46% and 1.40%. However, due to the extraordinary circumstances of the Covid-19 crisis and the EU's borrowing plans, the Commission proposed increasing the ceiling temporarily to 2.0% of the EU GNI. Hence, this increase is not permanently and rather artificial since it is necessary to enable the EU to borrow the funds required for the recovery. According to the Council's (2020) timeline first proposals will be provided within the first semester of 2021 and legislation should be introduced latest by 1 September. If new own resources are introduced, the GNI contributions of the member states will be adjusted.

NextGenerationEU (NGEU): Overview of Programs

While there was an initial political debate as to whether the recovery plan should flow through the EU budget or through an ad hoc inter-governmental arrangement, there was, in particular from Germany, a strong pressure to uphold the unity of the EU, strengthen European institutions, and avoid another inter-governmental construct. This means that even though the recovery fund and its instruments are designed to be temporary, they are being developed and implemented via a budget that is permanent in nature.

The NGEU program authorizes the Commission to borrow up to €750 billion in 2018 prices until 2026 and repay this debt by 2058. The biggest share of the mobilized resources is provided as grants and loans to the member states through the Recovery and Resilience Facility (RRF), while the rest is allocated to existing or within the MFF newly created EU policy programs that are focused on a specific sector or objective (see Table A2 in Appendix).

NextGenerationEU: Grants and National Recovery and Resilience Plans

Perhaps the most macroeconomically important and the most hotly negotiated element of the recovery plan has been the portion of grants to be disbursed to member states and the sharing of these resources. Over the course of the negotiations at the European Council, this was widely perceived as the central piece of the package. Securing a large grant portion came at the expense of European instruments that would have been centrally decided by the European Commission.

As a result, it remains that even though some of the recovery plan is financed at the EU level, its delivery is largely decentralized. The National Recovery and resilience plans to be submitted by EU member states as well as the approval and monitoring by the Commission are meant to provide some coordination and validation but this is likely to be limited.

As a result, the allocation per member states is central and is determined through distribution key proposed by the Commission both in time and by country: "for 70% of the total amount of €312,5 billion available in grants, the allocation key will take into account the Member State's population, the inverse of its GDP per capita, and its average unemployment rate over the past 5 years (2015-2019), always compared to the EU average. For the remaining 30%, the formula will replace the 2015-2019 unemployment rate indicator by the observed loss in real GDP over 2020 and the observed cumulative loss in real GDP over the period 2020-2021" (European Commission 2020e).

Hence, the first grants favor countries that are more severely hit by the socio-economic crisis. The redistributive character of the program will create net beneficiaries and net contributors. This can be

Table 1

RRF Grants and Net Fiscal Effect

Country	Total RFF grant in € billion (2018 prices)	RFF grant in % GNI (2018 prices)	Contribution to EU budget in % of GNI (2018 prices)	Difference between RFF grant and contribution
France	37.394	1.5	0.67	0.83
Germany	22.717	0.64	0.67	-0.03
Italy	65.456	3.6	0.66	2.94
Netherlands	5.572	0.68	0.69	-0.01
Spain	59.168	4.72	0.66	4.08

Note: Data on member state GNIs and their contributions are provided by the European Commission data chart on EU expenditure and revenue 2014-2020.
Source: European Commission (2020).

illustrated by comparing the total amount of grants received as a percentage share of the Member State's GNI and its contribution to the EU budget as a percentage share of its GNI (Table 1).

In what follows, we take the estimated grant components for Euro Area countries (Table 2) and add them to the fiscal stance obtained from national budgets. Assuming that the NGEU grants fully add up to the fiscal stance obtained from national budgets implies that none of the spending financed by NGEU grants would have otherwise happened (no substitution) and that none of the liabilities that these grants generate will be repaid before 2026 (no repayment).

Both assumptions are debatable. Indeed, at least some of the grant money is likely to be used for projects that would have otherwise been financed with domestic sources of financing. And at least some of the NGEU grants will likely be repaid in the form of larger EU budget national contributions or through new European taxes before 2026 and thus subtract from the overall fiscal impulse. But these simplifications are useful for making the point that, even under these generous assumptions, the European fiscal impulse is small.

