Review

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EN

Risks, challenges and opportunities in the EU's economic policy response to the COVID-19 crisis

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Executive summary

I The COVID-19 pandemic is the defining global health crisis of our time that has brought about a worldwide upheaval in daily lives and societies. Prompted by the urgency of the situation, all EU Member States have taken public health measures to stop the spread of the virus and limit the rise of the death toll.

II In the first half of 2020, the COVID-19 pandemic caused uneven - but in all cases substantial - GDP losses across Member States. The economic impact was uneven due to various factors such as differences in the structure of economies and health strategies to combat the pandemic as well as the different effects of the lockdowns on economic sectors.

III This review aims to provide an integrated picture of the main economic policy responses in the EU. We present an analytical description of the measures launched both at EU and Member States level and identify risks, challenges and opportunities for the future of EU economic coordination from the perspective of the EU external auditor. The analysis in this review is based mainly on public information, enhanced by the results of a survey of Member States fiscal authorities, by interviews with Commission staff and reference to our previous reports. We have not carried out audit work, so the findings are analytical rather than evaluative, and we do not make recommendations.

IV Governments adopted a wide range of short-term discretionary fiscal measures in response to the health and economic crisis. Their size and composition reflected the relative wealth of the Member States, rather than how badly the crisis has affected them. Member States have generally adopted measures in line with the EU crisis policy guidelines: job retention schemes and state aid to provide liquidity support to businesses made up the vast majority of measures. However, the composition of fiscal packages were heterogeneous across Member States. Current fiscal policies will considerably raise public debt levels but have effectively mitigated unemployment risks during lockdowns.

V The pandemic crisis may amplify the risk of economic divergence between Member States. The underlying policy factors include differences in fiscal situations and competitive distortions, resulting from different capacities of Member States to use state aid measures. The growing divergences can also arise from large and persistent unemployment, investment gaps, and risks to financial stability should the economic impact spread to the financial sector.

VI The initial EU response consisted of measures taken within the existing rules and policy frameworks to support national efforts to manage the crisis. Rapid ECB monetary interventions were accompanied by making use of available flexibility embedded in existing EU fiscal and state aid rules, by adopting EU ad-hoc economic policy guidelines and reassigning the EU budget towards crisis response measures (Coronavirus Response Investment Initiative packages). As a next step, three safety nets were created to provide targeted lending support to governments through the Commission ("SURE", or the European instrument for temporary Support to mitigate Unemployment Risks in an Emergency) and the European Stability Mechanism and to businesses through the European Investment Bank. The SURE instrument was operationalised by the Commission during summer 2020 and is expected to finance short-time work schemes in 17 Member States as of early autumn 2020.

VII Subsequently, the EU worked on developing larger support instruments to deal with the growing economic consequences of the pandemic. The largest measure was the NextGenerationEU worth €750 billion (not yet operational at the time of completing our review). The centrepiece is the Recovery and Resilience Facility, which features a new spending approach, i.e. it offers support conditional upon implementation of growth-enhancing reforms and investments rather than reimbursement of specific expenses, being the rule for the ESI funds or other EU programmes. The facility is aimed at addressing economic divergence risks and anchoring the recovery to the EU's green and digital strategies.

VIII Compared to the Member States' and the ECB's responses, the other EU financial measures can be slower in delivering support, as they generally entail political agreements and/or readjustment of spending rules. The programmes were still in the process of adjusting to the crisis situation, which is why there were no large disbursements of funds by the end of August 2020. The absorption depends on the nature and structure of the support instrument, and the capacity of Member States to use the funds in accordance with their procedures and conditions.

IX The set of measures at Member State and EU levels creates risks and challenges for the coordination of EU economic policy, its implementation and sound financial management of EU funds. We identified them in the following areas:

- Member States' fiscal packages and exceptional banking credit supply trigger new challenges for the EU authorities responsible for surveillance of fiscal positions, the internal market, labour markets and the financial sector;

- The effectiveness of the newly proposed recovery facility risks being impaired if its financial structure is not adequate, the recovery plans do not focus on growth-enhancing reforms and investments, the implementation is not timely, the level of absorption is low, co-ordination of measures at all levels is weak, planning and monitoring is not based on sound indicators or accountability is fragmented;

- The Commission will face the challenge of managing the financial risk of large scale EU transactions on capital markets.

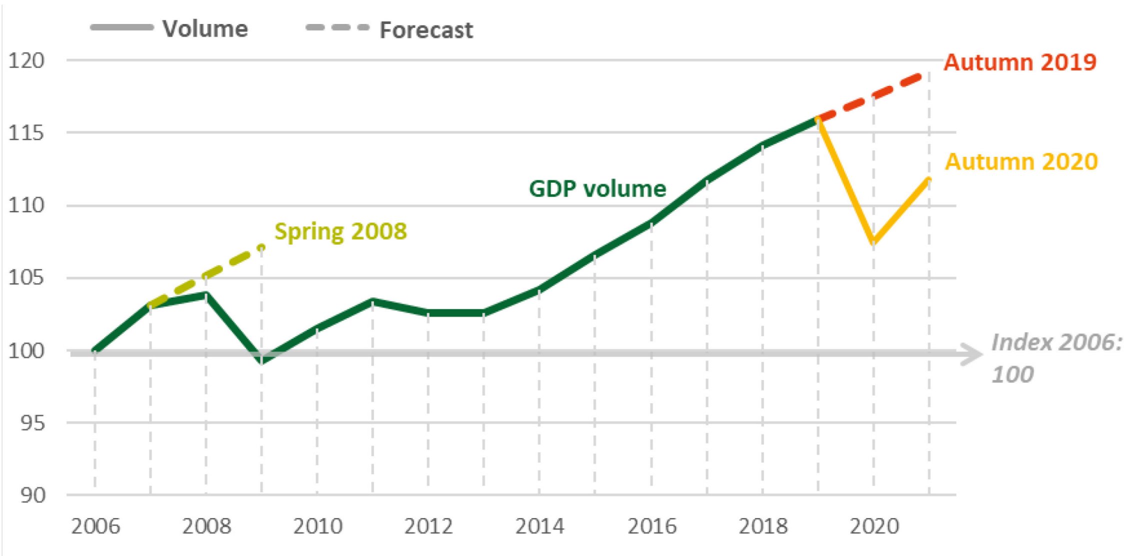
X We also identified opportunities arising from the EU economic response to the COVID-19 crisis. The implementation of the EU's financial response to the economic crisis is ongoing but may entail a strengthened role for EU institutions in the management of the EU's economic recovery. The creation of new temporary funds such as SURE and NGEU presents an opportunity to reflect on permanent improvements to the EU's budgetary capacity to react to major economic shocks and mitigate ensuing economic divergence across its Member States. This additional funding is also an important opportunity to promote EU priorities such as sustainable development and digitalisation, if the actions are carefully designed and thoroughly monitored within the European Semester.

Introduction

01 The COVID-19 pandemic reached the EU in February 2020, rapidly spread through all Member States, leading to a peak in mortality in April, and continues to pose a major health threat, both in Europe and worldwide. By the end of September, more than 3 million infections had been reported in the EU with a tragic toll of almost 150 000 deaths. Member States implemented a wide range of lockdown and prevention measures, which led to a reduction in contagion, but the resurgence in cases in the autumn of 2020 again posed challenges to health and economic systems alike.

02 In contrast to the global financial crisis, which evolved from weaknesses that had developed in the financial sector, the current economic shock affects the entire economy by disrupting household spending, business operations and global supply chains. According to the European Commission's forecast[1], divergence from the pre-pandemic economic growth path is significantly larger than it was during the previous crisis (see ***Figure 1***). EU-27 GDP is forecast to contract by 7.4 % in 2020 and may not return to pre-crisis level in 2021, entailing a risk of significant increases in insolvencies and job cuts.

Figure 1 – EU GDP volume index (in percentage) (2006-2021)



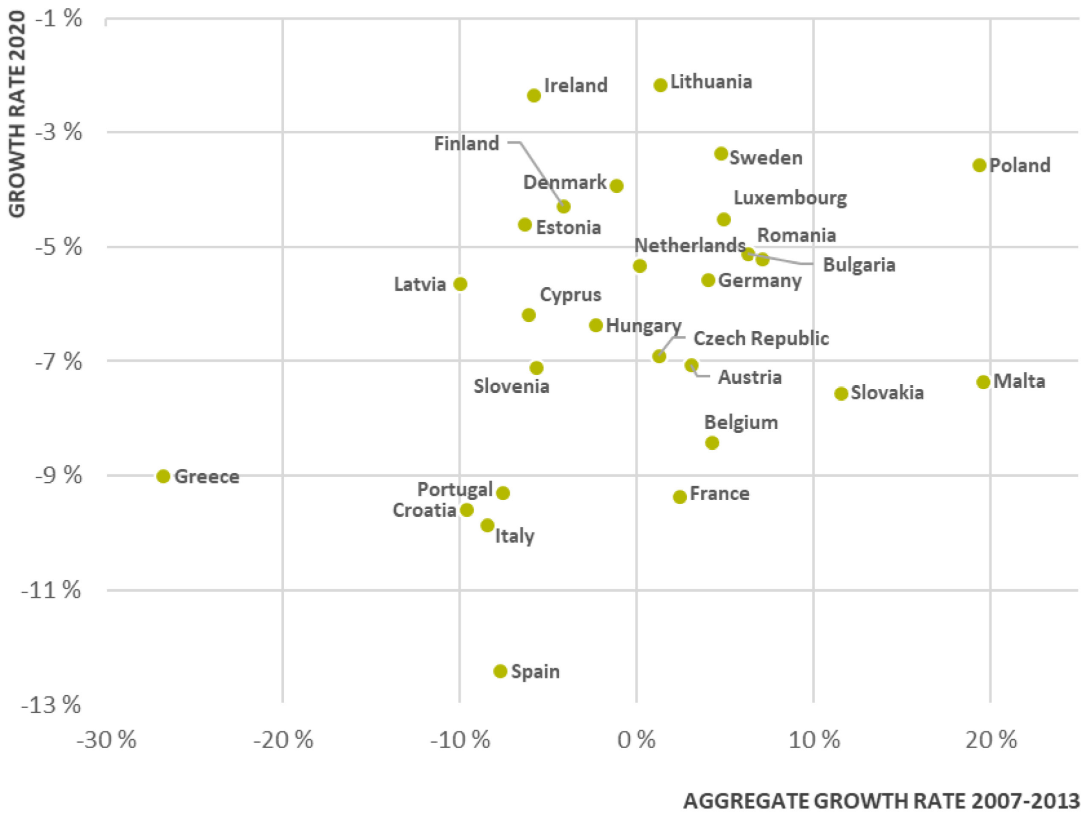
Source: ECA calculations based on Commission data and autumn forecasts (AMECO data set).

03 Despite the differences in the nature of the current and previous 2008-2013 crises, there is a strong correlation between GDP losses across Member States, which

[1] European Economic Forecast - Autumn 2020, Institutional paper 136, November 2020.

may pose new challenges for the economic convergence within the EU: For example, Greece, Italy and Spain appear to be among the most severely hit economies during both crises (see ***Figure 2***).

Figure 2 – GDP contraction during 2008-2013 crisis and 2020 crisis



Source: ECA calculation based on Commission data and autumn forecasts 2020 (AMECO data set).

04 Since March 2020, the economic shock of the lockdowns has necessitated EU and national economic policy measures on a large scale in response to the COVID-19 crisis to compensate for the loss of revenue for businesses and households. Following the global financial crisis and the ensuing European debt crisis, the EU's economic coordination of Member States was reinforced with new legislation (e.g. 'six pack' in 2011 and 'two-pack' in 2013) and financial assistance mechanisms (e.g. EFSM, ESM). In response to the pandemic crisis, the EU had to adapt some of the existing rules and create new financial support to tackle the effects of the economic shock.

Scope and approach

05 This is not an audit report, but a review based mainly on publicly available information or material specifically collected for this purpose. The objective of this review is twofold: to provide a descriptive overview and an objective analysis of the key national fiscal measures and EU economic measures in response to the ongoing COVID-19 crisis; to identify risks, challenges and opportunities for the coordination of EU economic policy, its implementation and the sound financial management of EU funds.

06 The publicly available information on the measures adopted in the EU is fragmented and spread across multiple sources and/or lacks consistency and systematic quantification, which hinders comparisons. This information is also important to help address the issues which arise from policy coordination and implementation and help analyse the lessons learned from the economic policy response to the crisis.The scope of the review includes economic measures taken at EU level between March and August 2020 and material follow-up actions which occcured after this date, and all significant fiscal measures (i.e. larger than 0.1 % GDP) taken at national level between March and June 2020.

07 In order to create a comprehensive overview of the measures, we gathered consistent and quantified data on EU and national measures based on publicly available information and information requested from the Commission. Moreover, since there is no dedicated database to centralise national fiscal stimulus measures and quantify them systematically, we conducted a survey of all 27 Member States' fiscal measures taken in reaction to the COVID-19 crisis as a way to fill the gaps in available sources of information. The survey includes national measures adopted up to 30 June 2020; hence, no updates of costs for such measures or other new measures adopted since then have been considered.

08 The survey provided central fiscal authorities with a standardised reporting template that helped us gather data in a systematic way on the adopted national fiscal measures including their description, timing, objective, estimated costs of the measures for 2020, and classify the data based on criteria such as budgetary and economic impact. Survey data was complemented by other publicly available information (such as European Fiscal Monitor, Stability and Convergence Programmes, published national budgets and budgetary announcements) when necessary. The review also takes into account previous ECA reports, interviews with Commission staff as well as opinions provided by an expert panel regarding the robustness of our analysis and the formulation of risks and challenges.

Diverse national responses focused on saving jobs and businesses whatever the cost

The economic impact of lockdowns varied across Member States and sectors

09 The causes of the current economic crisis are unique in modern history. While recent crises were triggered by unsustainable demand growth and/or the accumulation of macro-financial imbalances[2], the current large drop in output is caused by the effects of the pandemic and health policy measures on both demand and supply.

10 As health policies are mainly an area of national competence, the differences in the degree of Member States' preparedness during the initial contagion phase of the disease may explain why the onset of the health protection response to the pandemic in the EU was marked by hesitation, different approaches to lockdowns and border controls, and a gap in coordination of measures by Member States.

11 Estimated GDP losses actually experienced up to mid-2020 show considerable cross-country variation in the EU[3]. A substantial part of these differences across Member States during the COVID-19 crisis can be statistically correlated with an index of the stringency of containment or social distancing measures and the share of tourism in the economy. ***Annex I*** shows a regression we ran with these variables. The two explanatory factors are described here below.

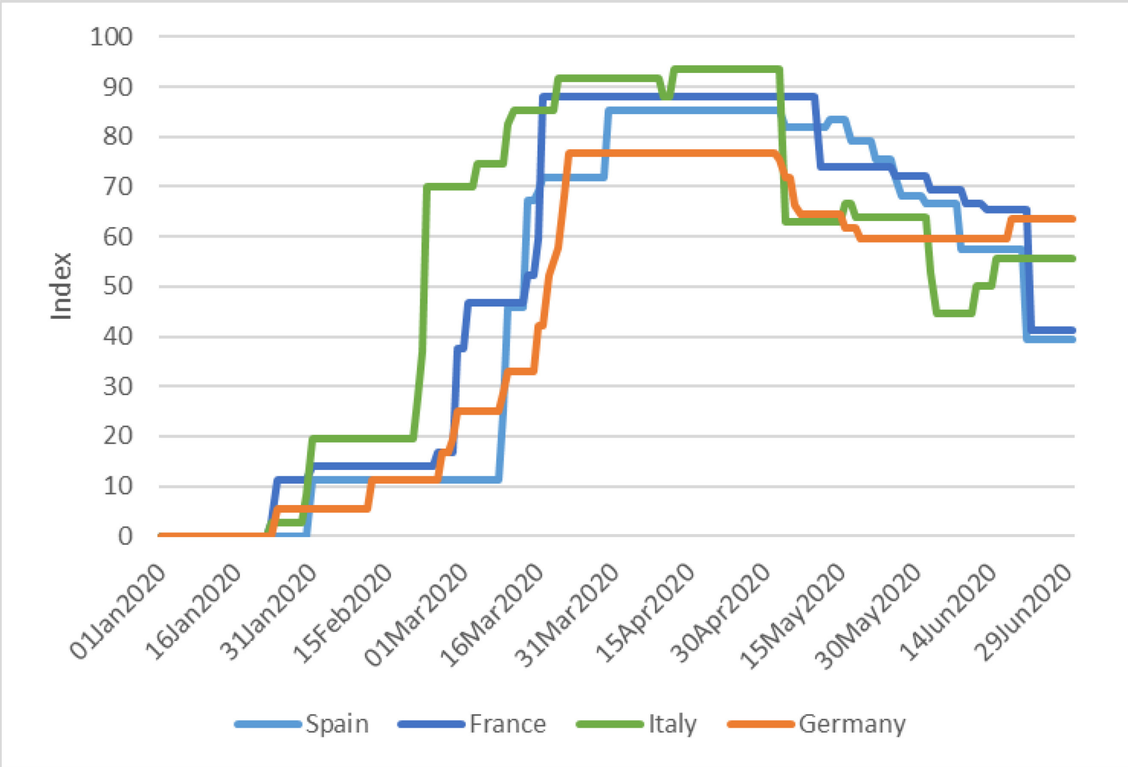
12 For example, the German shutdown in March was less severe than in Italy, France or Spain where all non-essential businesses were forced to close, which partly explains larger GDP falls in the latter countries (see also ***Figure 3***). Preliminary estimates show

[2] "Economic Crisis in Europe: Causes, Consequences and Responses" (Commission, 2009).

[3] Eurostat Newsrelease 133/2020 (8 September 2020).

that every month of strict confinement may cost a decline in annual GDP growth of up to 2 percentage points[4].

Figure 3 – Evolution of stringency of confinement measures in the first half of 2020



Source: Stringency Index (University of Oxford: https://covidtracker.bsg.ox.ac.uk/).

13 Data for the first half of 2020 shows large variations in the effects of the crisis on economic sectors (see ***Figure 4***). For instance, certain service sectors such as transportation, retail trade, leisure and hospitality are particularly hard-hit as the containment measures (lockdowns, social distancing or travel bans) have reduced the demand for such services.

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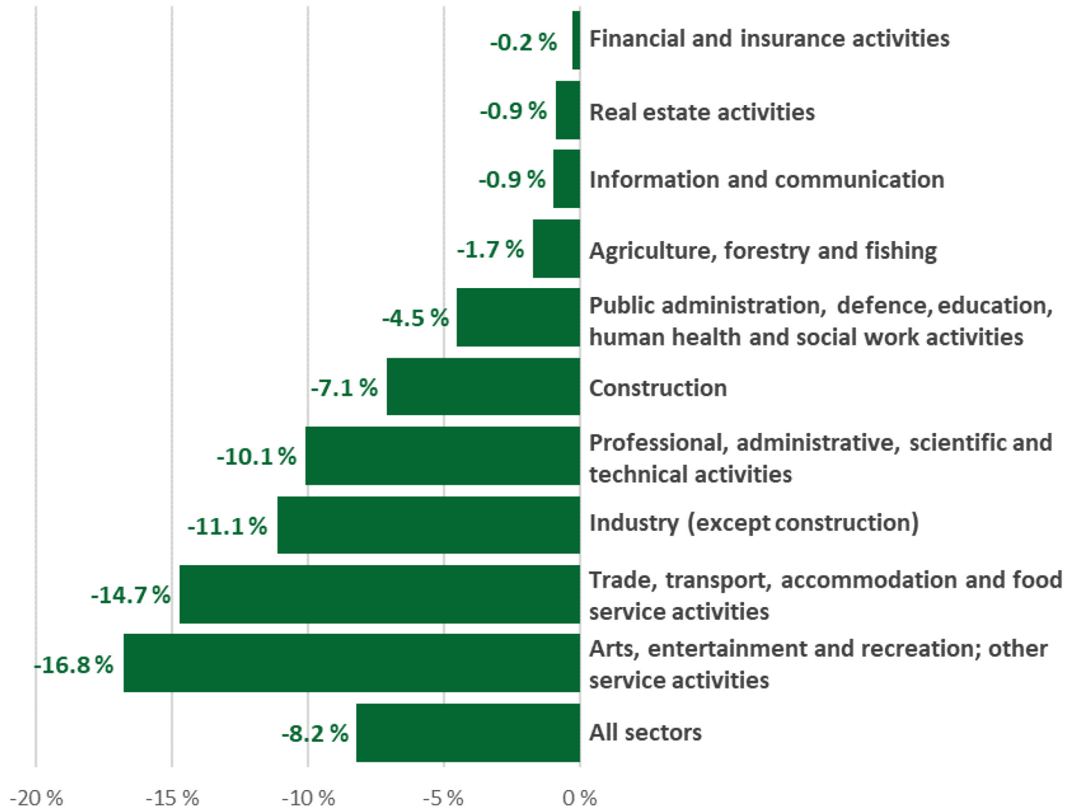
4 https://www.oecd.org/coronavirus/policy-responses/evaluating-the-initial-impact-of-covid-19-containment-measures-on-economic-activity-b1f6b68b/

Figure 4 – EU Gross value added volume changes in the first half of 2020



Note: percentage changes compared to same period in previous year.

