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Article

Discussing EU Policies and Mechanisms towards the COVID-19 Pandemic Crisis: A Case Study of Greece

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Abstract: This paper discusses the effectiveness of EU economic measures towards the pandemic crisis in the case of Greece. As the pandemic crisis was an exogenous and symmetric crisis, EU member states decided to take supply and demand side measures to tackle economic recession. Not only the Recovery plan for Europe (NGEU), but also the Escape Clause, as well as non-standard monetary measures, were implemented in order to achieve growth. Furthermore, fiscal expansion, as well as common debt extraction, using green and social bonds led to higher government spending and sovereign debt. The paper's research question is "Could fiscal expansion mitigate the economic consequences of pandemic crisis?" In other words, the research gap which this paper tries to fill is that for the contemporary EU response to two different crises, the economic and the pandemic. Our analysis, by using a comparative approach, shows that government spending and fiscal expansion is effective in the short-run, as the temporary measures led to higher GDP growth rates and lower unemployment rates, but in the long-run demand side measures led to higher inflation and higher sovereign debt.



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Keywords: pandemic response; public spending; EMU fiscal policy; government spending; Greece

1. Introduction

Is there a wide consensus among economists or governments on the use of the fiscal expansion tool? No, since on the one hand, according to the New Classical school of thought, counter-cyclical expansionary fiscal policy aiming to stimulate demand, in the long run, increases fiscal deficits and adds to sovereign debt [1]. On the other hand, not only can fiscal multipliers lead to an increase in aggregate demand (AD) and total income in the short run [2], but also the government must intervene with appropriate fiscal and regulatory policies to mitigate microeconomic market failures, such as negative externalities, by implementing the Pigouvian tax and the supply of public goods through public monopolies [3]. Furthermore, during periods of zero or negative interest rates (the liquidity trap), fiscal policy could be extremely effective [4], while according to other studies the health crisis period may be described as a liquidity trap, given that monetary policy proved ineffective, not only in the EU, but also in the USA and Japan [5,6]. Finally, it should be noted that fiscal and monetary policy are matters of macroeconomic controversy, as a result of the debate on aggregate supply (AS) elasticity and classical rational expectations [7] or on the Keynesian money illusion and effective demand.

The research question of this review paper is "Could fiscal expansion mitigate the economic consequences of the pandemic crisis?" The answer to this question will fill a gap in the academic literature regarding the effectiveness of fiscal expansion during pandemic crisis. Furthermore, there is no clear comparative analysis of how the EU mitigated the economic and the pandemic crises. Previous papers have already examined the effectiveness of fiscal policy during the economic crisis, but there is no relative research on the effectiveness of fiscal policy during the pandemic crisis [8,9].

Section 2 of the paper presents the debate on the effectiveness of fiscal policy, as well as the fiscal rules in the Economic and Monetary Union (EMU). In the next part, we focus on the Greek economy as a case study and discuss the fiscal expansionary policy of the EU. Section 4 presents the results of fiscal expansion, arguing that, in the short run, government spending is effective, but in the long run it creates demand-side inflation and increases public debt. Finally, the last section offers some concluding remarks.

