European Policies and Institutions to Face the Challenges of Transition

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Fiscal multipliers and spatial and sectorial spillover effects

EMU faces deadlock: necessity of fiscal consolidation versus risk of uneven results due to intricate network connections within an economy, complexity of targeting, essential for designing effective fiscal policies

- Crucial to consider fiscal **spillovers** when assessing the overall macroeconomic effects of this **fiscal** expansion (Pfeiffer and Varga, 2023)
- Considering spillover effects from **individual-country measures** increases GDP effects by around one-third, with the **US** experiencing a **distribution of 48%** of fiscal stimuli across all states (Flynn, Patterson, Sturm Becko, 2024)
- This bodes well for the **EU** regarding the **rationale** behind the Next Generation EU (NGEU) and cohesion funds
- Understanding the intricate network connections within an economy is essential for designing effective fiscal policies
- **Variation in multipliers**: Different fiscal policies yield varying multipliers
- **Importance of targeting**: Policymakers need to consider targeted policies
- **Spatial and sectoral spillovers**: Policies directed at specific firms or households have ripple effects across regions and sectors
- EMU faces **deadlock**: necessity of **fiscal consolidation** versus **risk of uneven results** due to due to **intricate network connections** within an economy, **complexity** of targeting, essential for **designing** effective **fiscal policies** (Chatziapostolou, Kosteletou, 2023)

Fiscal discipline
and the new GSP

«We are facing a geopolitical transition, driven by US-China decoupling, in which we can no longer rely on unfriendly countries for critical supplies. That will require a substantial reorientation of investment towards building capacity.» (Mario Draghi

«Good debt» and «bad debt» and the need for European Public Goods

That being said, in conclusion, despite there being more ways to pay off the public debt, it should be clear that there are no free lunches, and thus fiscal prudence must remain the guiding principle of fiscal policies even in the post-Covid Era

- **Fiscal discipline** makes a comeback with the **new SGP**
- In the **future** of Europe, however, **great challenges** include health, defense, demographics and climate change
- **EU Commission** estimates approximately **600 bn** per year in investments from 2024 to 2030 (EU Commission, July 2023; Draghi, Informal Ecofin, 22-24 February, 2024)
- About **20-25%** of these investments are public
- How will we finance them?
- There is a proposal for the establishment of a **European Debt Agency** to alleviate the ECB's balance sheet burden and fund **European Public Goods** (Giavazzi et Al., 2022)
- Moreover, there are proposals to expand the **European public budget** or issue additional **common public debt** to finance European Public Goods (Draghi and Macron, 2021, Buti, Caloccia, and Messori 2023, Buti, Papacostantinou, 2022, Pisani-Ferry, 2019).
- Meanwhile, the introduction and discussion of Draghi's concept of **'good debt' and 'bad debt'** are gaining momentum (Draghi, 2022)
- That being said, in conclusion, despite there being more ways to pay off the public debt, it should be clear that there are **no free lunches**, and thus **fiscal prudence** must remain the guiding **principle** of fiscal policies even in the post-Covid Era.

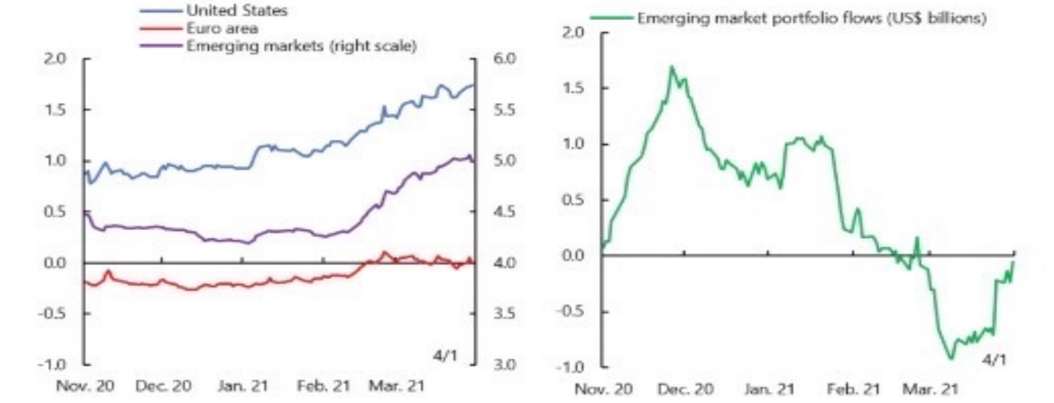
Are high public debts sustainable?

What about negative r –g and «debt revenues»?

What about «new supply economics»?

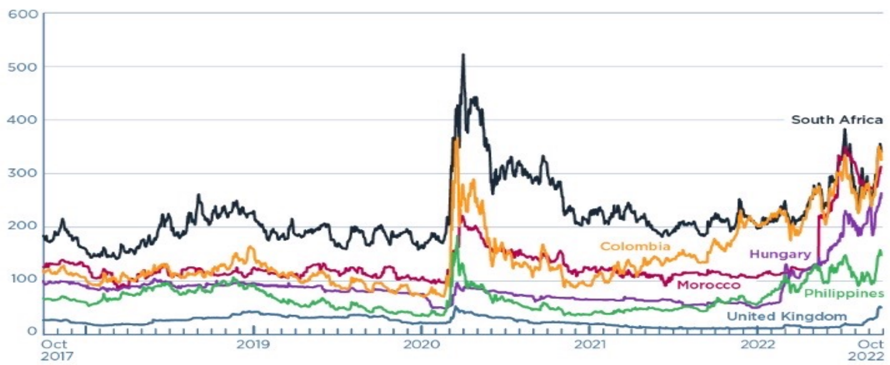
- The demand for **safe assets** is projected to remain **high in the future**, contributing to the continued long-term decline of interest rates (SLIDE 13 and 14)
- Economist **Olivier Blanchard** asserts that with inflation returning to low levels and a **negative r - g**, public debts in advanced economies may remain **sustainable** in the medium and long term (absent extraordinary shocks) and they can be **rolled over** time (Blanchard, 2019, 2023, Summers 2020) (SLIDE 15)
- Some economists argue that public debt can generate additional resources (**debt revenues**) to invest in the economy (Furman and Summers, 2020, Blanchard, 2023)
- Extraordinary relief and stimulus measures have sparked a **new debate** among economists regarding what Janet Yellen referred to as '**new supply-side economics**'
- This debate reevaluates the evolution and dynamics of **inequality**, financial market capital **misallocation**, and the role of safety in **triggering** economic **crisis**

