Europe’s recovery plan: Watch out for inconsistency!

by Jérôme Creel (OFCE & ESCP Business School) [1]

On 27 May, the European Commission proposed the creation of a new financial instrument, Next Generation EU, endowed with 750 billion euros. The plan rests on several pillars, and will notably be accompanied by a new scheme to promote the revival of activity in the countries hit hardest by the coronavirus crisis. It comes on top of the Pandemic Crisis Support adopted by the European Council in April 2020. A new programme called the Recovery and Resilience Facility will have firepower of 560 billion euros, roughly the same amount as the Pandemic Crisis Support. The Recovery and Resilience Facility stands out, however, for two reasons: first, by the fact that part of its budget will go to grants rather than loans; and second, by its much longer time horizon.

The Pandemic Crisis Support (and the complementary tools adopted at that time, see Creel, Ragot & Saraceno, 2020) consists exclusively of loans, and the net gains that the Member States could draw from them are by definition low: European loans allow a reduction in interest charges for States subject to high interest rates on the markets. The gain for Italy, which was hurt badly by

the coronavirus crisis, is in the range of 0.04 to 0.08% of its GDP (this is not a typo!).

Under the Recovery and Resilience Facility, the euro zone Member States would share 193 billion euros in loans and 241 billion euros in grants, or in total 78% of the amounts allocated (the rest will go to EU states that are not euro zone members). The loans will generate small net gains for Member States (savings on the infamous interest rate spreads), while the grants will lead to larger gains, since they will not be subject to repayment, other than via higher contributions between 2028 and 2058 to the European budget (if the EU's own funds have not been created or increased by then). In the short term, in any case, the grants received represent net gains for the beneficiaries: they will neither need to issue debt nor pay interest charges on such debt.

Expressed as a percentage of 2019 GDP, the net gains from grants are far from negligible (Table 1)[2]: 9 GDP points for Greece, 6 for Portugal, 5 for Spain and 3.5 for Italy. This will be even more significant given the expected fall in GDP in 2020. The determination of the Commission is therefore clear.

Despite all this, these grants are not intended to be used in the short term. The European Commission purportedly wanted the allocated amounts to be spent as quickly as possible, in 2021, 2022 and in any case before 2024. This is what it calls "front-loading": do

not put
off till the morrow what can be done today. Except that the key to the
distribution of the grant expenditures over time is somewhat in contradiction
with this principle (Table 2). The grant commitments would be concentrated in
2021 and 2022, but the actual disbursals are planned for later: less than a
quarter by 2023, half in 2023 and 2024, and the remainder after that. This kind
of gap is frequent: it takes a little time to design an investment project and
to ensure that it complies with the European Commission's digital ambitions and
low-carbon economy.

As a result, the grants to the Member States will
take a little time to actually be disbursed (Table 3), and the countries facing
the greatest difficulties will have to be resilient before receiving the stimulus
and… resilience funds. This seems contradictory. It will take until 2022 in
Greece and Portugal and 2023 in Spain and Italy to actually collect around 1
GDP point apiece. This corresponds to 3 billion euros for Greece, 2 billion for
Portugal, and 14 for Spain and Italy, respectively. By way of comparison,
Germany, France and the Netherlands will by then receive 5, 7 and 1 billion
euros, respectively, i.e. between 0.2 and 0.3 percent of their GDPs.

One can imagine the cries of outrage from the representatives of the frugal countries (Austria, Denmark, the Netherlands,

Sweden) that these immense outgoings reward countries that are not virtuous. They should be reassured: this is no boondoggle!