Source: ECA calculation based on Eurostat data.

Member States adopted a wide range of fiscal measures

14 Since February 2020 Member States' fiscal policies have focused on mitigating the short-term impact of the lockdowns and falling demand on incomes and employment. Closely mirroring the response to the 2008 crisis, they have consisted in the operation of automatic stabilisers (tax revenues, unemployment schemes) and the adoption of discretionary budgetary stimulus measures, such as tax reliefs or rate cuts, and exceptional spending, including on employment support and the health sector. Moreover, non-budgetary measures have been adopted to provide liquidity to economic actors (state loans, loan guarantees, tax deferrals etc.), which do not have a direct fiscal cost.

15 As of end-June 2020, our survey (see paragraphs ***07***, ***08***) shows that Member States have adopted almost 1 250 fiscal measures to counter the economic and sanitary effects of the pandemic accounting for about €3.5 trillion (27 % of EU-27 GDP estimated for 2020). We classified the measures in five main categories depending on their nature and on their impact on deficit (***Box 1***). The composition of the aggregated survey data is reported in ***Figure 5***. Guarantees account for €2 trillion, or 59 % of the measures, followed by discretionary expenditure measures (19 %), financial instruments (11 %), tax payment measures (6 %) and discretionary revenue measures (5 %).

16 The overall size of the response is large in comparison with the discretionary measures for 2009-2010 in product and labour markets that amounted to around 3 % of GDP[5]. The magnitude of the current response is more comparable to the size of discretionary measures and non-budgetary measures (guarantees, loans, equity support) to support the financial sector over the period 2008-2017, estimated at about 4 % and 34 % of EU GDP respectively[6].

5 "Public finances in EMU – 2010" (Commission, 2010), p. 19.

6 "State aid scoreboard 2018" (Commission, 2019), p. 34.

Box 1

Main classification of fiscal measures in our survey

Discretionary expenditure measures have a direct budgetary impact. These measures include subsidies to support incomes of businesses or households, measures to support employment, such as furlough schemes, and exceptional spending on healthcare costs, capital investment and research as well as interest subsidies, provisions for credit losses and other discretionary expenditure measures. We report estimated amounts of the measures for the current year as of end-June.

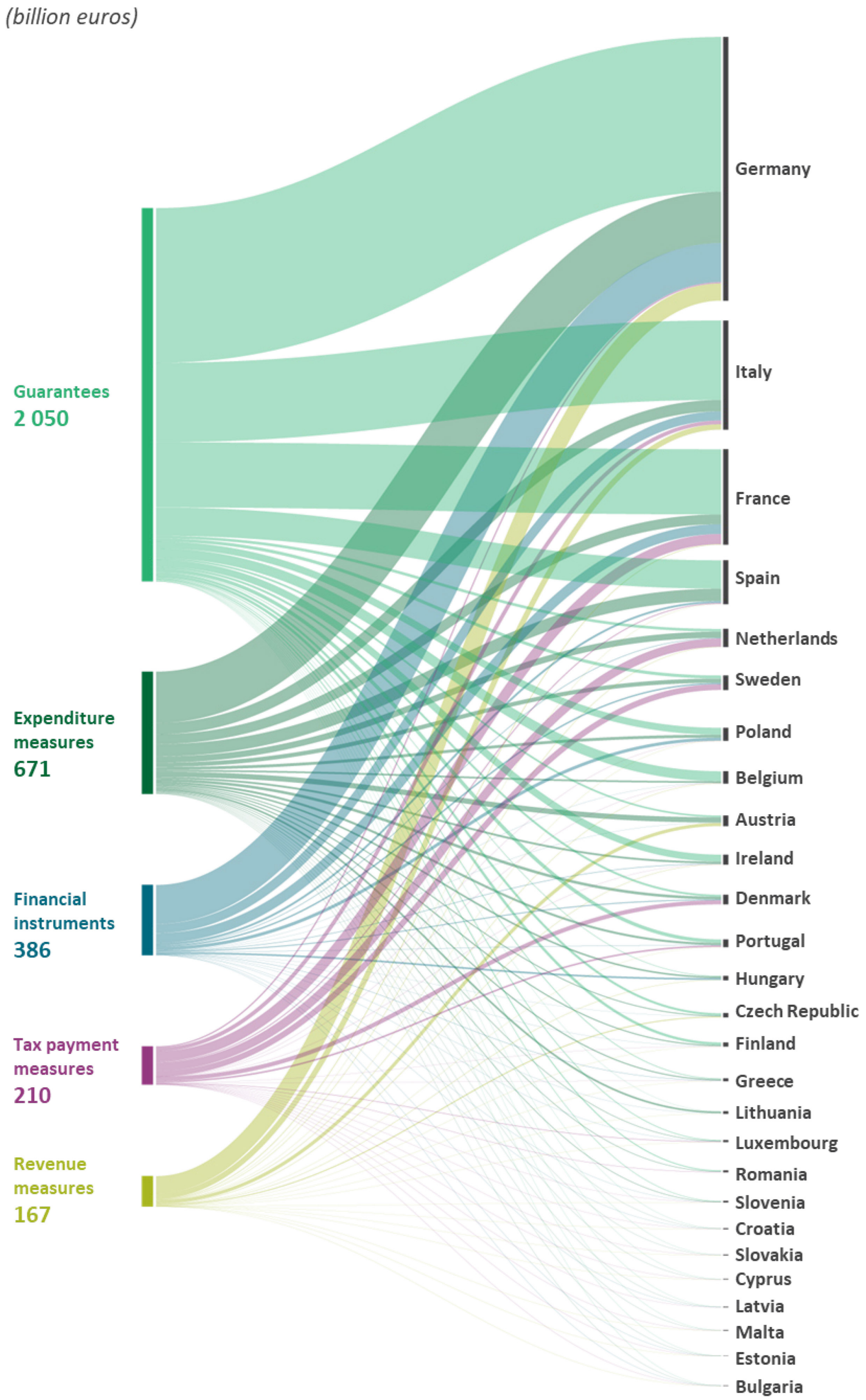
Discretionary revenue measures also have a direct budgetary impact. These measures include tax payment reliefs, tax rate cuts and other revenue measures. We report estimated amounts of the measures for the current year as of end-June.

Financial instruments aim to support the liquidity or solvency position of enterprises through loans or equity injections, which have an indirect budgetary impact if they are ultimately not repaid in full. We report the amounts of investments packages announced by public authorities up to end-June 2020.

Guarantees aim to support the liquidity position of enterprises through a promise from the government to repay the guaranteed debt granted by a financial institution in case of default. These measures have an indirect budgetary impact if the guaranteed financial instruments are not repaid in full. In our analysis, we report the amounts of guarantee packages announced by public authorities up to end-June 2020.

Tax payment measures aim to temporarily increase the liquidity position of enterprises through postponing tax or social contribution payments, which have no budgetary impact if the amount due is paid at a later point in time during the year. These measures include in particular tax deferrals and early tax refunds. In our analysis, we report estimated amounts of the measures for the current year as of end-June.

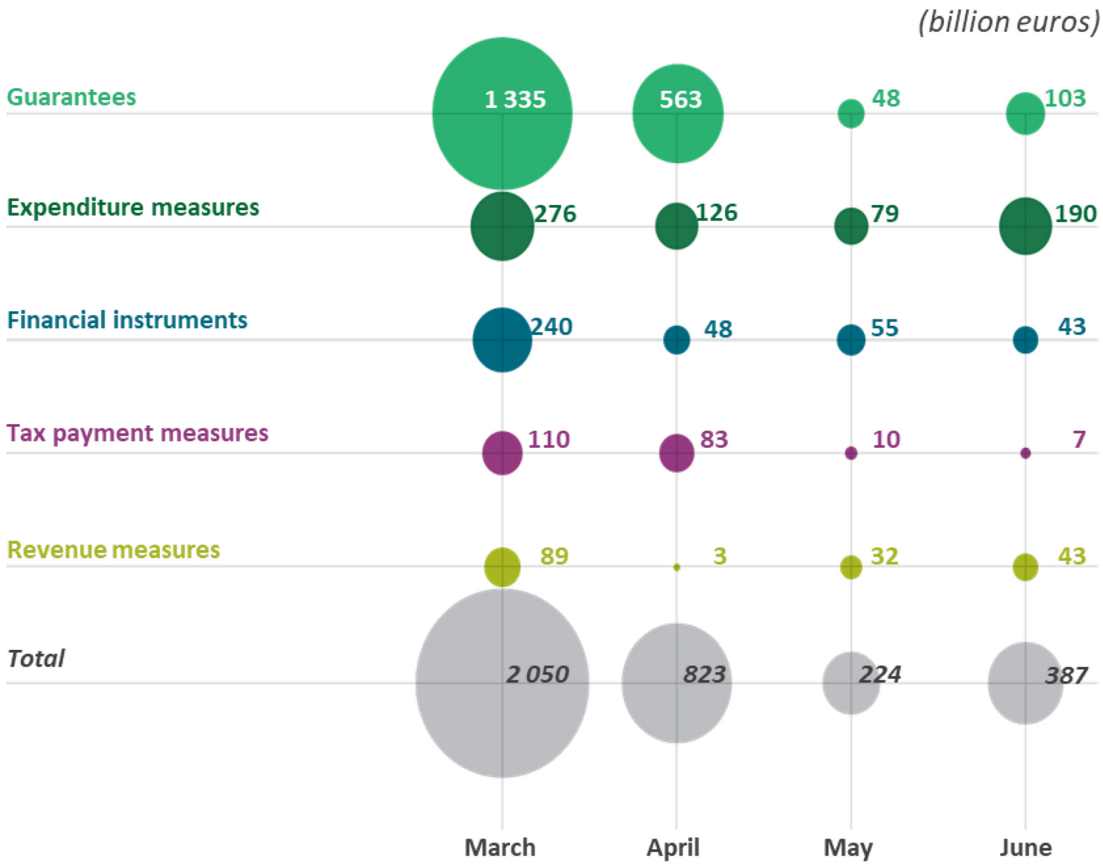
Figure 5 – Size of fiscal measures by categories



Source: Data from ECA survey.

17 The largest part of the measures, around €2.1 trillion or about 60 % of the amount involved was adopted in March when the first COVID-19 lockdowns were announced. Another set of measures, amounting to €0.8 trillion, were adopted in April, followed by a gradual decrease in May and June (***Figure 6***).

Figure 6 – Timing of fiscal measures



Source: Data from ECA survey.

18 The majority of guarantee schemes had been adopted by April. The stress in financial markets in March/April was one of the reasons why certain governments swiftly adopted large packages of guarantees and emergency loan schemes to support businesses' liquidity and overall investors' confidence at that time. The monetary interventions and subsequent recovery of financial markets explain why further schemes were not needed. The other types of measures have been spread more evenly across the crisis period. The hike in the amounts of expenditure measures in June reflects the renewal of certain temporary measures as well as the adoption of the recovery plan in Germany.

19 So far, the relative size of fiscal measures varied significantly across Member States. As illustrated by ***Figure 7***, four out of the five largest fiscal packages relative to their own GDP were adopted by the four bigger EU Member States, mainly due to the announced amounts of guarantee schemes. Germany launched the largest response with measures amounting to about 43 % of its GDP, followed by Italy (37 %), Lithuania (29 %), France (23 %) and Spain (22 %). In contrast, some countries which joined the Union later adopted significantly smaller fiscal packages: Bulgaria (2 %), Slovakia (5 %) and Romania (5 %) are the smallest among the Member States.

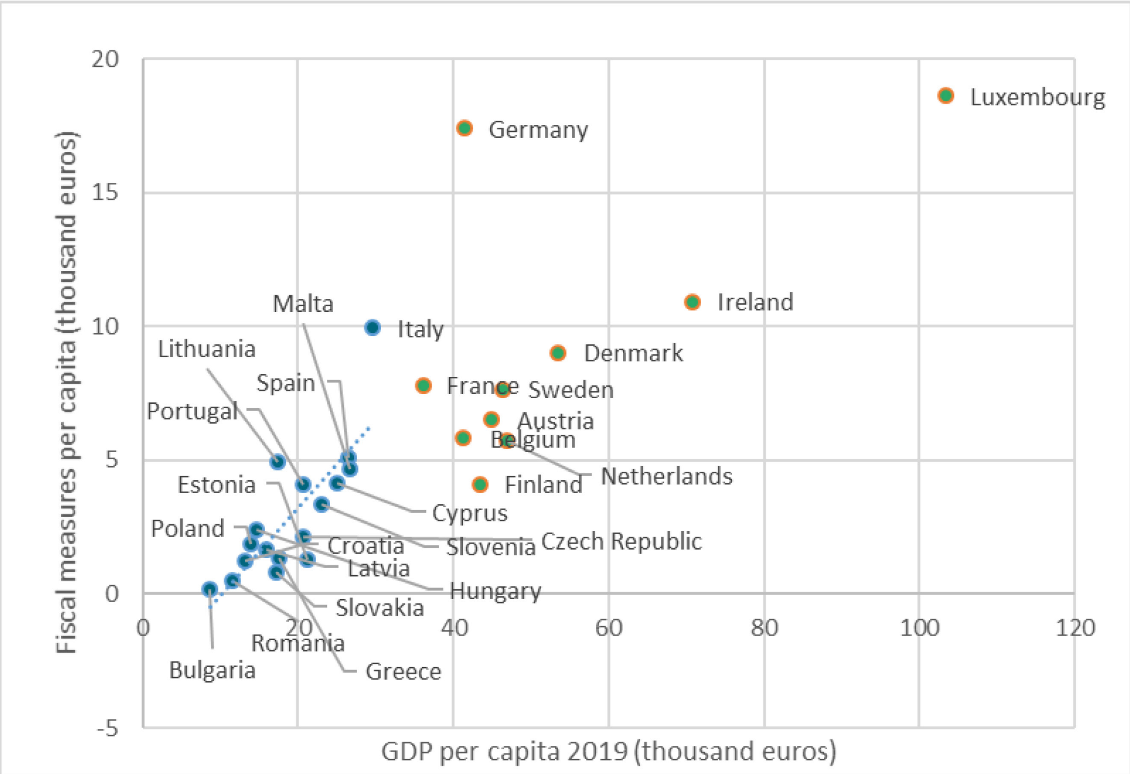
Figure 7 – Size of fiscal measures across Member States as a share of respective GDP

Note: The total amounts illustrate overall fiscal efforts but do not reflect various fiscal strategies which include measures with different types of financial and budgetary impacts as explained in ***Box 1***.

Source: Data from ECA survey.

20 We observed that countries with relatively lower GDP per capita adopted smaller fiscal packages per capita and have perceptibly limited response options, while countries with GDP per capita above the EU average adopted more varied fiscal reactions that did not appear to depend on the size of GDP (see ***Figure 8***). The higher the GDP per capita, the larger the fiscal packages but this linear relationship, which might indicate a fiscal constraint, disappears for countries with GDP per capita above the EU average.

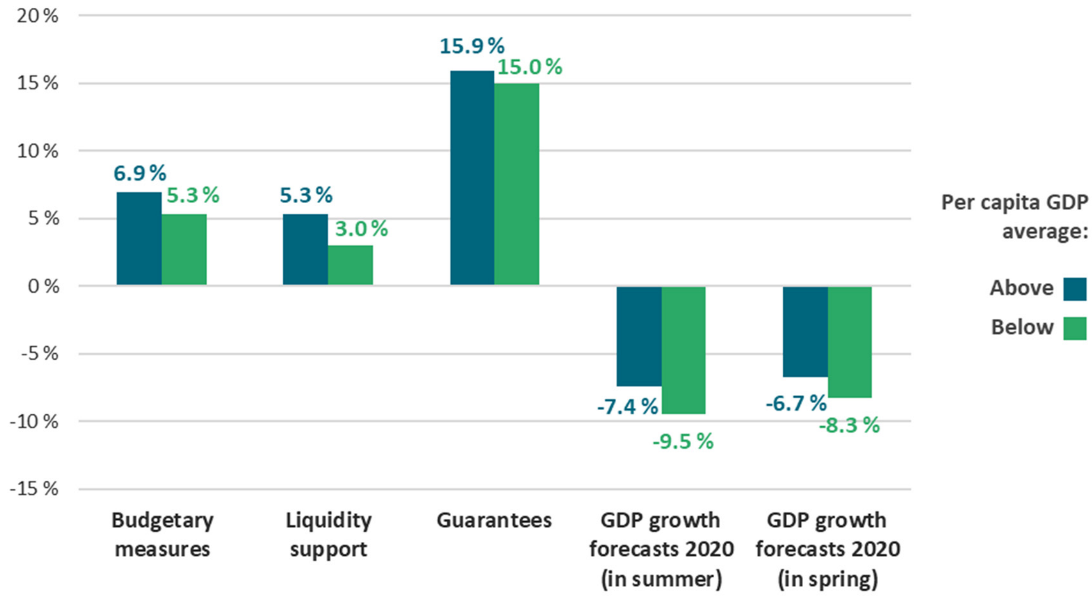
Figure 8 – The size of fiscal packages per capita compared to GDP per capita



Source: Based on ECA survey.

21 Based on our surveyed data, we calculate that countries with GDP per capita below the EU average as of end-2019 adopted aggregate amounts of fiscal measures as a share of GDP in 2020 that are lower than in the other countries (see ***Figure 9***). Moreover, the Commission estimates that they face a larger GDP fall in 2020 as compared to the other Member States. Hence, the size and composition of the adopted measures reflect the relative wealth of the Member States, rather than how badly the crisis was forecasted to affect them.

Figure 9 – Comparison of aggregate fiscal packages and estimated GDP falls in 2020



Note: Budgetary measures include revenue and expenditure measures; liquidity support refers to tax payment measures and financial instruments.

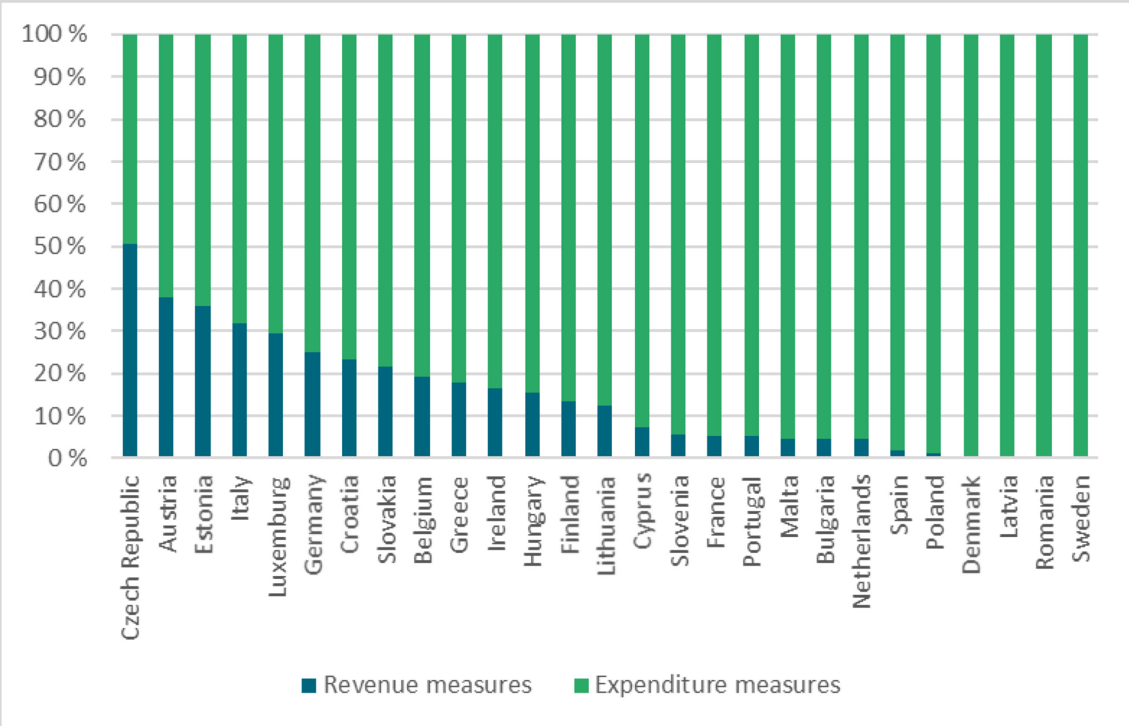
Source: Data from ECA survey and Commission GDP forecasts 2020.

