The EU economy post-Covid: recovery, resilience and governance

Presentation prepared for the DG ECFIN Webinar for national trade union representatives

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Brussels, 17th February 2022

Outline of presentation

- Lessons from previous crisis on current fiscal rules
  - Some illustrations
- Objectives for fiscal rules reform
- The ETUC proposals for the reform of fiscal rules

Considerations for reforming the current rules

- Can stifle recovery after large, protracted shocks;
  - Potential permanent/long-lasting economic and social scars;
- Have been pro-cyclical → failing to stabilize;
- Damaging for public investment→ how to tackle climate and social challenges ahead?
- More favourable conditions for public debt sustainability without overly restrictive fiscal stance:
  - real interest rate* – real output growth < 0

Damage to future recovery? An illustration with employment forecasts (I)

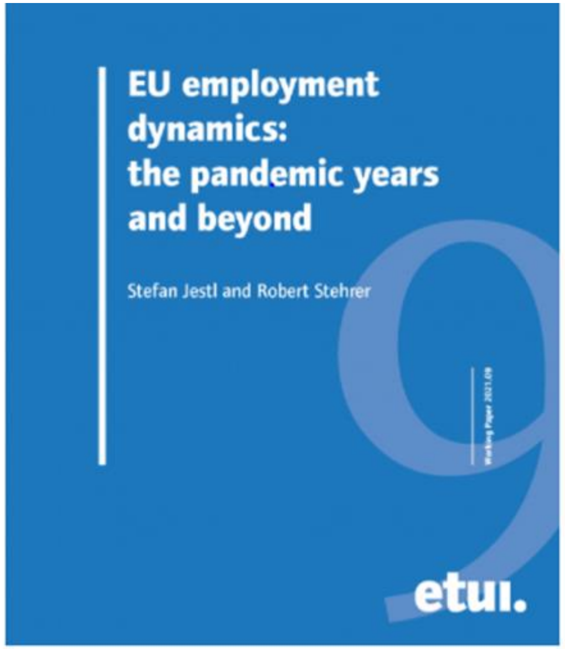
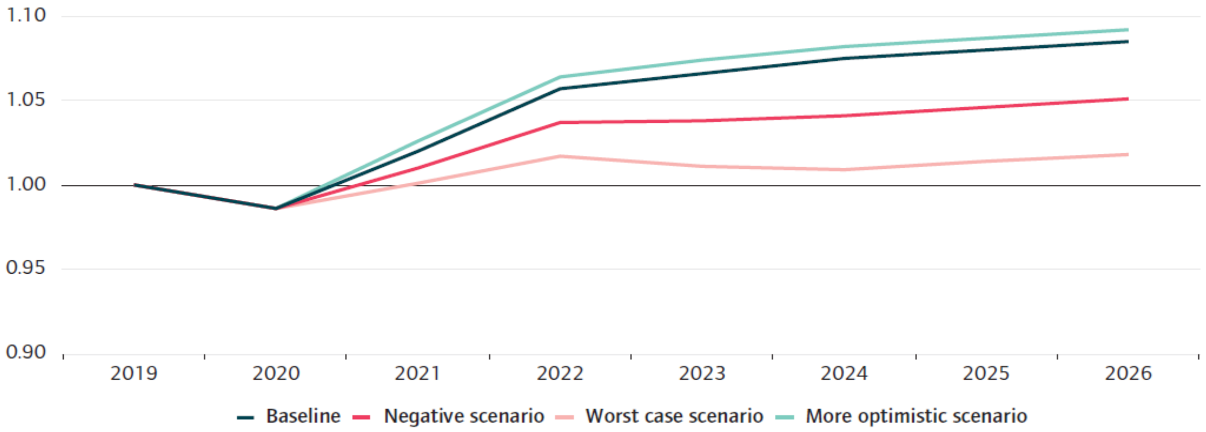
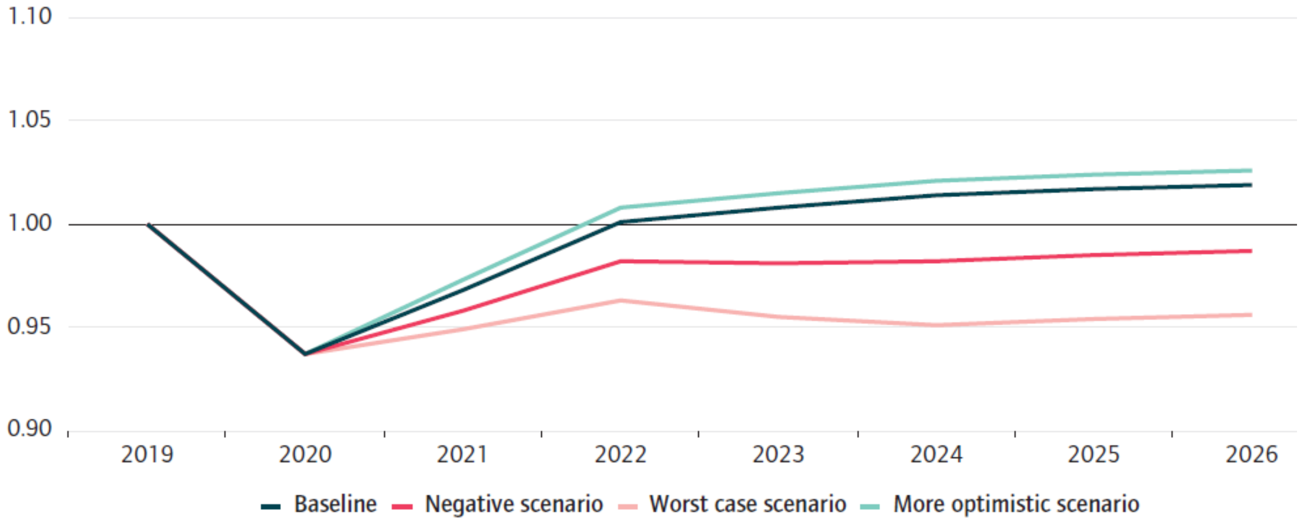


