EU INDEPENDENT
FISCAL INSTITUTIONS

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Foreword

Since the rapid spread of Covid-19 at the end of 2019, Europe and the US are now particularly affected. This public health emergency and the need to place European lives at the top of policy priorities has led to measures never seen in peacetime. Lockdown measures have severely disrupted economic activity in most countries.

The Covid-19 pandemic affects European economies through both supply and demand channels. If not properly counteracted, the deeper disruption of economic activity may cause long-lasting social and economic damage. Preserving the Single Market's integrity and, more broadly, Europe's productive potential is a critical priority. Swift fiscal action is needed to counter the economic downturn and restore economic activity as soon as the emergency is over.

To date, we have seen policy responses from the ECB, the European Commission and individual countries. The ECB reacted with additional monetary actions in March. The European Commission has activated the general escape clause in the Stability and Growth Pact (SGP) and suspended state aid rules. Member states throughout the EU have announced and are implementing various fiscal measures to contain the economic fallout.

In this special edition of the European Fiscal Monitor we summarise and compare the discretionary fiscal responses of 26 European economies. Through the eye of the Independent Fiscal Institutions (IFIs), we look not only at adopted measures but also at the deterioration of budget balances, where estimations are available, due to lower tax revenues and higher unemployment benefit payments. This edition reflects the observations of IFIs at the end of March. Measures under discussion at the national level and further estimations will be added when adopted.

Within their respective remits, the EU IFIs stand ready to closely monitor the budgetary situation as it evolves. The EU IFIs also stand ready to cooperate with EU and national institutions to design sustainable fiscal policies once the crisis is over to ensure that public finances return to a sustainable path.

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Introduction

Covid-19 is having a significant negative impact on the EU's economies. On the one hand, lockdowns restrict business-as-usual, causing a significant drop in output and a surge in unemployment. On the other hand, it lowers aggregate demand as individuals are asked to stay at home and reduce spending.

Based on the first estimations by EU IFIs, **Covid-19 could negatively impact budget balances in 2020 by 2.4% to 5.2%**. However, some EU member states have indicated that the budgetary impact could be up to four times larger if lockdown measures remain in force until the end of the year.

This special edition of the European Fiscal Monitor provides an overview of the fiscal measures taken in response to Covid-19 in 25 EU member states[1] and the UK.

Escape clauses

As of 31 March 2020, **14[2] out of the 26 countries have triggered national escape clauses** to suspend national budgetary restrictions. These clauses can only be activated in exceptional circumstances. For example, the German constitution allows the state to issue public debt of more than 0.35% of nominal GDP only in an emergency and upon the parliament's approval. On March 25th the German parliament activated the national escape clause and approved issuance of public debt amounting to EUR 156 billion (4.5% of GDP) to finance the impact of the shock and response measures.

In addition, the budgetary restrictions formulated at EU level have been suspended with the decision of the European Council to trigger the general escape clause embedded in the SGP. Member states can now deviate from the SGP-defined budget deficit and public debt levels. In some EU member states the general escape clause at EU level and the national escape clauses are directly linked. For instance, in Portugal the national escape clause was automatically triggered by the decision on the EU's general escape clause.

The fiscal capacity of some EU countries is also constrained by other policies. For instance, they are still subject to country-specific requirements. These must be adjusted separately. For instance, Greece would, according to the conditions of the Financial Assistance received in the past, have a primary surplus of at least 3.5% of GDP in 2020. However, the eurozone finance ministers agreed to suspend this target on March 16th, giving Greece more fiscal space to mitigate the consequences of the crisis.

[1] AT, BG, CY, CZ, DE, DK, EE, ES, FI, FR, GR, HR, HU, IE, IT, MT, LT, LU, LV, NL, PT, RO, SE, SI, SK.

[2] AT, BG, CZ, DE, EE, FR, GR, HR, IT, LT, LV, PT, RO, SI.

Fiscal measures

All countries have implemented some sort of fiscal stimulus in response to Covid-19 (see Figure 1). Although all European counties are hit by the Covid-19 virus, the fiscal capacity of countries differs. In general, countries with larger structural deficits and higher public debt have less capacity to implement measures to address the negative economic consequences of Covid-19.