Table 1. **Net gains from various recent European programmes, expressed as a percent of 2019 GDP**

	Max gain from use of Pandemic Crisis Support, SURE and the BEI*	Max gain from use of the Recovery & Resilience Facility loans**	Max gain from use of Recovery & Resilence grants***
Belgium	0.02	0.00	1.02
Germany	0.00	0.00	0.63
Estonia	—	—	3.60
Ireland	0.02	0.00	0.35
Grece	0.08	0.16	9.45
Spain	0.05	0.04	4.96
France	0.02	0.00	1.33
Italy	0.08	0.06	3.57
Cypru	0.07	0.08	4.99
Latvia	—	—	7.14
Lithuania	—	—	5.75
Luxembourg	—	—	0.16
Malta	0.03	0.01	1.51
Netherlands	0.01	0.00	0.64
Austria	0.02	0.00	0.75
Portugal	0.04	0.06	6.12
Slovenia	0.04	0.03	3.53
Slovakia	0.03	0.04	6.46
Finland	0.01	0.00	0.91

Note: The order of the countries corresponds to that set by the European Commission.
**Source:* Creel, Ragot & Saraceno (2020).
** Calculation of the amount of loans per country by applying to the total amount of loans announced by the Recovery & Resilience Facility the distribution rule for transfers between countries as set out in the document COM(2020) 408 final/3 of 2 June 2020, page 2, then using spreads (the same as in Creel, Ragot & Saraceno, 2020) to deduce the net gain.
*** *Source:* COM(2020) 408 final/3 of 2 June 2020, page 2.

Table 2. **Temporal breakdown of loans and grants under the Recovery & Resilience Facility, expressed as a percent of their total respective amounts**

		2021	2022	2023	2024	2025	2026	2027	>2027
Loans	Signatures	49.5	50.5						
	Payments	14.8	27.5	25.0	22.5	10.1			
Grants	Commitments	39.3	40.1	10.2	10.4				
	Disbursal	5.9	15.8	23.4	26.0	17.7	7.7	3.1	0.5

Note: In 2021, 49.5% of loans will have been signed, versus 50.5% in 2022.
Source: COM(2020) 408 final 28 May 2020, Table p. 40.

Table 3. **Schedule of disbursal of grants per country, expressed relative to the 2019 GDP of each country**

	2021	2022	2023	2024	2025	2026	2027
Belgium	0.06	0.16	0.24	0.26	0.18	0.08	0.03
Germany	0.04	0.10	0.15	0.16	0.11	0.05	0.02
Estonia	0.21	0.57	0.84	0.94	0.64	0.28	0.11
Ireland	0.02	0.06	0.08	0.09	0.06	0.03	0.01
Grece	0.56	1.50	2.21	2.45	1.67	0.73	0.29
Spain	0.29	0.79	1.16	1.29	0.88	0.38	0.15
France	0.08	0.21	0.31	0.35	0.24	0.10	0.04
Italy	0.21	0.56	0.83	0.93	0.63	0.27	0.11
Cypru	0.29	0.79	1.16	1.30	0.88	0.38	0.15
Latvia	0.42	1.13	1.67	1.86	1.26	0.55	0.22
Lithuania	0.34	0.91	1.34	1.49	1.02	0.44	0.18
Luxembourg	0.01	0.03	0.04	0.04	0.03	0.01	0.00
Malta	0.09	0.24	0.35	0.39	0.27	0.12	0.05
Netherlands	0.04	0.10	0.15	0.17	0.11	0.05	0.02
Austria	0.04	0.12	0.18	0.20	0.13	0.06	0.02
Portugal	0.36	0.97	1.43	1.59	1.08	0.47	0.19
Slovenia	0.21	0.56	0.82	0.92	0.62	0.27	0.11
Slovakia	0.38	1.02	1.51	1.68	1.14	0.50	0.20
Finland	0.05	0.14	0.21	0.24	0.16	0.07	0.03

Note: The order of the countries corresponds to that set by the European Commission.
Sources: COM(2020) 408 final/3, 2 June 2020, p. 2; COM(2020) 408 final 28 May 2020, Table p. 40; author's calculations.

[1] This text appeared in the 23 May 2020 edition of Les Echos, without the tables.

[2] The rule for the distribution of transfers between countries appears in the document COM (2020) 408 final/3 of 2 June 2020. For each country it depends on the size of its population, on the inverse of GDP per capita compared to the EU-27 average, and on the difference between its 5-year unemployment rate and the EU-27 average. In order to avoid an excessive concentration of grants to a few countries, ad hoc limits are imposed based on these three criteria. Germany will for example receive 7% of

the transfers,
France 10%, and Spain and Italy 20%, respectively.

