A Fiscal Authority for the EU: A quantitative Assessment of the Recovery and Resilience Facility

In this paper, we investigate the impact of the Recovery and Resilience Facility for Member States (MS) of the EU-27 on default risk in heterogeneous indebted countries. We focus on how fiscal integration can affect the default incentives of MS and its effect on sovereign spreads. Our model considers the European Commission as a supranational fiscal authority that acts as a 'quasi-sovereign' and competes with MS in the financial market for loans while also redistributing resources across countries. Using a quantitative multi-country model, we analyze the interaction between the Member States, a fiscal authority, and risk-averse international lenders. Our findings suggest that the implementation of the program leads to heterogeneous welfare effects across Member States but an overall improvement in total welfare. The supranational fiscal authority obtains loans on favorable terms, converts risky sovereign debt into safe debt, and provides insurance against negative shocks for sovereigns, thereby preventing sovereign default contagion.