EUROPEAN UNION STRATEGY AIMED AT LIMITING THE EFFECTS OF THE COVID 19 PANDEMIC

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Abstract

In this article, the authors considered the strategy of the European Union in terms of limiting the effects of the Covid 19 pandemic crisis. Thus, in order to mitigate the negative impact of COVID-19, the member states of the European Union have adopted a series of fiscal measures, considering in this regard, the monetary and banking policies for the countries of the euro zone, state aid, fiscal rules and budgetary and financial support measures. After the outbreak of the pandemic, a number of programs were launched, such as the pandemic emergency procurement program (PEPP), the asset purchase program (APP), the general rescue clause (PSC), the coronavirus response investment initiative (CRII and CRII+) and many more. In this article, the authors focused their attention on the strategy of the European Union in terms of limiting the effects of the Covid 19 pandemic and their impact.

Keywords: pandemic, strategies, fiscal measures, economic impact.
JEL classification: E50, G30

Introduction

To mitigate the negative impact of COVID-19, the member states of the European Union adopted almost 1,300 fiscal measures and committed approximately 3.5 trillion euros.

National governments did not go it alone, and European action has been significant since the outbreak of the pandemic. The general response to COVID-19 was focused around three pillars, namely monetary and banking policies (for euro area countries), state aid and fiscal rules, and budgetary and financial support measures.

Most of the ECB's interventions were already adopted in March 2020, in the very early stages of the pandemic, and were successively expanded in the following months. The swift action on the monetary front was then complemented by measures to stimulate banks to grant loans. The ECB's monetary policy response was focused on some main axes: keeping key interest rates unchanged (main refinancing operations: 0.00%; marginal

lending; facility: 0.25%; deposit facilities: -0.50%) ; long-term refinancing operations aimed at supporting bank loans (especially for small and medium-sized enterprises, SMEs) and the smooth functioning of money market funds (providing liquidity support); guarantee policy, such as the temporary increase in the risk tolerance of the Eurosystem to support the credit of the economy, easing the conditions for the use of credit claims as collateral (guaranteeing loans granted to SMEs and self-employed persons), renouncing the acceptance of instruments of Greek sovereign debt as collateral in the Eurosystem's credit operations and the general downgrade of collateral and asset purchase programs such as the ECB's new Pandemic Emergency Purchase.

Two measures should be mentioned: reduced interest, the rate for outstanding long-term refinancing operations and the introduction of a new series of non-targeted long-term pandemic emergencies.

Literature review

Aizenman J. et al (2021) considered the motivations behind Fed liquidity lines as well as the spillover effects of US dollar auctions by central banks using these lines, finding that access to Fed liquidity agreements was driven by the beneficiary economies' close financial and trade ties with the US. Albrizio S. et al. (2021) studied the ECB's euro liquidity position, which a direct effect since the premium paid by foreign agents to borrow euros in foreign exchange markets falls against currencies not covered by these facilities. Bahaj S and Reis R. (2018) point out that swap lines between advanced economy central banks represent an important new part of the global financial architecture. McCauley R. and Schenk R.C. (2020) analyzed the history of central bank swaps from several perspectives, floating exchange rate flows, offshore funding, Eurodollar funding liquidity and Libor yields. Panetta F. and Schnabel I. (2020) highlight the fact that warp and repo lines are useful tools in the toolkits of central banks, they are increasingly used as stabilization tools during times of financial market stress global, especially after the outbreak of the COVID-19 crisis.

Data, Results and Discussion

After the outbreak of the Covid 10 pandemic, the 750-billion-euro program (PEPP) was launched, which was increased to 1,350 billion euros on June 4, 2020, and to 1,850 billion euros on December 10. In addition, net purchases under the Asset Purchase Program (APP) which provided for sums of EUR 20 billion per month were extended and a package of additional net asset purchases of EUR 120 billion until the end of 2020 was temporarily introduced.