2. Previous Research

2.1. *Is a Tight Fiscal Policy Effective?*

New classical macroeconomic analysis debates the real business-cycle theory, according to which only short-run but not long-run fiscal expansion could affect unemployment and production [10]. More specifically, governments should not intervene in the economy by increasing public spending or money supply, because in the long run, this will lead to inflation [11] and increased public debt [12]. Moreover, according to the optimum currency area theory [13,14] introducing a single European currency would lead to a single European business cycle when in fact it led to increased stability in the financial sector [15]. It is accepted that boosting entrepreneurship leads to economic growth in the long run, and this is why governments should exercise economic policies that foster flexibility in the supply of resources and structural reforms that positively affect investment decision-making [16]. Moreover, new classical economists argue for the reduction of tax and social security contributions, increasing competition and flexibility in labor relations [17] as fiscal stability, while avoiding fiscal deficits, is of great significance in stimulating entrepreneurship and competitiveness [18]. According to the same view, governments should implement structural reforms to increase the international competitiveness of the economy, rather than increase government intervention, through government spending in the market [19]. Moreover, according to the neoclassical crowding-out effect theory, an increase in public debt and government spending leads to an increase in market interest rates, which ultimately crowds out private investment [20] thus explaining why neoclassical economists are against increasing government spending [21]. Furthermore, many neoclassical macroeconomists argue that fiscal multipliers are higher during recessions, but not higher than 1, and lower during economic growth, and as a result fiscal expansion does not bring about a long-term positive outcome in either scenario [22]. Nonetheless, decreasing taxation can contribute significantly to stimulating entrepreneurship, as the negative relationship between taxation and business activity is widely accepted [23]. New classical economists of supply economics, including Laffer, who developed the Laffer Curve, make special references to the relationship between taxation and AS [24], explaining that tax cuts could lead to higher tax revenues, as there is an optimum tax rate at which government maximizes total tax revenue.

2.2. *Fiscal Policy—More Flexible, or Tighten?*

Not only is the EU founded on Classical and New classical economic assumptions [25] and principles of strict fiscal discipline [26] but also, at the beginning of the 2010s, the economic governance in the EMU was tightened by introducing the Six Pack and the European Semester [27]. Following the pandemic crisis in 2020, the EU activated two unprecedented emergency measures for fiscal expansion, namely, temporarily freezing the Stability and Growth Pact rules and issuing common debt through Next Generation EU (NGEU). Note that the effectiveness of NGEU in the long run will depend on how resources are allocated among productive public investment, non-productive government spending and outstanding public debt repayment [28]. It should also be noted that, in terms of monetary policy, the European Central Bank (ECB) has already adopted non-standard monetary policy measures, such as the Asset Purchase Programme and the Pandemic Emergency Purchase Programme, aiming to achieve the medium-term target of lower than expected inflation, around, 2%.

Germany is sceptical about the quantitative easing programme and the temporary fiscal expansion measures [29], as well as about fiscal expansion aiming to increase AD affecting the financial stability within the single European market [30]. However, public debt is now defined as “good debt” when it is used to counter-cyclically address recession and as “bad debt” when it results from a lack of competitiveness in the economy. Fiscal federalism is a major challenge for the EMU [31], while fiscal federalism would also include issuing European debt, a policy that is to be accompanied by strict fiscal discipline rules.

2.3. Fiscal Rules in the EMU: Two Sides of the Same Coin

The EU has adopted the classical and neoclassical theoretical background, as well as welfare economics, which focus on the Pareto optimal allocation of resources and on policies that optimise social welfare, by increasing productivity and stimulating entrepreneurship through limiting government regulation of the market. The EU aims for sustainable economic growth and policies that support the green growth of the economy, namely, policies that do not undermine the economic growth prospects of future generations, supporting the view that fiscal balance stimulates entrepreneurship. The EMU is founded, *inter alia*, on the moral hazard theory and the no-bailout clause [32], which means that member states should avoid fiscal deficits, as this will ultimately lead to increased borrowing costs and decreased international competitiveness. Following the 2008 global financial crisis, the EU radically re-formed its fiscal governance, introducing enhanced fiscal surveillance mechanisms (e.g., European Semester) and tightening the regulatory framework for both the preventive and corrective arms of the Stability and Growth Pact. Moreover, EU leaders established the Euro Plus Pact (2011), the Fiscal Compact (2012), the Two Pack (2013) and introduced a group of fiscal surveillance and coordination mechanisms, including the golden rule, the budget cutter, the Macroeconomic Imbalance Procedure and Medium-Term Budgetary Frameworks, aiming to secure fiscal balance for the euro area countries. It is noted that the EMU was founded on the no-bailout clause and the absence of a lender of last resort [33]. However, current studies argue that the ECB not only operated as a *de facto* lender of last resort for the Eurosystem by buying sovereign bonds in the secondary markets through the quantitative easing programme, but also persistently supported and implemented the expansionary monetary policy, which nonetheless is not sufficient to bring stability in the euro area financial sector, as further measures are required. Finally, it is noted that the ECB has implemented non-standard monetary policy measures amounting to over one trillion euros to combat the consequences of the COVID-19 pandemic [34].