22 The composition of the fiscal responses also differs across Member States (see ***Figure 7***). Guarantees account for the main share in fiscal packages, which is particularly true for countries with the largest packages. For example, in Germany 58 % of the packages is made up of guarantees; this ratio is 73 % in Italy, 68 % in France, and 65 % in Spain. Our survey does not contain data on their implementation, but publicly available provisional data shows that the take-up of guarantees was lower than 10 % of the package in Germany, lower than 20 % in Italy, about one third in France and above 60 % in Spain[7].

23 Other Member States dedicated the largest share of fiscal packages to discretionary revenue and expenditure measures, such as Lithuania (81 %), Austria (81 %), Estonia (72 %) and Bulgaria (70 %). Governments resorted to these two types of measures to a variable degree (see ***Figure 10***).

[7] See also : https://www.ecb.europa.eu/pub/economic-bulletin/focus/2020/html/ecb.ebbox202006_07~5a3b3d1f8f.en.html

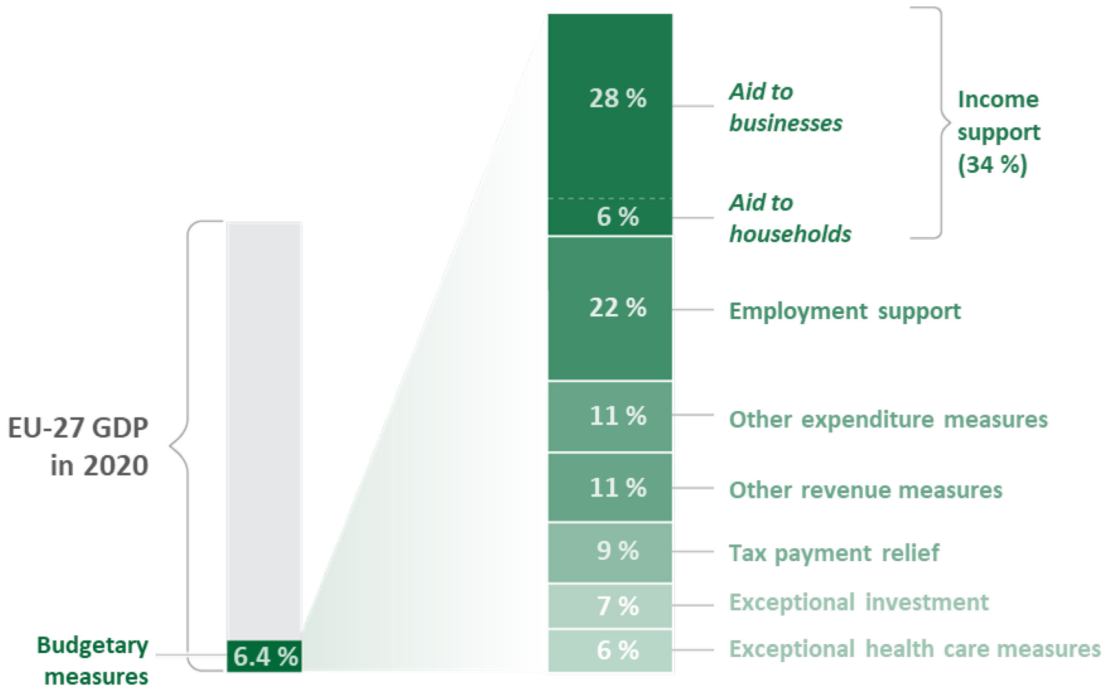
Figure 10 – Share of discretionary expenditure and revenue measures in overall budgetary measures



Source: Data from ECA survey.

24 The discretionary expenditure and revenue measures reported in the survey represent about 6.4 % of EU-27 GDP in 2020 and mostly consist of discretionary expenditure (see ***Figure 11***), out of which 2 % of GDP was earmarked for income support for businesses and 1.4 % of GDP for employment support such as short-time work schemes. Tax and social contribution payment reliefs represented the largest share of revenue measures.

Figure 11 – Composition of EU aggregate discretionary revenue and expenditure measures



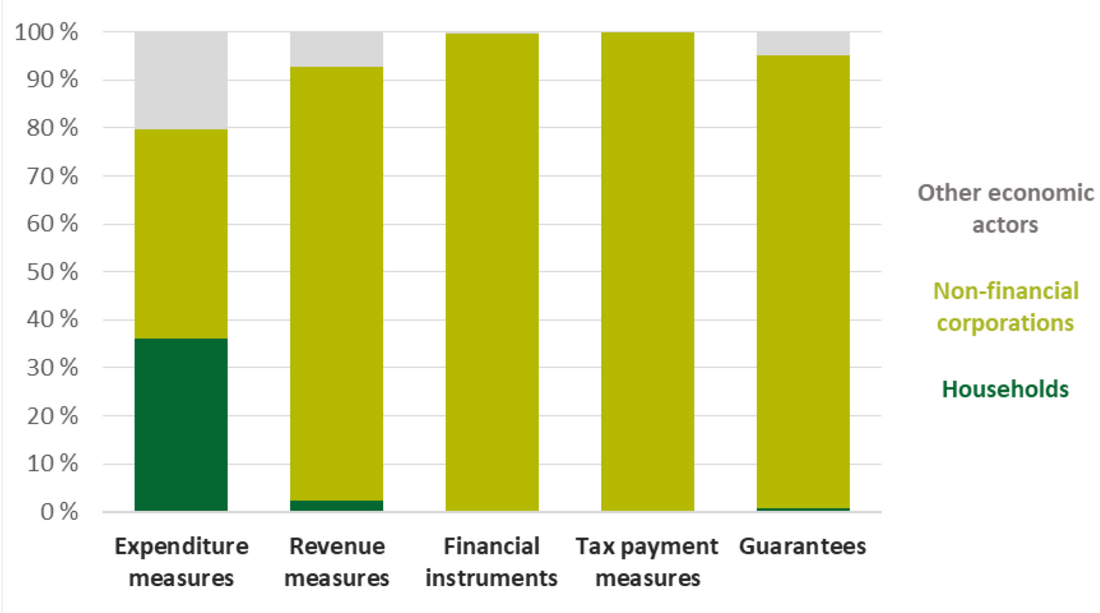
Source: ECA survey.

The measures mainly focused on immediate mitigation of unemployment and insolvencies

25 According to the Commission **policy guidelines** for Member States issued on 13 March 2020 (see paragraph ***43***), fiscal measures should target households and businesses to mitigate job losses and support households' and firms' incomes and liquidity. The following analysis shows that the fiscal measures adopted were generally in line with the guidelines.

26 In terms of economic actors, the fiscal measures targeted non-financial corporations (84 %) and households (8 %). While guarantees and liquidity instruments (tax payment measures and financial instruments) supported businesses' liquidity, 43 % of the volume of discretionary expenditure measures was directed to businesses while 35 % targeted households. 90 % of revenue measures targeted businesses, in particular through tax payment reliefs (see ***Figure 12***). Discretionary expenditure measures had a wider range of policy areas, including also health care, public investment, research, education, measures against poverty, etc.

Figure 12 – Breakdown of fiscal measures by targeted economic actors



Source: ECA survey.

27 The total amount of surveyed measures to directly support employment through short-time work schemes is €184 billion, with France (€32.5 billion), Spain (€29.4 billion), the Netherlands (€25.2 billion) and Italy (€23.7 billion) spending more than 60 % of the total amount (see ***Box 2***). The fiscal costs of short-time work schemes depend on several legal characteristics of the schemes (eligibility, wage replacement rates, duration etc.), the nature of containment measures and the volume of tele-workable activities in each country.

Box 2

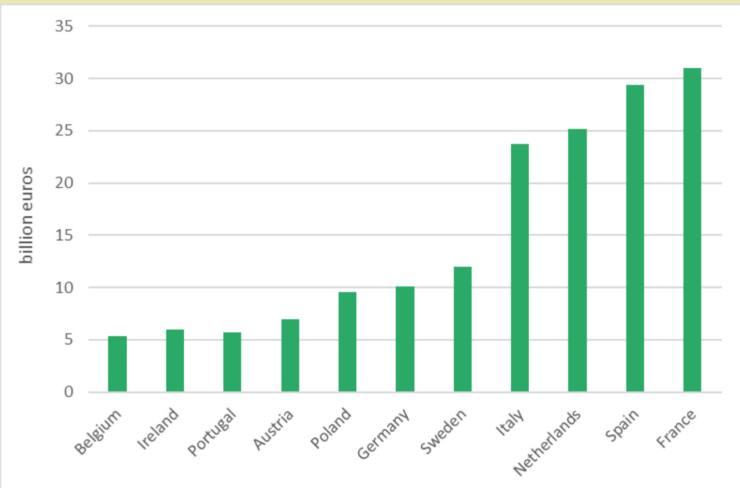
Short-time work schemes

Short-time work schemes are public programmes that allow firms experiencing economic difficulties to temporarily reduce the hours worked while providing their employees with income support from the government for the hours not worked. The scheme can involve a partial reduction in hours worked or full suspension of the employment contract for a limited period. The objective is to preserve employment through the crisis and allow firms to retain skills, expertise and labour.

During the global financial crisis, the Commission showed that the majority of Member States resorted to such schemes and experienced lower variability of employment, which diminished social costs of the crisis[8].

On 13 March 2020, the Commisison recommended the schemes to mitigate the adverse impacts of lockdowns on employment. More than 42 million workers benefited from short-time work schemes in April 2020 in the EU-27, at the height of the pandemic lockdowns, which represented about one quarter of the overall workforce[9]. The Commission estimates that the immediate budgetary cost of the schemes is half the cost of unemployment benefits that would be paid in the absence of such employment support[10].

Our survey shows that in 11 Member States fiscal measures to finance short-time work schemes could cost more than €5 billion in 2020:



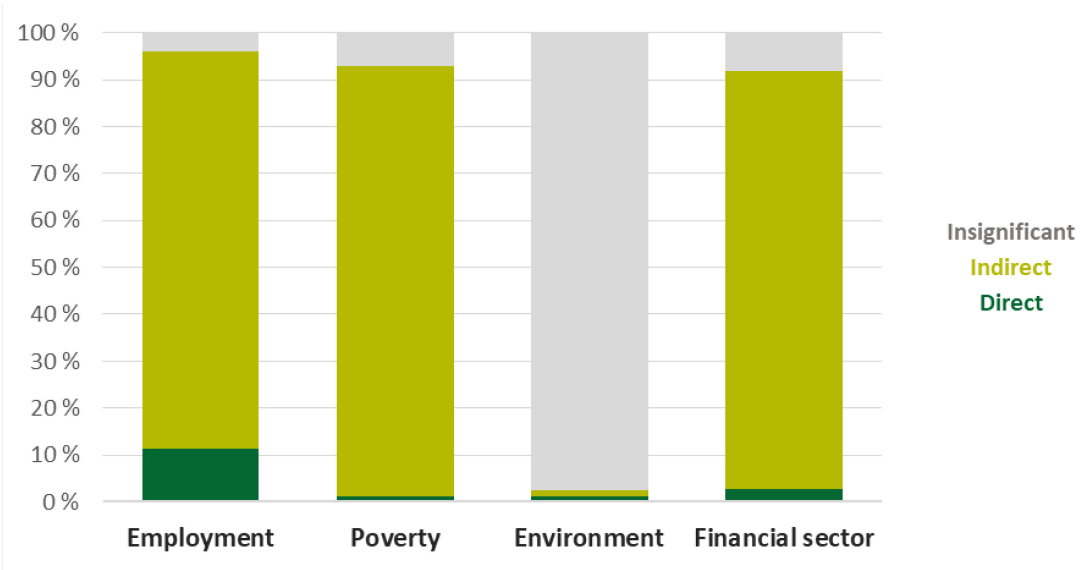
[8] “Short-time working arrangements as response to cyclical fluctuations” (Occasional Paper, Commisison, 2010).

[9] Policy Brief no 7/2020 (European Trade Union Institute, 2020)“.

[10] “Employment and Social Developments in Europe” (Commission, 2020), p. 114.

28 We categorised the national measures collected in our database according to their impact on employment, poverty, the financial sector and the environment. This categorisation is the result of a qualitative analysis based on the title, description and classification of measures as provided by Member States. The measures are assessed to have a "direct" impact if their objective is to impact – respectively – employment, poverty, the financial sector or the environment. The measures are assessed to have an "indirect" impact if they are likely to have any impact although it was not their primary objective, and "insignificant "if they are unlikely to have any impact. For example, expenditure measures that finance short-time work schemes have a direct beneficial impact on employment. Our assessment of the impact of measures is summarised in ***Figure 13***.

Figure 13 – Relative size of fiscal measures by expected impacts



Source: ECA survey.

29 Most of the measures targeted employment:

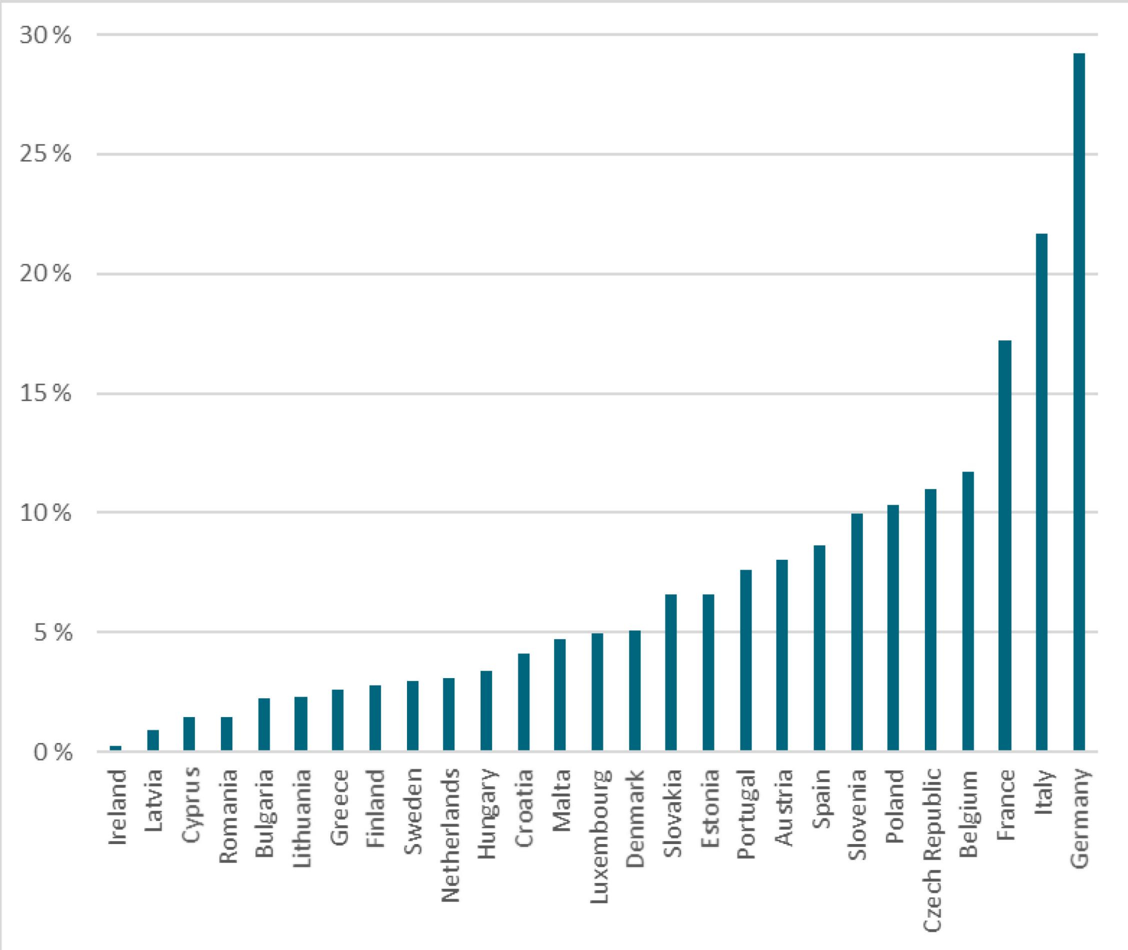
- Of the amounts the measures involve, 95 % have a direct or indirect effect on employment, of which 12 % is direct. Only 1 % of the measures directly target poverty. However, most of the measures contributing to the preservation of employment deliver an indirect contribution to limiting the impact of the crisis on poverty. Fiscal measures worth nearly €3.2 trillion are assessed to have a combined direct (1 %) and indirect impact on poverty (92 % of the total amount).

- As the financial sector, so far, is not directly affected by the COVID-19 crisis, only a marginal share of the measures was directly targeted at financial corporations. However, with their role as intermediaries in the distribution of the guarantees and other instruments, the financial sector is indirectly affected by 89 % of the total amount of measures. Moreover, the financial sector is also indirectly benefiting from the national fiscal measures that help prevent businesses' and households' insolvencies.

- Hardly any measures have an impact on environmental issues. The fiscal measures adopted that have a direct or indirect impact on the environment account for just 2 % of the total amounts deployed in response to the COVID-19 crisis. This does not take into account the beneficial impact of lockdowns on the environment (such as lower levels of pollution), which we were not able to quantify.

30 State aid is the major channel through which the Member Sates have provided support to domestic businesses during the crisis. The majority of the fiscal measures (67 %) have been approved by the Commission as state aid. By the end of June, the Commission had approved state aid worth €2.2 trillion (15.7 % of EU-27 GDP 2019), which mainly consisted of guarantees and liquidity measures. Given that a majority of the decisions approved by the Commission concerned "umbrella" schemes applicable to all sectors of the economy, their sectoral focus is not known. The intensity of crisis-related state aid varied greatly across Member States (see ***Figure 14***). In absolute terms, Germany accounted for almost half of the overall state aid decisions granted in the EU (€1 trillion), which corresponded to 29 % of the country's GDP.

Figure 14 – Approved state aid (total amount in percentage of respective GDP)



Source: Commission data as of end-June 2020.

