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EU financial assistance during COVID-19 pandemic: Are loans the solution?

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Abstract: This article deals with the European Union's reaction to the COVID-19 pandemic. The current crisis is having a negative impact on national economies. Based on legitimate concerns about the fiscal stability of the euro area and the EU as a whole, the Union has adopted a number of measures to support the Member States. As part of the solution to the coronavirus crisis, we cannot ignore the role of the European Stability Mechanism, in which financial assistance has been earmarked for euro area members. The article focuses on three instruments providing financial assistance in the form of loans: Pandemic Crisis Support, Support to mitigate Unemployment Risks in an Emergency (SURE) and the Pan-European Guarantee Fund. This EUR 540 billion rescue package was agreed by the Eurogroup on 9 April 2020. The article aims to identify the differences between these instruments and their target groups by analysing and comparing their legal bases, conditions and economic impact. As part of the contribution, we also mention countries that are not members of the euro area but have drawn assistance in the form of loans from the mentioned funds.

Keywords: coronavirus, crisis, European Stability Mechanism, European Union, financial assistance, loans

1. INTRODUCTION

The European Union and the whole world are facing a new crisis caused by the COVID-19 pandemic, which has suddenly and drastically affected not only the EU Member States but also the entire globalised world. The current crisis is having a negative impact on national economies. Member States that already had budgetary targets for 2020 certainly did not expect a stagnant economy, and so individual governments are facing a new situation. Member States will thus have to cope with an economic downturn.

To prevent the spread of the virus, some states adopted such drastic measures that the economic life of the country almost stopped. There has been a decline in the economic activity of households and entrepreneurs. By adopting strict measures, countries literally isolated themselves from neighbouring states. One of the isolation measures was the decision to close the borders between the Member States[1] or the declaration of a state of emergency[2]. In response to these measures taken by governments of the Member States, the European Union also decided to close its external borders.[3]

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One of the options offered to mitigate the effects of the crisis is to increase public spending. However, individual Member States are in financial difficulties and are facing the question of where to obtain the necessary funds.[4] It is already certain that we will be dealing with the effects of the crisis long after the spread of the pandemic has come under control. The EU is also working with this scenario, assessing the March 2020 situation as *unusual* and out of government control.[5]

Based on legitimate concerns about the stability of the euro area and the EU as a whole, the Union has adopted a number of measures, for example, the extension of the EU Solidarity Fund to health crises. In order to provide the Member States with immediate liquidity to address the impact of the coronavirus crisis, the EU also redeployed EUR 37 billion of available cohesion policy funding as part of the Corona Response Investment Initiative (CRII). The Coronavirus Response Investment Initiative Plus (CRII+) extends these measures by introducing exceptional flexibility for the use of European Structural and Investment Funds.[6]

The European Union's coronavirus response contains a diverse set of initiatives and measures, not only in the form of grants. Among others, we can name the relaxation of EU rules on state aid or public procurement. Morais suggests[7] that the solution may lie in a *mixed approach* combining different fiscal instruments (loan programmes, the use of the European Stability Mechanism, the involvement of the European Investment Bank on a large scale, and the establishment of a long-term recovery fund towards restarting the economy).

In this article, we focus on three safety nets protecting the sovereigns, workers and businesses. They all offer financial support in the form of loans. This rescue package was agreed by the Eurogroup on 9 April 2020.[8] Financial assistance is currently available under the following instruments: i) Pandemic Crisis Support, ii) SURE, and iii) Pan-European Guarantee Fund. Table 1 shows the division of instruments according to their providers.

Table 1. Financial support (loans) mitigating the negative impact of the pandemic.

Provided by	Instrument	Supports
European Stability Mechanism	Pandemic Crisis Support	Sovereigns
European Commission	SURE	Workers
European Investment Bank	Pan-European Guarantee Fund	Businesses

Source: authors' own table.