2.4. The EU Economic Bazooka: Escape Clause, SURE Programme & NGEU

On 23 March 2020, EU finance ministers activated the escape clause, as member states required fiscal flexibility to tackle the pandemic crisis. According to the decision, temporarily suspending the strict rules provided in the Stability and Growth Pact (SGP) enables fiscal expansion for the EU member states, to prevent procyclical fiscal policy, which would render the economic recovery of the EU more difficult [35]. Note that activating the escape clause during the previous decade could have helped to combat the recession more quickly [36].

The Support to mitigate Unemployment Risks in an Emergency (SURE) programme was another important measure introduced by the EU. On 19 May 2020, the European Commission approved the regulatory framework for the scheme, while the mechanism was first activated in September 2020. The temporary mechanism SURE focuses on leveraging financial resources to tackle the negative impact of the pandemic on the economy and society through public and private spending. The European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) programme can provide up to €100 billion of loans to member states in order to address the emergency and temporarily increase spending to support employment. The European Commission issues social bonds to fund this instrument. Social bonds assure investors that all funds raised are used to achieve a social goal. In October 2020, the EU-SURE social bond was listed on

the Luxembourg Stock Exchange. The social bond will be sold on the Luxembourg Green Ex-change (LGX), which is dedicated exclusively to sustainable securities.

On 9 April 2020, the euro area finance ministers (Eurogroup) decided on a comprehensive economic policy response to the COVID-19 crisis. By establishing new funding instruments, worth €540 billion, a safety net was created for workers and demand, for employers and supply, and for the sustainability of euro area member states' public finances. Specifically, the European Stability Mechanism (ESM) established Pandemic Crisis Support, a credit line available to all euro area member states to finance the increased cost of supporting their national healthcare systems and other related costs due to the COVID-19 crisis. This instrument will be available until the end of 2022.

Moreover, on top of activating the escape clause and establishing financial assistance mechanisms (SURE and ESM Pandemic Crisis Support), the EU decided to implement Next Generation EU (NGEU), an innovative scheme providing non-repayable grants of €390 billion to be allocated to the EU member states. In reality, this is the first joint issue of debt [37,38]. These Eurobonds are expected to contribute significantly to the long-term stability of the euro area [39]. The NGEU scheme focuses on investments and structural reforms that will lead the European economy towards a green and digital transformation. The NGEU focuses on tackling the economic impact of the coronavirus pandemic by stimulating entrepreneurship and long-term economic growth.

Taking these measures was necessary for the EU to prevent a spillover effect, which would have increased further the cost of tackling the impact of the pandemic, as also evidenced by the financial crisis period [40]. Many economists argue that addressing an additional deep recession requires symmetric corrective measures, to effectively manage credit risk and the increased borrowing costs for both governments and businesses [41], as the snowball effect could adversely affect the recovery of European economies.

Fiscal expansion and the positive impact on the Greek economy.

All EU national governments have increased public spending, aiming to support public healthcare facilities and stimulate both AD (fiscal multipliers and effective demand) and AS, by adopting emergency supportive fiscal measures, and all such policies lead to closer international economic cooperation [42].

Furthermore, governments took tax measures to mitigate supply and demand shocks. According to the OECD [43], many governments in the EU boosted the speeding up of refunds of excess input VAT, as well as simplified procedures for claiming relief from VAT. More-over, governments provided tax concessions for workers in health and other emergency-related sectors.