NextGenerationEU: Loans Only Provide Modest Fiscal Boost If Used

In addition to these grants, member states can apply for loans provided by the RFF for up to 6.8% of their Gross National Income (GNI). Member states might be inclined to do so if they can save borrowing costs un-

Table 2

Payments from NGEU Grants (Billion Euros)

	2021-2026	2021	2022	2023	2024	2025	2026
Euro area	331.9	30.4	43.8	79.3	91.8	52.9	33.7
% of GDP		0.3	0.4	0.6	0.7	0.4	n.a.
Austria	4.3	0.4	0.6	1.0	1.1	0.7	0.5
Belgium	7.0	0.6	1.0	1.6	1.8	1.2	0.9
Cyprus	1.3	0.1	0.2	0.3	0.4	0.2	0.1
Estonia	1.6	0.2	0.2	0.4	0.4	0.3	0.1
Finland	3.3	0.3	0.5	0.8	0.9	0.6	0.4
France	48.5	4.5	6.3	11.4	13.0	8.0	5.3
Germany	30.9	3.0	4.1	7.2	8.1	5.1	3.4
Greece	21.2	2.0	2.8	5.1	5.8	3.4	2.1
Ireland	2.0	0.2	0.3	0.5	0.5	0.3	0.2
Italy	89.3	8.0	11.8	21.5	25.3	14.0	8.7
Latvia	2.4	0.2	0.3	0.6	0.7	0.4	0.2
Lithuania	3.2	0.3	0.4	0.8	0.9	0.5	0.3
Luxembourg	0.3	0.0	0.1	0.1	0.1	0.0	0.0
Malta	0.4	0.0	0.1	0.1	0.1	0.1	0.0
Netherlands	7.7	0.7	1.1	1.8	2.0	1.3	0.9
Portugal	16.8	1.6	2.1	4.0	4.6	2.7	1.7
Slovakia	7.5	0.7	1.0	1.8	2.1	1.2	0.8
Slovenia	2.2	0.2	0.3	0.5	0.6	0.4	0.2
Spain	82.0	7.3	10.9	19.9	23.5	12.6	7.8
Non-euro area	88.3	8.8	11.6	20.9	23.6	14.6	8.8

Note: Amounts expressed in current prices. The calculations in Darvas (2020b) include not only the six components of NGEU grants (RRF, ReactEU, Just Transition Fund, EAFRD, rescEU, Horizon Europe), but also €5.6 bn in 2018 prices of InvestEU guarantees. Given the small number of guarantees, we did not attempt to remove the guarantee components from the total.
Source: Darvas (2020b) for NGEU amounts; IMF WEO October 2020 Database for EA forecasts of nominal GDP.

Table 3

RRF Loans and Net Fiscal Effect (Billion Euros)

		Scenario 1: full use of potential amount of 6.8% of GNI		Scenario 2: 50% use of potential amount of 6.8% of GNI	
Country	Bond yields (2019)	Amounts	Savings per year	Amounts	Savings per year
France	0.13%	169.35	0.22	84.67	0.11
Germany	-0.25%	241.3	-0.6	120.65	-0.3
Italy	1.95	123.46	2.41	61.73	1.2
Netherlands	-0.07	55.58	-0.39	27.79	-0.02
Spain	0.66	85.08	0.56	42.54	0.28

Note: Data on bond yields provided by Eurostat (Eurostat 2020).
Source: Darvas (2020a).

der the RFF, since the EU provides these loans under favorable terms. But like ESM loans, stigma appears to have been attached to the use of this facility, with several member states already indicating that they would abstain from drawing on these funds.

The fact that stigma remains attached to using a facility with very limited conditionality (commitment to abide by Country Specific Recommendations) speaks to the scars left by IMF and ESM programs during the sovereign debt crisis. Beyond the stigma and scars, the economic benefits appear in any case relatively modest for borrowing member states so long as the ECB carries on with its current purchase program and maintains low financing rates for member states.

While the intertemporal benefits of these borrowing (the net present value of the lower borrowing cost) is not small and could justify the effort (Darvas 2020a), the contemporaneous savings for each single year is rather moderate. Under current conditions, the financial gains from lower borrowing costs are in the millions (Table 3). Given these small financial gains and the willingness of markets to provide funding for member states, we do not think that the loan component of NGEU will generate new extra spending. Unlike for grants, we therefore do not add these amounts to the overall fiscal impulse for the euro area.

ESM Loans Will Not Be Used

The clear rejection of the ESM loans as a useful instrument to deal with this crisis is an important political turn. The fact that no member state wanted to use them, and that the ECB explicitly stated that it was not the right instrument for this crisis[17] clearly undermines the case for its economic contribution to the recovery.