This article aims to identify the differences between these instruments and their target groups by analysing and comparing their legal bases, conditions, and economic impact.

2. EUROPEAN STABILITY MECHANISM

The European Stability Mechanism (ESM) is a permanent financial assistance fund, set up under the Intergovernmental Treaty framework establishing the ESM. Its primary objective is to safeguard the stability of the euro area for which it uses various financial instruments. An intergovernmental agreement established this mechanism and as an intergovernmental organisation it should be activated in the event of situations or "shocks" and events that could potentially jeopardise the stability of the euro area or the EU as a whole. The ESM serves as a tool to prevent the spread of that negative situation to other states. The ESM was activated as a rescue system as part of the so-called *euro crisis*, which eventually manifested itself in more than one euro area country. Following its predecessors, the EFSM and EFSF, the European Stability Mechanism provided financial assistance to Spain, Cyprus and Greece using financial instruments.[9]

We are of the opinion that the current "Covid situation" can be viewed similarly. Therefore it fulfils the characteristics based on which euro area Mem-

ber States could request the activation of ESM assistance. In this context, we list the common features that led the EU to activate the ESM in times of a *euro crisis*, i.e. the current situation fulfils the features of i) unexpected events, ii) that have an impact, iii) on more than one Member State, iv) adversely affecting the national economy of the EU as a whole. If the situation is not resolved, the economic situation of individual countries may worsen, and the recession will deepen.[10]
Assistance from ESM can be provided on the basis of Article 13 of the ESM Treaty framework which regulates how the Member State of the euro area can request financial assistance from the Fund[11], under what circumstances and under what conditions.

3. PANDEMIC CRISIS SUPPORT

Given that the ESM was established with the primary objective of maintaining and safeguarding the stability of the euro area, which is affected by this crisis, it seems logical that financial assistance will be allocated from this fund. Thus, during the negotiations on 8 May 2020 it was agreed that the ESM would be allocated about EUR 240 billion, which will be used to support the economies of euro area members (for all 19 members) with the maximum average maturity of the individual loans of 10 years and an interest rate of 0.1%. This interest rate would be calculated from the borrowed amount, which must not be higher than 2% of its GDP at the end of 2019.[12]

The ESM has established the Pandemic Crisis Support where it uses the option of activating the credit line, the so-called Enhanced conditions credit line[13], when it can operate on the primary market or provide loans. This credit line supports domestic financing of direct and indirect healthcare, cure and prevention related costs due to the COVID-19 crisis and on the basis of conditions to be specified.[14]

In addition to the creation of this credit line, there were also options involving the issuance of Eurobonds. We recall that this crisis has hit the whole world, and governments are struggling with large budget deficits. The question arose as to whether activating the ESM or issuing the so-called "Corona bonds" (a one-off mutual European bond issuance by euro area countries) would help to solve this crisis. The question is whether this joint responsibility could mean that the costs associated with funding will cause further problems.[15] There was also an opinion supporting the implementation of a European-wide progressive wealth tax (assessed on the net worth of the top 1%); the revenues would be used to repay Eurobonds as common bonds.[16] The introduction of such a tax is obviously a controversial topic, some authors believe this tax could have a positive impact on the migration of taxpayers within the EU, and at the same time support real solidarity in the fight against the consequences of the pandemic. However, creating and negotiating conditions for these instruments, like corona bonds or European-wide tax, seem more complicated than negotiating the ESM assistance.

The ESM credit line accounts for about half of the total allocation of EUR 540 billion[17], the other half consists of individual loans provided by the European Investment Bank and funds used from the SURE employment scheme,[18] which are elaborated further below.