Interest Rates in Andanced Economies and Emerging Markets



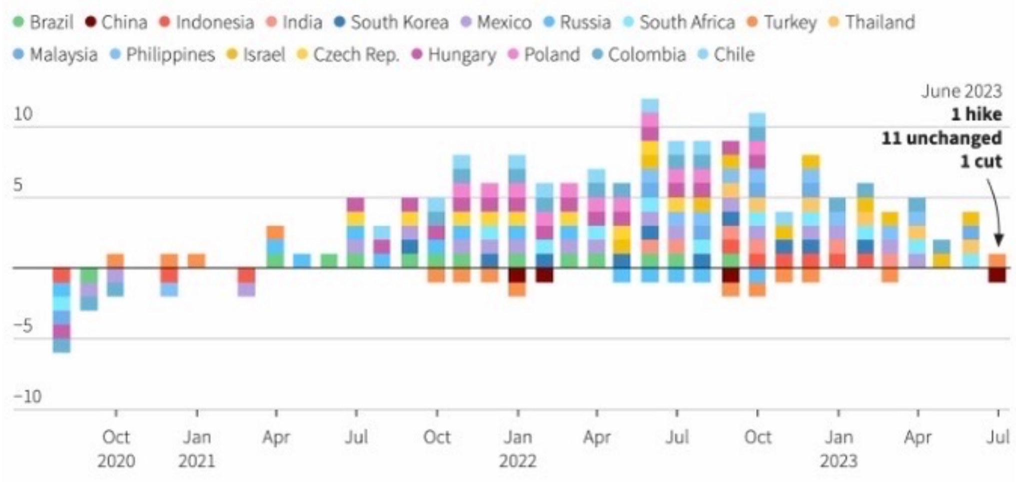
Sources: Haver Analytics; Institute of International Finance; IMF calculations

