From Crisis to Recovery: The EU Response to the Covid Crisis

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The Covid Shock: Whatever it Takes

• An atypical crisis: demand-cum-supply shock

• Most of the emergency response was put in place by countries (repeat after me, we are not the United States of Europe)

• Massive fiscal effort to:
  ▪ Scale up health care capacity
  ▪ Keep the economy alive when in lockdown
    - Sustain incomes (job retention schemes, unemployment benefits etc)
    - Provide firms with liquidity (guarantees, loans, deferral of payments, subsidies)

• The EU acted as a facilitator
  ▪ ECB: PEPP
  ▪ Commission:
    - Suspension clause of SGP
    - Softer state aid rules
    - Financial assistance (e.g., SURE, Pandemic ESM, etc)
Unprecedented support for labour markets

Figure 3.9. Public Spending on Retention and Reallocation Policies: Before COVID-19 and Response to COVID-19
(Percent of GDP)

Average public spending to preserve employment after the COVID-19 shock is dramatically larger than job retention spending in the past. The rise in health sector spending alone is on par with average spending on reallocation in the past.

Sources: IMF, COVID-19 Policy Tracker; Organisation for Economic Co-operation and Development; and IMF staff calculations.
Note: Bars show the average public spending on the indicated area as a share of GDP. See Online Annex 1 for further details.
Labour market support: the case of France

• April 2020 “Activité partielle” (job retention scheme)
  ▪ 70% of gross wage paid by the government. Extended to services
  ▪ (Partially) renewed until June 2021
  ▪ Total cost, €27bn (1.3% of GDP). In December 2.4mln workers still covered
  ▪ The advantages of job retention schemes: No need to explain to this crowd!

• Cut social contributions for firms

• Labour markets and the Plan de relance
  ▪ €100bn in 2 years (40% financed by Next Generation EU)
  ▪ Mostly public investment and incentives for private investment
  ▪ Measures for labour markets:
    - Youth training (€9bn)
    - Long run “activité partielle” and retraining (€7.6bn)
    - Training (€1bn) and social inclusion (€0.32bn)
A costly dam...

Change in Public debt as % of GDP

Source: European Commission AMECO
...but also quite a successful one: Eurozone

<table>
<thead>
<tr>
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<th>% Change 2019-2020</th>
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<tr>
<td>Real GDP</td>
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<td>Gross wages and salaries</td>
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<td>Employment</td>
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Source: European Commission Ameco Database
The medium run: Recovery and structural transformation

• The challenges ahead
  ▪ Restart growth
  ▪ Jump on a (socially, environmentally) sustainable growth path
  ▪ Manage the debt legacy

• These are tasks beyond individual countries’ possibilities
Investing for the Recovery: Next Generation EU

- Large borrowing by the Commission (€750bn).
  - Distributed to countries in grants (€390bn) and loans (€360bn)
  - Repaid in 2028-2058
  - A complement to the MFF (€1050bn)
- Main instrument, Recovery and Resilience Facility (€672.5bn)

- Three priorities
  - Ecological transition
  - Digitalization
  - Cohesion

- Climate action is the main item
  - 37% of National Recovery and Resilience plans investment
  - Just transition Fund, created for investments in low-carbon energy. (€10bn)
Public Investment at the Centre of the Stage

- A broad (tangible and intangible) definition of public capital
- Public Investment in EU declined from 2008 to 2016. Infrastructure: -25%
- Fiscal consolidation identified as the main driver of the drop
- The German case
  - Severe deterioration of public capital stock since 2000
  - Demographic change, decarbonization and digitalization → Additional investment needs
  - Sector by sector analysis leads to the estimation of €450bn over the next decade.


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A Preview: Out on December 1st!

Part I - Outlook
1. Public investment in the pandemic – Europe at a glance (A. Brasili, A. Kolev, D. Revoltella, J. Schanz)
2. From fiscal consolidation to the Plan de relance: investment trends in France (M. Plane, F. Saraceno)
3. Public investment in Germany: much more needs to be done (Katja Rietzler, Andrew Watt)
4. Relaunching public investment in Italy (Giovanni Barbieri, Floriana Cerniglia)
5. Public investment in Poland (Adam Czerniak, Sebastian Pluciennik)

Part II – Challenges
7. Crowding In-Out of Public Investment (Luigi Durand, Raphael Espinoza, William Gbohoui and Mouhamadou Sy)
8. Investing in Health (Pierre Yves Geoffard)
9. Education, human capital and social cohesion (Lieve Fransen, Romano Prodi, Edoardo Reviglio)
10. Covid-19 and the corporate digital divide (Desiree Ruckert, Reinilke Vugelers, Antilia Virginie, Christoph Weiss)
11. EU Investment in Energy Supply for Europe (Carlo Jaeger, Diana Mangalagiu)
12. Environmental Impact Evaluation of a European High Speed Railway Network along the ‘European Silk Road’ (Mario Holzer, Katharina Weber, Muhammad Usman Zahid, Maximilian Zangl)
13. Cohesion Policy and Public Investment in the EU (Giuseppe Coco, Raffaele Lagravinese)
Some concluding remarks

- The US vs the EU: beware of comparisons
  - Different institutions play an important role: Automatic stabilization does not make the headlines, but it counts!
  - Fiscal space is an issue for most of the world economy

- Massive fiscal effort. Who will pay? If all goes well, nobody!
  - Secular stagnation and low interest rates
  - Chronic excess private savings requires chronic government negative savings
  - Investment creates debt but also capital
  - The key to debt sustainability is credibility

Source: Lukasz and Summers 2019