The 26 countries combined adopted more than 200 fiscal measures in response to Covid-19. These are new measures, but also extensions and revisions of existing policies.[3]

Most countries implemented **between 4 and 10 different fiscal measures** to mitigate the shock. Only Luxembourg and Spain implemented significantly more measures: 20 and 25, respectively.

Direct fiscal measures

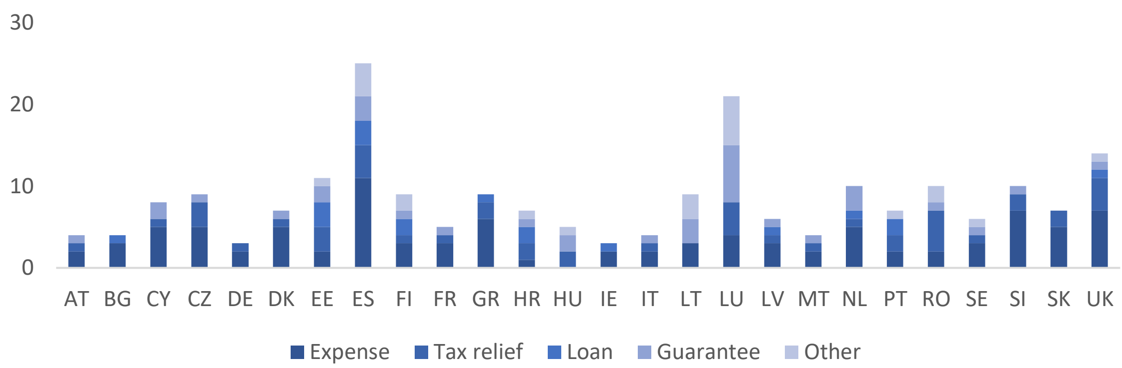
Nearly all countries resorted to **measures with a direct budgetary impact**. These measures, such as fiscal expenditure and tax reliefs, lead to worsening budget balances.

The fiscal expenditure measures aim to avoid unemployment and mitigate short-term corporate cashflow problems. The large majority of the countries are granting **financial aid to affected workers** as well as to **companies and the self-employed** (23 out of 26 countries, in both cases).

Moreover, a significant minority of countries (nine) have increased their spending on **national health sectors**. These expenses are mostly public purchases of sanitary equipment and protective gear, healthcare staffing and compensation for extra hours.

Tax relief measures achieve similar objectives by **reducing the immediate tax burden for taxpayers**. Nearly all countries have postponed tax deadlines (24 countries). These measures delay receipt of part of the tax revenues, but at the same time it is expected that the large majority of the amounts due will ultimately be paid. Moreover, there are also nine countries that have introduced tax waivers for

Figure 1 Number of Covid-19 related fiscal measures adopted as of 31 March 2020



Source: European Fiscal Monitor

[3] Detailed responses are available on the website.

certain groups, such as firms and the self-employed most affected by containment measures.

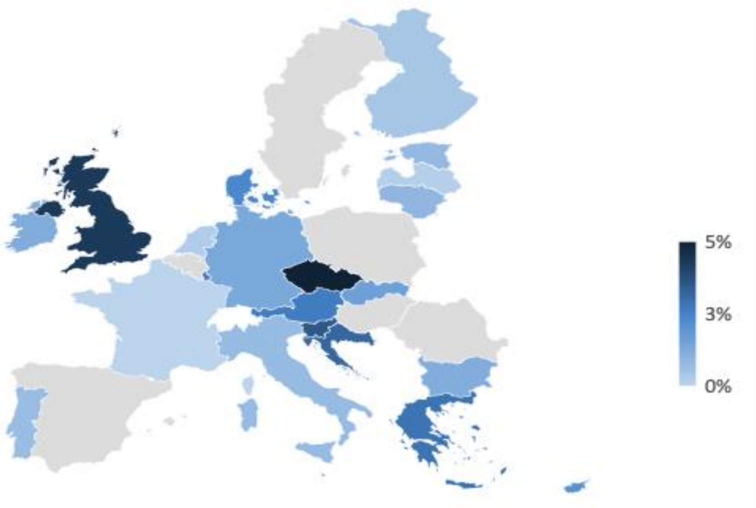
The magnitude of the immediate fiscal response is unprecedented (see Figure 2). Most countries will increase their spending by around 1.6% of GDP and give tax relief for another 1.4% of GDP. Nearly all countries have budgeted these measures for a short term only (up to one year). This means that if funds are insufficient governments will have to extend or renew the fiscal stimulus. Austria, France, the Netherlands and Spain have introduced open-ended packages whose size remains to be seen.