Cost of Sovereign Debts from Default 5-years credit swaps default, basis points

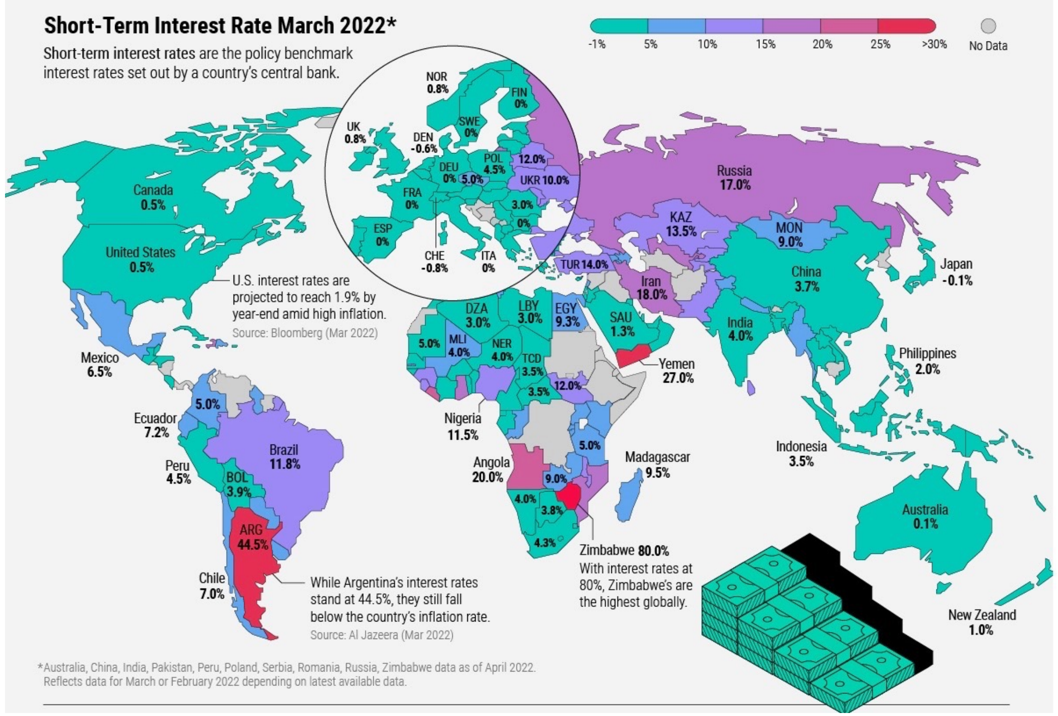


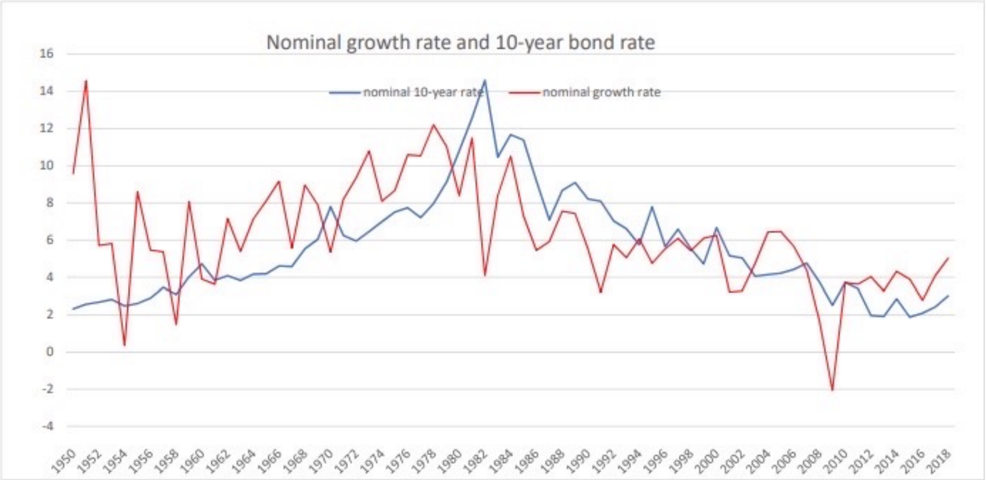
Sources: Bloomberg

Emerging Markets Interest Rates

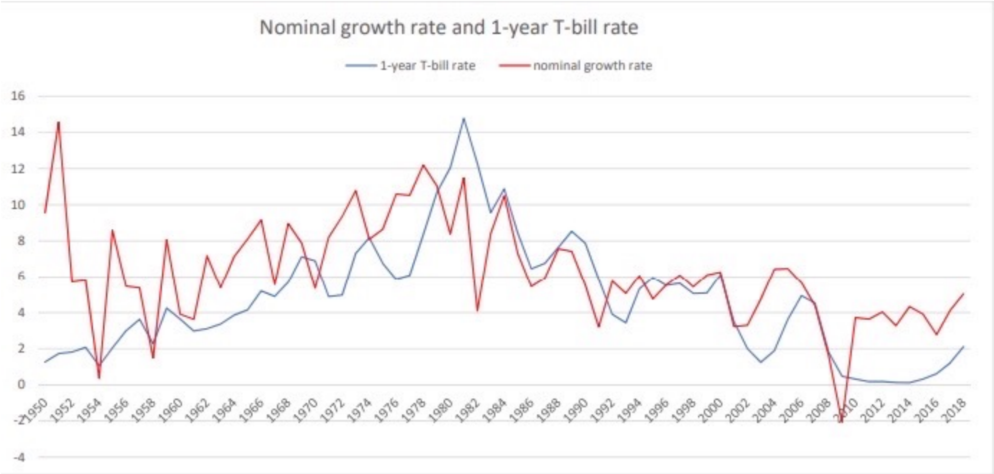


Sources: Refitiv Datastream/Reuters, July 3, 2023. By Vincent Flasseur and Karin Strohecker

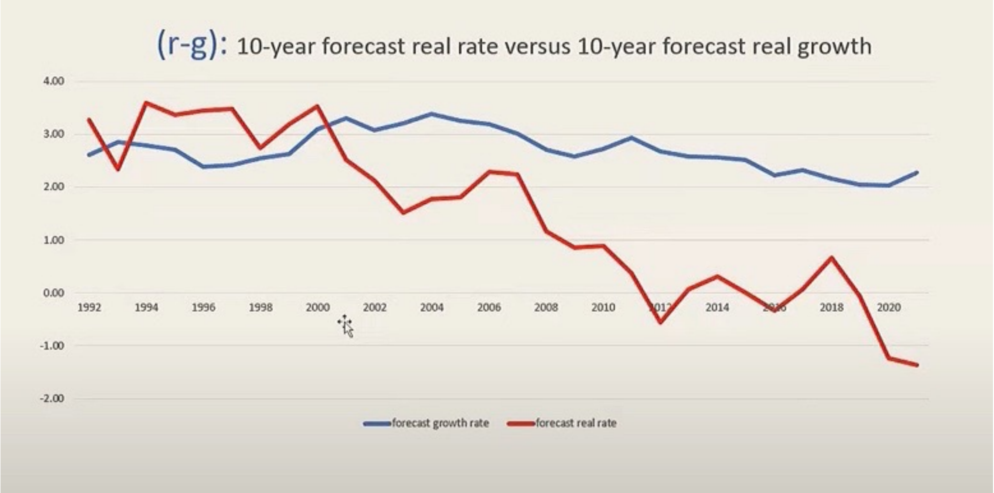




Sources: Blanchard (2019)



Source: Blanchard (2019)



Source: Blanchard (2023)

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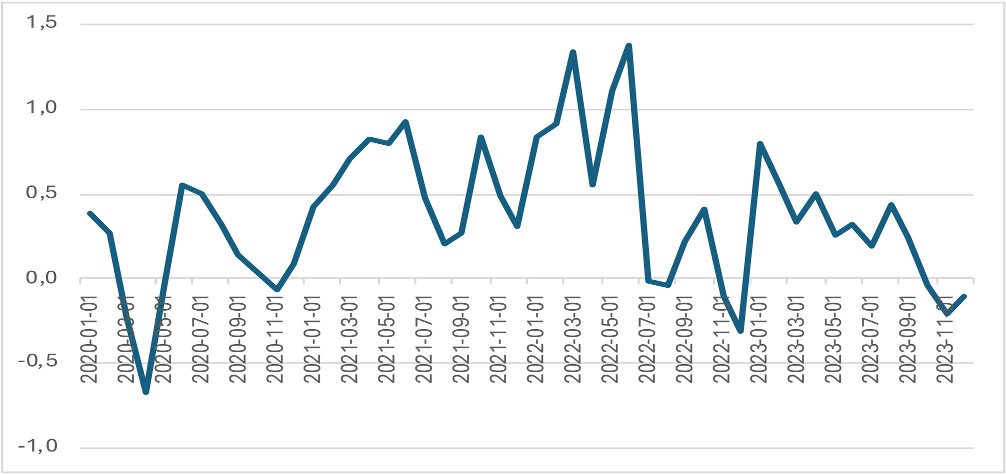
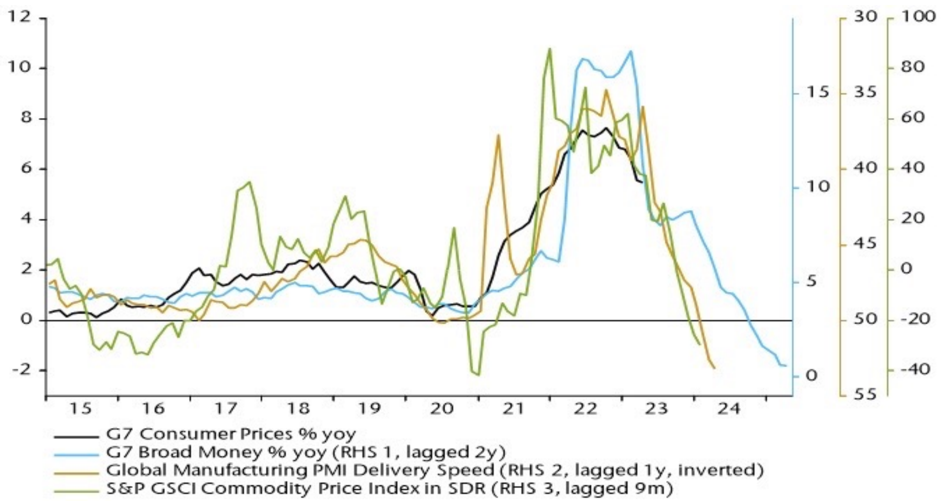
Consumer Price Index: All Items: Total US for United States



