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Credit Day: Covid-19 as a black swan or temporary inconvenience?

Institut Économique Molinari[1]

This year Credit Day for the European Union falls on the 17th of December. This is the day which, on average, EU member states have spent their tax-based revenues and start borrowing to meet their needs. Compared to 2019, this represents a one-day improvement, continuing the positive trend which began in 2018.

12 EU member states display a budget surplus, while 16 do not have enough funds to cover the whole year of spending. Some states show a remarkable change, such as Cyprus delaying its Credit Day considerably, while others remain relatively stable. Central governments bear the bulk of the deficit, while regional, local and social security administrations are generally stable in their surplus.

With Covid-19 hitting economies hard in 2020, the present data should be treated carefully. The expectations are that the average debt-to-GDP ratio in the eurozone will increase by 16.7 percentage points, and governments should make sure borrowing regimes in this period are responsible and temporary.

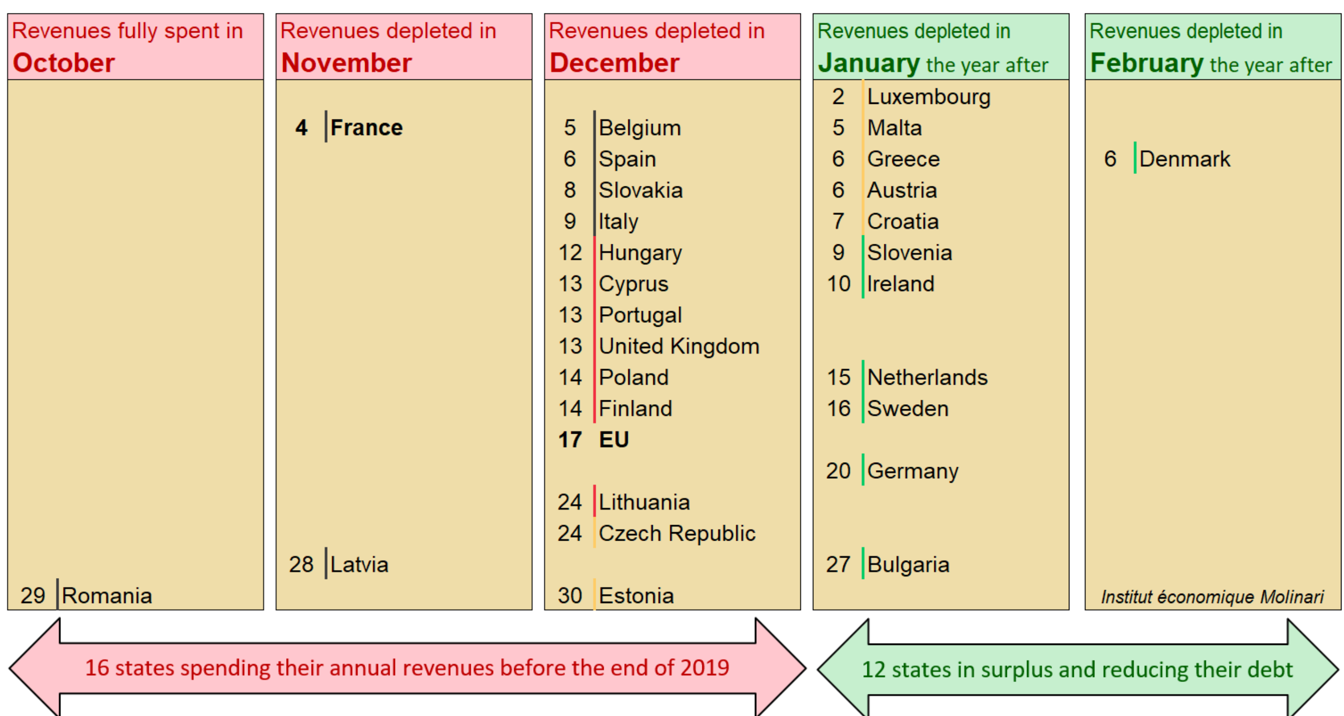

Figure 1: Calendar of EU central administrations have spent all their revenues

An intuitive approach to understanding government budgets

The yearly study by the Institut Économique Molinari illustrates the scope of public debt and deficit for the general public. It does so by using the Credit Day (instead of GDP) as a measure to compare the 28 EU member states' expenses and revenues. Credit Day is when national treasuries exhaust their annual tax revenues and commence borrowing to fund present expenditure. The conclusions drawn are based on Eurostat data from the last fiscal year.

The study indicates minimal improvement from 2018 with the average Credit Day falling on the 17th of December 2020. This is 15 days before the fiscal year ends and, thus, one day later than the previous year's average. On a country-specific level, we can observe a visible divide between the EU28. Denmark, Bulgaria, Germany, and 9 other countries presented a budget surplus whilst 13 other nations consumed all their resources by December 2019. Finally, three member states – France, Romania, and Latvia – performed the worst by having spent all tax income by October or November. Notably, France and Romania have been part of the trio of countries furthest out of balance in the past three years. Overall, some countries have made substantial improvements, but others have struggled to reduce their fragility to unexpected shocks. This implies that the latter will have an even more difficult time in the coming fiscal years to rebalance their budgets from Covid-19 related spending.

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Trends of EU28 central governments' deficits

The results of the study find mixed trends within the EU for regarding fiscal responsibility, even though the general direction appears to be towards improvement. This is also probably due to the opportunities seized by many states during the 2019 period of growth to bring accounts in order.