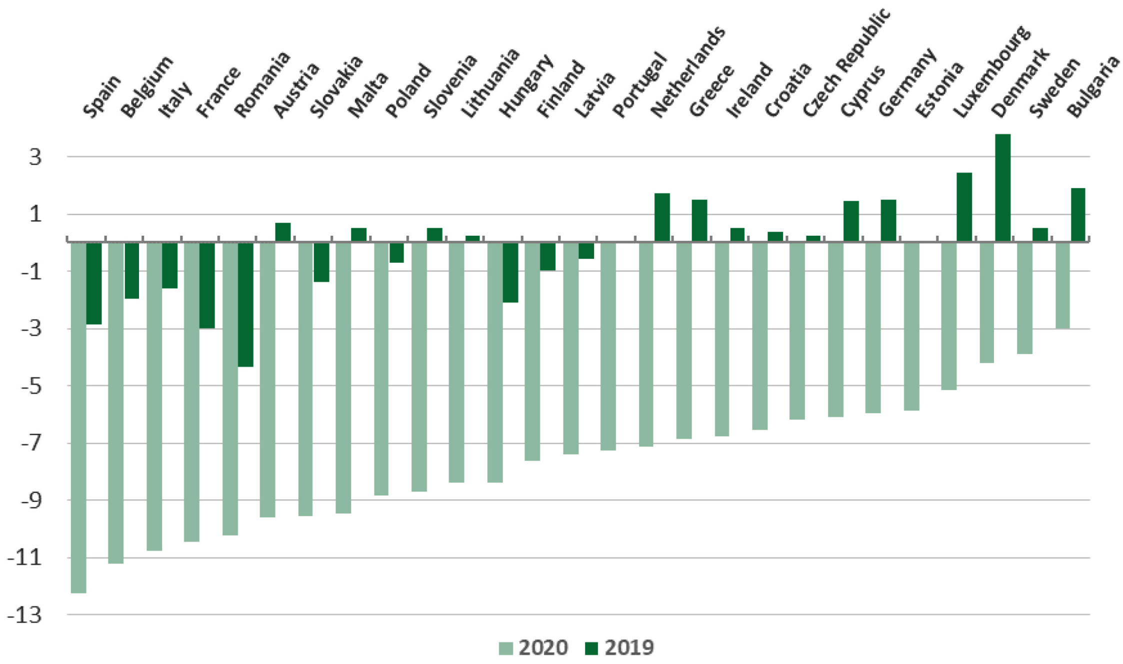
The measures helped save jobs but resulted in large deficits

31 While the pandemic is unfolding and its socio-economic impacts are likely to evolve as well, we looked at the initial consequences of the fiscal measures that have been adopted by the time of our review.

32 The initial fiscal responses to the economic crisis are likely to have a severe impact on government **deficits**. This is due to the fact that tax revenues have fallen because of the decline in economic activity and because of discretionary measures such as tax reliefs or rate cuts, and exceptional spending, including on employment support and the health sector. Moreover, according to our survey, budget savings to finance the measures account for less than 0.1 % of EU GDP. Future fiscal costs may also arise from impairment losses on the sizeable guarantees and liquidity measures granted to businesses.

33 In November 2020, the aggregate budget deficit was forecast to be above 8 % of GDP for the EU in 2020 and some countries suffering a substantial contraction of GDP may experience deficits greater than 10 % (Spain, Belgium, Italy, France). It is probable that 26 Member States will not comply with the EU deficit limit of 3 % of GDP (see *Figure 15*) in 2020. Deficits may increase public debts in the range of about 20 % of GDP over 2020-2021 but the estimates vary largely across countries[11]. Deficit and debt forecasts are subject to upward pressures due to current economic uncertainties. In November, the Commission revised the GDP growth forecast for 2021 from 6.1 % to 4.1 %.

Figure 15 – Fiscal balances (in percentage of GDP)

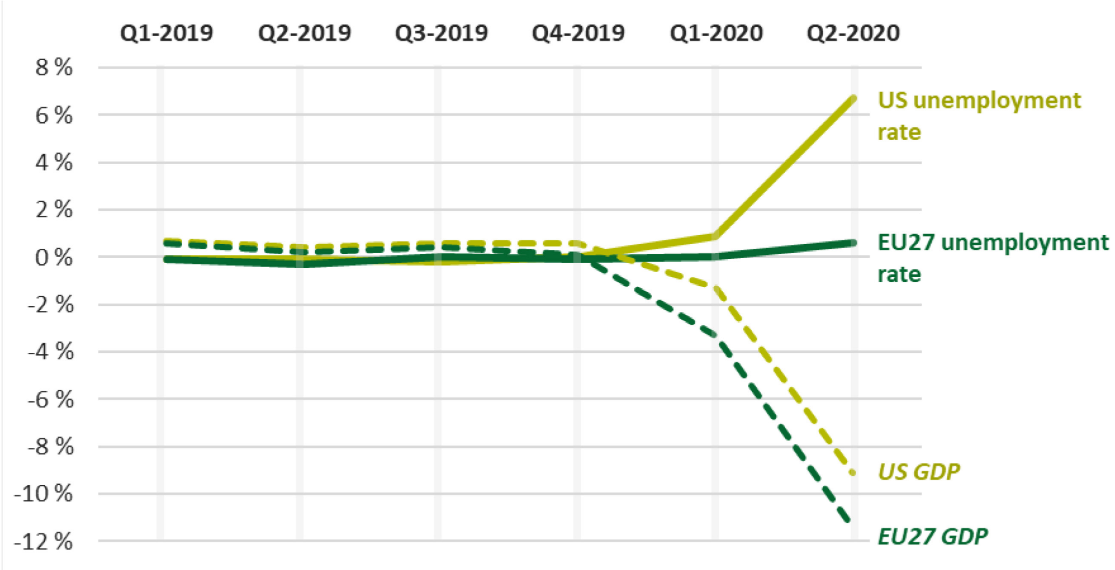


Source: Commission autumn forecasts (2020).

34 So far, the short-time work schemes and state aid schemes made available by governments have coped with the liquidity needs of businesses and hence mitigated massive layoffs. Indeed, the recent increases in **unemployment** rates are small compared to the fall in output. In the EU unemployment rose much less than in the United States (see *Figure 16*) where public authorities did not incentivise generalised job retention schemes, but rather prolonged unemployment benefits.

[11] Commission autumn forecasts (2020).

Figure 16 – Changes to unemployment rate and GDP volume compared to previous quarter in the EU and the United States



Note: Changes to unemployment rate are nominal, changes to GDP volume are growth rates.

Source: ECA calculations based on OECD data.

35 Fiscal measures have played a key role in the stabilisation of disposable incomes. The consumer surveys by the Commission indicate a significant amassing of involuntary **savings**[12], which is a direct consequence of the confinement measures, fiscal measures and high uncertainty. When the lockdowns reduced businesses' sales of products and services, the fiscal measures maintained a relatively stable purchasing power for employees, leading to household saving rate at an all-time high of 16.9 % in the euro area in the first quarter of 2020. These savings have the potential to contribute to a rapid recovery of consumption if uncertainty related to economic prospects dissipates.

[12] Eurostat newsrelease (3 July 2020).

36 Public **investment** was not a priority of the crisis management. In our survey, we asked Member States to report any investment decisions in response to COVID-19 crisis. Surveyed data shows that they represented less than 0.5 % of EU GDP. Without the public investment announced in the German recovery plan (June 2020), they accounted for 0.1 % of EU GDP. Public investment could contribute to the rebound of the economies in the post-pandemic period. On 23 April 2020, the European Council welcomed the Joint Roadmap for Recovery that recommended unprecedented investment to help relaunch and transform European economies[13].

[13] https://www.consilium.europa.eu/media/43384/roadmap-for-recovery-final-21-04-2020.pdf

The implementation of the EU's substantial economic response is ongoing

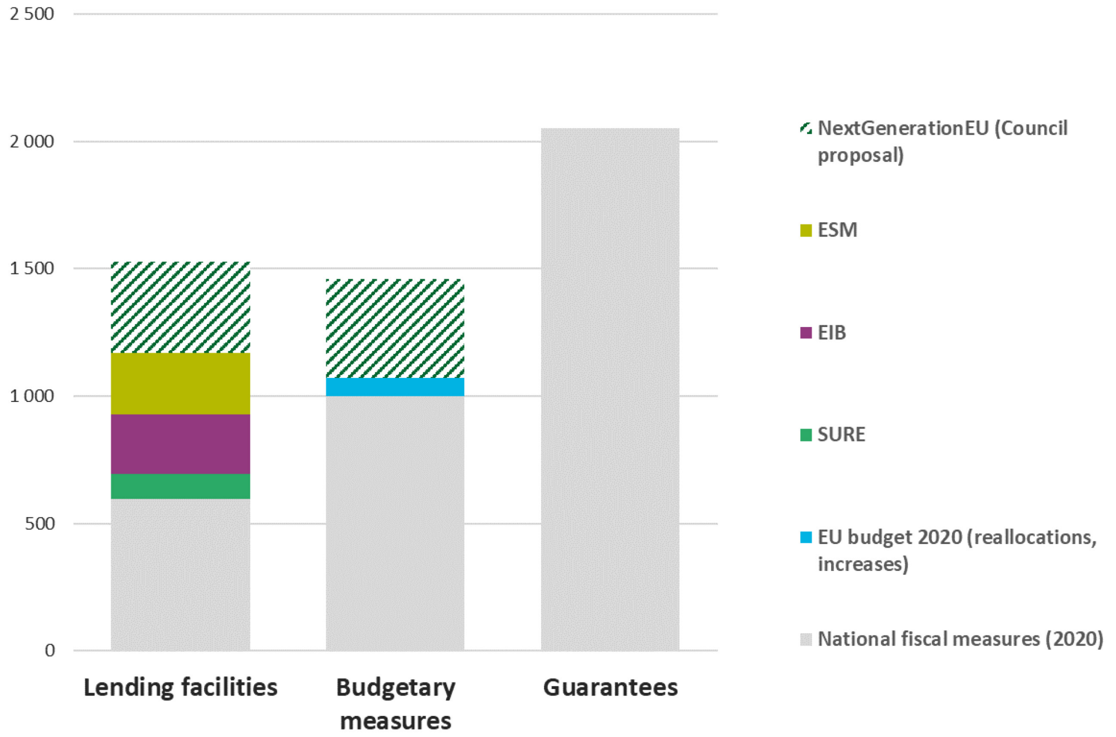
37 The initial EU response to the economic crisis (March 2020) was prepared against the background of a rapidly evolving epidemiological situation and the first Member States' general lockdowns (see brief chronology in ***Annex II***). There were immediate actions and decisions that were taken within the existing rules, such as EU budgetary measures, ECB monetary interventions, lending decisions by the EIB (European Investment Bank) and the ESM (European Stability Mechanism), and Commission coordination actions.

38 As the pandemic crisis unfolded, the EU economic response became more sizeable to reflect recovery needs and lately has consisted in an agreement by the European Council to create a new temporary EU budgetary support instrument to promote economic recovery and resilience called "NextGenerationEU" (NGEU).

39 The EU and the ESM financial measures (adopted or under adoption, excluding ECB monetary interventions) have an overall value of over €1 363 billion[14]; split into grants (€430 billion) and loans (€933 billion). The core of European budgetary support takes the form of the grant component of the proposed NGEU, which represents about 40 % of national budgetary measures forecast in 2020 (see ***Figure 17***). The EU amounts are the maximum available and may not necessarily be used in full.

[14] Including NextGenerationEU (amounts agreed by the European Council).

Figure 17 – Comparison of EU and Member States' estimated financial response to the crisis (in billion euro)



Note: The data on the proposed NGEU is based on the European Council conclusions. The proxy for national budgetary interventions is the difference between 2020 and 2019 fiscal balances estimated in the Commission's autumn forecasts (2020). Data on other national measures are based on our survey. NGEU resources are to be allocated over several years, which is here being compared to Member States' public finance deficit in a single year.

Source: ECA's calculations based on data as of August 2020.

EU competences in areas not linked to monetary and economic coordination were limited during the crisis

40 **Early policy interventions by the ECB**, notably large-scale asset purchases (under the Pandemic Emergency Purchase Programme initially worth €750 billion and then increased by €600 billion) were aimed at stabilising conditions on financial markets. ECB interventions were also aimed at easing banks' financing conditions through new longer-term refinancing operations (LTROs) and easing collateral requirements. Certain non-euro area central banks (Denmark, Croatia, Hungary, Romania) benefited from the ECB's provision of euro liquidity to their respective banking systems.

41 The EU faced a number of constraints and limited competences, in respect of certain areas in which it could have contributed to the pandemic response. In part, these included the lack of competences to act in certain areas, and in part this resulted from a lack of consensus and preparedness before the onset of the crisis on building certain mechanisms/instruments. Key constraints included:

- **Competences in health care policy:** EU action in the area of public health is limited to support and complement public health policy of the Member States, which hold the main responsibility in this area. The EU's budget for investment in the health sector ("third health programme") was worth €0.5 billion which represented 0.05 % of the total amount of the current MFF 2014-2020. The ECA is about to publish a separate review on the EU's initial contribution to the public health response to COVID-19.

- **Competences in confinement measures:** Lockdowns and similar measures were decided entirely by Member States themselves, which have exclusive competences in the area of public security. The Commission had a secondary role to play by ensuring voluntary co-ordination and providing soft guidelines to limit the adverse consequences for the integrity of the internal market and free movement of goods and people. However, the Commission can check whether the measures are justified, i.e. suitable, necessary and proportionate to public security objectives[15].

- **Preparedness for economic crises:** The Council and the Commission have competences to coordinate Member States' economic policies within the European Semester (with specific rules on fiscal surveillance) and to verify compliance of state aid schemes with EU rules. The Council and the Commission also manages financial assistance to Member States that are experiencing severe economic or financial disturbance (EFSM, balance-of-payments facility).

- **EU budget rules:** The EU budget is not designed to mitigate large scale economic shocks in the short run, as it is limited by the spending ceilings of the Multiannual Financial Framework and various spending rules of the budgetary programmes. In particular, any reallocations of investment programmes for this purposemay take time to implement, depending on the nature of investments and programming cycles. Moreover, budgetary contingency margins and reserves embedded in the current budgets are not large: the ECA had already suggested keeping more appropriations in reserve[16]. In particular, towards the end of the MFF 2014-2020, the available margins are lower.

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[15] See "Coordinated economic response to the COVID-19 Outbreak" (COM(2020) 112 final).

[16] https://www.eca.europa.eu/other%20publications/briefing_paper_mff/briefing_paper_mff_en.pdf

Flexible economic coordination was rapidly deployed

42 After the outbreak of the pandemic and with no prospect of a rapid return to normality in respect of the economic situation, it was clear that the EU had to react in a flexible way in order to allow Member States to design appropriate responses to the specific health and economic situations. This meant allowing for:

- more flexible application of key EU economic rules or coordination processes;
- adopting ad-hoc guidelines to limit the impact of emergency national measures on the functioning of the single market.

43 A series of decisions were therefore taken to address a number of key economic policy aspects:

- On 13 March 2020, following up on the European Council conclusions of 10 March, the Commission adopted exceptional **policy guidelines** for Member States[17] outside the remit of the traditional economic coordination processes of the European Semester. They encouraged immediate fiscal stimulus measures to cushion the emerging economic crisis, such as short-time work schemes to mitigate job losses and support households' income, liquidity injections and credit/export guarantees to help companies with working capital;
- On 19 March 2020, the Commission also **adopted a specific temporary state aid framework** that allowed Member States to grant public support to domestic companies/sectors affected by the crisis[18]. Specific rules on state guarantees, loans and other crisis-relevant instruments complemented other possibilities already available to Member States under state aid rules. The Commission amended the initial framework four times up to end-October to extend its applicability (from end-2020 to June 2021, except for equity support which is prolonged until end-September 2021) and ensure adequate coverage of research activities as well as equity support;

[17] "Coordinated economic response to the COVID-19 Outbreak" (COM(2020) 112 final).

[18] "Communication from the Commission - Temporary Framework for State aid measures to support the economy in the current COVID-19" (OJ C 91 I/01, 20.3.2020).

- On 20 March 2020, for the first time, the Commission proposed the activation of **the general escape clause of the Stability and Growth Pact**[19], allowing all Member States to temporarily depart from the budgetary requirements that would normally apply and initiate large-scale fiscal stimuli[20]. The temporary departure from the adjustment path towards the medium-term budgetary objective is allowed, provided that this does not endanger fiscal sustainability in the medium term;

- On 20 May 2020, the Commission **proposed Country Specific Recommendations** (CSRs) within the European Semester that reiterated common policy objectives to mitigate the crisis' severe consequences in the short-term and to relaunch growth in the medium-term. For the first time, these CSRs did not contain fiscal recommendations regarding the adjustment path towards mid-term objectives. Instead, they focused on the immediate crisis support and mid-term recovery through green and digital transitions.

44 Throughout the period, the Commission adopted guidelines to coordinate certain **health security measures** in the areas where the normal functioning of the internal market was affected. For example, the Commission issued guidelines to limit the consequences of border management on the free movement of goods and services (23 March 2020) and on labour (on 30 March 2020). Given national prerogatives on health policies, the Commission did not issue binding rules. In September 2020, the Commission proposed a Council Recommendation to establish a general framework for the coordination and communication of measures restricting free movement[21].

The EU mobilised available funds and created new safety nets for businesses, governments and employees

45 The financial support from the EU has rapidly evolved from **immediate reallocations of funds and mobilisation of flexibility instruments** within the current EU budget to the adoption **of financial safety nets** for business, Members States and

[19] The activation of the "general escape clause", as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn.

[20] Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact (COM(2020) 123 final).

[21] https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1555

employees with the aim of fighting the immediate economic consequences of the crisis.

46 The first measures proposed by the Commission after the outbreak of the crisis consisted of an extension of existing action. These were within the MFF and mainly financed through budgetary reallocations (see also ***Annex III***). By the end of August increases in the 2020 EU budget represented 2.3 % of initial commitment appropriations, exhausting all margins under the ceilings of expenditure of the current MFF. The main actions financed to complement national spending during the crisis were:

- On 13 March 2020 the Commission decided to redirect the ESI funds under cohesion policy for 2020 to the **Coronavirus Response Investment Initiative (CRII)**, with the intention of addressing the most urgent needs related to health care expenditure, support for SMEs and short-term work measures. €8 billion of **pre-financing would not be returned to the Commission** and would provide cash injections to Member States for crisis-related projects. Member States can access the resources by amending their existing operational programmes through a simplified and accelerated process, while in some cases benefitting from some flexibility to reallocate funding directly;
- Also on 13 March 2020, the Commission decided to unlock EUR 1 billion from the European Fund for Strategic Investments (EFSI) to serve as a guarantee to the European Investment Fund (EIF) to support small businesses hit by the economic impact of the coronavirus pandemic. This guarantee is intended to incentivise banks across the EU to provide up to €8 billion of working capital loans to around 100 000 SMEs;
- On 30 March 2020, the EU amended the scope of the **European Union Solidarity Fund** (EUSF) to include major public health-related emergency measures. At that moment, up to €0.8 billion were available for that instrument in 2020. Due to subsequent disbursements for other emergencies, the available amount in 2020 decreased to €0.18 billion;
- On 2 April 2020, CRII was complemented by measures to temporarily allow for more flexible use of **uncommitted ESIFs** (European Structural and Investment Funds) worth €54 billion for COVID-19 related projects ("**CRII+**"). This includes more flexible transfers between funds, thematic objectives and operational programmes, as well as a 100 % EU-cofinancing rate for expenditure, with an estimated impact on payments of €14.6 billion;

- On 14 April 2020 the EU amended the Regulation for the activation of the **Emergency Support Instrument** with a €2.7 billion budget in 2020 to support Member States' response to health crisis, for example through Advance Purchase Agreements with coronavirus vaccines developers.

47 On 16 March 2020, the EIB Group also announced exceptional financing measures:

- **Financing for businesses** by providing €28 billion from existing programmes:
  - **Guarantees for SMEs:** On the basis of €1 billion unlocked from the European Fund for Strategic Investments (EFSI), the EIF would provide €2.2 billion worth in guarantees that aim to mobilise up to €8 billion in financing for at least 100 000 SMEs, through the COSME (the EU programme for the competitiveness of SMEs) and InnovFin programmes[22];
  - **Dedicated liquidity lines for banks:** providing working capital support for SMEs and mid-caps of up to €10 billion;
  - **Dedicated asset-backed securities purchasing programmes:** to allow banks to transfer risk portfolios of SMEs loans, mobilising up to €10 billion.
- **Financing for projects in the health sector** up to €5 billion.

48 As the lockdowns were prolonged and first national economic forecasts started to show the potential impacts, the Euro group proposed a package of emergency **safety nets** on 9 April 2020. It was aimed at supporting public finances, businesses and employment at the same time, thereby fighting the immediate consequences of the crisis. The all-inclusive package worth €540 billion rested on three pillars:

- **Pandemic Crisis Support from the ESM:** temporary instrument worth €240 billion, i.e. half of the ESM's lending capacity, to be used for direct and indirect medical costs related to COVID-19 incurred since February 2020. Access would be limited to 2 % of Member States' GDP as of end-2019;
- **Financing of EU firms through the EIB Group:** €200 billion of financing, backed by a temporary €25 billion Pan-European Guarantee Fund (PEGF) to help companies, especially SMEs facing liquidity shortages. The Member States have to contribute

[22] https://ec.europa.eu/commission/presscorner/detail/en/ip_20_569

to the Guarantee Fund in accordance with their shareholding in the EIB. The EU budget and the ESM are also allowed to contribute;

- **SURE – temporary financial support to mitigate unemployment risks in an emergency:** €100 billion to finance on demand the increase in national public spending on short-time work and similar schemes and, as an ancillary measure, on some health-related measures in particular in the workplace. The instrument would be managed by the Commission and be subject to EU financial rules. SURE takes the form of a lending scheme underpinned by a system of guarantees worth €25 billion granted by Member States to the Union budget.