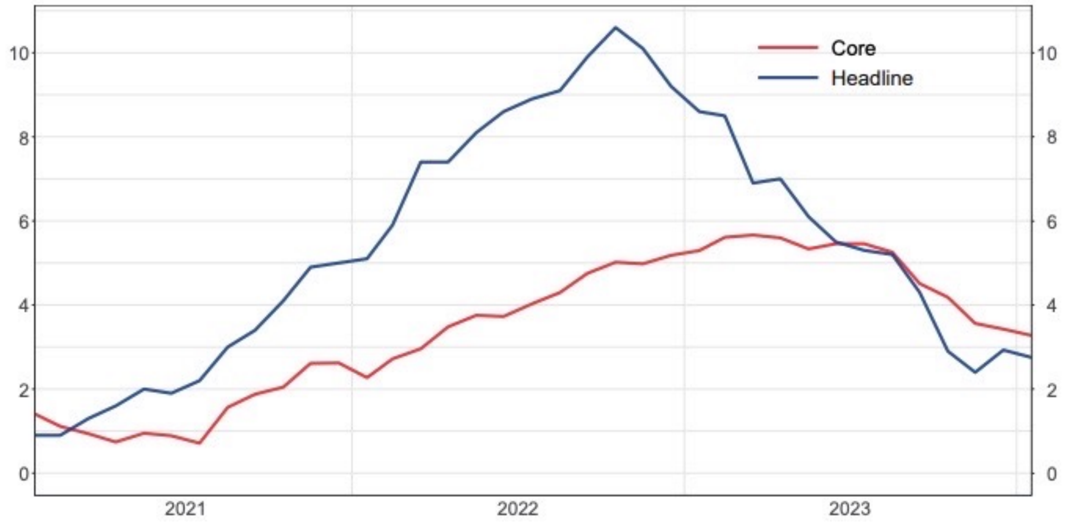
Sources: FRED economic data

G-7 Consumer Prices Broad Money, PMI Delivery and Commodity Prices



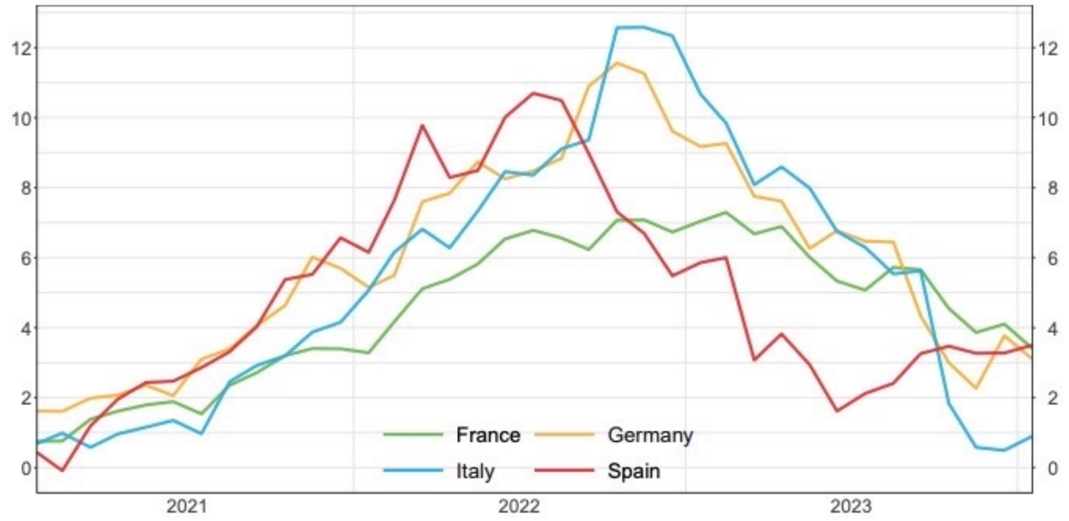
Source: Janus Anderson Investors on Refinitiv Datastream