3. The Case of Greece

In 2020, the Greek government increased government spending to about 14% of GDP (i.e., over €23.5 billion), using measures such as loan guarantees, supporting the unemployed through benefits and supporting businesses and households. The Greek government took tax measures to mitigate supply and demand shocks. Moreover, the Greek government decreased direct (income tax) and indirect (VAT) taxes in 2020 and implemented deferred tax payments (tax deferrals). Tax and other relief measures were taken for enterprises, freelancers and personal businesses. For example, it implemented 25% deduction on instalments of assessed tax liabilities, while it provided an acceleration of refunds of income tax and VAT to enterprises. In addition, the VAT rate was reduced to 6% (from 24%) on many goods and fiscal expansion led to employment and social Security measures, e.g., the reduction by 25% of freelancers' social security contributions.

Furthermore, Greek bonds, both sovereign and corporate, were eligible under the quantitative easing programme implemented by the ECB to tackle the COVID-19 pandemic—the Pandemic Emergency Purchase Program (PEPP). Moreover, up until December 2021, the Greek government had received funding of €5.26 billion through SURE to protect employment.

According to Eurostat, in October 2019, the seasonally adjusted unemployment rate was 16.8% and there were 793,000 unemployed people. Two years later, in October 2021, the seasonally adjusted unemployment rate was 13.3% and there were 617,500 unemployed people. Therefore, the unemployment rate declined by more than three percentage points, or by over 175,000 unemployed, during the pandemic period. In January 2020, the unemployment rate was 15.8% while in December 2020 it was 15.6%.

Thus, it is clear that boosting government spending decreased unemployment rates. However, what is impressive is that the GDP also decreased, due to the supply shock. As illustrated in the following Figure 1, the Greek economy slipped into a deep recession in 2020, as a result of the pandemic crisis, but in 2021 it was growing again.

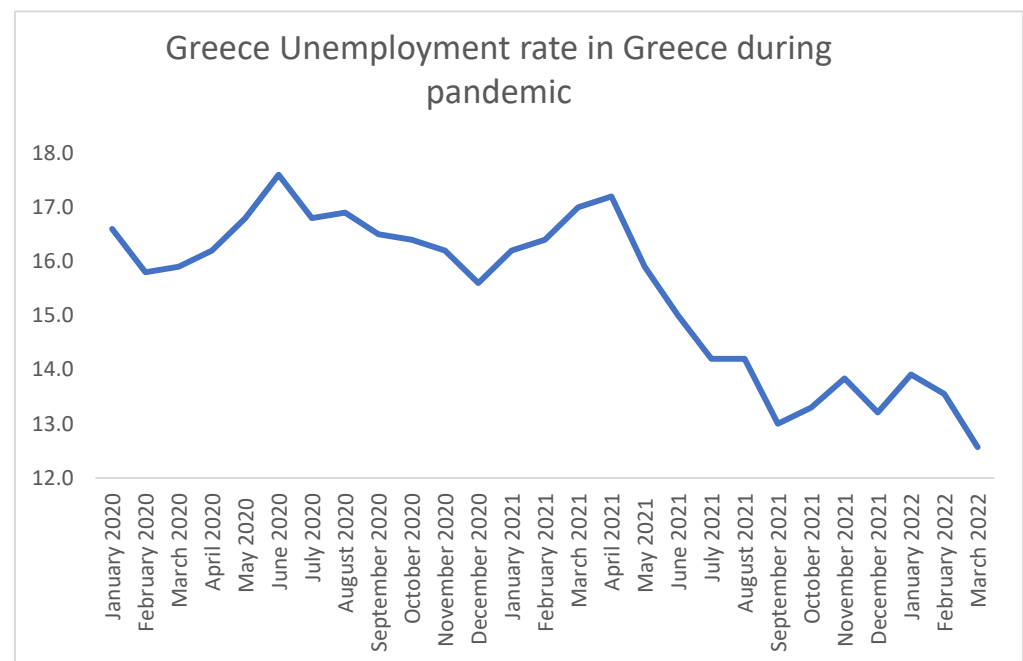


Figure 1. Unemployment rate in Greece during the pandemic crisis. Source: Eurostat.

