BRIEFING

The economy and coronavirus: Weekly Picks

This paper provides a summary of some recent analyses of the economic and financial effects of the coronavirus and some policy recommendations made in the public domain to mitigate these negative effects.

Some recent economic estimates

Given the high uncertainty of the economic impact stemming from the lockdown measures, **the ECB** [published](#) **on 1 May 2020** projections under three scenarios. The ECB notes that these COVID-19 outbreak economic impact estimations by no means are replacing and should not be seen as an indication of the regular forecasts provided by the ECB and the next round of macroeconomic projections should be published in June 2020. Overall, the scenario analysis is based on the same broad narratives as for the global economy and are built on containment policy measures feeding into the economy through negative real-financial feedback loops. However, this analysis does not take into consideration other non-linear amplification mechanisms, such as severe losses to household income and persistently high unemployment as a result of an increase in bankruptcy rates in the corporate sector.

The three scenarios presented by the ECB differ in the duration of the strict lockdown measures and their impact on sectoral economic activity, the economic effects of protracted containment measures during a post-lockdown transition period, the behavioural responses by economic agents to minimise economic disruptions and other aspects.

- *In the first (mild) scenario, strict lockdown and further containment measures, as well as rapid advances in medical treatments, entail relatively short-lived strict lockdown periods (ending in the course of May 2020), a gradual return to normal activity thereafter and only temporary economic losses.*
- *In the second (medium) scenario, a short-lived strict lockdown period (also ending in the course of May 2020) is followed by relatively stringent and protracted containment measures, implying a delayed return to normal activity, as well as persistent output losses.*
- *In the third (severe) scenario, a longer-term strict lockdown period (ending in the course of June 2020) has only limited success in containing the spread of the virus, thus requiring ongoing tough containment measures to remain in place even after some loosening of the very strict lockdowns. The sustained efforts to prevent the spread of the virus would continue to significantly dampen activity across sectors of the economy until a vaccine (or another effective medical solution) were to become available. This is not expected to occur until around mid-2021. Therefore, this scenario envisages significant and permanent output losses.*

Based on the ECB scenario analysis, the economic activity contraction is expected to be unprecedented, reaching the real GDP decline of around 5%, 8% and 12% under the mild, medium and severe scenarios, respectively, in 2020. The economic sectors that are expected to experience relatively larger loss in their value added are retail trade, transport, accommodation and food service activities compared to manufacturing, construction and other sectors. Under the assumptions used for these illustrative scenarios, the marginal impact of an additional month of lockdown measures on the annual euro area GDP level is initially, approximately, between 2 and 2½ percent.

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According to the ECB, as containment measures allow for a gradual normalisation of economic activity, real GDP is expected to increase by around 6%, 5% and 4% under the mild, medium and severe scenarios, respectively, in 2021. Under the severe scenario, in particular, real GDP is expected to remain well below the level observed at the end of 2019 until the end of 2022.

According to the 4 May results of the Q2 2020 ECB Survey of Professional Forecasters, expectations for growth in euro area real GDP averaged -5.5%, 4.3% and 1.7% for 2020, 2021 and 2022, respectively. These represent large revisions from the previous round of -6.6 percentage points for 2020 and +3.1 percentage points for 2021. At 1.4%, average longer-term expectations for real GDP growth were unchanged.

Fitch rating of bonds issued by the EU, EIB and ESM

Fitch expects that EU debt service would remain fully covered by 'AAA'MS's potential additional contributions up to the 'own resource ceiling' (currently set at 1.20% of their gross national income) combined with new guarantees from MS of up to EUR25 billion. The current Fitch rating of the EU rests on its AAA MS. The ESM will not need additional resources from its shareholders as it is already very strongly capitalised, in line with its mandate to provide up to EUR500 billion of support to eurozone sovereigns (compared with EUR90 billion of loans currently). And the EIB Group's guarantees will be fully backed by guarantees from EU MS.

In Fitch's view, the main risk to EU supranational ratings remains the potential impact of the global pandemic on asset quality via weaker creditworthiness of EU-based entities, including sovereigns. Marked weakening in asset quality could affect the ratings of the EIB and the ESM, which are based on their intrinsic credit quality. The EU rating would be affected by lower support from 'AAA' rated MS if we were to downgrade any 'AAA' MS, or from a weakening in our assessment of the cohesion of EU MS. In Fitch's view, reaching a new agreement on a significantly increased 'own resource ceiling' could test this cohesion, which is a key factor in their assessment of the propensity of MS to support the EU.

Recommendations to the EU by the Tax Justice Network (28 April 2020)

"The EU must, finally, to say 'no more': no more tax abuse, no more profit shifting, and no more exploitation of other countries by the UK, Netherlands, Switzerland and Luxembourg and others. The agenda to achieve this change is clear and contains three components.