Euro-area Inflation



Source: Eurostat. Monthly data. For January 2024, preliminary data

Inflation in the Main Euro-area

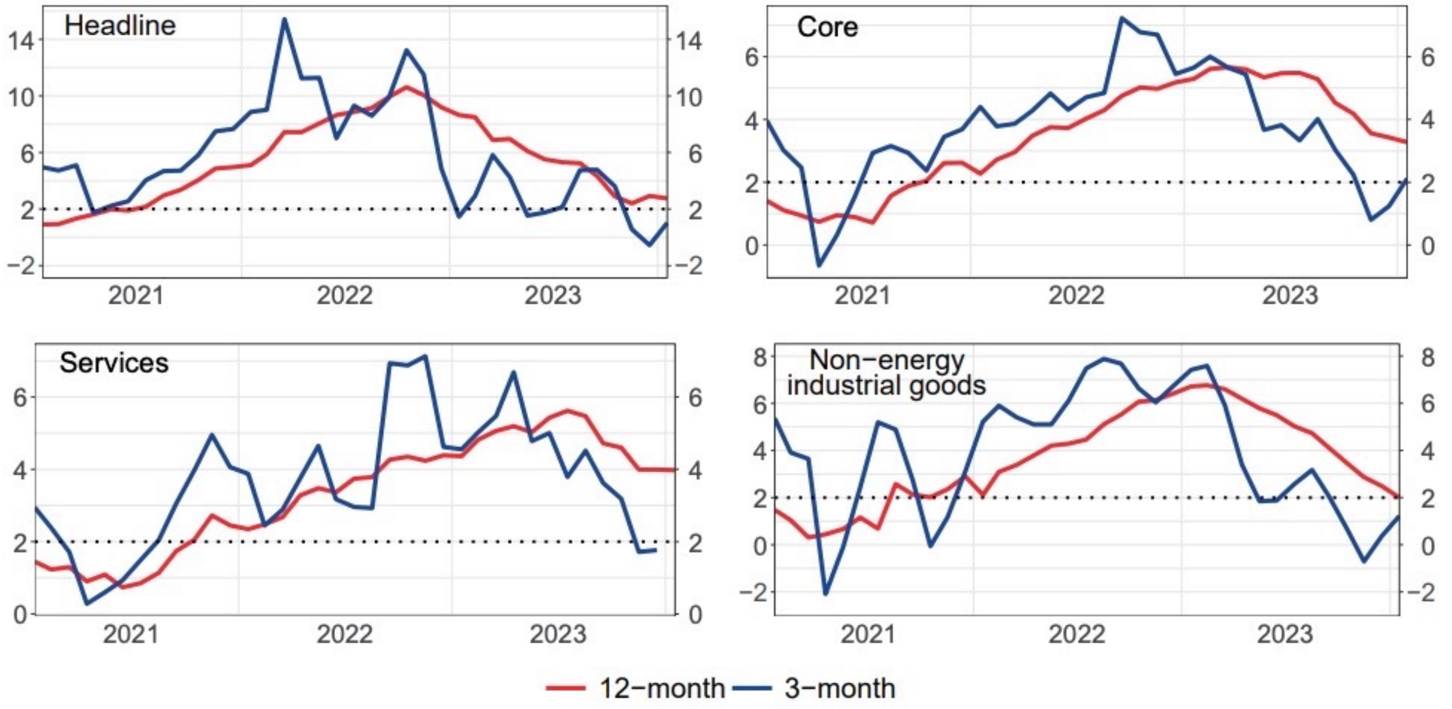


Source: Eurostat. Monthly data. For January 2024, preliminary data

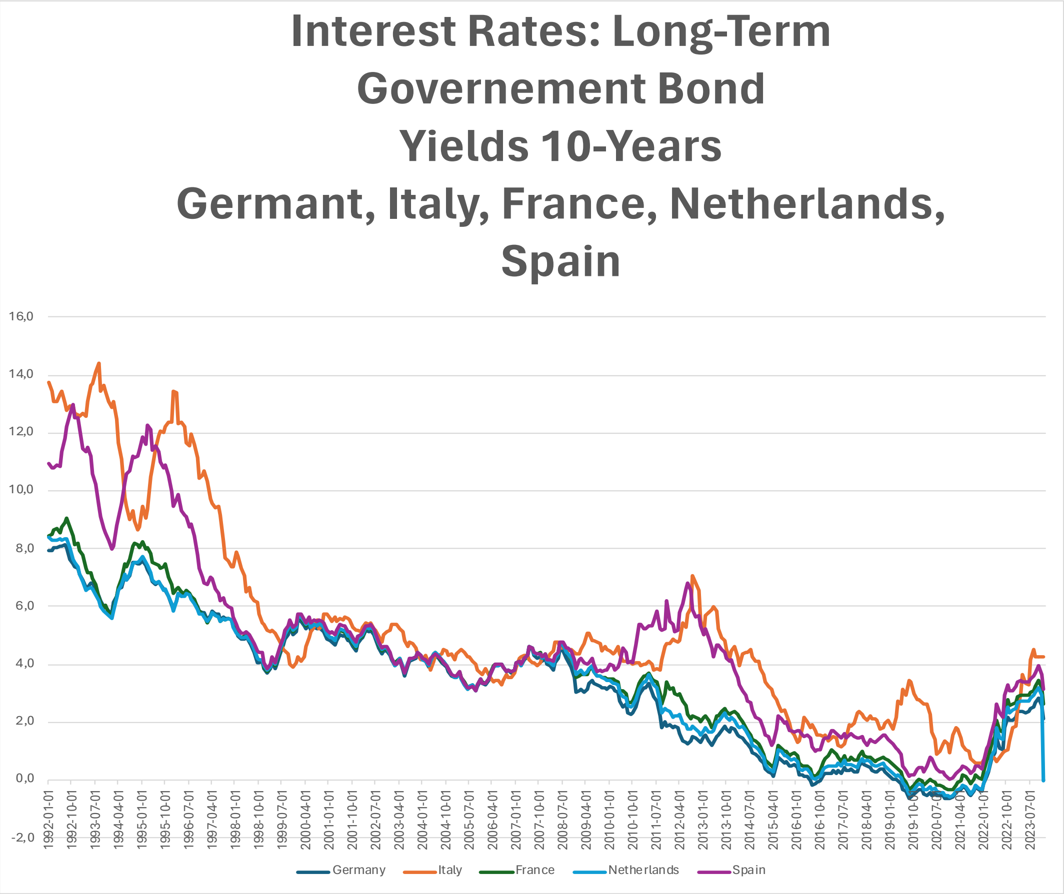
Headline and core inflation in the euro area
Disinflation process well under way

Progress towards the 2 per cent target continues to be rapid

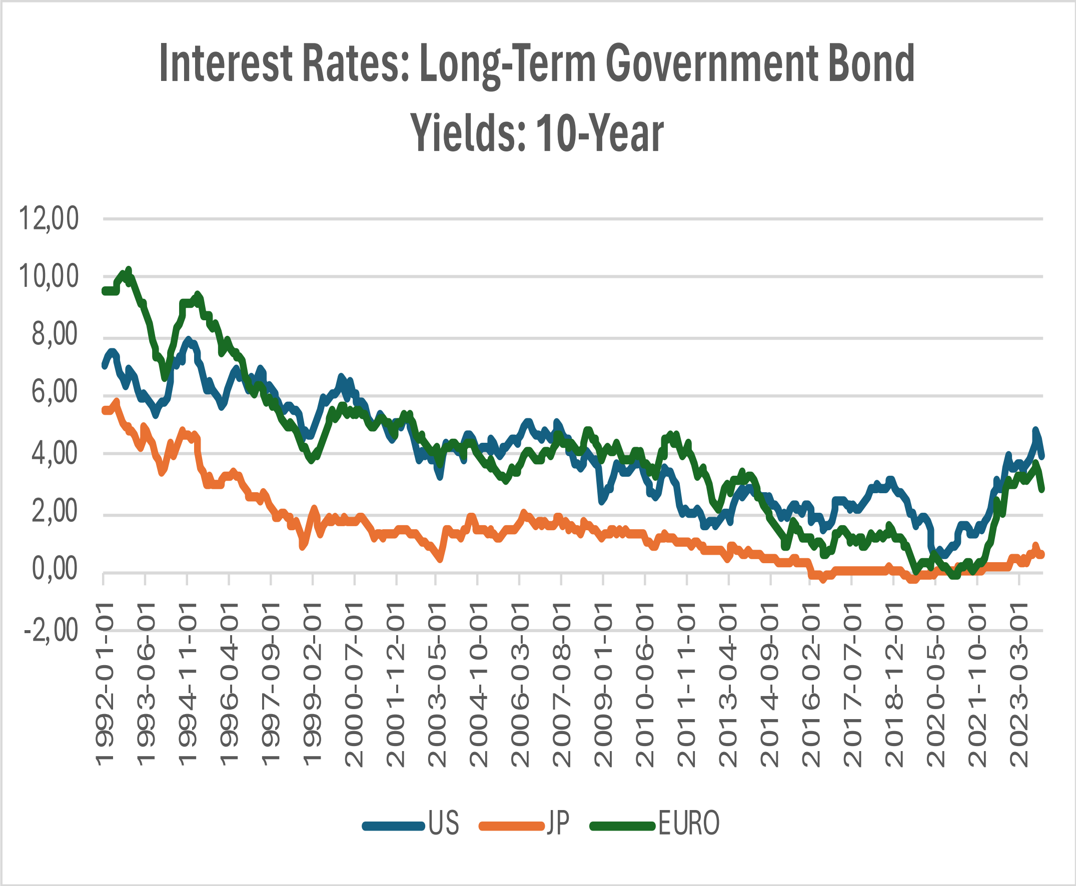
… the time for a reversal of the monetary policy stance is fast approaching



Sources: Based on ECB and Eurostat data. (1) Monthly data. 12-month percentage changes and annualized 3-month percentage changes, calculated using seasonally adjusted data.