49 The European Council endorsed the proposal on 23 April and called for the package to be operational by 1 June 2020. The ESM instrument was approved on 15 May by the ESM Board of Governors, including confirmation of eligibility for all euro area countries. Moreover, on 26 May the EIB Board of Directors approved the structure and business approach of the new fund. The SURE Regulation was adopted by the Council on 19 May. However, due to the length of ratification procedures, the PEGF was not operational by August, while SURE was activated on 22 September, after all Member States had signed the guarantees.

With the NextGenerationEU instrument, the EU proposed sizeable financial support for return to sustainable and resilient recovery

50 On 23 April 2020, the European Council decided to work towards establishing a recovery fund to respond to the COVID-19 crisis and tasked the Commission with coming up with a proposal urgently. One month later, the Commission proposed an unprecedented EU temporary fund ("NextGenerationEU") worth €750 billion, following an earlier Franco-German proposal (18 May), together with a modified proposal for MFF 2021-2027 to take account of the socio-economic consequences of the crisis. It was agreed by the European Council, with several important changes, on 21 July 2020. Together with the MFF 2021-2027, the agreement proposes an overall €1 824.3 billion in EU support for Member States.

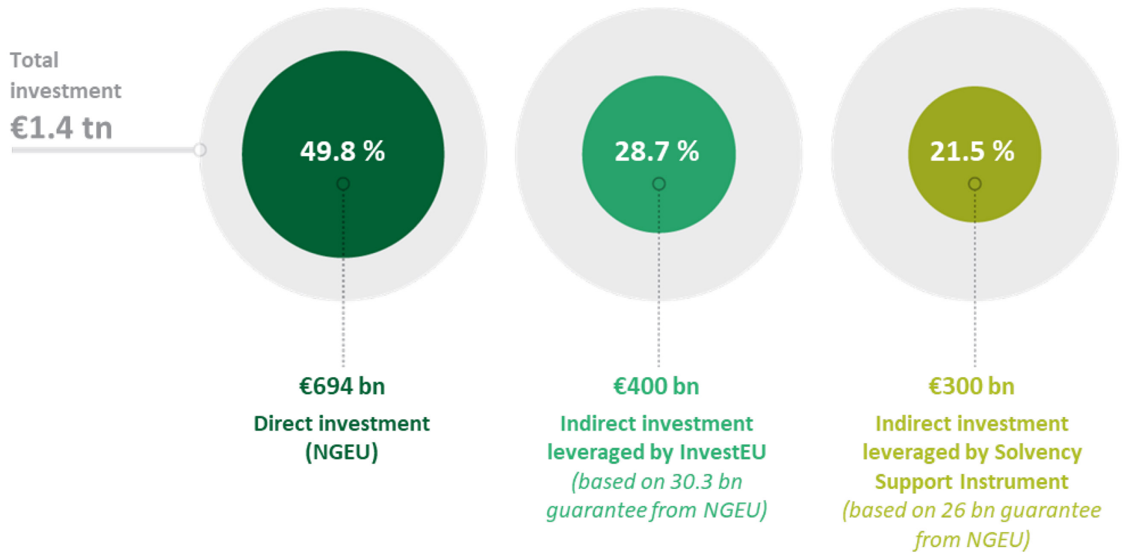
51 The NGEU will provide financing for a number of programmes that will support the recovery process. The centrepiece is the Recovery and Resilience Facility (RRF). The RRF is aimed at supporting the recovery of Member States' economies, and tackling the effects of the pandemic crisis, through coordinated investments and structural reforms with a focus on convergence and green and digital transitions streamlined across all policy domains. As for SURE and EFSM (created during the sovereign debt crisis), the legal basis for NGEU is Article 122 TFEU that allows for targeted financial assistance in exceptional crisis situations, such as natural disasters.

NGEU - expected impacts

52 The Commission estimates[23] that the impact of NGEU is likely to be considerable for the EU-27 economy:

- It could increase (private and public) investment by €1.4 trillion over 2021-2022 (see ***Figure 18***) and hence fill the expected investment gap opened up by the crisis over the period 2020-2021, as follows:
  - Most of the funds (about €700 billion) are to directly finance investments;
  - Specific provisioning for guarantees (about €56 billion) to two programmes (InvestEU and the Solvency Support Instrument) are to leverage private investment up to €700 billion.
- Because of the investment mobilised, the Commission estimates that the level of GDP in the EU-27 will be around 2 % higher in 2024 than current forecasts.

Figure 18 – Potential investment generated by the NGEU over 2021-2022



Source: ECA calculations based on Commission proposal.

[23] "Identifying Europe's recovery needs" (Commission staff working document, SWD(2020) 98 final).

NGEU - scope and composition

53 NextGenerationEU is intended to achieve some of the following innovative approaches:

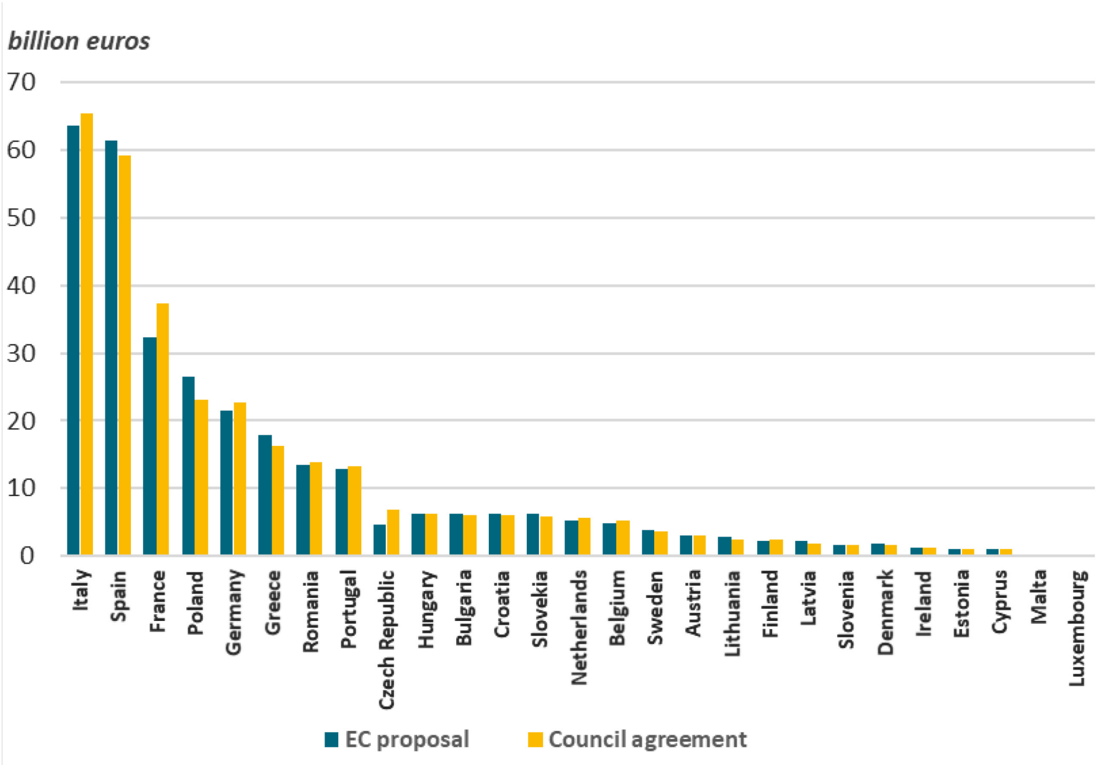
- **A much larger role for the EU** - the temporary instrument will almost double the amount of the EU long-term budget for the period 2021-2027;
- Support through **diversified financial support** (grants, loans, provisions for guarantees) **and programmes** managed directly or indirectly by the Commission or under shared management (see ***Annex IV***);
- According to the European Council agreement, nearly 90 % of the recovery instrument funding will be allocated to a novel facility (RRF) to be disbursed subject to certain conditions related to **reforms and investments** that tackle national challenges identified within the **European Semester**;
- **Frontloaded support for a rapid impact:** up to 70 % of the RRF non-repayable support will have to be committed in 2021–2022 and the rest in 2023, according to the European Council agreement. Moreover, the European Council agreed to finance **retrospective expenditure** relevant to RRF objectives starting from February 2020;
- A**llocation** keys for new programmes funded under NGEU (RRF, REACT-EU) reflecting their specific purpose and different from those for ESIFs;
- A different financing approach through borrowing on the **capital markets**. For the first time, the EU will borrow to finance non-repayable support.

54 Given the urgency and exceptional circumstances, the Commission proposal was not subject to an impact assessment or stakeholder consultation but was accompanied by a staff working document identifying EU recovery needs. It remains unclear how the proportion of grants to loans was established and reconciled with the objectives of the fund. After negotiations on the composition of the package, the European Council agreed to reduce the share of non-repayable support in the package (from the €500 billion initially proposed to €390 billion), offset by an increase in the level of loans from €250 billion to €360 billion.

Allocation of the RRF

55 The criteria used for **allocating the RRF funds to Member States** differ from those used in other major MFF programmes. For loans, the maximum ceiling depends on GNI and should not exceed 6.8 % (European Council proposal). For non-repayable support, the allocation depends on convergence indicators such as population, GDP per capita and the unemployment rate. Following a proposal of the European Council, in the allocation key for the year 2023, the unemployment criterion is replaced by the loss in real GDP observed over 2020 and by the cumulative loss in real GDP observed over the period 2020-2021. The change concerned 30 % of the grants (see ***Figure 19***). This reflects the dual objective to tackle the socio-economic impact of the pandemic and address structural challenges that hamper growth and job creation.

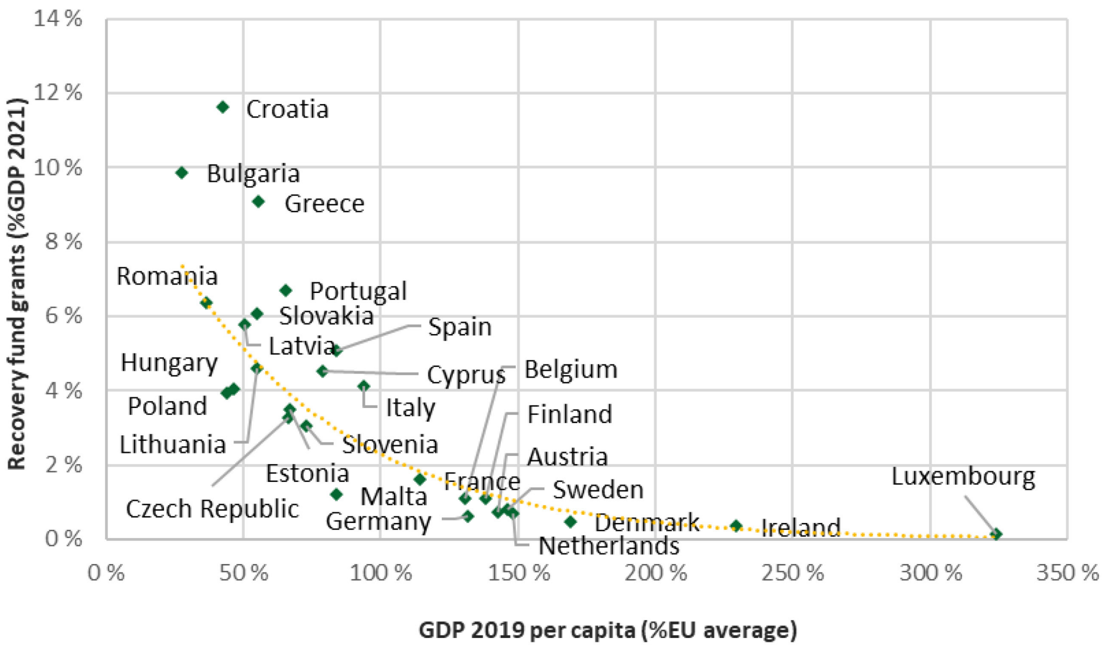
Figure 19 – Estimated non-repayable support allocation under the RRF



Source: ECA calculation based on allocation keys.

56 The estimated allocation of funds mostly reflect indeed pre-crisis economic weaknesses and convergence levels within the EU (see ***Figure 20***). The allocation of funds to Member States calculated with either of the two methods also indicates that the same three largest recipients (Italy, Spain and France) should receive cumulatively about half of the total volume of grants (using current projections of GDP development in 2020-21). They are also expected to suffer substantial decreases in GDP during the crisis (see ***Figure 20***).

Figure 20 – Relationship between allocation of RRF grants and GDP convergence level



Source: ECA calculations based on Commission data on GDP and European Council agreement on the allocation of RRF and REACT-EU by countries.

57 The effective allocation of the funds will depend on the Member States' capacity to meet the conditionality of the RRF. In order to get access to RRF funding, Member States will have to prepare national Recovery and Resilience Plans (RRPs) setting out **their reform and investment agendas** for the years 2021-23 and to submit them to the Commission by 30 April. The Commission established a "Recovery and Resilience Task Force" on 16 August 2020 to steer the implementation of RRF and coordinate it with the European Semester[24] and set out guidance on the drafting of RRPs[25]. The plans will have to be adapted as necessary in 2022 to serve as a basis for the final allocation of funds in 2023. The plans will be assessed by the Commission (and approved by the Council) and the disbursement of funds will be subject to successful implementation of the milestones in the plans. Higher absorption of RRF loans may also depend on differences between respective sovereign bond yields and interest cost of the RRF borrowing.

[24] https://ec.europa.eu/info/departments/recovery-and-resilience-task-force_en

[25] https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1658

Financing the NGEU

58 The NGEU will be financed through the **capital markets**. The Commission will be authorised to borrow funds on behalf of the European Union strictly limited to the amount of €750 billion (in 2018 prices). This allows the EU to mobilise large resources in a short period of time, without increasing national public debts during the crisis.

59 The grants component of the NGEU will have to be repaid between 2028 and 2058 at the latest through future EU budgets. At the time of writing this review, there are uncertainties and debates regarding the design of **new own resources** to facilitate the repayment of EU obligations.

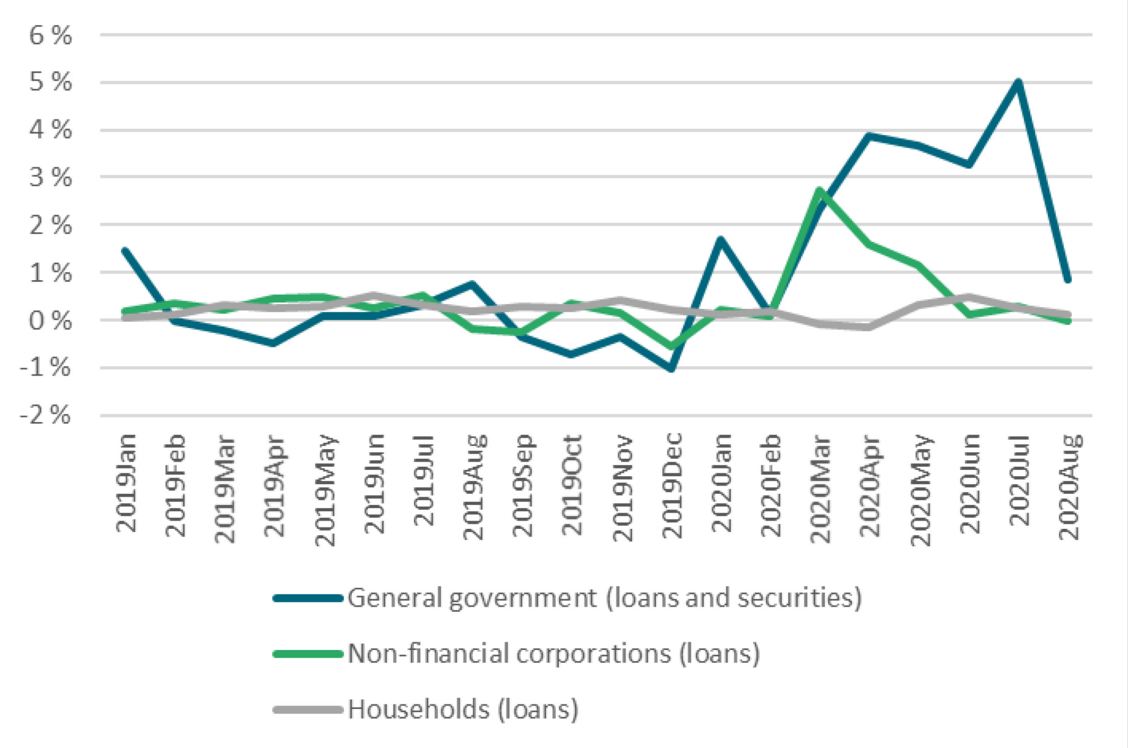
Some financial measures were not implemented or have not yet reached final beneficiaries

60 The ECB's market interventions have had immediate stabilising effects on the financial markets. In particular, euro area government spreads stabilised at lower levels than the peaks reached in mid-March, following the announcement of the ECB emergency plan[26]. Moreover, banks have also benefited from relaxed monetary funding, a temporary easing of certain EU capital requirements and loan guarantees granted by governments. As a result, the loans of euro area monetary financial institutions (MFI) to non-financial corporations and governments have increased by large growth rates since February 2020 (see ***Figure 21***). However, most of the credit provided to businesses was aimed at financing working capital, while credit for fixed investment has been decreasing[27].

[26] ESMA Report on Trends, Risks and Vulnerabilities No 2 (September 2020), p. 17.

[27] https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200714~d6b166d17c.en.htm

Figure 21 – Monthly growth rates of euro area MFIs' loans



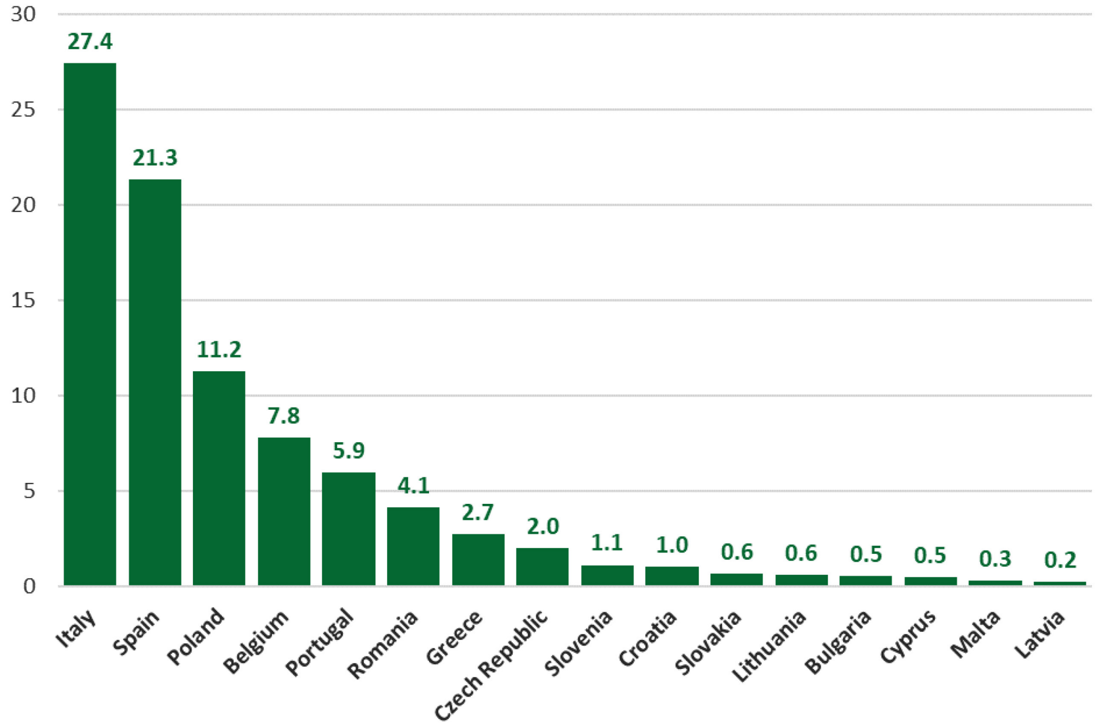
Source: ECA calculations based on ECB data (BSI dataset).

