

FISCAL POLICY RESPONSE TO THE CRISIS IN THE EURO AREA AND THE UNITED STATES

Luis Guirola, Iván Kataryniuk and Carlos Moreno

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This box compares the fiscal impulse announced in the euro area and in the United States since the onset of the COVID-19 pandemic. The stimulus has two components. First, national authorities have adopted discretionary fiscal policy measures, the breadth of which is unprecedented in recent decades. Second, automatic budget stabilisers, such as unemployment benefits, have operated in both areas. Assessing the contribution of the fiscal policy response to the health crisis requires taking into account the role played by both these components.

The discretionary fiscal policy measures adopted in both areas have been focused on providing income support to households and firms. In the case of households, the funding of short-time work schemes was extended in many euro area countries, while in the United States the duration and generosity of federal unemployment insurance were increased. In addition, moratoria on interest payments and rentals were introduced in both areas. In the case of firms, far-reaching public guarantee programmes have been approved to encourage new lending to the business sector.¹ In general, the measures announced are temporary and their direct impact is concentrated mainly in 2020 and 2021 H1. In Europe, national responses have been complemented with supranational policies,² including the NextGenerationEU (NGEU) programme³ whose funds, once approved, will become available between 2021 and 2026.

Some of the measures described have an immediate budgetary cost, such as those affecting the labour market, while others entail only a contingent liability for general government until such time as they are enforced, such as the guarantees. But both types of measures have a positive impact on the economic situation in the short term. The final budgetary impact of this broad raft of

measures will ultimately depend on their level of implementation. It is important to note that insofar as some of the measures approved build on existing programmes, estimates of the fiscal effort they entail should consider only the additional expenditure incurred by the new measures, after subtracting the inertial component of the programmes already in place.

Bearing in mind all the above, Chart 1 presents an estimate of the fiscal impulse associated with the discretionary measures that have direct budgetary impact, both for the euro area and the United States. In 2020 this impulse is estimated to amount to 6.3 percentage points (pp) of GDP in the euro area and to 8.4 pp in the United States, when the metric used is the change in the cyclically-adjusted primary balance estimated by the IMF in October 2020.⁴ However, given the temporary nature of the vast majority of the measures, and the impact that the IMF assumes the NGEU will have in Europe, the overall fiscal policy stance over a longer horizon would be slightly expansionary in the euro area. Chart 2 sets out the amounts approved under the public guarantee programmes established in both regions. These amounts, which have not necessarily been used in full, are significantly higher in the euro area.⁵

With regard to the role played by the automatic stabilisers, the academic literature has documented that these stabilisers are larger in the European economies, although it is difficult to quantify the differential income stream being generated as a result in the current crisis. There are several reasons why the US government budget has less automatic stabilisation capacity than those of the euro area countries.⁶ These include a smaller public sector (see Chart 3), a less progressive tax system and a less generous unemployment insurance system.⁷ The United States also has greater institutional constraints at the

1 See L. Cuadro-Sáez, F. López-Vicente, S. Párraga and F. Viani (2020), "Fiscal policy measures in response to the health crisis in the main euro area economies, the United States and the United Kingdom", *Occasional Paper* No 2019, Banco de España.

2 See M. Delgado, I. Kataryniuk, F. López-Vicente and J. J. Pérez (2020). "Supranational debt and financing needs in the European Union", *Occasional Paper* No 2021, Banco de España.

3 See Banco de España (2020), Box 5, "Next Generation EU: Main characteristics and impact of its announcement on financial conditions", *Economic Bulletin* 3/2020.

4 See *Fiscal Monitor*, October 2020.

5 No comparable data is available for the euro area and the United States on the extent to which these programmes have been used.

6 See P. Burriel, P. Chronis, M. Freier, S. Hauptmeier, L. Reiss and D. Stegarescu (2020). "A fiscal capacity for the euro area: lessons from existing fiscal-federal systems", *Occasional Paper* No 2009, Banco de España.

7 See S. Albrizio, J. C. Berganza and I. Kataryniuk (2017). "Federal unemployment insurance in the United States", *Analytical Articles, Economic Bulletin* 2/2017, Banco de España.

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sub-national government level – given the nominal budget balance rules and individual state’s debt limits – compared with European rules which, broadly speaking, permit a medium-term approach since they do not factor in the impact of the economic cycle.