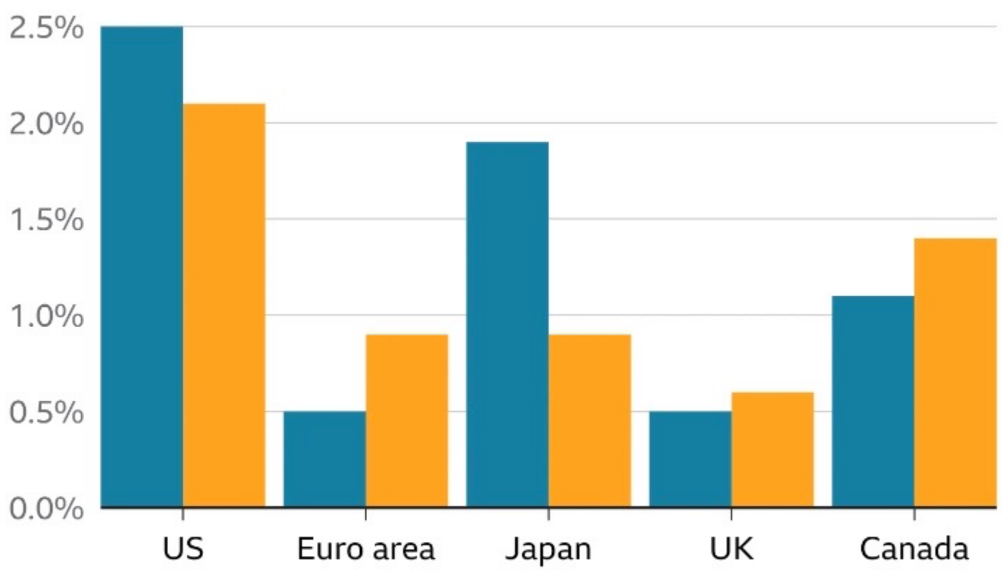


Source: OECD



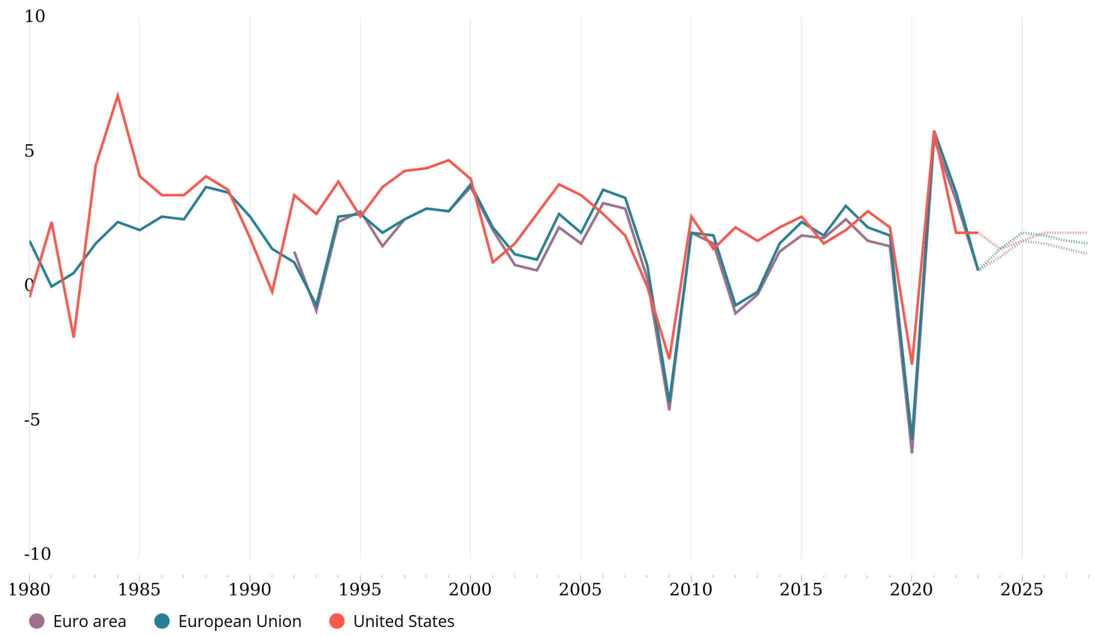
Source: OECD

Growth Projections by IMF
Annual percentage change in real GDP in 2023 and 2024



Source: IMF

Real GDP growth
USA, EU and Euro-area
(Annual percent change)
1980-2023



Source: IMF

Stimulus Plans in the US, EU and Worldwide

- In **America**, support plans totaling over **5,6 tn dollars**
- **3.1 tn** to address the emergency (**CARES ACT**)
- **2.2 tn** for decade-long investment support plans (**Bipartisan Infrastructure Law** 1.2 tn, **Chips and Science Act** 280 bn, and the **Inflation Reduction Act** 783 bn)

- In **Europe**, public resources mobilized amount to around **3,8 tn euros**
- **2.1 tn** (**deficit UE-27 2020-2022 – or 690 bn** in deficit beyond the threshold of 3%) following the suspension of the GSP
- **1.7 tn** for six years in EU funds (**NGEU** 750 bn, **REACT-EU** 50 bn, **Cohesion policy** 534 bn**, REPoweEU** 300 and **SURE** 100 bn, others 32 bn).
- The IMF has estimated that stimulus plans launched **worldwide** in 2020 alone amounted to **14 tn dollars.**

What is Bidenomics?

Is expansive fiscal policy sustainable?

Stimulus plans are too large and at risk of creating inflation?