For all intents and purposes, very much like the RRF loans, an ESM loan would in any case only be macroeconomically useful if the ECB stopped containing government bond yields through its policies. Even if it stopped, it is natural that member states would always prefer instruments that appear or truly come with the least economic conditionality and political cost. The ESM ranks last in this pecking order and it is therefore expected that none of the funds made available will be used during this crisis. This in turn raises more fundamental questions about the future of the ESM, especially now that it no longer has a monopoly over joint European borrowing (Guttenberg 2020).

SURE Program

The temporary Support to mitigate Unemployment Risks in an Emergency (SURE) is part of the EU's temporary and coordinated response to the coronavirus crisis. It allows providing financial assistance in the form of loans to support member states' sudden rise in public expenditure due to short-time work schemes or similar job-retention measures. In addition, the loans can also be used to finance health care measures related to the Covid-19 pandemic.

While this initiative was in the works for a while, it was legislated and implemented at remarkable speed. To provide SURE loans to member states, the European Commission was allowed to issue social bonds.[18] The bonds are backed by voluntary guarantees of up to €25 bn from member states in accordance with their relative share in the EU's Gross National Income (GNI) from the 2020 EU budget. The implementation and usage of the loans granted is monitored by the Commission, which reports to the European Parliament (EP), the European Council, the Economic and Financial Committee, and the Employment Committee. But, unlike ESM loans, SURE have been broadly viewed as being offered without conditionality.

Of the €100 billion in loans made available by SURE, €90.3 billion have already been requested by a total of 18 countries. All requests have been approved and €31 billion have already been disbursed.[19]

[17] https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp201119_transcript~353ee9966e.en.pdf?e776a01e4d652a18ec61dde92bfcd272.

[18] Social bonds are a special bond framework that signals to investors that the resources mobilised will be used to address the socio-economic crisis caused by the pandemic (European Commission 2020d).

[19] The amounts disbursed and requested are as follows: Belgium (€7.8 billion), Bulgaria (€511 million), Czechia (€2 billion), Greece (€2 billion/€2.7 billion), Hungary (€504 million), Spain (€10 billion/€21.3 billion), Croatia (€0.51 billion/€1 billion), Italy (€16.5 billion/€27.4 billion), Cyprus (€250 million/€479 million), Ireland (€2.5 billion), Latvia (€120 million/€192 million), Lithuania (€300 million/€602 million), Malta (€120 million/€244 million), Poland (€1 billion/€11.2 billion), Portugal (€5.9 billion), Romania (€4 billion), Slovakia (€631 million), Slovenia (€0.2 billion/€1.1 billion). Disbursements obtained from 11/07 and 12/1 European Commission press releases.

That almost all financial resources provided under SURE are exhausted demonstrates that this assistance was needed.

Yet, its macroeconomic impact remains limited, not only because of its relatively small size, but also because the actual support from loans is much lower than from grants. Our simple calculation suggests that at the current level of interest rates, savings in interest costs for euro area member states are negligible. At the current 10-year yield rates, Spain and Italy for example only save around €23.5 million and €180 million in borrowing costs per year.[20] SURE is thus only marginally supporting Member States' responses to the crisis.

EIB Guarantees

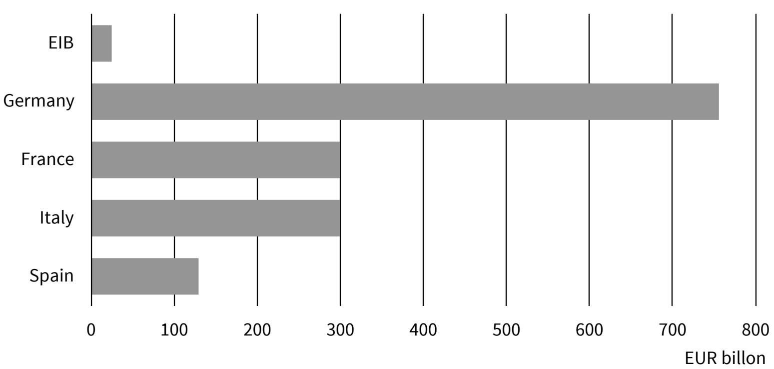
In addition to SURE, the European Investment Bank (EIB) is taking part in the concerted EU response to the pandemic and its socio-economic consequences. The EIB provides credit lines and financial support to businesses in the EU, especially to small- and medium-sized enterprises (SME) facing severe liquidity and funding needs in the light of the pandemic.