From the point of view of non-euro area member states, the asset

purchase program is the most relevant for ECB measures. While the literature is sparse and does not provide sufficient information regarding the impact of the PEPP, findings related to the non-standard monetary measures adopted by the ECB since 2015 suggest that non-euro area countries (especially South-Eastern European countries) have a certain positive effect on prices and, in some cases, on production, largely determined by trade channels. A similar impact should be expected from PEPP. During that period, the exchange rate did not appear to be an important factor as all exchange rates remained fairly stable. It is hard to say whether this would be true now, given that volatility has increased quite a bit since 2020.

In addition to measures directed at euro area countries, to avoid market disruptions, the Eurosystem has established liquidity arrangements with several central banks outside the euro area, including bilateral swaps, repo lines and the newly created Eurosystem Repo Facility (EUREP) for central banks.

These measures were important for some member states outside the euro area.

The swap and repo lines of the Eurosystem were widely used during the financial crisis and function as monetary policy instruments, consisting of providing euros to central banks outside the euro area (in exchange for amounts in foreign currencies) to meet the needs of liquidity in euros in case of financial stress.

The objective was to prevent feedback effects that could have a negative impact on the transmission mechanisms of the ECB's monetary policy and lead to financial stability risks. At the same time, EUREP was established in June 2020 as a temporary (until January 15, 2023) and precautionary facility in the context of the pandemic, with the aim of expanding access to the Eurosystem's liquidity arrangements beyond swap and repo lines. EUREP allowed non-euro area central banks to access euro liquidity against euro-denominated debt securities issued by euro area central governments and international institutions. It is currently being used in response to the uncertain environment caused by Russia's invasion of Ukraine. In March 2022, the ECB established a EUR 10 billion preventive swap line with the Central Bank of Poland to supply euros if needed. Following the Russian Federation's invasion of Ukraine, the Polish zloty (as well as the Hungarian forint) experienced significant selling, leading to depreciation. Euros available at the central bank can be used to defend the currency. There were also extended repo agreements with Hungary.

Given the financial outflows and increasing pressure on bond yields following the outbreak of the Covid 19 pandemic, central banks in merging European markets including Croatia, Hungary, Poland and Romania have also adopted APPs.

The short programs were quite good and most of the acquisitions happened in 2020, with the only exceptions being Poland and Romania, which made some additional acquisitions in 2021.

It is interesting to note that, if Croatia were to enter the Eurosystem as expected in January 2023, it would hold a much smaller share of sovereign bonds than the other Eurosystem banks. This aspect is true for the central banks of countries such as Estonia, whose sovereign debt is very small, but which participated in the PEPP. When the decision is made to sell securities held for monetary policy on the balance sheets of central banks, the question will arise as to what this entails for Croatia. Since the amount is limited, it is not a source of concern, but there is a different treatment in the case of Croatia.

While the monetary and banking measures were adopted without problems and quickly, on the fiscal level, the response of the European Union was slower. The first step on the fiscal line was aimed at facilitating the fiscal position at the national level. Due to the outbreak of the pandemic, the Commission quickly adopted two important decisions: the introduction of a temporary framework for state aid and the activation of the general rescue clause of the Stability and Growth Pact (SGP).

The temporary state aid framework was adopted by the Commission, based on Article 107 TFEU, on 19 March 2020. Initially, the temporary framework allowed five types of interventions in the context of the pandemic crisis, such as grants or tax advantages of up to to EUR 800,000 for companies with a lack of liquidity, state guarantees for loans taken from company banks, subsidized public loans to companies with favourable interest rates, specific guarantees for banks channelling state aid to the real economy and the insurance of long-term export credits short.

A first amendment to the framework on 3 April 2020, the Commission allowed two additional types of aid, namely: targeted support in the form of deferred tax payments and/or suspensions of social security contributions and targeted support in the form of wage subsidies for employees, i.e. short-time work schemes.

A second amendment was introduced on 8 May 2020 to allow targeted public intervention in the form of recapitalization aid to non-financial companies in difficulty. As the crisis deepened, several European businesses that were not struggling before the COVID-19 outbreak suffered losses, which reduced their equity capital and reduced their ability to borrow in the markets. Therefore, the purpose of the Commission’s intervention was to facilitate the recapitalization, provided that the beneficiaries and the member states develop an exit strategy following the recapitalization. Beneficiaries were subject to prohibitions on dividends and share buybacks.