First, the EU should **adopt a full version of the long-debated Common Consolidated Corporate Tax Base** without further delay. Specifically, EU member states should assess the taxable profits in their jurisdiction on a unitary basis, taking a share of each multinational's global (not EU), consolidated profits in proportion to the share of the multinational's employment and sales in the country in question. (Tangible assets should be excluded, since values are too easy to manipulate.) At a stroke, this approach cuts through transfer pricing manipulations and the difficulties posed by digital companies, on a consistent and transparent basis. Immediately, too, it ends the possibility of profit shifting within the EU and puts an end to the manipulations of the axis of avoidance.

Second, EU member states should agree a **minimum effective corporate tax rate** of at least 25%, including a ban on tax rulings that can undermine this, to end the race to the bottom and eliminate any remaining incentives for profit shifting within the bloc. A short-term excess profits tax – perhaps 50% or even 75%, on profits above some initial level – would ensure pro-social redistribution in this time of need, from companies such as Amazon that stand to profit disproportionately from government decisions to lock down societies.

The third measure is the simplest: transparency. EU members should require all multinationals to publish annually their **country by country reporting**, showing the location of their employment, sales, declared profits and tax paid. This will provide full accountability, allowing the public to confirm both that multinationals are paying their fair share, in the right places, and that EU member states too are behaving in solidarity.

These steps, taken together, would end the corporate tax havenry of the axis of tax avoidance; would raise important new revenues for all EU members to support their COVID responses and beyond; and would establish the basis for accountable corporate tax sovereignty long into the future.".

Key elements and state of play of the streamlined 2020 European Semester

Due to the pandemic crisis, Member States have adopted emergency measures with major budgetary consequences and the Council, based on a proposal by the Commission, has invoked the general escape clause under the SGP and hence the fiscal recommendations as adopted by the Council in July 2019 are not applicable. Many Member States have also triggered national escape clauses to suspend national budgetary restrictions.

In accordance with the European Semester cycle, Member States were expected to submit in April 2020 their National Reform Programmes (NRPs) and Stability or Convergence Programmes (SCPs). On 6 April 2020, the Commission provided guidelines on how the format and content of the 2020 SCPs can be streamlined in light of the exceptional circumstances related to the Covid-19 pandemic and the severe constraints under which Member States are working. The Commission recognises that the exceptional circumstances demand particular understanding of the difficulties that Member States may face in providing the data usually required in their SCPs. The guidelines for streamlined SCPs have also been shared with the Independent Fiscal Institutions (IFIs).

On 16 April 2020, as a consequence to the exceptional circumstances, the EU Finance Ministers have agreed on the simplification of information requirements for the 2020 European Semester:

> *Given the high degree of uncertainty as a result of the socio-economic fallout of the COVID-19 pandemic, the Commission has put forward a simplified process for this year's European Semester exercise. This is intended to preserve the European Semester's main milestones, while taking into account the challenging times member states are facing. In particular, there would be a streamlined approach for the submission of national reform and stability or convergence programmes (NRPs and SCPs) by member states.*

According to the Commission website, 15 Member States have so far submitted a SCP and 14 Member States have submitted a NRP.

The Commission expects to publish its economic forecast later this week and its proposals for 2020 Country Specific Recommendation in late May. During a normal Semester Cycle, the Council format would discuss the Commission's proposals before endorsement by European Council in June and final adoption by Council in July.

For an overview of the implementation of 2019 CSRs, please separate EGOV document.

Policy recommendations in the public domain: Some picks from last week

M. Motta, M. Peitz - *The EU recovery fund: An opportunity for change* (30 April 2020):

The European Commission has been asked to develop a proposal for a new recovery fund of more than €1 trillion. Given the substantial support needed by most sectors in the present circumstances, it is crucial to identify the ones which are most important to proper functioning of the EU economies. Based on the principle of subsidiarity, this column formulates two general criteria to identify these sectors: those for which (i) the volume of cross-border trade within the EU is large, or (ii) externalities across member states are important. Support schemes should be oriented towards the future and not try to preserve the status quo ante.

A. Balleer, B. Gehrke, B. Hochmuth, C. Merkl - *Guidelines for cost-effective use of SURE: Rule-based short-time work with workers' consent and aligned replacement rates* (01 May 2020):

As reaction to the COVID-19 crisis, the EU has implemented 'temporary Support to mitigate Unemployment Risks in an Emergency' (SURE), which consists of financial assistance up to € 100 billion in the form of loans to member states. SURE loans have to be used for the preservation of employment, either in the form of short-time work (STW) or similar schemes. STW provides a subsidy to employers to compensate their workers for temporary working-time reductions. These working-time reductions may then be an alternative to layoffs for firms. We argue that SURE loans can be a useful instrument to *stabilise the labour market. We have defined guidelines for national governments for effective usage of SURE loans. Most importantly, STW should be implemented with clear rules, as Balleer et al. (2016) find substantial automatic stabilisation of unemployment at very low costs due to a rule based STW. As SURE is potentially a cost-effective automatic stabiliser at the European level (if used properly), it may be the starting point for a more ambitious European (un)employment insurance system (see Vandenbroucke et al. 2020).*