The EIB created a €25 billion European Guarantee Fund (EGF) backed by member state contributions that are determined in accordance with their share in the EIB and other institutions. The EGF is expected to enable further lending of up to €200 billion from the private sector, but these leverage calculations are fraught with uncertainty. In addition, it is not clear that the EIB can focus on countries where domestic institutions lack the capability of providing similar and these resources are most needed. When compared to the corporate sector guarantees underwritten across the EU by governments and their promotional banks these numbers appear extraordinarily modest if not irrelevant (Figure 6).

[20] The calculation uses a simple geometric mean of November 10-year yields rates for Spain and Italy of respectively 0.11%, and 0.642%. Using the higher interest rates that these two countries faced back in March 2020 (1.25% for Spain and 2.39% for Italy) would have yielded savings of €266 million and €658 million per year.

Figure 6

Total Envelopes of EIB and National Guarantee Schemes



Source: EIB (2020).

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CONCLUSION

Measuring the aggregate European fiscal stance after Covid-19 is difficult. National and European measures overlap. Traditional indicators of the fiscal stance are affected by a myriad of technical problems. And uncertainty remains about the time it will take to vaccinate the population and the resolve of governments to maintain fiscal support. The difficulty of the task is, however, no excuse to avoiding it and this paper tries to provide a transparent attempt.

According to our tentative estimates, after being strongly expansionary in 2020, European fiscal policy is expected to be only mildly expansionary in 2021 and turn sharply contractionary in 2022. This suggests that, despite NGEU and talks of national recovery packages, the necessary fiscal policy support is far from guaranteed beyond the acute phase of the crisis. Indeed, the policy response has allowed spending whatever it takes to allow a freezing of the economy without too many social ramifications and avoided the failure of otherwise healthy companies. But the fiscal plans for 2021 are probably not stimulative enough to encourage a rapid recovery especially if governments withdraw emergency support measures as currently planned.

At the European level, the recovery plan while symbolically meaningful has two fundamental weaknesses: it is largely based on loans rather than grants, and the grants part has come at the expense of truly European instruments. As a result, its delivery still relies on national fiscal planning and disbursement capacity. There are therefore still considerable execution risks that could upend the EU's recovery plans, dealing a blow to the general confidence financial markets have shown in the EU's crisis response.

At the national level, member states still have to prepare National Recovery and Resilience Plans[21] for 2021, whose assessment will in principle be rapid and uncontroversial, but which could open up debates and tensions if certain member states are not deemed consistent enough with the country-specific recommendations. Then they have to prepare their fiscal plans for 2022 that could be largely driven by the EU's return to the Stability and Growth Pact. These two important milestones could be central in determining the appropriateness of the European aggregate fiscal stance, which in any case is on course to be far smaller than that of other advanced economies.