Figure 10 Persons employed EU27, 2019=1



Source: Own calculations.

Figure 11 Hours worked EU27, 2019 = 1



Source: Own calculations.

Damage to future recovery? An illustration with employment forecasts (II)

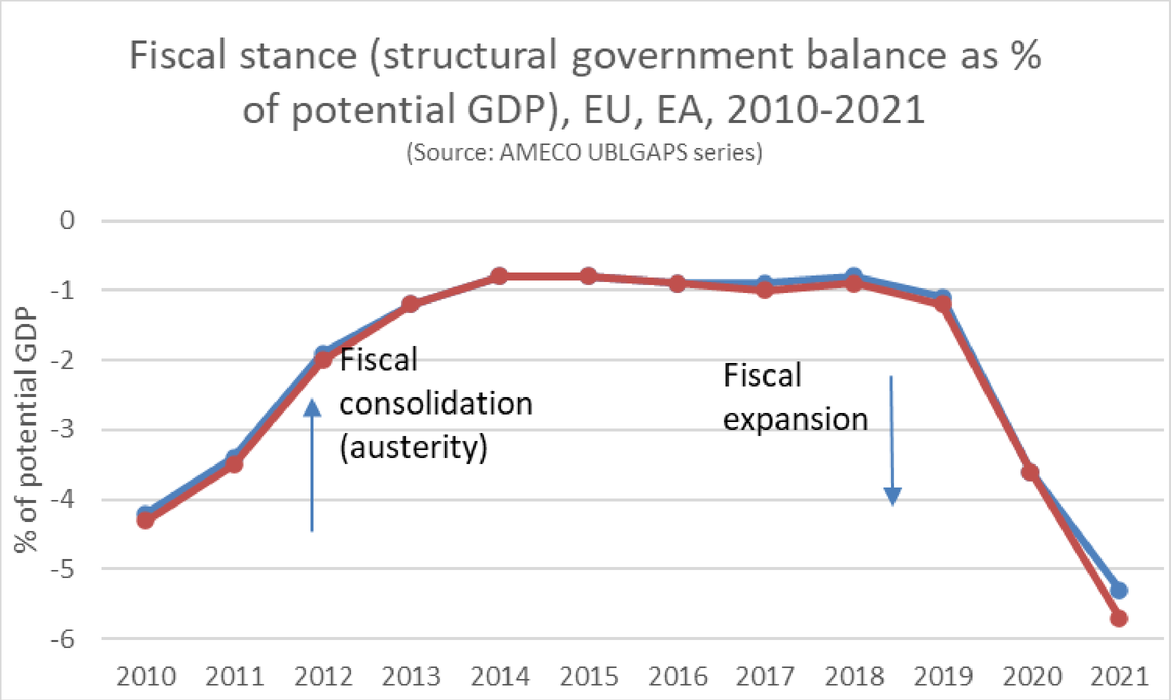
- [Source: Jestl and Stehrer 2021](#).