Sweden and Covid-19: No lockdown doesn't mean no recession

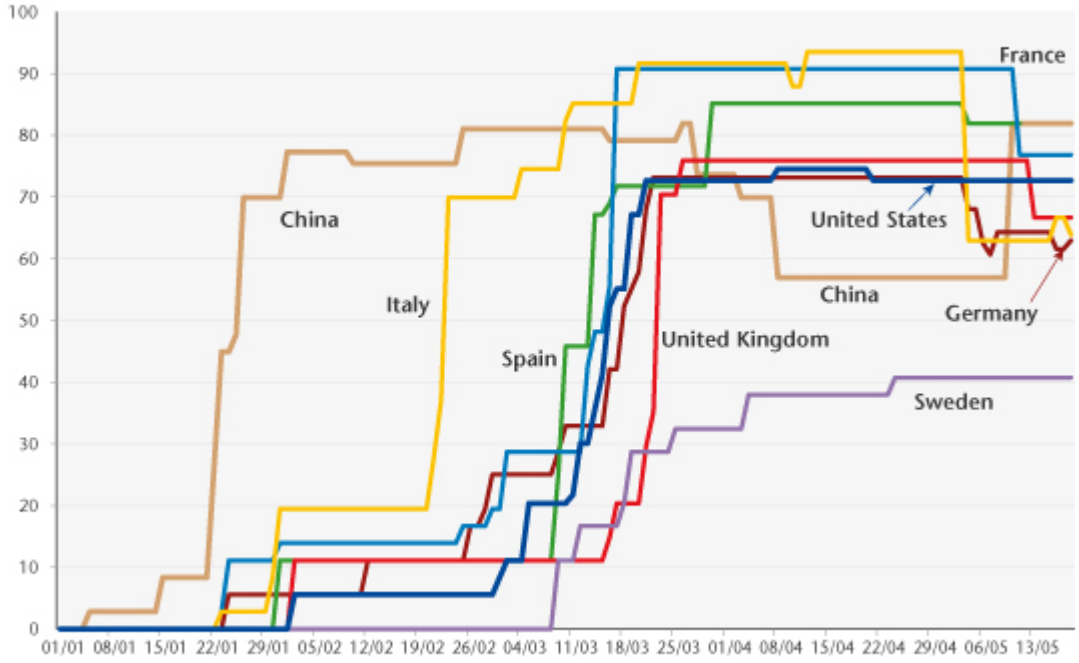
By Magali Dauvin and Raul Sampognaro, DAP OFCE

Since the Covid-19 pandemic's arrival on the old continent, a number of countries have taken strict measures to limit outbreaks of contamination. Italy, Spain, France and the United Kingdom belatedly stood out with especially strict measures, including lockdowns of the population not working in key sectors. Sweden, in contrast, has distinguished itself by the absence of any lockdown. While public events have been banned, as in the other major European countries, there were no administrative orders to close shops or to impose legal constraints on domestic travel[1].

Given the multiplicity of measures and their qualitative nature, it is difficult to break

down all the decisions taken, and in particular to express their intensity.
Researchers at the University of Oxford and the Blavatnik School of Government
have nevertheless built an indicator to measure the severity of government
responses[2]. This indicator clearly shows Sweden's specific situation with respect to the rest of Europe (Figure 1).

Figure 1. Index of severity



Source: T.Hale, S.Webster, A.Petherick, T.Phillips and B.Kira (2020). *Oxford COVID-19 Government Response Tracker.*

The mobility data supplied
by Apple Mobility provides a complementary picture of the severity of
containment measures across countries. At the time of the toughest lockdowns, automobile
mobility was down by 89% in Spain, 87% in Italy, 85% in France and 76% in the
United Kingdom. The decline was less severe in Germany and the United States
(about 60% in both countries). Sweden ultimately saw its traffic reduced by
"only" 23%. While these data should be taken with a grain of salt,