A third amendment to the temporary framework was adopted on 29 June 2020 to allow Member States to provide public support to all micro and small enterprises, i.e. enterprises with fewer than 50 employees and less than EUR 10 million in turnover annual and/or total annual balance sheet, even if they were already in financial difficulty on December 31, 2019. This amendment was adopted under the conditions of temporary recapitalization measures for those cases where private investors contributed to the capital increase of companies together with the state. The aim was to encourage significant private capital injections with participation in companies, limiting the need for state aid and the risk of distortion of competition.

In 2020 alone, member states adopted fiscal measures worth 2.3 trillion euros under the temporary regime. Most of the state aid measures consisted of guarantees, representing 82% of the total measures. The remaining measures were divided between discretionary spending, such as short-time work programs, income support measures for households or businesses (6%); financial instruments (8%) and discretionary income measures (3%). In absolute terms, among countries outside the euro area, Poland (12%) and Hungary (11%) ranked first, while the measures in Romania and Bulgaria amounted to only 1.47% and 1, respectively .33% of GDP.

Since the impact of guarantees on the national budget materializes only when the borrower is unable to repay the loan received, then the use of guarantees could have a misleading picture of the relative budgetary efforts of the member states.

State aid control is an essential part of the European Union's competition policy, which aims to avoid distortions at the level of the internal market and ensure fair competition conditions between member states and companies. That is why the suspension of the rules in the temporary framework may have had an impact on the convergence of the trajectories of countries outside the euro zone.

The long-term repercussions remain unclear. With a lack of sufficient tracking data on the actual use of guarantees, which constitute most of these measures, it is impossible to establish a clear picture of the overall support provided by Member States. In general, it can be observed that member states with larger budgets have the ability to spend more on aid for national companies, giving them an advantage over competing European ones.

Sectoral studies on the impact of the temporary framework are able to provide anecdotal evidence that indicates discrepancies in the implementation of aid between member states.

While such support has generally served as a tool for member states to counter the effects of the health crisis, some countries have granted ad hoc aid to companies involved in research unrelated to COVID-19.

The general rescue clause of PSC was activated by the Commission with the stated aim of giving Member States the necessary flexibility to take the necessary measures to support health systems, civil protection and protect economies. The clause allows the governments of the member states of the European Union to temporarily leave the adjustment path towards the medium-term budget objective. This considerably affects the application of the European Semester, i.e. the framework for the coordination of economic policies at the level of the European Union. The specific recommendations for each country were launched on May 20, 2020, the first time since the creation of the European Semester and focused on two objectives: providing an immediate economic policy response, addressing and mitigating the health impact of the Covid 19 pandemic, and resuming economic activity supporting the ecological transition and digital transformation in the short and medium term.

The relaxation of fiscal rules has been particularly critical for those member states with high levels of debt. The importance of the fiscal maneuvering space for the more indebted member states is highlighted by the strong correlation between their debt to GDP ratio in 2019 and the percentage point of growth compared to 2020.

This can be explained by the combined effects of GDP contraction, particularly large in highly indebted countries, and the simultaneous increase in deficit levels.

Interestingly, experienced non-eurozone countries had relatively low initial debt-to-GDP levels in 2019. The size of the fiscal response appears very heterogeneous. Bulgaria, Denmark and Sweden had some of the lowest deficits in the European Union, and Poland and Croatia had results close to the euro area average, while Romania was well above this value.

The Commission intervened by designing support at the level of the European Union to help member states directly in their fiscal effort, by introducing three measures: the Coronavirus Response Investment Initiatives (CRII and CRII+), the European Investment Bank (EIB) Initiatives and SURE.

In April 2020, the Commission launched two packages of measures: the Response to the Coronavirus Investment Initiative (CRII) and the Coronavirus Response Investment Initiative Plus (CRII+), with the objective of mobilizing the cohesion funds of the European Union to face the pandemic crisis. Flexibility has been introduced that makes it possible to transfer unallocated European Union funds between types of funds and categories of regions and to use amounts allocated to pre-financing and unspent, as well as to increase the European Union co-financing rate to 100% for the accounting year 2020-2021.

The objective of the two initiatives was to use the flexibility of the European Union budget to support the health sector.