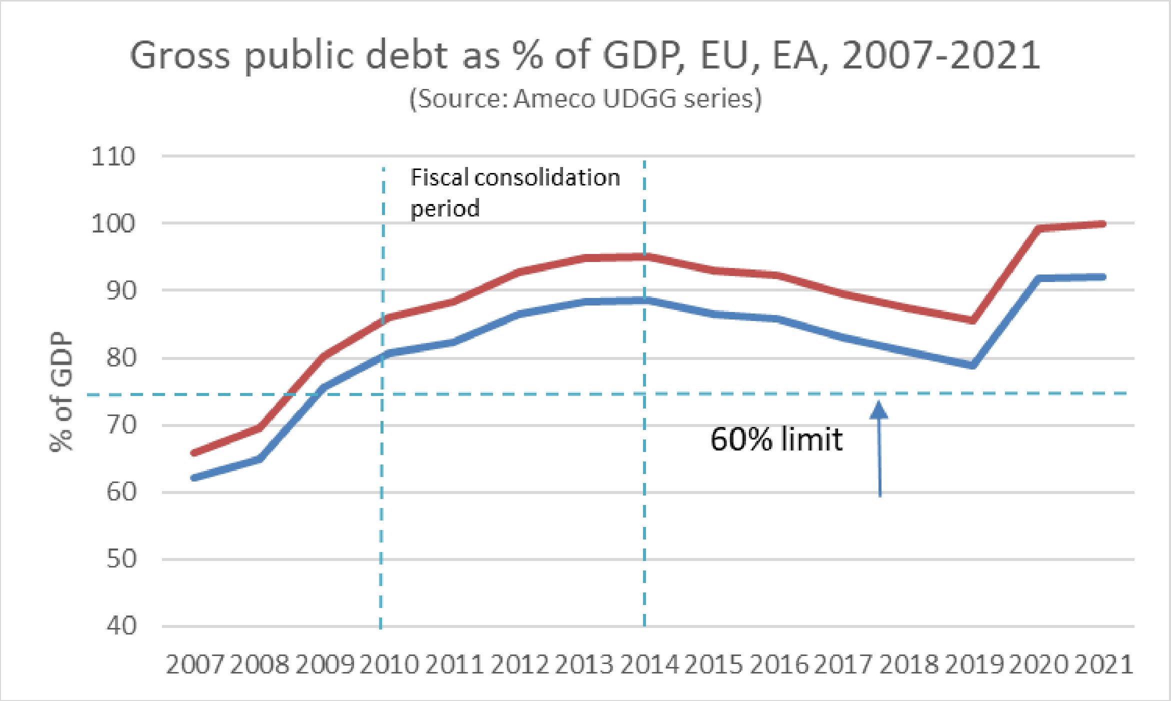
Table 5 Worst-case scenario, 2019=1

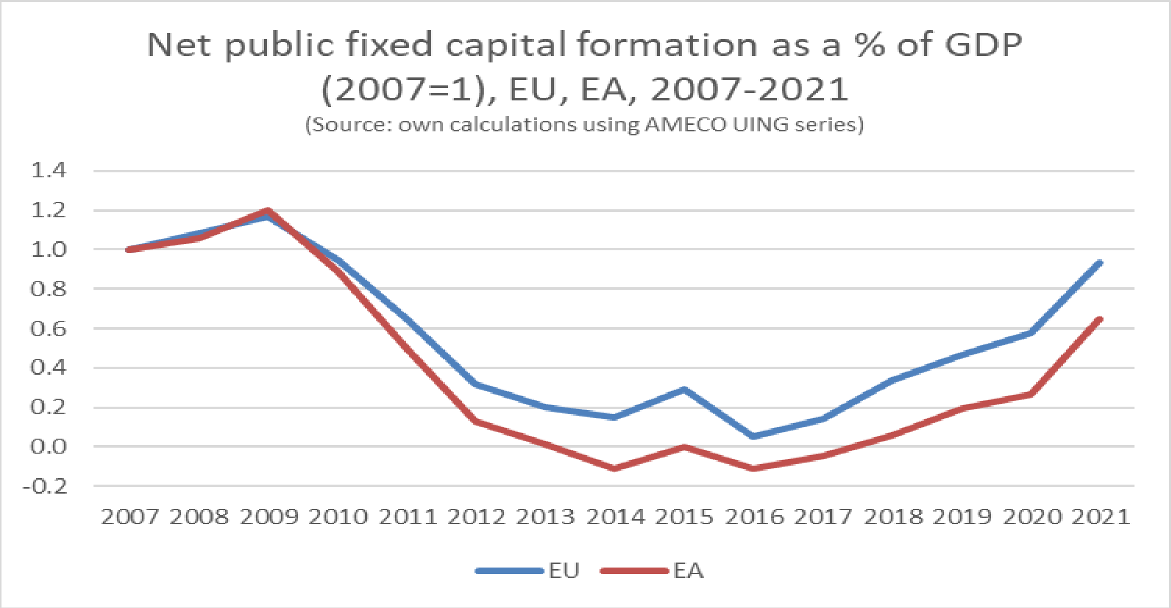
	Persons employed								Hours worked							
	2019	2020	2021	2022	2023	2024	2025	2026	2019	2020	2021	2022	2023	2024	2025	2026
AUT	1.00	0.99	1.00	1.01	1.02	1.03	1.04	1.06	1.00	0.91	0.92	0.93	0.93	0.94	0.95	0.96
BEL	1.00	1.00	1.02	1.02	1.02	1.02	1.03	1.04								
BGR	1.00	0.98	0.98	0.98	0.98	0.97	0.98	0.98	1.00	0.95	0.95	0.95	0.95	0.95	0.95	0.96
CYP	1.00	1.00	1.00	1.01	1.02	1.04	1.06	1.08	1.00	0.94	0.94	0.95	0.95	0.96	0.98	1.00
CZE	1.00	0.99	0.99	0.99	1.00	1.00	1.01	1.02	1.00	0.94	0.95	0.95	0.95	0.96	0.97	0.97
DEU	1.00	0.99	1.00	1.01	1.01	1.01	1.02	1.03	1.00	0.95	0.96	0.97	0.96	0.96	0.97	0.97
DNK	1.00	0.99	0.99	0.99	0.98	0.97	0.98	0.98	1.00	0.97	0.96	0.95	0.94	0.93	0.93	0.93
ESP	1.00	0.96	1.01	1.03	1.04	1.05	1.06	1.07	1.00	0.90	0.94	0.96	0.97	0.98	0.99	1.00
EST	1.00	0.97	0.97	0.97	0.97	0.97	0.98	0.99	1.00	0.94	0.92	0.92	0.91	0.91	0.91	0.91
FIN	1.00	0.99	0.99	0.99	0.99	0.99	0.99	1.00	1.00	0.98	0.98	0.98	0.97	0.97	0.98	0.98
FRA	1.00	0.99	1.02	1.04	1.03	1.03	1.04	1.05	1.00	0.92	0.95	0.96	0.95	0.95	0.95	0.96
GRC	1.00	0.99	0.99	1.02	1.04	1.05	1.08	1.11	1.00	0.89	0.89	0.91	0.92	0.93	0.95	0.98
HRV	1.00	0.99	1.01	1.04	1.07	1.10	1.15	1.18	1.00	0.98	1.00	1.02	1.04	1.06	1.09	1.12