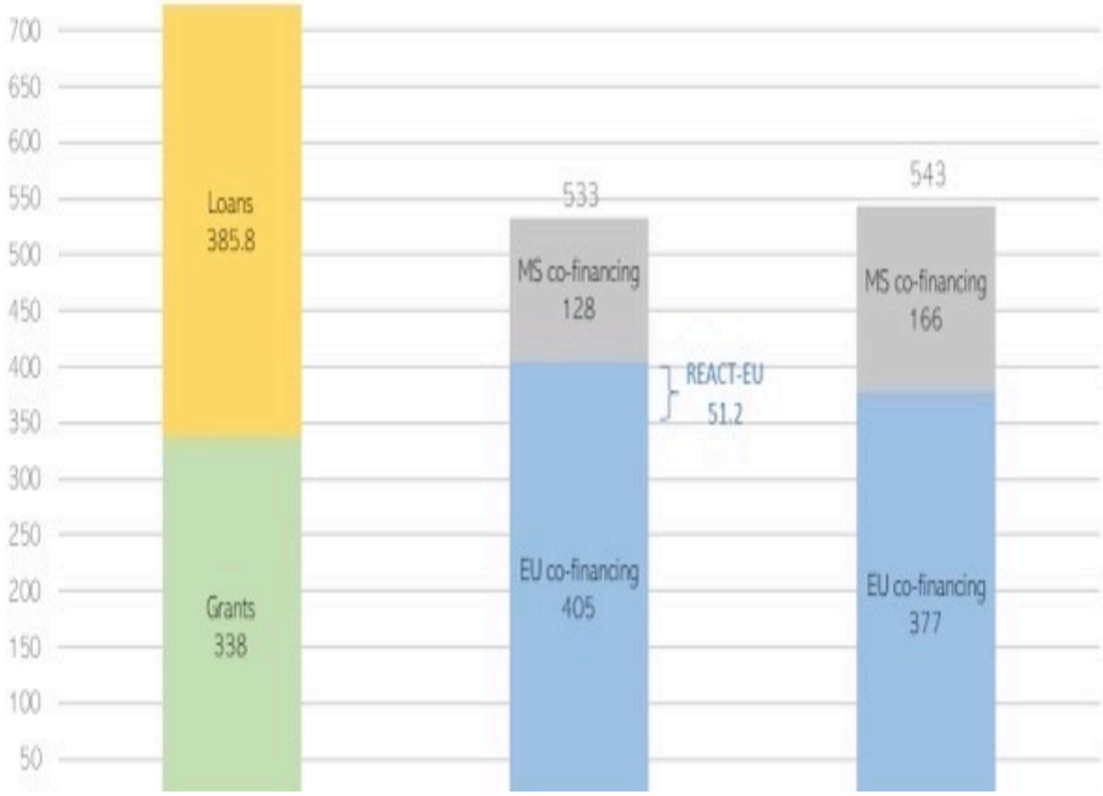
- In the USA, **Bidenomics** is launched
- From "trickle-down" to "trickle-up"
- Significant **incentives** for businesses and research
- Large plans for fixed and social **infrastructure**
- Providing more **support to the middle class**, and investing in the youth and support for elderly care
- Moreover, the **IRA** is generating significant **business investment** and **attracting investors** from all over the world
- Is expansive fiscal policy sustainable?
- Are the extraordinary **stimulus** plans **too large** and at risk of creating inflation?

Will NGEU and Cohesion Funds foster upward convergence?

«In the US, we are seeing a new focus on so-called "statecraft," where federal spending, regulatory changes, and tax incentives align to pursue US strategic goals. Europe lacks an equivalent strategy to integrate EU level spending, state aid rules, and national fiscal plans — as the example of climate change shows»
(Mario Draghi)

- **NGEU** expected to benefit all euro area countries through positive spillovers and **transformative momentum**
- Takes effect through **three channels**: structural reform, fiscal stimulus, and risk premium
- **Complements** cohesion and development funds (SLIDE 10)
- Given NGEU's nature, it's crucial to consider **fiscal spillovers** when assessing overall macroeconomic effects

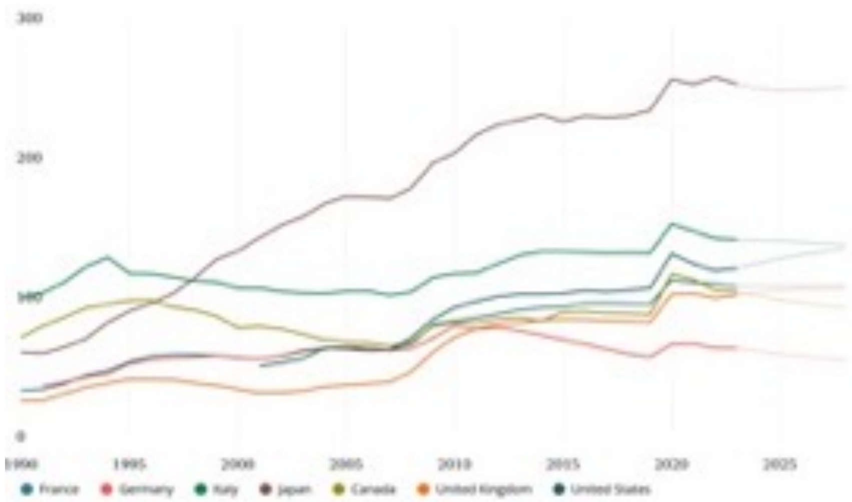
European Stimulus Funds



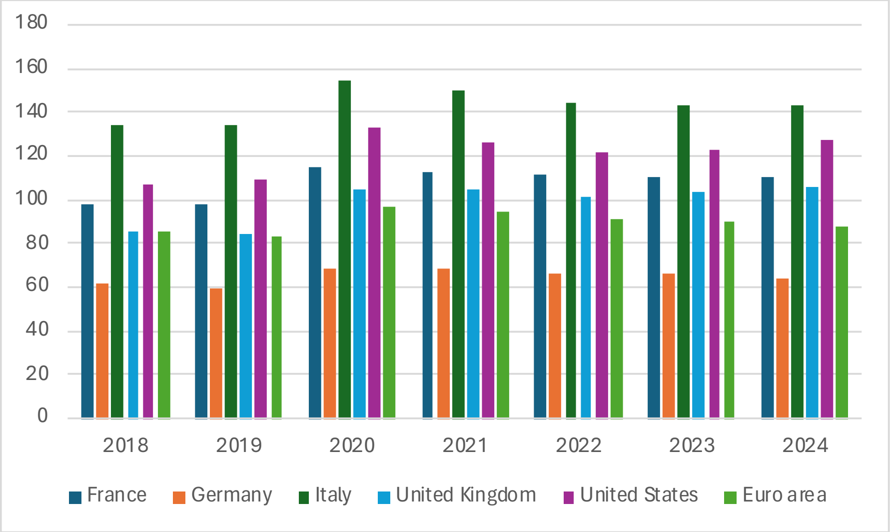
Financial size of RRF (2020-2026) and Cohesion Policy (2014-2020 and 2021-2027), € billion