J. Bjerkem - *Europe's hidden weapon in combatting COVID-19: The Single Market* (30 April 2020):

The Single Market will play a crucial role in Europe's recovery from COVID-19. As state involvement and attempts to shield strategic sectors will become the global norm, EU member states will become even more reliant on their common market. To ensure a speedy recovery, the EU should, therefore, be as forceful in reinstating its Single Market as it was when putting it on hold. However, in the post-COVID-19, it will not be enough to merely reinstate the Single Market as it was before – it will have to be improved significantly.

T. Löyttyniemi - *Coronataxes as a solution* (30 April 2020):

In Europe, the public debate has centred around Coronabonds, while inflationary solutions have also been receiving academic attention. This column argues that a more practical solution is to introduce simple, temporary 'coronataxes' over the next five to ten years. These taxes could be implemented nationally and supported by European-level coordination. Even though taxation undermines economic growth, there are, unfortunately, no sound alternatives. Those who demand substantial subsidies and quick action on the part of the governments and central bank are presumably willing to accept coronataxes in exchange. The coronatax would be a natural solution, in preference to complicated schemes that would anyway fail to address the core problem. Coronabonds and central bank-generated stable inflation would only be conceivable when all other options are exhausted. Strong economic growth will hardly rescue us because the challenges of an ageing population will only grow and erode the basis for growth across Europe.

Á. Gereben, M. Wolski - *The impact of public sector lending to SMEs on employment and investment* (29 April 2020):

With the coronavirus crisis unfolding, many countries have announced new lending and guarantee programmes dedicated to supporting businesses' access to finance. This column examines the impact of such programmes, focusing on European Investment Bank lending schemes. The findings suggest that publicly funded lending support programmes can make a difference in maintaining employment and investment activity at the firm level. Overall, our results support the view that publicly funded lending support programmes can make a difference in maintaining employment and investment activity at the firm level. The results matter for economic policy design in the context of the current economic downturn, as they confirm that EIB-intermediated lending schemes have been successful in terms of influencing the economic decisions of the final beneficiaries, and suggest that the resulting know-how may prove effective when designing instruments aiming at mitigating the impact of the COVID pandemic.

G. Corsetti, A. Erce - *Maturity, seniority and size: Make sure the ESM's pandemic crisis support is fit for purpose!* (29 April 2020): *The Eurogroup recently agreed to provide support during the Covid crisis through a dedicated European Stability Mechanism credit line. A discussion is playing out in European capitals, most intensely in Rome and Madrid, regarding the usefulness of tapping these credit lines. While the final details are still pending, this column evaluates the conditions that seem to be currently on the table. As these programmes provide very little interest savings, designing them in such a way that would not trigger disruptions in the bond markets of borrowing countries is key. To this end, the ESM should consider waiving its seniority and engaging with countries using longer maturity structures.*

L. Boone, Á. Santos Pereira - *Europe must act now to prepare the aftermath of the pandemic crisis* (27 April 2020): *The crisis faced by Europe is extraordinary and requires extraordinary responses. It is also a unique opportunity for Europe, and in particular the EMU, to consolidate its economic and financial architecture and to promote Europe as the engine of "shared prosperity". This column argues that a significantly reinforced and revamped ESM or a new financial instrument based on joint issuance are possible vehicles to translate words into action. the ESM is ill suited to provide widespread fiscal support to euro area countries to counteract the economic fallout of the pandemic. If the ESM is to play a significant role in the challenges posed by the current crisis, its firepower will have to be substantially upgraded, the conditionality requirements will have to be significantly watered down and replaced by an allocation usage condition (namely, fund all pandemic-related spending). An alternative is the creation of European financial instruments that mutualise a large part of the fiscal costs and financing of the crisis. More specifically, the launch of one-off, ad-hoc European debt instruments should help finance fiscal needs at a relatively low cost for all euro area members and for the euro area as a whole. This would have the advantage of not adding directly to the national debt numbers, provided such a feature is part of the original design.*

For an overview of some previous EGOV Weekly Picks:

- The economy and coronavirus - Weekly Picks - 27/04/2020
- The economy and coronavirus - Weekly Picks - 15/04/2020
- The economy and coronavirus - Weekly Picks - 06/04/2020
- The economy and coronavirus - Weekly Picks - 30/03/2020

And for some other recent or topical papers by EGOV:

- EU/EA measures to mitigate the economic, financial and social effects of coronavirus
- A recipe for a sustainable and legitimate new EU/EA fiscal instrument?
- The SURE: Main Features
- What do we know about the BICC today?
- The proposed amendments to the Treaty establishing the European Stability Mechanism

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