According to the Commission's proposal, CRII proposed to mobilize 37.3 billion EURO of European public investments to combat COVID-19. The national allocation of investments within the CRII had a clear geographical pivot to the eastern, non-euro zone, and southern member states. This is not a surprise, because CRII and CRII+ consisted of a redeployment of the structural funds, which in the multiannual financial framework benefited these two groups of countries to a great extent. It can be seen that the logic of the CRII initiative was to give a second chance to the member states that had a delay either in spending or committing their structural funds, by using these measures to mitigate the consequences of COVID 19.

The amounts involved are relatively small, as CRII and CRI1+ were launched in the last year of the MFF 2014-2020, when most of the funds had already been committed.

In order to track the effective use of CRII and CRII+ funds to mitigate the consequences of COVID 19, in May 2020, the Commission proposed a voluntary list of program-specific indicators, to be applied at the level of all Member States of the European Union, following to identify all changes to the National operational program.

An advantage of using the information available through these voluntary indicators is the ability to distinguish between different types of expenditure rescheduled to support people, for example part-time work arrangements, additional salaries for medical staff, IT equipment, personal protective equipment and services for vulnerable groups. Given that not all Member States have adopted the common voluntary indicators proposed by the Commission, the support will probably be greater.

In addition to the modification of the operational programs, some member states also accepted the 100% EU Funding option, allowed under CRII+ in order to benefit from the flexibility under CRII/CRII+.

The intervention of the European Union in the first phase of the crisis was not limited to actions within the CFM. Together with the EIB, in April 2020 the Commission presented a support action plan to unlock €28 billion in funding to ease liquidity and working capital constraints for SMEs and medium-sized enterprises.

The financing package consisted of:

- dedicated warranty schemes based on existing programs for immediate implementation. The European Investment Fund (EIF) was offered financial guarantees in the amount of 2.2-billion-euro intermediates, unlocking 8 billion euro in available financing;

- liquidity lines dedicated to banks to ensure additional support for working capital for SMEs and with an average capitalization of up to 10 billion euros. The sub-operations consisted of loans for SMEs and eligible medium-sized financial intermediaries and national and regional promotional banks;
- dedicated asset-backed securities (ABS) purchase programs to enable banks to transfer risk to SME loan portfolios, mobilizing up to an additional €10 billion.

In parallel with the first package of measures, the Commission and the EIB announced a reserve of projects in the health sector worth 5 billion euros. The purpose of this instrument was to finance infrastructure, equipment improvement in the health sector and work projects for the development of a vaccine against COVID 19.

The European Guarantee Fund (EGF) was created in April 2020 with €25 billion of guarantees, allowing the EIB, in partnership with local lenders and national promotional banks, to issue special guarantees explicitly aimed at encouraging banks to provide liquidity to SMEs and mid-cap companies.

The EIB's intervention could mobilize 13 billion euros in guarantees from pre-existing programs and 25 billion euros belonging to new actions. Among the member states outside the euro zone, Poland benefits from the largest volume of approved financing (2.66 billion euros) and the largest number of projects (13), followed by Romania (1.36 billion euros and 10 projects).

Conclusions

From the study done and presented in this article, some conclusions can be drawn. First of all, the use of discretionary measures provides some indications regarding the geographical distribution of state support aid and could allow partial conclusions to be drawn regarding the main beneficiaries of these measures. In this sense, there does not seem to be a clear pattern along the often-observed geographic area of North-South, East-West dividing lines, nor with regard to pre-COVID-19 debt burden. This remains valid for member states outside the euro area. Looking at the two Nordic countries with relatively low debt levels, Denmark has introduced the largest volume of measures in this group, and Sweden with 1% of GDP is only fifth in this respect. There are some positive assessments at the country level, but further research is needed to analyze the effects of market distortions.

Another conclusion is that the impact of CRII and CRII+ on nominal convergence in countries outside the euro zone is difficult to assess. The flexibilities brought by these measures seem to have been appreciated by the

authorities and the Commission initially estimated that the measures could mobilize 37 billion euros in public investments. A large part of the funding was allocated to health-related expenses, for the emergency purchase of medical equipment, which does not directly affect nominal convergence indicators.

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