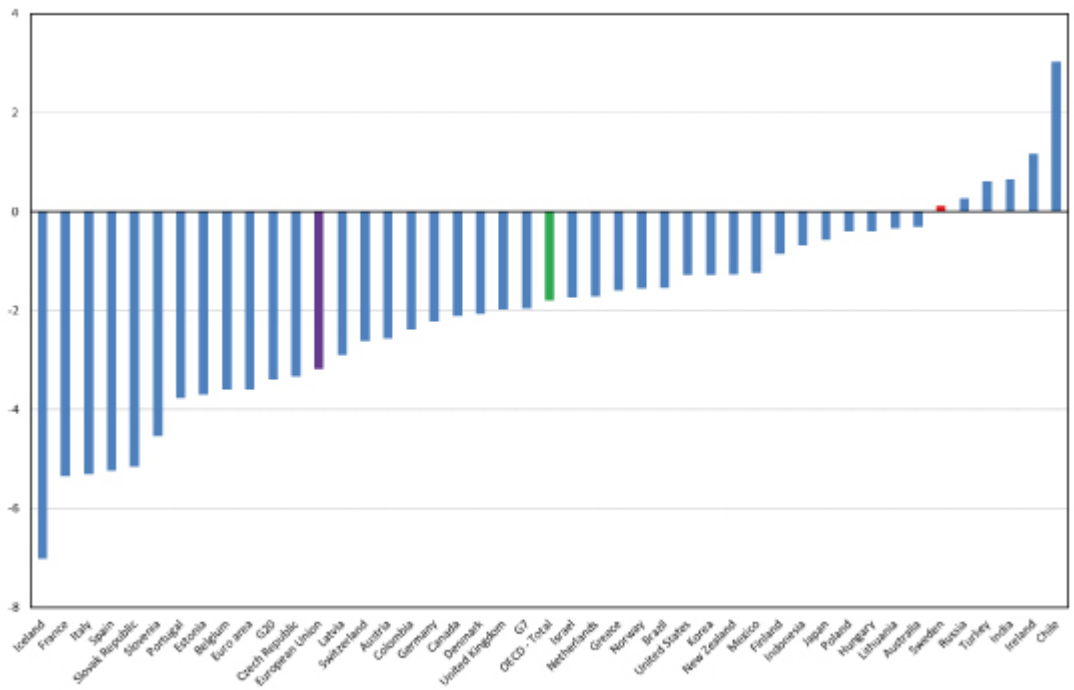
they also give a clear signal about the timing and scale of the lockdowns in different countries, once again pointing to a Swedish exception.

During the first half of May, the various European countries began to gradually ease the measures taken to combat the spread of the Covid-19 epidemic.

Sweden's GDP resists in Q1

In our assessment of the impact of lockdowns on the global economy, we highlighted the correlation between the fall in GDP observed in the first quarter and the severity of the measures put in place to combat Covid-19. In this context, Sweden (in red in Figure 2) fares significantly better than the OECD member countries (green bar), and especially the rest of the European Union (purple bar). Although this is a first estimate, GDP has not only held up better than elsewhere, but has even stabilized (-0.1%).
Only a few emerging economies, which were not affected by the pandemic at the beginning of the year (Chile, India, Turkey and Russia), and Ireland, which benefited from exceptional factors, performed better in the first quarter [3].

Figure 2. GDP Growth in Q1 2020



Source: OECD.

The relative resilience of Sweden's GDP in the first quarter seems to suggest that the country might have found a different trade-off between epidemiological and economic objectives compared to other countries[4]. However, this aggregate figure masks important developments that need to be kept in mind. In the first quarter, the stabilisation of Swedish GDP was due to the positive contribution made by foreign trade (up 1.7 GDP points) to a rise in exports (up 3.4% in volume terms), particularly in January, before any health measures were taken.

In the first quarter, Swedish domestic demand pulled activity downwards (by -0.8 GDP points due to household consumption and -0.2 GDP points due to investment), as in the rest of the EU. The

shock to domestic demand was of course more moderate than in the euro area, where consumption contributed negatively to GDP by 2.5 points and investment by 0.9 points. Nevertheless, the physical distancing guidelines issued in Sweden must have had a significant impact during the first quarter.