Examining the findings in Figures 1 and 2, we notice a paradox. On the one hand, the Greek economy was in deep recession in 2020, as GDP decreased by €16.41 billion or by over 9% but, on the other hand, the deep recession did not lead to higher unemployment due to the fiscal expansion measures implemented by the Greek government and the EU mechanisms.

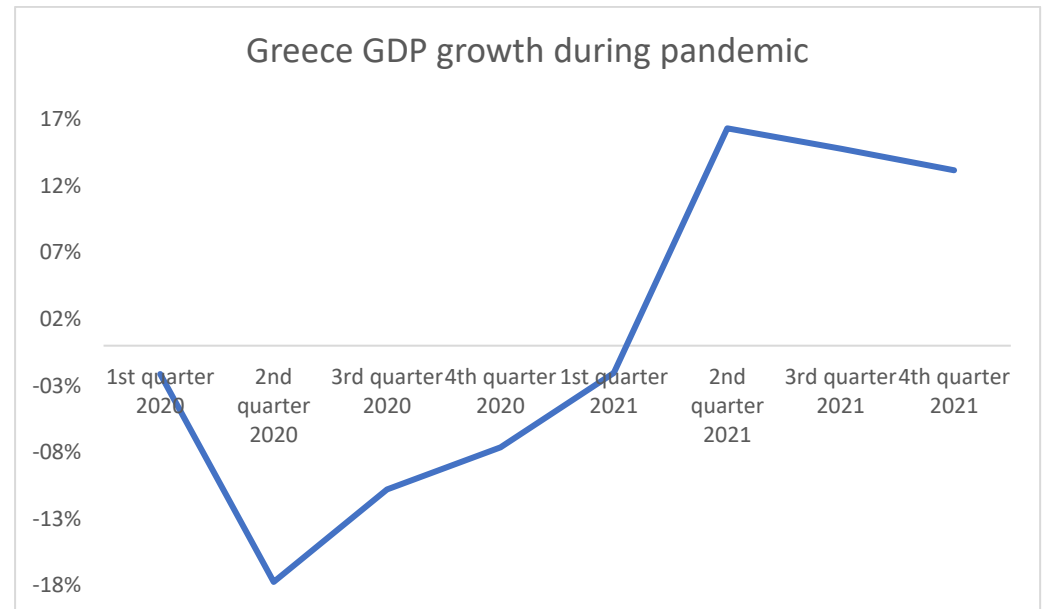
After 10 years of austerity measures in almost all economic sectors [44,45] due to the economic crisis, the Greek government implemented fiscal expansion to stimulate employment. As an AD stimulus, the expanded unemployment insurance program appears to have been quite effective [46]. The fiscal counter-cyclical policy led to new jobs in the public sector (Government as an employer of last resort), while companies were funded through the SURE programme, to keep workers secure. Fiscal expansion decreased the productive gap and increased effective demand and fiscal multipliers and, as a result, cyclical unemployment was tackled.

It is demonstrated that the employment rate was relatively strong because workers kept jobs and not because workers left the labour market and were no longer counted in the statistics, as Table 1 describes.