HUN	1.00	0.98	0.99	1.01	1.02	1.03	1.04	1.05	1.00	0.94	0.95	0.97	0.98	0.99	1.00	1.01
IRL	1.00	0.99	0.97	0.95	0.94	0.92	0.91	0.90	1.00	0.98	0.96	0.94	0.92	0.91	0.90	0.89
ITA	1.00	0.98	1.00	1.02	1.02	1.02	1.03	1.03	1.00	0.89	0.91	0.92	0.92	0.92	0.92	0.93
LTU	1.00	0.98	0.97	0.97	0.96	0.96	0.96	0.97	1.00	0.94	0.93	0.92	0.92	0.91	0.92	0.92
LUX	1.00	1.02	1.04	1.05	1.06	1.07	1.09	1.11	1.00	0.97	0.98	0.99	1.00	1.01	1.03	1.05
LVA	1.00	0.98	0.98	0.99	0.99	1.00	1.01	1.02	1.00	0.94	0.94	0.94	0.94	0.94	0.95	0.95
MLT	1.00	1.02	1.03	1.04	1.06	1.07	1.10	1.13	1.00	0.93	0.94	0.95	0.97	0.98	1.01	1.04
NLD	1.00	0.99	1.00	1.00	1.00	1.00	1.00	1.01	1.00	0.97	0.98	0.98	0.98	0.98	0.99	1.00
POL	1.00	1.00	0.99	0.99	0.98	0.98	0.98	0.98	1.00	0.99	0.98	0.97	0.97	0.96	0.95	0.95
PRT	1.00	0.98	1.00	1.03	1.03	1.04	1.06	1.08	1.00	0.91	0.92	0.95	0.96	0.97	0.99	1.00
ROU	1.00	0.98	0.98	0.97	0.95	0.94	0.94	0.94	1.00	0.99	0.98	0.97	0.95	0.94	0.94	0.93
SVK	1.00	0.98	1.00	1.01	1.02	1.03	1.04	1.06	1.00	0.91	0.91	0.91	0.92	0.92	0.92	0.93
SVN	1.00	0.99	0.99	1.00	1.01	1.02	1.03	1.04	1.00	0.94	0.94	0.94	0.94	0.95	0.96	0.96
SWE	1.00	0.99	0.99	0.99	1.00	1.00	1.01	1.02								
EU27	1.00	0.99	1.00	1.02	1.01	1.01	1.01	1.02	1.00	0.94	0.95	0.96	0.96	0.95	0.95	0.96