The average EU Credit Day has improved by just one day compared to 2019. Once again, polarization across member states is a problem that is continually becoming more accentuated. For instance, Denmark has expanded its surplus, with its Credit Day falling on the 6th of February. At the same time, Romania's position has worsened with revenues depleted by the 29th of October. Downwards shifts are counterbalanced by notable progress in some states. Cyprus has considerably delayed its Credit Day compared to the previous year, leaving it with only 18 borrowing days, and Greece – the obvious candidate for budget improvement – has moved from a deficit to a modest surplus.

Among the major economies of the EU, Germany maintains its stable surplus, while France drops even lower to 58 days of unfunded spending – 11 days more than 2019. Italy and the UK show small improvements, reducing their deficits marginally. On the backdrop of the current negotiations of post-Covid-19 recovery funds, it is worth considering the stark contrast in Credit Day changes between so-called 'frugal' states and supporters of more heavy-handed reliance on pooled debt solutions.

Romania, one of the 'big three', went from depleting its resources on the 12th of November in 2018 to the 29th of October in 2019. This deterioration of member states' fiscal position may represent a danger for the EU economy as a whole.

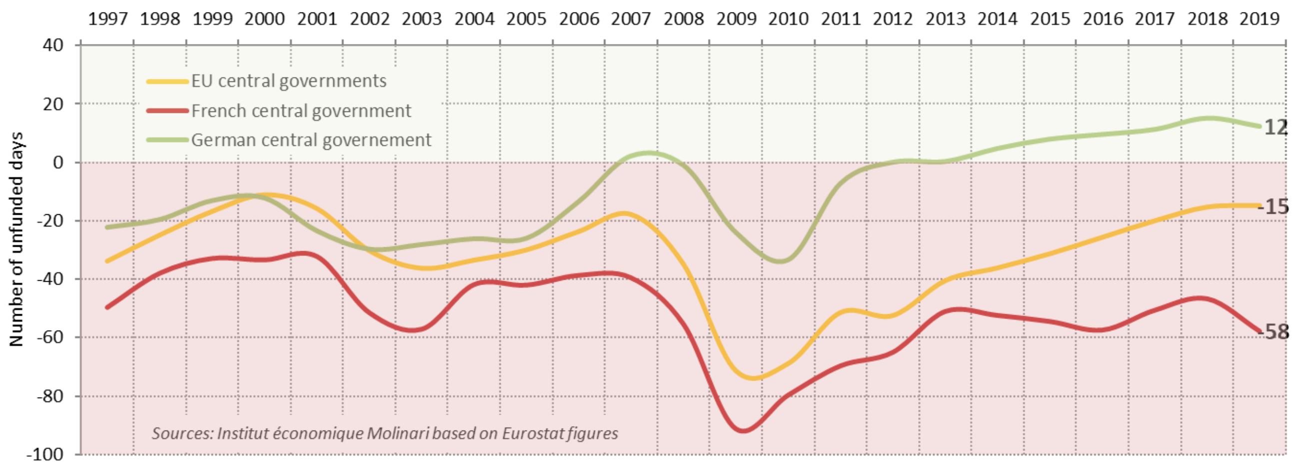

Figure 2: Number of unfunded days of EU28, French, and German government spending

Another interesting finding of the study is the correlation between expenditure and satisfaction. Contrary to popular belief, the OECD Better Life indicator shows that, in general, there is no clear relationship between public spending and quality of life. The study compares public spending as a share of GDP with the Human Development Index. On average, 8 countries (Finland, Ireland, Austria, the Netherlands, Luxembourg, Denmark, Sweden, and Germany) with a better budget balance than the EU28 average obtain higher HDI scores. This indicates that the common pro-spending argument that higher spending increases living standards is ungrounded.

Countries with many unfunded days, running major budget deficits, appear to be primarily those with unstable political climates shaped by populism and factionalism. In Romania, for instance, the high budget deficit is mainly a consequence of increased spending on public sector wages and special pension schemes. In France, Macron's response to the 'yellow-vest' strikes throughout the country also involved increased expenditure. Reducing deficits will be difficult even in the long term, irrespective of the Covid-crises. French public finances are destabilised by an aging population, pension funds are sporadic and the pay as you go represents 98% of pensions. It is interesting to note how we see this pattern of populist traction applying predominantly to countries with fractious party politics such as Italy and Belgium. In these countries, sectional interests are more likely to capture policy priorities. Instead, those states with more stable and cohesive governmental environments, like Sweden and Germany, appear to fare better in terms of public debt.

Predictions for 2020 and 2021

The Covid-19 pandemic in Europe and the according restrictive measures adopted by European governments to slow the spread of the disease have prompted heavy public spending to mitigate the negative impact on the economy. The EU has scrapped the European Semester and suspended the Treaty's deficit criterion, which no euro-area country would currently satisfy. This will have severe repercussions on national budgets, especially those of central governments. The ECB has predicted a 16.7 percentage point rise in debt-to-GDP ratio for the euro aggregate area with considerable heterogeneity expected. These stark

differences in fiscal packages and spending behaviours adopted by EU governments will require a unified recovery plan after the crisis, with the aim of preserving the positive progress from 2019.

Conclusion

Overall, the EU28 have slightly improved their budgetary position in 2019 compared to the previous fiscal year. The majority of EU countries have, thus, reduced the number of days funded by borrowing instead of tax income. However, particular attention should be paid to the budget deficits of the bottom trio France, Romania, and Latvia. In light of the high spending related to the Covid-19 pandemic, a deterioration of fiscal deficits in the EU28 is predictable. This condition, through a unified recovery plan, need not necessarily derail the positive EU trend. Finally, like previous years, the *Better Life* study indicated that greater spending is not related to greater quality of life.

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