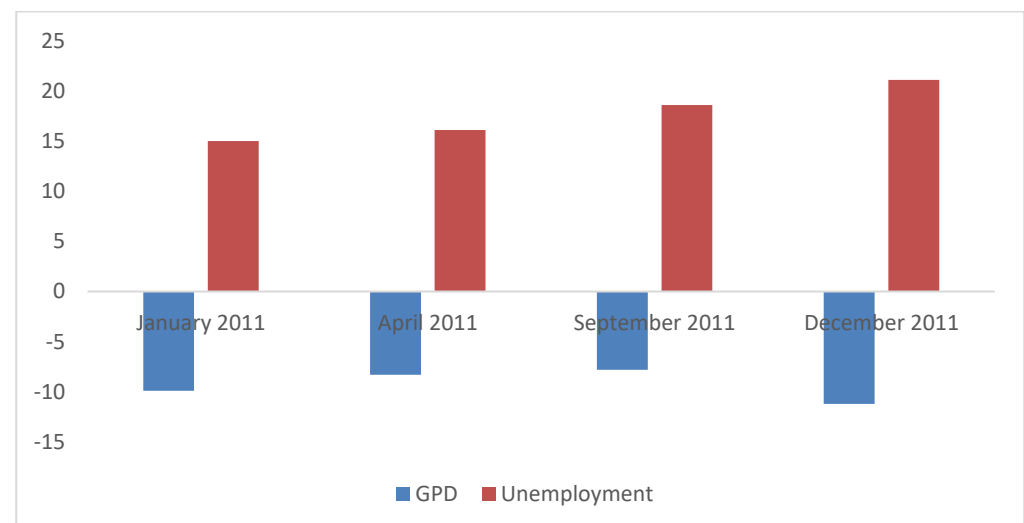
Table 1. Greece's unemployment indexes (in thousands).

Date	Employed	Unemployed	Non-Active
19 December	3906	764	3239
20 December	3878	717	3256
21 December	4062	598	3188

Source: Eurostat.

**Figure 2.** Greece's GDP growth rate during the pandemic crisis. Source: Eurostat.

Finally, the impact of the recession on the economy, namely, the decrease in GDP, did not affect unemployment rates in 2020 and 2021. This had not happened in the previous economic crisis (2008–2012), when a decrease in GDP by 9% in 2011 led to an increase in unemployment by 7%, as illustrated in Figure 3. Nonetheless, during the financial and economic crisis, Greek governments implemented pro-cyclical contractionary fiscal policy, which ultimately led to much deeper recession.

**Figure 3.** Unemployment rate and GDP growth in 2011. Source: Eurostat.

Comparative analysis of Figures 1–3 confirms the effectiveness of the temporary fiscal expansionary measures taken by the EU and the Greek government during the pandemic crisis (2020–2021).

At this point, it should be noted that, according to Okun's law, a 1% increase in the unemployment rate leads to a larger than 1% decrease in GDP [47,48]. Therefore, maintaining unemployment rates can have multiple benefits for the economy, such as faster economic recovery. Based on the above, it is clear that decreasing unemployment rates was the main goal of the emergency and temporary fiscal and financial measures established by the EU, so that the temporary fiscal expansion activated effective demand and protected the Greek economy from the pandemic crisis.

Note also that, according to Eurostat, inflation in Greece was negative in 2020, as there was a -1.2% change in inflation compared to 2019, while in March 2021 inflation was -1.6% lower than in March 2020. This shows that the ECB monetary measures were not enough to mitigate the decrease in price levels (disinflation), thus fiscal expansion was effective, as was the case during the liquidity trap period. However, quantitative easing (increase money supply using non-standard monetary measures) and escape clause fiscal expansion led to high inflation rates in 2021.

According to the Greek Public Debt Management Agency, on 31 December 2019, the Greek government debt was €356 billion, while 27 months later, on 30 March 2022, the government debt was €394 billion. Apart from the increase in public debt, during the pandemic crisis there was also a decrease in the Greek government's cash reserves from €22.8 billion to €18.8 billion. Fiscal expansion led the Greek public debt to over 200% in 2021, while the Greek government will also need to address the decrease in cash reserves.

Regarding the new borrowing cost, it is noted that in 2019, the new borrowing cost was at 1.65% (weighted average). The Greek government, even during the pandemic, has issued sovereign bonds with a particularly low interest rate and borrowing cost, which confirms that international markets trusted the reform programme implemented by the Greek government. Specifically, in 2020, the Greek government carried out three issues of sovereign bonds, with an interest rate of 2% (€2 billion for seven years), 1.5% (€5.5 billion for 10 years) and 1.87% (€4.5 billion for 15 years). In 2021, the Greek government carried out two consecutive issues of sovereign bonds, with an interest rate of 0.75% (€3.5 billion for 10 years) and 1.87% (€2.5 billion for 30 years).