Note: For Malta results calculated at total economy level are presented. Information on hours worked not available for BEL and SWE. IRL introduced a methodological change in the GDP calculation, and is characterised, next to ROU, by a relatively high historic labour productivity growth rate (see Table 23 and 24).
Source: Own calculations.

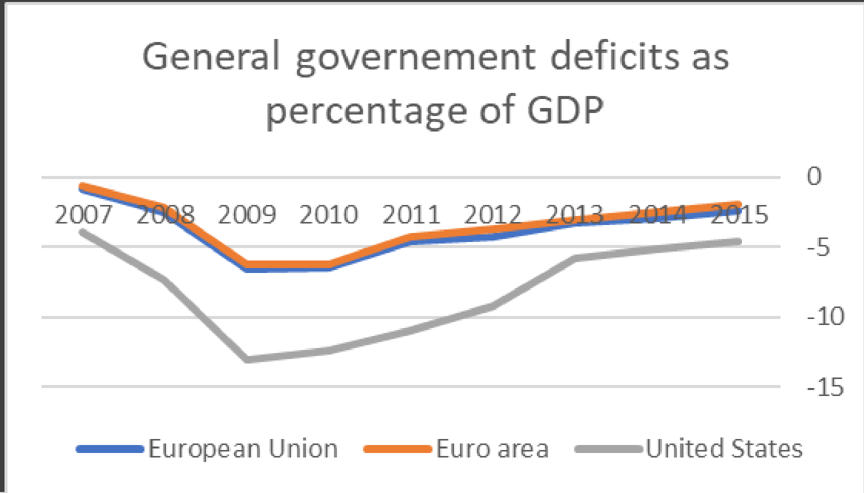
Current fiscal rules, public investment, and public debt