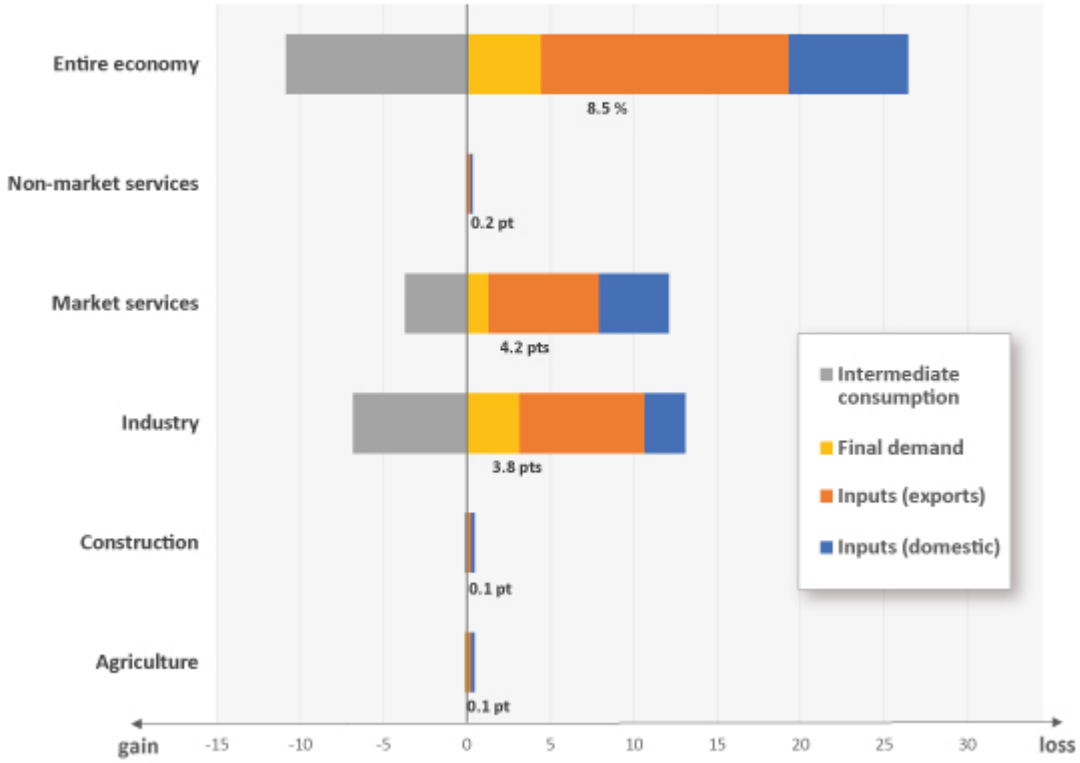
In a troubled global context, Sweden will not be able to escape a recession

If we assume that the avoidance of a lockdown and the relatively limited administrative closures (confined to public events) did not give rise to any significant shock to domestic demand – which seems optimistic in view of the first quarter data – Sweden will nevertheless be hit hard by the shock to international trade[5].

According to our calculations, based on the entry-exit tables from the World Input-Output Database (WIOD)[6] and our estimates related to the lockdown shocks in Policy Brief 69, value added is expected to fall by 8.5 points in Sweden in April due to the containment measures taken in the rest of the world. The shock will hit its industry especially hard, more or less in line with what we estimate globally (-19% and 21%, respectively). Unsurprisingly, the *refining industry* (-32%), the *manufacture of transport equipment* (-30%) and *capital goods* (-20%), and the

other manufacturing industries sector (-20%) will be hit hardest by the collapse of global activity. Since a significant share of output is intended for use by foreign industry, the worldwide containment measures will lead to a reduction of almost 15 points in Swedish output in April (Figure 3). The same holds for commercial services: exposure to global production chains is hurting *transport* and *warehousing* (-15%) and the *business services* sector (-11%). Ultimately, the containment measures will have an impact mainly through their effect on intra-branch trade.

Figure 3. Contributions to the reduction in value added in April in Sweden



Source: WIOT, OFCE calculations.

The weakness of Swedish manufacturing, weighed down by international trade, seems to be confirmed by the first hard data available. According to

the Swedish Statistical Office, exports fell by 17% year-on-year, a figure comparable to the decline in world trade as measured by the CPB for the same month (-16% by volume). Given this situation, manufacturing output will be 17% lower in April than a year earlier.

What could be said about domestic demand in Q2?