Indirect fiscal measures

Many countries have also taken indirect fiscal measures. Most common are government guarantees on loans provided by financial institutions and loans disbursed directly by state-owned institutions. The aim of these measures is to facilitate the access of companies and the self-employed to working capital, **without incurring a large immediate impact on the fiscal deficit**. Instead, the impact is spread over the entire lifetime of loans and only occurs in the case of non-repayment. Given the impact of the shock and the potential longer period with low or negative economic growth likely to follow, many lenders might struggle to repay the loans, which would have negative implications for public finances in the longer term.

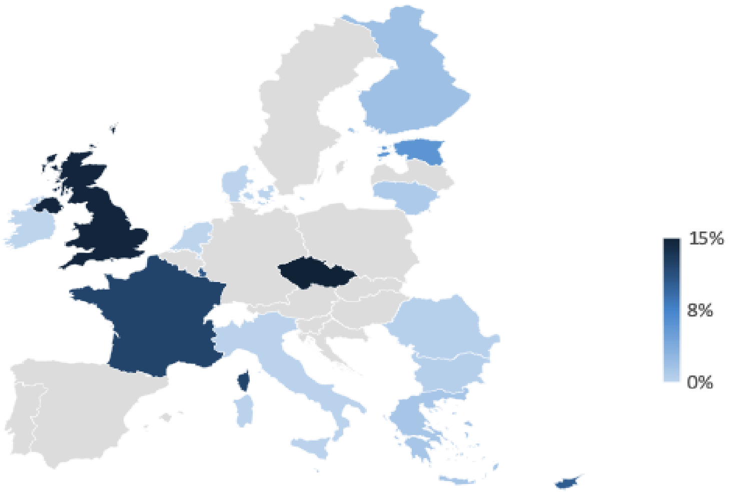
Most countries implemented guarantees (20 countries). The scale of this measure is largest among all categories of fiscal measures, with 6.4% of GDP on average, whereas the immediate budgetary impact is very limited. Most guarantees have been adopted for the short term, but Greece, Luxembourg, Latvia and Romania have measures for long-term guarantees in place.

Figure 2 Direct Fiscal impact of COVID related measures (% of GDP)



Source: European Fiscal Monitor

Figure 3 Indirect Fiscal impact of COVID related measures (% of GDP)



Source: European Fiscal Monitor

A substantial minority of the countries have introduced public loans (11 countries). On average these countries have allocated around 1.0% of GDP. Estonia and Finland have allocated substantially more, with 2.3% and 1.9% of GDP respectively. Most of the implemented public lending programmes have a maturity of up to one year. However, there are also countries that introduced medium-term measures: they will lend for up to five years.

Some countries have **also adopted other measures** to mitigate the economic consequences of Covid-19. These are mostly changes to legislation, budget reallocation and credit moratoria.

In addition, some countries have facilitated receipt of unemployment benefits, outlawed evictions of tenants and seizures, etc. In the domain of prudential regulation, some countries have also relaxed the capital requirements for banks, thereby easing the lending to temporarily constrained borrowers.

Impact on IFIs' activities

Covid-19 has also affected the daily activities of IFIs. Most IFIs postponed or cancelled at least part of their usual reports to free up resources to estimate the budgetary and economic impacts of the crisis and government measures.

Moreover, many EU IFIs are cooperating with national governments to design sustainable fiscal policies that contribute to economic recovery.

Finally, the current situation is delaying the budgetary processes in several member states, which might lead to delays in the endorsement of the governments' forecasts by IFIs. As of end-March, the execution of the Stability Programmes has been put on hold in several member states. It is not clear whether all countries will meet the deadline of April 30th.