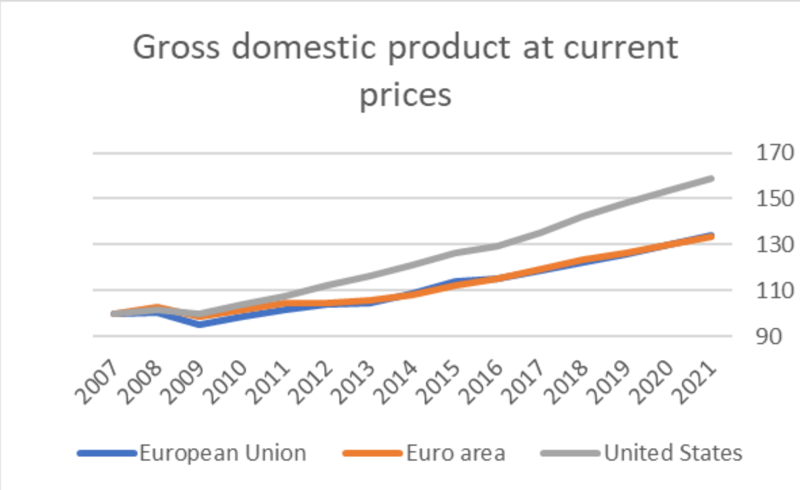


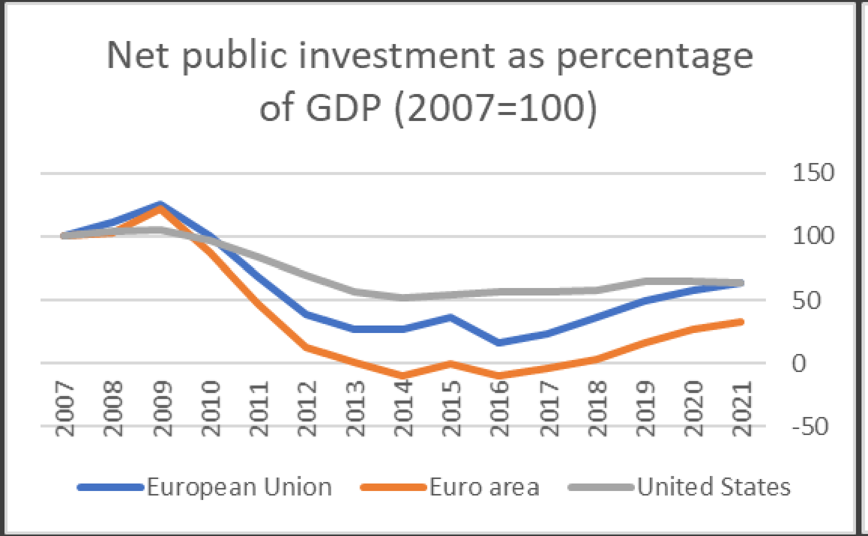


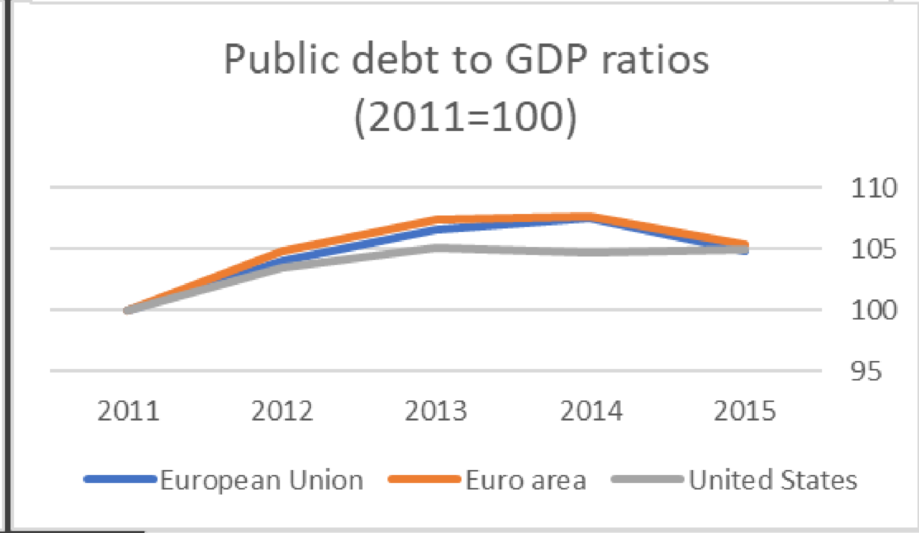


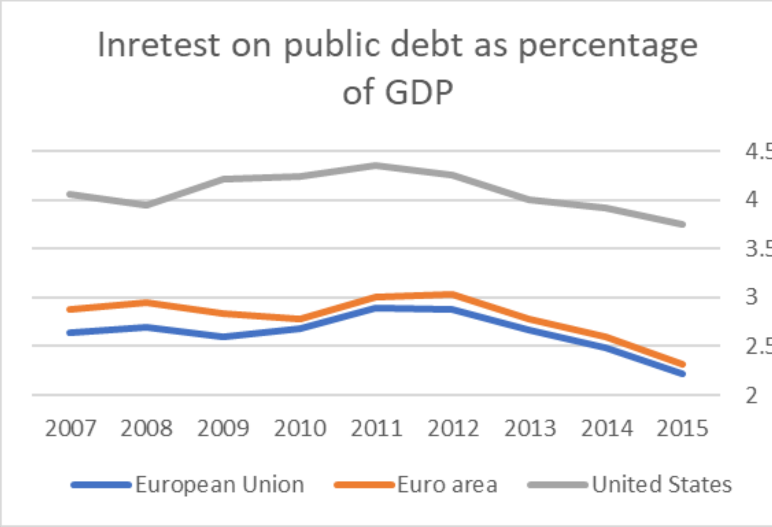
A quick comparison (USA)