Furthermore, Greek fiscal expansion measures are focusing on achieving a higher total income in the economy, while many economists underline the current challenges and prospects of Greek and EMU economies, such as the need to boost structural competitiveness, address institutional reforms and change the political conditions [49,50].

Overall, Figure 4 confirms that fiscal expansion is an effective tool in mitigating the pandemic's consequences on the economy, as government spending increases aggregate demand, using fiscal multipliers, but counter-cyclical fiscal expansion leads to a higher public debt and demand-side inflation, because fiscal expansion is effective only in a short-run period (demand-pull inflation). The Greek government increased government spending, implementing a countercyclical expansionary fiscal policy, to stabilize the economic cycle, spending more than 40 billion €. It created a primary and fiscal deficit, which led to a higher public debt of more than 200% of GDP in 2021. In the short run, countercyclical fiscal policy is effective, because demand side measures boost consumption and stabilize the economy, as the results ensure that the unemployment rate did not increase. On the contrary, during the pandemic crisis, the unemployment rate decreased. The results ensure that the Greek government has boosted government spending, implemented an expansionary fiscal policy, decreased cash reserves and aimed at tackling the demand and supply shocks due to the pandemic crisis. The results demonstrate that demand-side measures, such as fiscal expansion and money supply expansion (quantitative easing and pandemic quantitative easing) led to demand-pull inflation. They also demonstrate that the Greek economy escaped the liquidity trap (second semester of 2020) by implementing demand-side measures and moving into inflation pressure (second semester of 2021). Therefore, fiscal expansion is

effective in the short run, but in the long run demand-side measures lead to higher prices (inflation) and higher public debt [51].

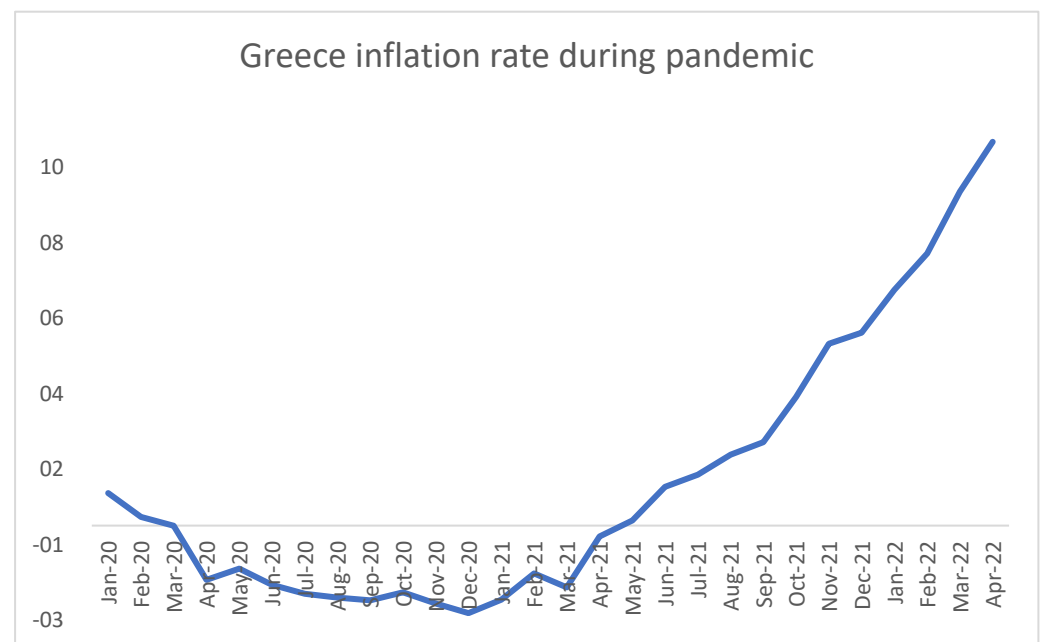


Figure 4. Inflation rate in Greece during the pandemic crisis. Source: Eurostat.