In a context of widespread uncertainty, domestic demand may continue to suffer. Indeed, Swedish households can legitimately question the consequences of the shock for jobs – mainly in industry – described above. On the other hand, fear of the epidemic could deter consumers from making certain purchases involving strong social interactions, even in the absence of legal constraints. What do Swedish data from the beginning of Q2 tell us about Swedish domestic demand?

In Sweden, consumer spending fell in March (-5% year-on-year). Note that the country's precautionary guidelines and physical distancing measures were introduced on 10 March. The fall steepened in April, after the measures had in force for a full month (-10% year-on-year). The measures in place hit purchases of clothing (-37%), transport (-29%), hotels and catering (-29%) and leisure (-11%). While the data remain patchy, May's retail sales, an indicator that

does not cover the entire consumer sector, suggest that sales were still in a dire state in clothing stores (-32%). In addition, new vehicle registrations continued to fall in May (-15% month-on-month and -50% year-on-year). Pending more recent data on activity in the rest of the economy, the volume of hours worked[7] in May remains very low in hotels and catering (-50%), and in household services and culture (-18%), suggesting that significant and long-lasting losses to business can be expected.

On the positive side, the data show a trend towards the normalization of household purchases in May for certain consumer items. As in other European countries, the recovery was particularly strong in household goods, where retail sales returned to their pre-Covid level, and in sporting goods, while food consumption remained buoyant.

Ultimately, the health precautions taken by Sweden since the onset of containment measures are akin to those implemented in the rest of Europe since the gradual easing of the lockdowns. While the shocks to the consumption of certain items are less severe than those observed in France, it is noticeable that, in the context of the epidemic, some consumer goods could be severely affected even in the absence of administrative closures. In addition to the recessionary

impact imported from
the rest of the world, Sweden will also suffer due to domestic demand, which is
expected to remain limited particularly in certain sectors. The Swedish case
suggests that clothing, automobile, hotel and catering, and household services
and culture could suffer a lasting shock even in the absence of compulsory measures.
According to data available in May, this shock could reduce household
consumption by 8 percentage points, which represents 3 GDP points. How lasting the
shock is will depend on the way the epidemic develops in Sweden and in the rest
of the world.

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[1] The Swedish institutional framework
helps to explain in part this differentiated response, which focuses more on
individual responsibility than on coercion (see https://voxeu.org/article/sweden-s-constitution-decides-its-exceptional-covid-19-policy). The country's low population density
could also help explain the difference in behaviour vis-à-vis the rest of
Europe but not in relation to its Scandinavian neighbours.

[2] This indicator attempts to synthesize
the containment measures adopted according to two types of criteria: first, the
severity of the restriction for each measure taken (closure of schools and of businesses,
limitation of gatherings, cancellation of public events, confinement to the
home, closure of public transport, restrictions on domestic

and international
travel) and second, whether a country's measures are local or more generalized.
For a discussion of the indicator see Policy brief 69.

[3] Booming exports in March 2020 (up 39% in value) driven by strong
demand for pharmaceuticals and IT offset the fall in Ireland's domestic demand during
the first quarter.

[4] This post on the OFCE blog does not
focus on the effectiveness of Swedish measures with regard to containing the
epidemic. Mortality from Covid-19 is higher in Sweden than in its neighbours (Norway,
Finland, Denmark), suggesting that it has run more epidemiological risks. This is
provoking a debate that goes well beyond the purpose of this post, but which does
deserve to be raised.

[5] International trade may actually impact
growth more than expected due to constraints on international tourism. In 2018,
Sweden actually ran a negative tourism deficit of 0.6% of GDP (source: *OECD*
Tourism Statistics Database), which could have an effect on domestic
activity if travel remains limited, especially during the summer.

[6] Timmer, M. P., Dietzenbacher, E., Los, B.,
Stehrer, R. and de Vries, G. J. (2015), "An Illustrated User Guide to the World
Input–Output Database: The Case of Global Automotive Production", *Review of International Economics*., 23: 575–605

[7] In May, the volume of hours worked was down 8% year-on-year (after -15%). The recovery in hours worked in May was due mainly to manufacturing and construction. The recovery was less pronounced or even non-existent in business services.