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Table A1

Emergency and Non-emergency Measures in the Five Largest Euro Area Countries

Emergency measures aimed at addressing the public health situation:	
Germany	Additional health spending for hospital beds and purchase of protective equipment (0.7% of GDP in 2020; 0.2% of GDP in 2021).
France	Additional expenditure to strengthen healthcare services (0.4% of GDP in 2020).
Italy	Transfers to lower levels of government (1.3% of GDP in 2020; 0.1% of GDP in 2021) and additional resources for healthcare, education and research (0.3% of GDP).
Spain	Creation of a Covid-19 fund to help regions ensure the provision of essential public services (1.4% of GDP in 2020; 0.1% of GDP in 2021), a transfer to finance higher health expenditures by the regions (0.3% of GDP in 2020; 0.1% of GDP in 2021), additional resources for the health ministry (0.1% of GDP in 2020; none in 2021).
Netherlands	Higher health care contributions (+0.1% of GDP in 2020).
Emergency measures aimed at compensating workers and firms for income losses:	
Germany	Kurzarbeit, short-time work, scheme to keep people employed (until the end of 2021) (0.8% of GDP in 2020; 0.2% of GDP in 2021), support for SMEs (0.8% of GDP in 2020; 0.1% of GDP in 2021), and support for self-employed (0.6% of GDP in 2020; none in 2021).
France	Funding of a partial unemployment benefits scheme (1.4% of GDP in 2020; 0.4% of GDP in 2021), the creation of a solidarity fund and other support measures to provide direct support to small and very small enterprises as well as self-employed (0.8% of GDP in 2020).
Italy	A wage supplementation scheme and financial support scheme for the self-employed (2.1% of GDP), the compensation for losses experienced by firms (0.7% of GDP), budget provision for guarantees from the enlarged "SMEs guarantee fund" (0.5% of GDP). These measures have been reinforced with the second wave (0.3% of GDP).
Spain	A short-term work scheme, measures for the self-employed and for the workers ill with Covid-19 (3.0% of GDP in 2020; 0.4% of GDP in 2021).
Netherlands	Preserve employment (NOW, temporary emergency measure for employment opportunities, short-term work scheme paid to the employer, 1.8% of GDP in 2020); supporting self-employed (TOZO, temporary emergency measure bridging scheme for independent entrepreneurs and flex-workers, 0.4% of GDP in 2020); and compensate entrepreneurs in affected sectors (TOGS and TVL, income support for entrepreneurs in affected sectors, 0.4% of GDP in 2020).
Non-emergency measures aimed at fostering the recovery:	
Germany	Stabilization of social security contribution rates, the reduction of supplement for green energy and a VAT tax cut (0.7% of GDP in 2020; 0.5% of GDP in 2021).
France	Hiring bonuses, additional public investment and subsidies to businesses (0.2% of GDP in 2020), permanent reduction in taxes on production (0.4% of GDP in 2021), permanent increase in mainly healthcare wages and increased health care expenditures (0.2% of GDP in 2021). Additional measures to reinforce the healthcare system (0.3% of GDP in 2021).
Italy	Suspension of the regional tax on productive activities (0.2% of GDP in 2020), lowering of social security contributions, extension of tax incentives in poorer regions (0.4% of GDP in 2021), tax credit for employment income (0.1% of GDP in 2021) and a new streamlined family bonus (0.2% of GDP in 2021).
Spain	Nationwide minimum income scheme (0.1% of GDP in 2020; 0.1% of GDP in 2021), salary increase in the public sector (0.3% of GDP in 2020; n.a. for 2021), pension revalorizations (0.1% of GDP in 2020; 0.1% of GDP in 2021).
Netherlands	Permanent reduction of the lower income tax rate, an increase in the labor tax deductibility,a reduction in the lower corporate tax rate.

Source: Draft Budgetary Plans (2020).

Table A2

The Programs Underlying NextGenerationEU

Program	Implementation	Resources[(a)] (€bn in 2018 prices)
Recovery and Resilience Facility (RRF)	70% committed in 2021-22, 30% in 2023. Actual payments will however be disbursed from 2021 to 2026.[(b)] Member states prepare a national recovery and resilience plan consisting of a reform and investment strategy for 2021-2023 allowing for a green and digital transition and taking into considerations the country specific-recommendations by the European Commission. The national RFF plans will be reviewed and adapted in 2022 for final allocation of funds in 2023. The Commission assesses national plans within two months of submission and Council approves assessment (QMV). Each member state can take up a loan up to 6.8% of its GNI. Countries repay the loans they issue but benefit from favorable terms. The timeline for commitments and payments is the same as for grants. Pre-financing for the RFF is scheduled for 2021 and amounts 10%.	672.5 Loans: 360 Grants: 312.5
Recovery Assistance for Cohesion and the Territories of Europe (ReactEU)	Funding for cohesion policies and aid for deprived regions while commitments to high-income member states are capped. The allocation key is based on the experienced decrease in GDP and the level of as well as the change in total and youth unemployment. Provides funding for employment subsidies, short-time work schemes, youth employment measures and liquidity and solvency for SMEs. Allocated to projects via member states' managing authorities.	47.5
Horizon Europe	EU's investment program in Research and Innovation to facilitate technological advancement, digitalization and an eco-friendly economy.	5
InvestEU	Provision of an EU guarantee for the EIB and national promotional banks to support and strengthen i) investment in sustainable infrastructure, ii) R&I and digitalization, iii) SMEs and midcaps, iv) social investment, and v) the development of strong and resilient value chains.	5.6
European Agricultural Fund for Rural Development (EAFRD)	Support for rural areas, agricultural and forestry sectors (co-financed by member states) to help structural changes required by European Green Deal.	5
Just Transition Fund	Alleviating socio-economic impacts of regions that are most affected by transition to a green economy due to large carbon-intensive sectors and industries or coal mining.	10
RescEU	Grants and procurements managed by the European Commission that shall be used to strengthen infrastructure for health emergency responses.	1.9
		TOTAL: 750

Note: [a] Numbers based on the Final Conclusion of the July 21, 2020 European Council. These numbers are still valid as 11 November 2020, but may evolve following negotiations with the European Parliament; [b] A commitment is a promise to pay, not a disbursement.
Source: Authors' compilation.