61 Unlike financial policy interventions, the uptake of other new EU measures has generally been modest but different for each of the instruments, reflecting their different conditions and procedures. From the status of absorption (see ***Annex V***), it is clear that swift decision making does not necessarily translate into immediate funding support – absorption depends on the nature and structure of the support instrument, and the capacity of Member States to use these funds in accordance with the procedures and conditions which apply for eligibility to use the funds. In particular, the ESI funds are not designed to react swiftly to a crisis, unlike an insurance fund or a fiscal automatic stabiliser. Nevertheless, some of the regulations have been adapted to increase the speed of the response, including benefitting from retroactive eligibility as of 1 February 2020 (under CRII and CRII Plus packages).

62 The implementation of crisis-related EU lending operations is ongoing. The EIB approved or signed COVID-19 loans for €18.1 billion (see ***Annex VI***) and the recently agreed guarantee fund managed by the EIB became operational at the end of August 2020 after the completion of all legal procedures. No SURE financing has been disbursed by the end of August. However, in September 2020 the Council adopted first financing decisions for 16 Member States that used nearly 90 % of the budget. Through SURE loans, the EU can pass on favourable interest rates for those Member States with large public debt (such as Italy, Spain and Belgium), but also for those with a small local debt market. This can be seen from the set of Member States which requested SURE support (see *Figure 22*).

Figure 22 – SURE approved loans for short-time work schemes

billion euros



Source: Council Implementing Decisions (September 2020).

63 The NGEU instrument had not yet been adopted at the time of completing our review. Agreement between EU leaders has opened the way to formal negotiations between the European Parliament and the Council on the size and composition, and on the details of the different regulations governing the programmes financed through NGEU. Moreover, the Own Resources Decision linked to the financing of the EU budget through NGEU needs to be ratified by all Member States according to their constitutional requirements and NGEU will therefore not be implemented before 2021.

The crisis triggers new risks, challenges and opportunities for EU economic coordination

64 COVID-19 economic policy response involves a wide range of measures at national and EU levels, triggering risks, challenges and opportunities for EU economic coordination and integration for two reasons. First, the pandemic may generate risks of economic divergence on different dimensions of Member States' economies. Second, the EU's response to the emerging difficulties in Member States entails challenges and opportunities for the EU's economic governance to design and implement appropriate measures that ensure steady economic convergence within the EU.

Risks stemming from uneven economic developments in Member States

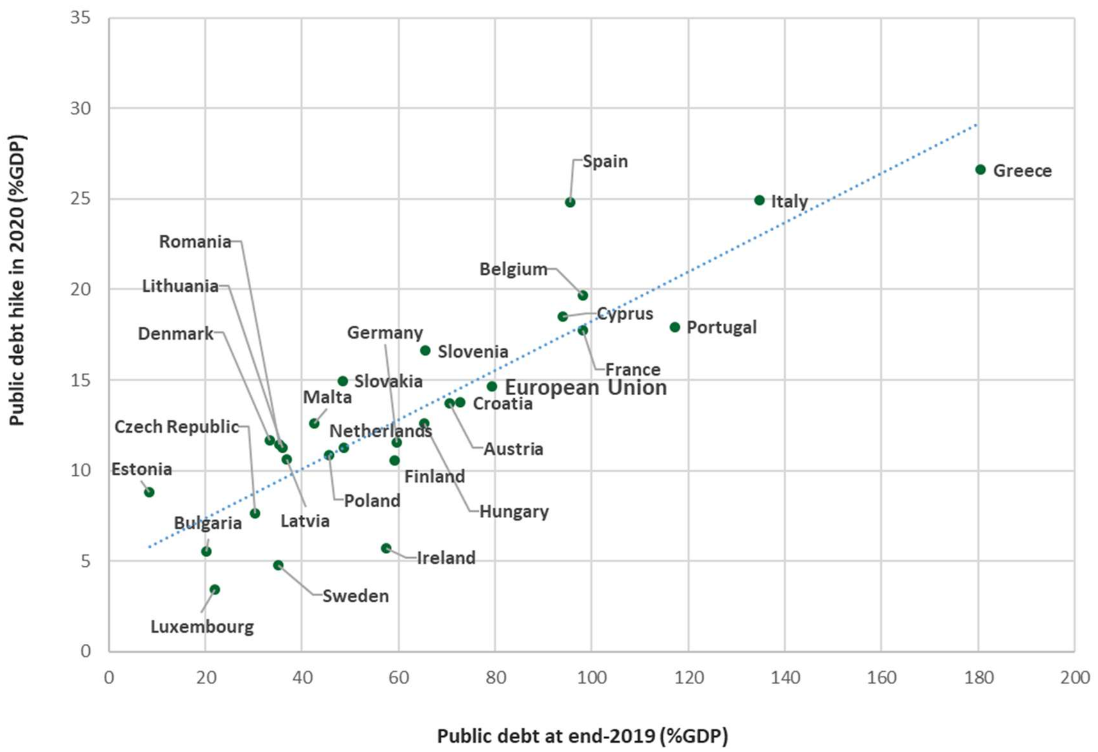
65 The effects of the pandemic and national crisis-specific policies may raise **risks of economic divergence** within the EU and **low growth perspectives** stemming from:

- Fiscal divergence;
- Competition distortions of state aid measures;
- Large and persistent unemployment;
- Low investment.

66 The pandemic may amplify **fiscal divergence** between Member States: the Commission forecasts higher debt rises in 2020 in the countries which already had larger public debts before the crisis (see ***Figure 23***). This is particularly due to the amplified effect of GDP losses on debt ratios in high-debt countries (see ***Annex VII***). For example, the impact of GDP losses on debt ratios is the highest in Greece, Italy and Spain, and these countries are also expected to suffer some of the largest GDP contractions in 2020. The Commission has recently assessed that public debt position remains sustainable in all euro area Member States but projections are surrounded by particularly large uncertainties[28].

67 Growing public debts and concerns about their sustainability may subsequently constrain fiscal firepower to react to other crises, finance long-term growth and economic convergence within the EU and contribute to EU strategies. Hence, the new EU action plans to invest in climate and digital transitions may face new national financing constraints. So far, the massive fiscal measures taken during the crisis have aimed at mitigating the immediate short-term effects of the pandemic (see paragraph ***29***) but have not financed recovery strategies.

Figure 23 – Relation between pre-crisis public debts and forecast debt growths in 2020



Source: ECA calculations based on Commission data (autumn 2020).

68 The Commission assessed that the full functioning of the **single market** is key to boosting post-pandemic recovery[29]. Data on fiscal measures shows that certain

[28] https://ec.europa.eu/info/sites/info/files/economy-finance/annex_2_debt_sustainability.pdf

[29] https://www.consilium.europa.eu/media/43384/roadmap-for-recovery-final-21-04-2020.pdf

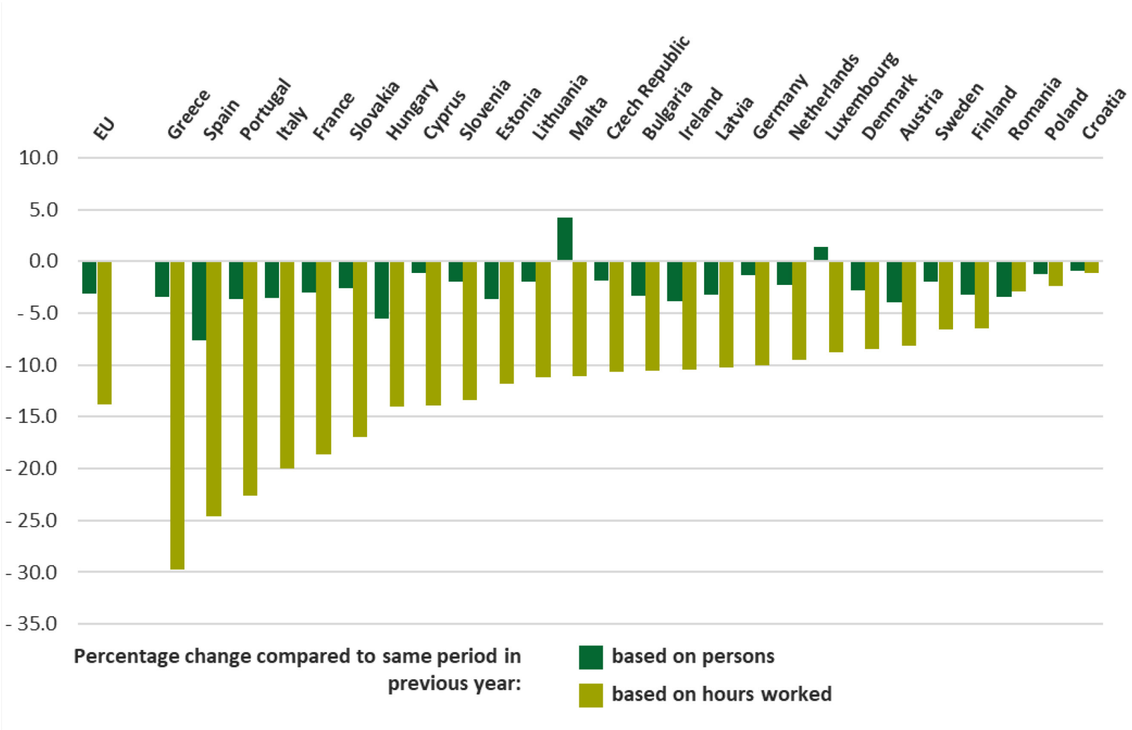
Member States have adopted relatively larger packages of state aid (see paragraph ***30***). Depending on their duration and degree of implementation, divergent national reactions to the crisis (massive state aid, confinement measures) may persistently distort the level playing field in the single market and pose challenges for economic convergence and competitiveness in the EU.

69 Current **employment** support measures mitigate short-term unemployment risks (see paragraph ***34***) but they do not take into account developments in the viability of businesses. A subdued recovery and persistent risks to public health may lead to structural demand shifts and insolvency problems for an increasing number of businesses, despite job retention schemes. Recent considerable falls in total hours worked in the EU economy by about 15 % in the first half of 2020 compared to the same period of the previous year (see ***Figure 24***) point to potentially large growths of unemployment and divergent impacts across Member States.

70 Previous experience with job retention schemes during the global financial crisis shows that prolonged use risks supporting declining businesses, eventually delaying restructuring and holding back productivity growth[30]. The timely introduction of new types of fiscal measures to finance active labour market policies (such as training, reskilling) may be required to support the necessary reallocation of resources in the economy.

[30] "Short-time working arrangements as response to cyclical fluctuations" (Occasional Paper, Commisison, 2010).

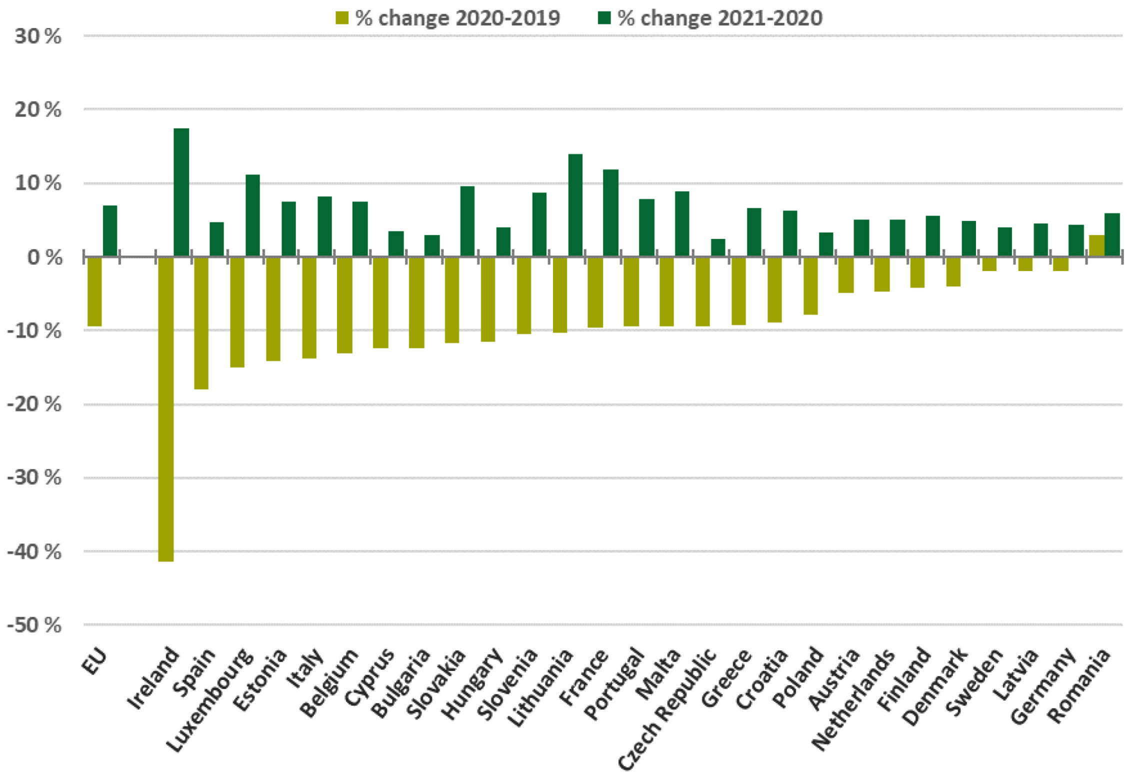
Figure 24 – Total employment changes as of end-June 2020



Source: Eurostat data.

71 A high degree of uncertainty related to economic prospects, falls in businesses' revenue and growing corporate debts during the pandemic may hold back private **investment**. Current forecasts show falls in investment in 2020 comparable to those experienced during the financial crisis (2008-2013) and that there is a wide variation in the fall in investment expected this year, which may contribute to the risk of increasing economic divergence in the EU (see ***Figure 25***). An investment gap that persists over the years risks contributing to low long-term growth. The lack of public investment may amplify such risks; it has not been a priority for the national fiscal responses to the crisis so far (see paragraph ***36***).

Figure 25 – Gross fixed capital formation in private sector (percentage change)



Source: ECA calculations based on Commission data (autumn 2020).

Challenges for current economic and fiscal policy coordination frameworks

72 The EU has shown agility in applying the flexibility of its economic coordination (e.g. suspension of fiscal rules and temporary changes to state aid rules). This was necessary to allow Member States to adopt quick and customised reactions to the evolving crisis. However, the extraordinary relaxation of key rules, even if temporary, may challenge the **capacity of the European Union to coordinate** national economic policy responses during the crisis and the recovery.

Challenges for EU fiscal coordination

73 Member States' massive fiscal response to the crisis triggers challenges for future EU coordination of fiscal policies:

- Growing fiscal debts and risks (see paragraph ***66***) could render the return to current **EU fiscal rules** more difficult. Even during the pre-crisis growth period, certain Member States did not fully comply with them[31]. A future challenge for the EU's governance will be how to design a return to current or new rules that does not hamper either Member States' post-pandemic recoveries or debt sustainability. The solution can build on the current Commission review of EU economic governance[32].

- Moreover, the activation of the "**escape clause**" (see paragraph ***43***) allowed national fiscal policies to respond to the crisis in a flexible way but without any EU coordination. It did not clarify certain operational aspects (e.g. indications of the timing of and conditions for exit or review)[33], which may hamper the coordination of medium-term fiscal targets.

Challenges for EU coordination of employment policies

74 Coordination of national employment policies is an EU competence within the framework of the European Semester. Employment was a priority under the previous EU economic strategy ("Europe 2020") and is part of the current EU strategy for sustainable development[34] and of the Commission's political guidelines for 2019-2024. The crisis poses risks for the effective functioning of EU labour markets (see paragraph ***69***). The challenge is for the Commission to monitor them and design appropriate CSRs and EU financing to coordinate timely national responses to rises in unemployment, for example SURE (see paragraph ***48***).

Challenges for EU competition policy

75 With regard to coordination of **the internal market**, the Commission adopted a legal framework that is aimed at providing objective criteria for the design of national state aid schemes and conditions to limit distortions to competition, especially for undertakings with significant market power (see also paragraph ***43***). However, the size of the state aid schemes adopted differed across Member States, and, depending on the level of uptake, they may un-level the playing field between companies in the internal market (see paragraph ***68***). The Commission will face a major challenge in

[31] ECA special report 18/2018: "Is the main objective of the preventive arm of the Stability and Growth Pact delivered?"

[32] "Communication on the Economic Governance Review" (Commission, February 2020).

[33] "Assessment of the fiscal stance appropriate for the euro area in 2021" (European Fiscal Board, 1 July 2020).

[34] https://ec.europa.eu/info/strategy/international-strategies/sustainable-development-goals/eu-approach-sustainable-development-0_en

monitoring market developments and substantial volumes of state aid. The Commission had already used this type of framework during the financial and sovereign debt crisis[35] and we noticed that state aid rules applied by the Commission to the financial sector were not adapted to changing market realities and regulatory frameworks[36].

76 Moreover, as long as confinement measures and border controls continue to challenge the functioning of the single market and fundamental European freedoms such as cross-border free movement of goods and citizens, the Commission is playing and will continue to play an important role in defending such freedoms, by checking the proportionality of national measures (see paragraph ***44***).

Challenges for EU surveillance of the financial sector

77 **The banking system** is better placed to withstand the shock than in 2008[37], even though some Member States still face relatively high levels of non-performing loans (NPLs). First indications show that it provided exceptional liquidity to the economy (see paragraph ***60***). NPLs are expected to increase sharply as a consequence of the economic shock and growing unemployment, which creates greater risks of future banking crises[38]. The Commission, the ECB and EU financial authorities (ESRB, EBA, ESMA, EIOPA, SRB) will be playing a challenging role in monitoring the financial risks and/or adopting appropriate mitigation measures while preserving the credit flow to the economy.

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[35] "Communication from the Commission - Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis" (OJ C 16/01, 22.1.2009); "Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis" (OJ C 329/07, 7.12.2010).

[36] ECA special report 21/2020 "Control of State aid to financial institutions in the EU: in need of a fitness check".

[37] ECA review 5/2020 "How the EU took account of lessons learned from the 2008-2012 financial and sovereign debt crises".

[38] https://www.ecb.europa.eu/pub/financial-stability/fsr/html/ecb.fsr202005~1b75555f66.en.html#toc22

EU recovery instrument: new opportunities, risks and challenges

78 The proposed NGEU entails new risks, challenges and opportunities for the EU coordination of economic policies and the sound financial management of EU funds:

- Financial adequacy risks;
- Implementation risks;
- Monitoring risks;
- Accountability risks;
- Challenges for the financial risk management;
- Opportunities for strengthened EU economic coordination.

Financial adequacy risks

79 The NGEU instrument is financially significant and will provide funding for a number of key programmes and thematic areas. However, during the course of negotiations several other ambitious ideas for support in specific areas were not supported by the European Council. As a prominent example, the European Council's agreement on the NGEU excludes the Commission's proposed instrument to support **businesses' equity** (SSI), without any alternative envisaged (see ***Annex IV***). There is a risk that:

- no appropriate solution is found to alleviate the excess leverage that an increasing number of businesses may face during the current crisis. Therefore, there is a risk of massive bankruptcies and/or hostile takeovers by foreign competitors that may undermine the proper functioning of the single market and the competitiveness of the EU;
- the target of the Commission proposal to finance €1.4 trillion in investment may be missed as the SSI was designed to leverage up to €300 billion investment.

80 The effectiveness of NGEU will also depend on **its size in relation to the duration and impact of the pandemic**. Although significant, the new financial packages are based on the Commission's spring forecasts that had major downside risks[39]. If the

[39] "European Economic Forecast – Spring 2020" (Commission), p. 68.

risks materialise, the estimated impact of the instrument, its amount and/or structure may need to be reassessed accordingly.