4. Discussion

All EU member states responded to the COVID-19 pandemic crisis, increasing government spending to support public healthcare systems and transfer funds to households and companies. However, a group of researchers disagree about the aggressiveness of pandemic fiscal packages. Others, divide the effectiveness of fiscal expansion using a group of macroeconomic indicators, such as tax revenue, public revenue and public debt [52] Benmelech and Tzur-Ilan [53] divide the countries into high-income and low-income, underlining that high income countries announced larger fiscal measures than lower-income countries. The systematic literature review proves that the EU responded much more quickly to the economic instability caused by the pandemic crisis compared to the 2008 financial crisis response [54].

The EU was better prepared, as reforms in the euro area economic governance which were implemented during the previous decade (2010–2019) created a much safer framework with many safety nets [55]. The following reforms are some of the mechanisms that prevented economic recession from transforming into an economic crisis: the ESM, which provides financial assistance to the euro area states, the Banking Union, the non-standard monetary policy measures, such as the APP and the PEPP, the current decisions to activate the escape clause and the establishment of the SURE programme and NGEU mechanism, all of these constituting the “EU economic bazooka”. These reforms led to a completely different and much more successful and effective way of tackling economic instability and mitigating the pandemic outputs. Moreover, borrowing costs did not increase for the EU member states, as opposed to what many southern countries had experienced in the previous economic crisis (2010–2012). In addition, the unemployment rate decreased during the pandemic crisis compared to the extent of the recession, especially when compared to the levels it reached during the previous crisis. Two key factors contributed to tackling economic stability successfully. The first was that the pandemic affected all EU economies symmetrically. Therefore, it was easier to activate the escape clause, since all EU economies shared a common problem. The second factor was that the recession was exogenous, due to the health crisis, and was not caused by any endogenous structural deficiencies of the

member states. As a result, it was easier to tackle consequences effectively through the adoption of common proposals at the EU level.

The discussion above suggests that not only Greek bonds but also any sovereign bonds in the EU were subjected to speculative attacks through increases in spreads, as opposed to the 2010–2012 period, as the extent of the potential financial assistance provided by the EU mechanisms fully secured the funding of fiscal deficits created by the euro area governments. On the other hand, some researchers argue that the pandemic crisis led to higher cost of sovereign debt [56].

The implications of the results underline the effectiveness of fiscal stimulus in the real economy, but at a high cost. So, on the one hand, national governments and EU can stabilize the economic cycle using fiscal expansion, but on the other, they lead to higher fiscal deficit as well as public debt and demand side inflation.

5. Conclusions

This paper argues that fiscal expansion can stabilize the economic cycle, but it leads to higher fiscal deficit, public debt and demand side inflation. In Greece, the recession combined with counter-cyclical fiscal policy and fiscal stimulus led to an increase in public debt. Greek public debt exceeding 200% of the GDP on 2021 is a representative example, showing the negative effects of fiscal stimulus. Current literature underlines that fiscal federalism is required in the EMU, rather than imposing additional strict fiscal rules, to tackle recession effectively [57]. Some policy proposals in order to mitigate pandemic consequences are green and blue investments, structural reforms implementation, such as the National Growth Strategy Plan [58] and reforms to decrease the economic asymmetry in the EMU [59,60]. Finally, further research could analyse the effectiveness of tax and other fiscal measures in macroeconomic stability and growth, using independent quantitative analysis with deeper analysis and reflection among variables [61].

The paper's main limitation is the lack of econometric analysis, due to the lack of historical data, that could validate our main findings. Further research could fill this gap and analyze the comparative analysis, including not only the economic and pandemic crisis, but also the energy crisis. As the EU take measures and establish mechanisms in order to mitigate the different types of crises, it could be interesting to make a comparative analysis of the triple crisis (economic, pandemic, energy). As fiscal expansion was used during each crisis, further research could evaluate the effectiveness of government spending on different periods.

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