RRF and Cohesion Policy (2014-2020 and 2021-2027) resources in six Member States, € billion

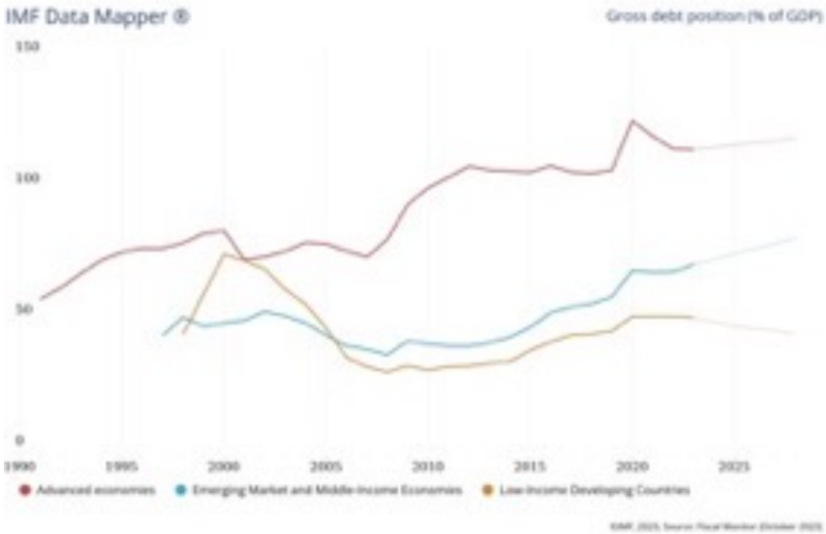
Sources: IMF Fiscal Monitor



Source: IMF Fiscal Monitor



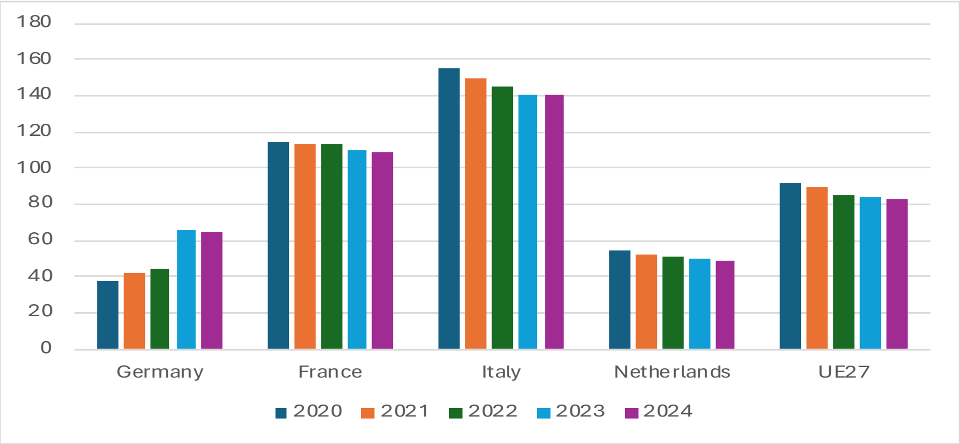
Source: IMF Fiscal Monitor



Source: Eurostat. IMF Fiscal Monitor

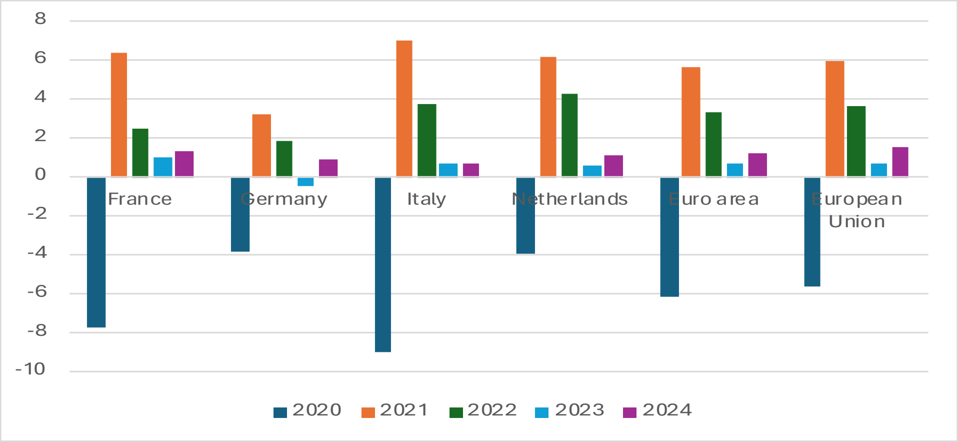
Fiscal Stance in Europe

Gross Debt
(as a percentage of GDP)



IMF Oulook October 2023

GDP Real Growth
(annual percentage change)



IMF Oulook October 2023

Interest Expenditure
(as a percentage of GDP)

	2020	**2021**	**2022**	**2023**	**2024**
Germany	0,6	0,6	0,7	0,8	0,9
France	1,3	1,4	1,9	2	2
Italy	3,5	3,6	4,4	4	4,1
Netherlands	0,7	0,6	0,5	0,7	0,7
UE27	**1,4**	**1,4**	**1,6**	**1,7**	**1,8**

Net lending (+) or net borrowing (-)
(as a percentage of GDP)

	2020	**2021**	**2022**	**2023**	**2024**
Germany	4,3	-4,3	-2,6	-2,3	-1,2
France	-9	-6,5	-4,7	-4,7	-4,3
Italy	-9,7	-9	-8	-4,5	-3,7
Netherlands	-3,7	-2,4	0	-2,1	-1,7
UE27	**-4,7**	**-3,4**	**-3,1**	**-2,1**	**-2,4**

Source: European Commission 2023 spring forecast