Implementation risks

81 The effectiveness of the NGEU and next MFF in mitigating the impacts of the COVID-19 crisis on growth and convergence is not guaranteed. It will depend crucially on the features of implementation, in particular:

- **Timely availability of funds**, which depend on factors such as swift ratification of the Own Resources Decision by Member States; swift adoption of the new long-term budget and sectoral legislation; the Commission's capacity to steer the implementation of the projects rapidly and smoothly.
- **High absorption**, as the NGEU can only produce the desired impacts if Member States can absorb the funds. However, high absorption is at risk. Already in the previous programming period of the European cohesion policy, we identified considerable absorption problems: some of the Member States with the lowest absorption in the current programming period are likely to get substantial support from the RRF[40].
- **Quality of spending and of reforms**, in particular Member States' strategies and capacities to seize the growth-enhancing opportunities offered by the new EU financing channels. There is a risk that Member States will not be willing or able to implement ambitious reforms or investments. In 2019, the Council reiterated the need for further structural reforms to remove bottlenecks to investment[41]. In the framework of the European Semester, we observed low rates of implementation of CSRs and that the effectiveness of the European Semester depended on the level of national ownership and commitment by Member States to implement CSRs within reasonable timeframes[42].

82 The objectives of the RRF are common to other EU programmes, which has advantages in terms of complementarity and synergy. However, it increases the risk of **double funding** and competition between different programmes. The ECA suggested

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[40] ECA opinion 6/2020 on Recovery and Resilience Facility.

[41] "Council conclusions on In-depth reviews and implementation of the 2018 Country Specific Recommendations" (3 May 2019).

[42] ECA special report 16/2020 "The European Semester – Country Specific Recommendations address important issues but need better implementation".

that the RRF should include suitable mechanisms to ensure coordination with other sources of EU funding and to ensure additionality[43]. The Commission guidance to Member States[44] requires appropriate arrangements to ensure that the demarcation between the different instruments will be respected throughout the implementation of the recovery and resilience plans and double funding will be excluded at all times.

Monitoring risks

83 We have recently pointed out a number of weaknesses related to the functioning of the European Semester, for example the selection and prioritisation of CSRs and cases where National Reform Programmes submitted by Member States do not clearly link their proposed measures with CSRs or broader EU objectives[45]. These points are relevant also for the plans put forward by the Member States in relation to the RRF, which should explain how they intend to use the funds to address EU priorities and the CSRs[46]. There is therefore a risk that the RRPs, being a basis for the disbursement of the RRF, will not feature sufficiently **clear national strategies and ambitious objectives**. Unlike the National Reform Programmes, those plans will have to be endorsed by the Commission and Council, which should mitigate such risks.

84 Moreover, while milestones and targets have to be set at Member State level in their RRPs, we have pointed out that the proposed regulation does not contain any **common result indicators** and EU level targets[47]. This would facilitate better monitoring, measurement, evaluatation and audit of the implementation of the RRF at EU level, and guide Member States in using their resources more effectively to achieve EU goals. In its Communication on the 2021 Annual Sustainable Growth Strategy[48], the Commission provided a number of EU indicators and targets in its seven European flagships. In its guidance to Member States, the Commission invited Member States to explain which parts of the RRP contribute to such flagships.

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[43] ECA opinion 6/2020 on Recovery and Resilience Facility.

[44] Commission staff working document – Guidance to Member States for recovery and resilience plans, 17.9.2020 SWD(2020) 205 final.

[45] ECA special report 16/2020 “The European Semester – Country Specific Recommendations address important issues but need better implementation”.

[46] “Guidance to Member States on Recovery and Resilience Plans – Part 2” (SWD(2020) 205 final).

[47] ECA opinion 6/2020 on Recovery and Resilience Facility.

[48] “Annual Sustainable Growth Strategy 2021” (COM(2020) 575 final).

Accountability risks

85 The crisis measures will bring new risks for the EU's financial management, and consequently for audit and public accountability. The ECA has reported that instruments outside the EU budget do not have adequate provisions with regard to accountability to citizens for the results of implementing EU policies[49]. The initial financial initiatives (CRII and SURE) are designed to comply fully with EU financial regulations.

86 The more recent RRF is not an ESI fund and hence it takes a different approach to accountability. In our opinion on the RRF[50], we highlight some important considerations with respect to the **audit and accountability provisions of the RRF** (see ***Annex VIII***). We stress in particular the need for close monitoring based on verifiable indicators and targets, clear parliamentary scrutiny and clear audit rights. High standards of accountability and comprehensive audit arrangements may also contribute to the effectiveness of the facility .

Challenges for the financial risk management

87 The new crisis instruments (SURE, NGEU) entail large scale **borrowing and lending operations** (see paragraphs ***48***, ***58***). While this is as such not a new activity for the Commission, it will face the challenge of scaling up its administrative capacities in a short period of time to ensure the sound management of larger transactions in capital markets than ever before, including bond issuance and the management of financial risks (such as interest rate risk, credit risk, fraud risk).

88 The Commission's borrowings will finance both grants and guarantees (NGEU) and loans (NGEU, SURE). The loans have to be repaid by the Member States and hence do not require additional EU resources, unless the EU budget guarantee is called in the event of a default. There is currently no proposal for a formal mechanism (such as post-programme surveillance[51] in the case of the lending from the EFSM and the ESM) to monitor Member States' repayment capacity for such loans.

89 The grants component will be repaid directly from the EU budget after 2027 and by 2058 at the latest. To meet these obligations, the European Council agreed to

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[49] "Future of EU finances: reforming how the EU budget operates" (ECA, Briefing Paper, February 2018), paragraph 26.

[50] ECA opinion 6/2020 on Recovery and Resilience Facility.

[51] Regulation (EU) No 472/2013.

transfer exceptional national contributions up to 0.6 % of respective GNI to the EU budget per year until the borrowed amounts are fully repaid. The European Council agreed to create a new own resource based on non-recycled plastic waste and to explore the introduction of other **new own resources** in future (e.g. carbon border adjustment mechanism or a digital levy), but the details will need to be clarified in the future proposals of the Commission. The introduction of new EU own resources is an opportunity to reduce pressure on national and EU budgets and the impact of any political risks on the integrity of EU revenues. New sources of revenue can also contribute to EU priorities such as climate action and sustainable development.

An opportunity for strengthened EU economic coordination

90 EU's economic strategies, such as green and digital transitions, single market action plan[52]and industrial strategy[53] (recently adopted) can steer post-pandemic recovery, boost investment and act as leverage to lift long-term economic growth path of EU economies. We note that anchoring the proposed RRF to the European Semester is aimed at **coordinating national recovery strategies** and effectively aligning them with the EU's economic strategies. It may incentivise Member States to spend the additional funding on structural reforms and investment with high impact on long-term growth. The Commission has proposed that clear milestones and verifiable progress criteria should be included in the RRPs, which should be subject to thorough monitoring during the implementation phase.

91 The design of the RRF also creates the opportunity to generate a **rapid impact** on economic recovery. In particular, the possibility to frontload the funds and different spending rules (see paragraph ***53***) reverses the hitherto prevailing logic of EU-budget spending, which typically increased towards the end of the financial framework period due to the lengthy process of programming and project preparation. The new logic - based on policy milestones - may contribute to the recovery shortly after the economic shock if the implementation of milestones and targets is not subject to major delays.

92 The previous financial and sovereign crises in the EU triggered substantial reforms of EU financial rules (single rule book, Single Supervisory Mechanism, European System of Financial Supervisors) or led to reinforced or new mechanisms of economic coordination ("six-pack", "two-pack", European Semester, macro-imbalance

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[52] https://ec.europa.eu/info/sites/info/files/communication-enforcement-implementation-single-market-rules_en_0.pdf

[53] "A New Industrial Strategy for Europe" (COM/2020/102 final).

procedure) or new types of macro-financial assistance available to Member States (ESM, EFSM)[54]. However, the EU financial assistance available (EFSM, balance-of-payments facility) was not used during the pandemic crisis, as it was designed to address different types of crisis and to correct economic imbalances.

93 While EU fiscal rules are in place, the ongoing crisis tends to aggravate previous fiscal divergence trend (see paragraph ***66***) and re-opens the debate on the need for common macroeconomic stabilisation tools in the monetary union[55]. The Eurogroup recommitted to continue the work to further strengthen the architecture and resilience to shocks of the monetary union[56]. The COVID-19 crisis may provide the opportunity to look again at initiatives intended to strengthen economic co-ordination in the euro area, proposed prior to the outbreak of the pandemic (see ***Annex IX***).

94 The current crisis has different impacts and causes but also offers the opportunity to reflect on further improvements to the **financial capacity of EU institutions** to react rapidly to major economic shocks in order to mitigate potential economic divergence across its Member States driven by such shocks. The evolution of EU measures during this crisis has shown that the EU budget was not adapted to the scale of Member States' needs (see in particular paragraphs ***41***, ***46***, ***61***). The NGEU and SURE are temporary but may test the need for the establishment of such permanent stabilisation instruments.

This review was adopted by Chamber IV, headed by Mr Alex BRENNINKMEIJER, Member of the Court of Auditors, in Luxembourg on 24 November 2020.

For the Court of Auditors

Klaus-Heiner LEHNE
President

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[54] ECA review 5/2020 "How the EU took account of lessons learned from the 2008-2012 financial and sovereign debt crises".

[55] "Assessment of the fiscal stance appropriate for the euro area" (European Fiscal Board, July 2020).

[56] "Statement on COVID-19 economic policy response" (Eurogroup, 16 March 2020).

Annexes

Annex I – Variation of GDP losses across countries during the pandemic: a statistical explanation

No weights

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.049077	0.055015	0.892075	0.3830
TOURISM1	-0.730315	0.328399	-2.223861	0.0378
STRINGENCY	-0.360840	0.129799	-2.779996	0.0116
R-squared	0.430685	Mean dependent var		-0.112609

GDP weights

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.000870	0.000337	2.578985	0.0179
TOURISM1_Y	-1.805882	0.258049	-6.998202	0.0000
STRINGENCY_Y	-0.331146	0.009569	-34.60612	0.0000
R-squared	0.983588	Mean dependent var		-0.005994

Population weights

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.000939	0.000471	1.992262	0.0602
TOURISM1_P	-1.526311	0.328663	-4.644001	0.0002
STRINGENCY_P	-0.325346	0.014576	-22.32012	0.0000
R-squared	0.964087	Mean dependent var		-0.006027

Note: For the three cross-country regressions, the dependent variable is the decline of GDP volume in the second quarter of 2020, year-on-year (Eurostat data). The explanatory variables found significant are: the Stringency Index from Oxford University[57], tourism share in total employment (Eurostat data). The regressions are specified under three alternatives to validate the robustness of the results: While the countries receive an identical weight in the unweighted regressions, the large countries are more important in the (GDP and population) weighted approaches.

[57] https://covidtracker.bsg.ox.ac.uk/

Annex II – Main EU economic reactions (March-August 2020)

MARCH

12 ECB decides to conduct additional longer-term refinancing operations (LTROs) to provide liquidity to banks and an additional asset purchase programme worth €120 bn valid until the end of 2020 in response to stress in financial markets. ECB decides to allow euro area banks to operate temporarily below certain capital requirements.

13 Commission adopts Guidelines on coordinated economic response to the COVID-19 Outbreak.

16 EIB Group announces measures from existing programmes to mobilise up to €40 bn to finance health-related actions and crisis-hit businesses, to be partly guaranteed by EU budget.

18 ECB decides to launch a temporary Pandemic Emergency Purchase Programme (PEPP) with an enveloppe of €750 bn.

19 Commission adopts Temporary Framework based on art. 107(3)(b) of TFEU to enable governments to support businesses during the crisis (through grants, guarantees, subsidised loans, recapitalisations).

23 The Council endorses the Commission proposal to activate the "general escape clause" of the EU fiscal rules.

30 Adoption of amendments to ERDF Regulation and Common Provision Regulation to provide flexible use of EUR 37 bn cohesion funds to finance crisis-related actions in areas most in need.

APRIL

09 Eurogroup in inclusive format agrees to create three financial safety nets worth €540 bn to be managed by the ESM, the EIB Group and the Commission.

17 Adoption of an EU amending budget 2020 with additional €3 bn for Emergency Support Instrument and civil protection mechanism.

30 ECB decides to conduct Pandemic Emergency Longer-Term Refinancing Operations (PELTRO) between May and December 2020 in order to provide liquidity to banks.

MAY

27 Commission proposes a EU recovery fund ("Next Generation EU") worth €750 bn.

JUNE

04 ECB decides to increase the envelope of PEPP by €600 bn and to extend the horizon of PEPP to at least the end of June 2021.

JULY

21 European Council agrees on a EU recovery fund ("Next Generation EU") worth €750 bn.

Annex III – COVID-19-related changes to EU budget 2020 as compared to initial budget

MFF Heading	Redeployment	Commitment allocations reinforced	Payment allocations reinforced
Competitiveness for growth and jobs	1.7		
Economic, social and territorial cohesion	54		22.6
Of which: *CRII* *CRII+*	 *54*		 *8* *14.6*
Sustainable growth: natural resources	0.1		0.7
Security and citizenship		3	
Of which: *Emergency Support Instrument*		 *2.7*	
Global Europe	11.5	0.1	
Special instruments outside MFF ceilings (EUSF)	0.2		
Total commitment appropriations	**67.5**	**3.1**	
Total payment appropriations			**23.3**

Note: data in billion euros as of end August 2020.

Source: Commission.

Annex IV – Amounts available under the NGEU

01 Most of the NGEU funds are concentrated on supporing **cohesion and economic convergence**:

- **€672.5 billion for the Recovery and Resilience Facility** (agreed by the European Council): represents the key novel instrument of the NGEU, which will offer large scale financial support for investments and reforms that restore the growth potential of the economies, address challenges identified in the context of the European Semester, and contribute to implementing EU green and digital strategies;

- **€47.5 billion for the REACT-EU programme** (agreed by the European Council): consisting of cohesion grants to be allocated to Member States based on the severity of the economic crisis.

02 **€30 billion grant support** (agreed by the European Council) will reinforce the MFF Headings "Single Market, Innovation and Digital" and "Natural Resources and Environment":

- **A reinforcement of MFF allocation to InvestEU:** the programme is the successor of EFSI and aims to continue to support strategic investments. The European Council reduced the proposed allocation for guarantees from the initial €31.2 billion to €5.6 billion, whereby its economic impact will be more limited. The proposed 'Strategic Investment Facility' under Invest EU that aimed to promote the new EU industrial strategy was not agreed;

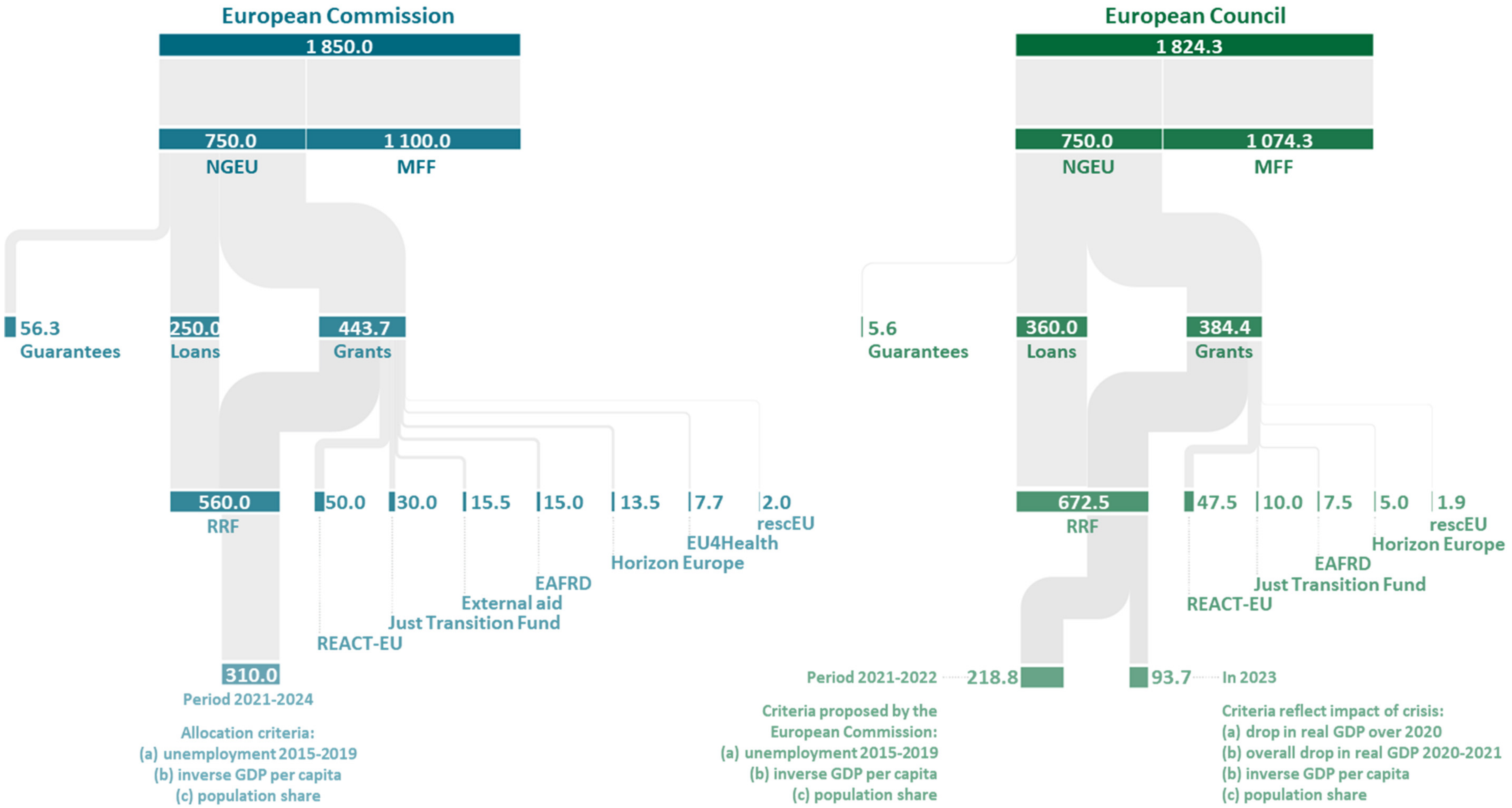
- The proposed €26 billion allocation to a new **Solvency Support Instrument** was not agreed by the European Council. It aimed to help prevent insolvencies through equity investments in sectors which are more financially impacted by the pandemic;

- **A reinforcement of some programmes: Horizon Europe** (to provide support for health and climate-related research and innovation activities), **RescEU** (to reinforce Union's civil protection mechanism), **EAFRD** (to provide assistance to farming and food sectors hard-hit by the crisis) and **EU4Health** (to provide targeted support to improve national health systems). Some of their financing was not agreed by the European Council;

- **The Just Transition Fund:** the fund is aimed at supporting economic diversification and reconversion of the territories most affected by the transition to low carbon economies. The Commission proposal allocated €30 billion to the fund, on top of €10 billion included in the next MFF. However, the European Council reduced the allocation to €10 billion.

03 The figures in this annex refer to the agreed measures as of end-August 2020 (see also ***Figure A***).

Figure A – NGEU components: Comparison of Commission and European Council proposals (in billion euros)



Annex V – Level of implementation of different EU and ESM financial measures

Institution	Instruments	Available funds	Status of uptake
Commission	CRII/CRII+	€54 billion in 2020	As of end-July 2020, there were 97 confirmed coronavirus-relevant operational programme amendments from 18 Member States. By October, about €14 billion have been reallocated in 23 Member States and the UK for investments dedicated to fighting the economic and health crisis. Additional €8 billion is available for the Member States as non-recovered annual pre-financing. However, given the procedures and current budgetary allocations, it is likely that available resources in 2020 will be limited to €8 billion pre-financing, while the remaining funds may be paid starting with 2021.
	EUSF	€0.18 billion in 2020	19 Member States have requested assistance but no money has been used yet as the allocation per countries was under Commission's appraisal up to the end of 2020. As of October, the Commission proposed to disburse advance payments to 7 Member States that requested them. Full payments for COVID-19 applications are expected to be mobilised in 2021, subject to budgetary availability.
	ESI	€2.7 billion in 2020	The Commission adopted a Financing Decision and two amendments up to end August, allocating all but €100 million of the funding. A substantial share of the funds were allocated to the agreements with vaccines developers.
	SURE	€100 billion in lending support	Following Commission proposal in August, the Council approved requests from 16 Member States for loans amounting to €87.4 billion in September. In October the Council approved €0.5 billion for Hungary and the Commission successfully issued the first €17 billion bonds to finance SURE.