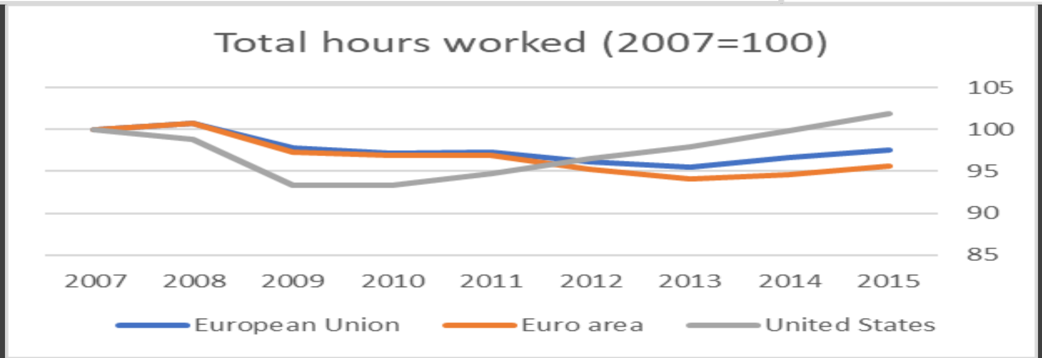












New fiscal rules - Objectives

- **Less austerity**: Estimations by the European Fiscal Board (2020) show that if unchanged EU fiscal rules were activated after lifting the general escape clause, the foreseen debt ratio reduction path would overburden some Members States, with significant negative economic, social and political consequences, risking the economic recovery in the EU
- **Less procyclical**: The debt reduction rule would have an even stronger procyclical effect than it already had before the pandemic. It could lead to turbulences in the sovereign bonds' markets, destabilising the common currency.
- **Preparing future challenges**: A reform of the EU fiscal rules is not only necessary for the purpose of a short to medium term stabilisation of the economy. It is also of vital importance in order to finance the socio-ecological transformation of our economy, guaranteeing full employment, high quality jobs and just transitions.

New fiscal rules- ETUC’s proposals (I)

- **Strengthening public investment**: The EU fiscal framework needs to be reformed in a way to better protect public investments. The multiplier effect of public investment is particularly high, and cuts in public investment, therefore, have a particularly negative impact on economic growth and employment. **The ETUC continues to advocate a golden rule for public investments, to safeguard productivity and the social and ecological base for the well-being of future generations**. This means that net public investments, as defined in the national accounts, need to be excluded from the calculation of the headline deficits. the ETUC suggests a broader definition of public investments. The European Commission’s guidance to Member States in the context of the Recovery and Resilience Facility and the definition of investments therein constitutes a good starting point.
- **Reforming cyclical adjustment methods**: The European Commission’s method determining the structural balance has proven to be problematic because the calculated potential output is strongly influenced by the current economic situation. Downward revision of potential output has severe consequences on the calculated structural deficit and the consolidation efforts identified respectively. Making the calculation of the potential output less sensitive to cyclical fluctuations can open up fiscal room for Member States for countercyclical economic policies.
    - One option would be to use medium-term averages for potential growth or to revise potential output estimates only in the medium term, e.g. every five years
    - Another option would be averaging several potential output estimates[xxxviii] or integrating hysteresis effects

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New fiscal rules- ETUC's proposals (II)

- **Flexible and country-specific debt adjustment paths** : the ETUC welcomes the suggestion regarding the differentiation of the fiscal adjustments in the Member States, while maintaining debt sustainability. A country-differentiation of debt to GDP reduction strategies should be based on a comprehensive economic analysis taking into account factors such as: the initial level of debt and its composition; the interest rate-growth differentials as a matter of sustainability; inflation perspectives; the projected costs of ageing and environmental challenges; unemployment and poverty levels; internal and external imbalances; and, primarily, whether the fiscal adjustment is realistic]. It is of upmost importance to develop country-specific plans that enable Member States to effectively manage their public spending and investment over the long-term bearing in mind a broad range of economic, social and environmental factors.
- **Public expenditure rule**: The ETUC suggests abandoning the contested concepts of structural deficit/balance and instead implement a public expenditure rule in a revised fiscal framework. It is widely accepted that the change in the structural balance is a problematic indicator for the orientation of fiscal policy since it considerably underestimates the extent of fiscal restraint in phases of crisis and overestimates the success of consolidation during an upswing.
  - ✓ Nominal public expenditures would be calculated net of interest payments, of net public investment, of unemployment spending and spending related to minimum incomes schemes, and of the estimated impact of any new discretionary revenue measures, especially since particularly urgent measures required to address the substantial staff shortages in health and social care and the related problem of low wages in these sectors. The limits could be determined by the medium-term growth rate of real potential output plus the ECB target inflation rate of 2%. Increases in permanent nominal expenditure growth above this limit would be allowed if revenues are increased correspondingly. Such a rule would stabilise expenditure growth over the cycle and enable full implementation of automatic stabilisers

Thank you for your attention!

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