By way of illustration, Chart 4 sets out estimates based on microsimulations drawing on individual data.⁸ On this evidence, the automatic stabilisers in the euro area would

be able to absorb a larger portion of a negative shock on gross household income than those in the United States (absorbing 38.5% compared with 32.2%), owing to the different levels of progressivity of the tax system in the two areas. In the event of an income shock affecting only a single sub-set of households and resulting in their unemployment, the automatic stabilisers would absorb 48.5% of the shock on household disposable income in the euro area and 33.4% in the United States, reflecting

Chart 1
CHANGE IN CYCLICALLY-ADJUSTED PRIMARY BALANCE (% OF GDP)

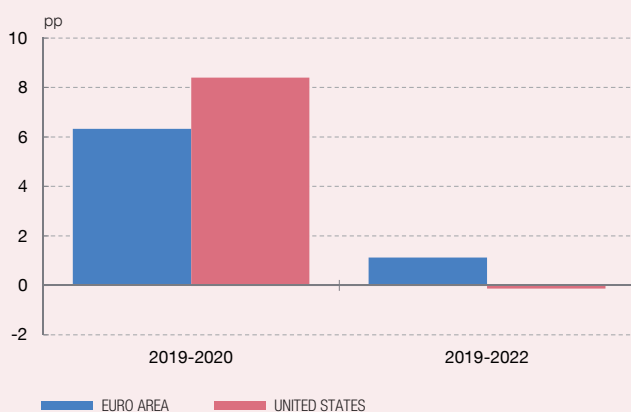


Chart 2
DISCRETIONARY FISCAL POLICY MEASURES WITH NO IMMEDIATE BUDGETARY IMPACT: GUARANTEES

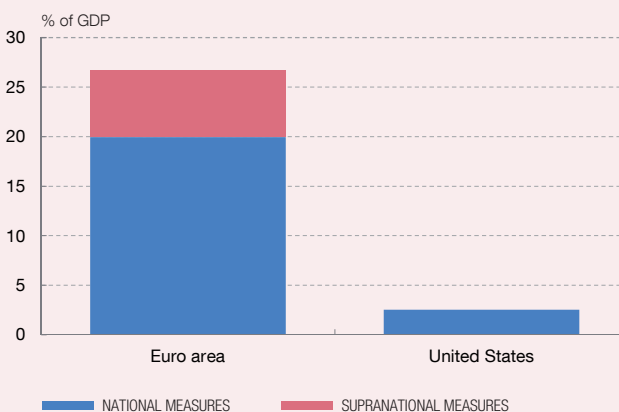


Chart 3
SIZE OF GENERAL GOVERNMENT IN THE EURO AREA AND THE UNITED STATES (a)

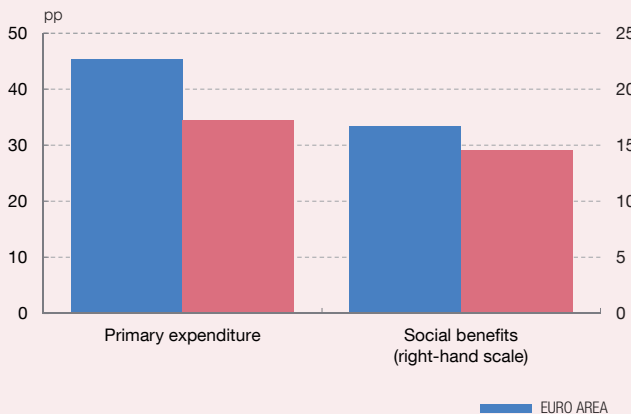
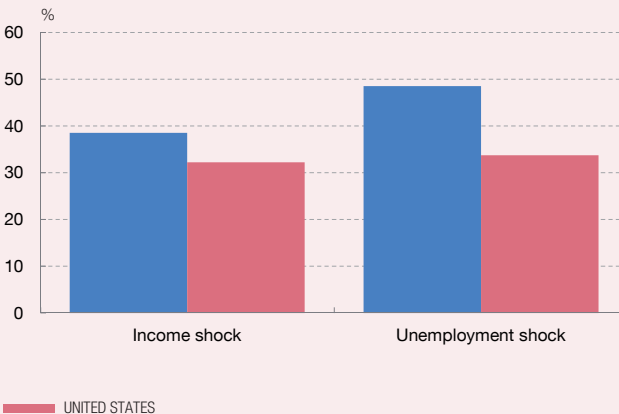


Chart 4
AUTOMATIC STABILISERS: STABILISATION OF DISPOSABLE INCOME IN FACE OF DIFFERENT SHOCKS (DOLLS ET AL., 2012)



SOURCES: IMF, OECD, AMECO and Dolls et al. (2012).

a 2019 data.

8 See M. Dolls, C. Fuest and A. Peichl (2012). "Automatic stabilizers and economic crisis: US vs. Europe." *Journal of Public Economics*, 96(3-4), 279-294.

the differences in the power of unemployment insurance in the two areas.

In short, the euro area and US authorities have responded to the crisis by swiftly adopting highly ambitious fiscal policy measures. Comparing the response in the two areas is complex, since at least three elements must be considered. First, the discretionary measures adopted

with a direct budgetary cost. Second, the measures generating contingent liabilities for general government. Lastly, the estimated income stream stemming from the operation of the automatic stabilisers. Although the first factor appears to have had the most impact, in the United States, in 2020, consideration of the other two components provides a more balanced assessment of the relative efforts of the euro area and the United States.