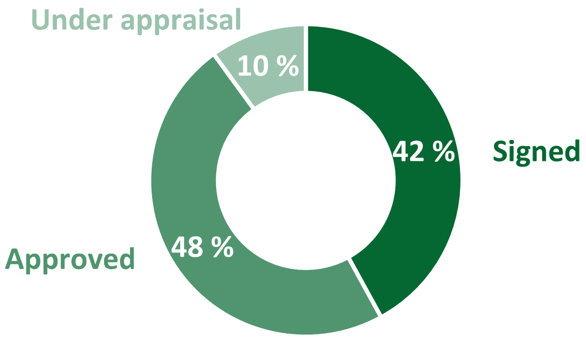
EIB	Initial COVID-19-related initiatives	€28 billion of potential financing	By mid-August the EIB had received 72 requests for COVID-19-related projects amounting to €21 billion from 23 Member States. Out of this amount, the EIB approved or signed projects for €18.1 billion, while €2.1 billion was under appraisal.
	PEGF	€200 billion of potential financing	Preparatory procedures have been completed at end-August once at least 60 % of national guarantees to the fund were ratified. No financing project had been launched by the end of August.
ESM	PCS	€240 billion	No Member States' requests received.

Source: ECA based on compiled data.

Annex VI – State of play of the EIB's financial reaction to the COVID-19 crisis

01 As of 18 August 2020, the EIB reports 72 financing projects: 15 are under appraisal, 26 have been signed and the remaining 31 have been approved. Projects approved amount to €8.8 billion, while those signed €10.1 billion and those under appraisal €2.1 billion (see ***Figure A***). Almost 55 % of the projects were submitted between June and July, accounting for about 75 % of the total budget.

Figure A – Breakdown of COVID-19 related projects by approval status



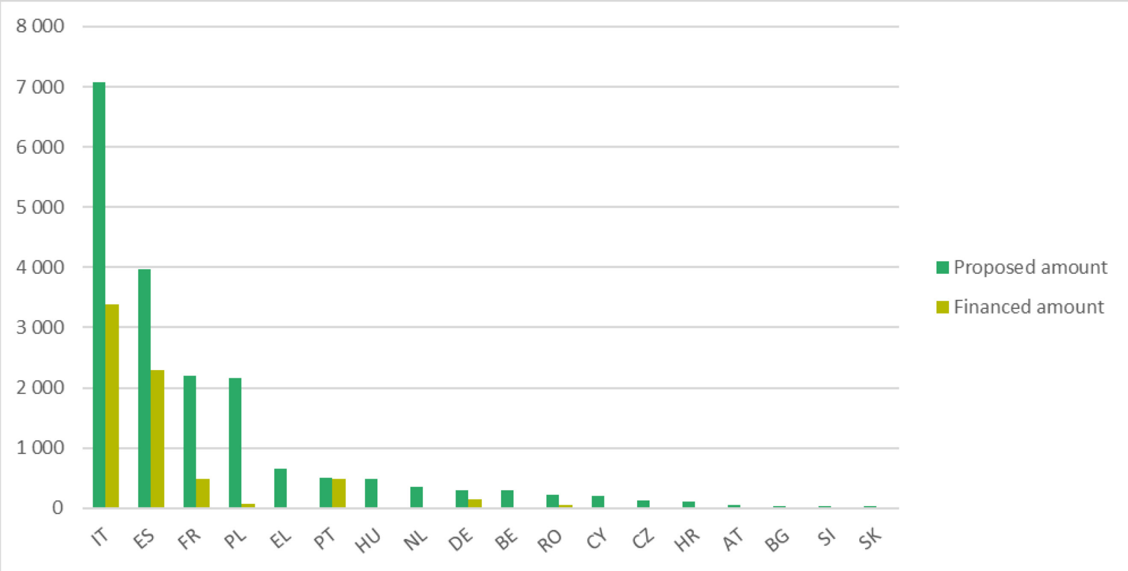
Note: Before financing approval by the Board of Directors, and before loan signature, projects are under appraisal and negotiation.

Source: EIB public database[58].

02 Italy is the country with the highest number of EIB projects (18), followed by Spain (13), Poland (5) and France (5). In terms of budgeted amount (see ***Figure B***), Italy is the country that is benefiting the most so far from an EIB intervention (€7 billion), followed by Spain (€4 billion), France (€2.2 billion) and Poland (€2.1 billion).

[58] https://www.eib.org/en/projects/pipelines/index.htm?q=covid&sortColumn=projectStatusDate&sortDir=desc&pageNumber=0&itemPerPage=25&pageable=true&language=EN&defaultLanguage=EN&yearFrom=2020&yearTo=2020&countries.region=1&orCountries.region=true&orCountries=true&orSectors=true&orStatus=true

Figure B – Breakdown of COVID-19 related projects by country



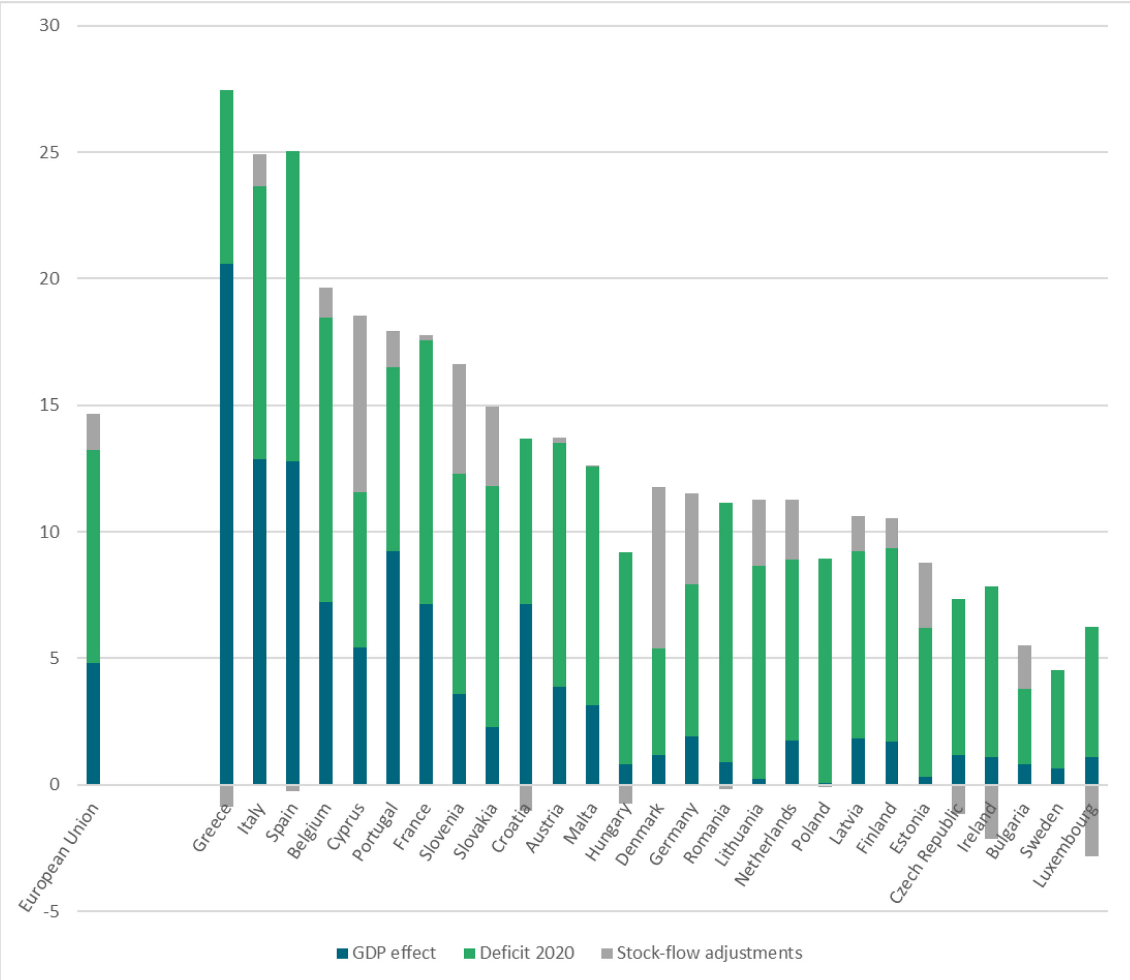
Source: EIB public database.

03 79 % of them target SMEs (57 projects), 11 % healthcare (8), 4 % energy (3), 3 % R&D (2) and 2 % environment. In terms of amounts involved, 66 % of the guarantees go to SMEs (€13.909 million), 29 % to healthcare projects (€6.142 million), 2 % to energy (€400 million) and 1 % respectively to environment (€300 million) and R&D (€150 million).

Annex VII – Key factors explaining the differences of changes in public debt ratios

01 The variation in hikes in forecast public debts as a share of GDP[59] is mostly driven by the size of expected deficits and stock-flow adjustments (such as public loans and capital injections put in place during the crisis), but also by the effect of GDP contraction. The impact of GDP losses on debt ratios is larger in countries with high debt ratios (see ***Figure A***). Moreover, large falls in GDP are expected in most high-debt countries (see ***Figure B***).

Figure A – Composition of changes to public debt in 2020 (in percentage of GDP)



Source: Commission autumn forecasts (AMECO).

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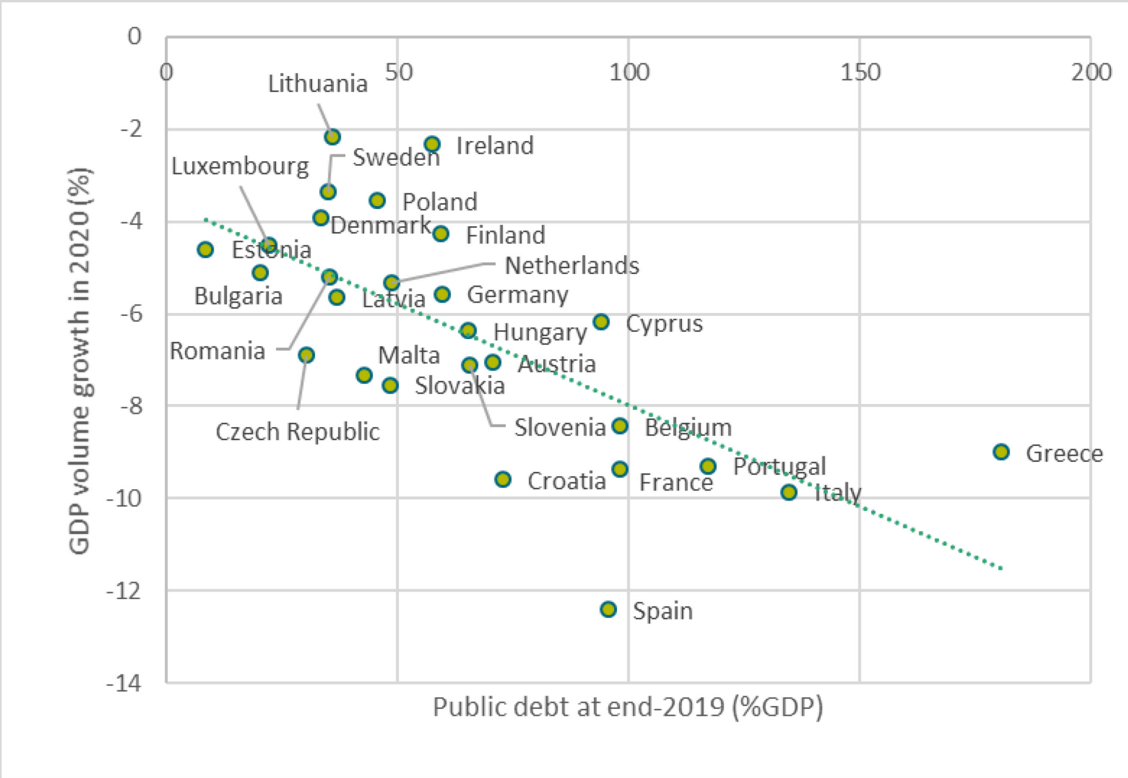
[59] Based on Commission spring forecasts (2020).

Figure B – Larger GDP falls are forecast in high-debt countries



Source: ECA calculations based on Commission autumn forecasts (2020).

Annex VIII – Accountability issues within the Recovery and Resiliance Facility

In our opinion concerning the Commission proposal establishing a Recovery and Resilience Facility[60] we highlight several accountability issues:

- The scope as well as the objectives of the RRF are rather broad and cover a wide range of policy areas. There is neither a quantification of the expected results at EU level nor for the allocation of funds to different objectives. However, in the guidance on RRPs, the Commission suggested earmarking of 37 % of funds for climate action and 20 % for digital transition;

- With respect to role of the European Parliament in providing oversight and scrutiny, the proposed RRF regulation[61] envisages the transmission of the assessment of the RRPs to the European Parliament, the submission of an annual report and an evaluation report four years after the regulation comes into force. In our opinion we suggested that the role of the European Parliament in the budgetary and discharge procedure should be clearly defined in the proposed RRF regulation, given that RRF expenditure will be managed based on the EU budgetary rules of external assigned revenue;

- Article 287(1) of the Treaty on the Functioning of the EU empowers the European Court of Auditors to audit any revenue or expenditure of the Union. Recital 40 of the proposed RRF regulation recalls the duties of the any person or entity receiving Union funds to fully cooperate in the protection of the financial interests of the Union and grant the necessary access and rights to the ECA for audits. However, in our opinion we recommended, for reasons of clarity, that the proposed RRF regulation should clearly provide for the ECA right of audit for the grants as well as the loan component of the RRF;

- After tabling the initial RRF regulation proposal, the Commission has proposed proportionate rules to ensure the protection of the financial interests of the Union, which are being dicussed at the time of the completion of this review. They are partially reflected in the Presidency compromise and the European Parliament's amendments;

- We noted that spending under the RRF is front-loaded and the evaluation will be published after the bulk of spending has been carried out. It may be inevitable

[60] ECA opinion 6/2020 on Recovery and Resilience Facility.

[61] Proposal for a Regulation of the European Parliament and of the Council establishing a Recovery and Resilience Facility (COM(2020) 408 final).

because swift implementation is one of the objectives of the facility. There is a risk that any lessons learned through the evaluation would therefore be of limited use for the management of the reminder of the RRF;

- Having been placed under the coordination of the European Semester, in our special report on the European Semester we highlighted the challenge of measuring the effectiveness of policy intervention for multiple and simultaneous objectives and areas of intervention.

Annex IX – Previous ideas for more ambitious economic coordination instruments

01 The pandemic exposed once more the difficulty of managing major shocks in the euro area in the absence of EU fiscal capacity. Some ideas to build EU permanent fiscal tools to combat large economic shocks had not reached consensus before the outbreak of the pandemic. In particular, during the 2017-2019 negotiations of the next EU multi-annual budget, the Commission put on the table several ideas for financial instruments that could mitigate major macro-economic shocks to the EU's economy:

- **A macroeconomic stabilisation tool** – in May 2018, the European Commission proposed to establish the European Investment Stabilisation Function with the aim of absorbing large asymmetric macroeconomic shocks in the euro area. Under this solution, the EU budget would guarantee back-to-back loans of up to €30 billion. The loans would be available to Member States experiencing such shocks and complying with strict eligibility criteria for sound fiscal and macroeconomic policies. The support was to be used to maintain public investment levels. While the NGEU has a similar purpose, it is temporary and its financing mechanism includes both grants and loans.

- **A European unemployment reinsurance scheme** – an idea re-iterated in several variants by the Commission, economists and Member States. The scheme proposed by the Commission[62] would act as a "reinsurance fund" for national unemployment schemes (but would not provide benefits directly to the unemployed. The scheme would provide more breathing space for national public finances in times of crisis. In its work programme (January 2020), the Commission announced its intention to propose such a scheme. The SURE programme can be seen as a first step towards a European unemployment scheme, but with its discretionary nature and limited scope, it does not meet the ambitions of the initial idea of an automatic stabiliser.

- As of end-2019, Eurogroup was still analysing appropriate solutions for a **budgetary instrument for convergence and competitiveness** (BICC) of the euro area to be financed by the next MFF that would finance reforms that strengthen convergence between Member States in accordance with the priorities of the European Semester. It would replace the Commission proposal for a **Reform Delivery Tool** initially launched in May 2018.

[62] https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-emu_en.pdf

02 The idea of "Eurobonds" (bonds issued jointly by euro area member states) was first raised by the Commission in 2011[63] during the sovereign debt crisis. As the COVID-19 crisis worsened, renewed proposals for joint debt issuance emerged at political level, in thinks-tanks and academia, such as "Corona bonds". The funds could be raised, for example, by the European Investment Bank. Thanks to the mutualisation, the corona bonds would be a cheaper source of financing for many Member States as compared to their own sovereign bonds. Several Member States, including those hit worst by the crisis, supported this concept, but others strongly opposed it. The proposed NGEU fund was the resulting compromise.

63 "Green Paper on the feasibility of introducing Stability Bonds" (Commission, 2011).

Acronyms and abbreviations

AMECO: Annual macro-economic database of the European Commission's Directorate General for Economic and Financial Affairs

CRII: Coronavirus Response Investment Initiative

CSR: Country Specific Recommendations

EBA: European Banking Authority

ECA: European Court of Auditors

ECB: European Central Bank

EIB: European Investment Bank

EIOPA: European Insurance and Occupational Pensions Authority

EFSI: European Fund for Strategic Investments

ESI: Emergency Support Instrument

ESIFs: European Structural and Investment Funds

ESM: European Stability Mechanism

ESMA: European Securities and Markets Authority

ESRB: European Systemic Risk Board

EU: European Union

EUSF: European Union Solidarity Fund

GDP: Gross Domestic Product

GNI: Gross National Income

MFI: Monetary Financial Institution

MFF: Multiannual Financial Framework

NGEU: NextGenerationEU

NPL: Non-performing loan

PCS: Pandemic Crisis Support

PEGF: Pan-European Guarantee Fund

RRF: Recovery and Resilience Facility

RRP: Recovery and Resilience Plans

SME: Small or Medium-sized Enterprise

SSI: Solvency Support Instrument

SURE: Support to mitigate Unemployment Risks in an Emergency

Glossary

Automatic stabiliser: A components of fiscal policy that fluctuates with the business cycle (tax revenues, welfare spending etc.).

Country-specific recommendations: Policy guidance formulated annually by Commission to Member States on how to maintain sound public finances. The Commission then submits them to the Council for endorsement in July in the context of the European Semester.

European Semester: Annual cycle of economic and budgetary policy coordination in the EU in which policy guidance is provided to Member States.

Financial assistance: EU financial support (such as loans) provided to Member States in financial distress to restore them to macroeconomic or financial health and ensure they are able to meet their public-sector or balance-of-payments obligations.

Financial market: Market for the sale and purchase of shares, bonds, commodities, currencies and other financial assets.

Monetary financial institutions: Central banks, resident credit institutions as defined in EU law, and other resident financial institutions whose business is to receive deposits from entities other than MFIs and, for their own account, to grant credits and/or make investments in securities.

Multiannual financial framework: The EU's spending plan setting priorities (based on policy objectives) and ceilings, under six main headings, generally for seven years. It provides the structure within which annual EU budgets are set, limiting spending for each category of expenditure. The current MFF covers 2014-2020.

Non-performing loan (NPL): A loan on which payments have been overdue for a specified time span (usually 90 days), or where there is evidence that full repayment is unlikely.

State aid: Direct or indirect government support for a business or an organisation, putting it at an advantage over its competitors.

ECA team

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The European Union and its Member States implemented a variety of measures to limit and counter the economic damage caused by the ongoing COVID-19 pandemic. This review provides an integrated overview of these measures taken at national level by June and EU level by August 2020. The review also flags risks, challenges and opportunities for the future of EU economic coordination.

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