4. SUPPORT TO MITIGATE UNEMPLOYMENT RISKS IN AN EMERGENCY

In April 2020, there were already more than 42 million applications for support for workers on short-time work or similar schemes in the EU.[19] The temporary Support to mitigate Unemployment Risks in an Emergency (SURE) supports national short-time work schemes and similar measures as a response to the current crisis caused by the COVID-19 pandemic. From a legal perspective, SURE is based on Article 122 TFEU. Established on 19 May 2020, it provides financial assistance to the Member States (up to EUR 100 billion in total), which has to address sudden increases in public expenditure to preserve jobs. Affected Member States can borrow money on favourable terms.[20]

The instrument supports all Member States, not just those in the euro area. However, not all Member States would find SURE attractive as they have cheap access to financial markets themselves, for instance Germany. On the contrary, for countries like Italy or Spain, these loans are likely to be cheaper than their own borrowing costs.[21]

The procedure is as follows. First, the Member States request financial support after activating their short-time work schemes or similar measures to support the self-employed. The European Commission consults the Member States before submitting a proposal for a decision to the Council. For each Member State, the Council implementing decision contains all the necessary details, such as the amount of the loan, its maximum average maturity, number of instalments, description of national measures, etc.[22]

The Commission has proposed to grant financial support of EUR 87.8 billion to seventeen countries. The Czech Republic is one of the sixteen Member States to benefit from SURE so far.[23] Table 2 shows the financial support granted to the Czech Republic, Greece, Italy, Poland and Spain.

TABLE 2. FINANCIAL ASSISTANCE GRANTED TO SELECTED COUNTRIES UNDER SURE.

<table>
<tr><th>Country</th><th>Date of request</th><th>Commission proposal</th><th>Council decision</th><th>Maximum loan (EUR)</th><th>Availability</th><th>Loan maturity</th><th>Instalments (max.)</th></tr>
<tr><td>Czechia</td><td>07/08/2020</td><td rowspan="5">24/08/2020</td><td rowspan="5">25/09/2020</td><td>2 billion</td><td rowspan="5">18 months</td><td rowspan="5">15 years</td><td>8</td></tr>
<tr><td>Greece</td><td>06/08/2020</td><td>2.7 billion</td><td>8</td></tr>
<tr><td>Italy</td><td>07/08/2020</td><td>27.4 billion</td><td>10</td></tr>
<tr><td>Poland</td><td>06/08/2020</td><td>11.2 billion</td><td>10</td></tr>
<tr><td>Spain</td><td>03/08/2020</td><td>21.3 billion</td><td>10</td></tr>
</table>

Source: authors (based on Council Implementing Decisions (EU) 2020/1345, 2020/1346, 2020/1349, 2020/1353, and 2020/1347).

Loans are underpinned by Member States' guarantees. On 7 October 2020, the Commission announced that it would issue EU SURE bonds of up to EUR 100 billion as social bonds. The Commission plans to use the cash inflows stemming from the EU SURE debt issuance to disburse the loans to the Member States in instalments.[24]

5. PAN-EUROPEAN GUARANTEE FUND

Small and medium-sized enterprises (SMEs) are extremely sensitive to economic downturns, especially in southern European countries. Even in crisis, bank loans and credit lines remain the main sources of SMEs' financing.[25] Endorsed by the European Council as part of the overall COVID-19 response package, the EIB Group has created the Pan-European Guarantee Fund (EGF). The Board of Directors agreed on the EGF structure and business model on 26 May 2020. With EUR 25 billion, this guarantee fund primarily scales up the support for SMEs by mobilising up to EUR 200 billion. All 27 EU Member States contribute proportionally according to their shares in the EIB. Most of the financing is available through intermediaries, e.g. commercial banks or national institutions.[26] How is the EGF support allocated to beneficiaries?

- Small and medium-sized enterprises: at least 65%;
- Companies with 250 or more employees: up to 28% (with restrictions above 3,000 employees, and up to 5% can be used for companies active in the area of health);
- Venture and growth capital and venture debt: up to 7%.

The Pan-European Guarantee Fund is also temporary; its initial investment period lasts until 31 December 2021. Any extension would have to be approved by contributors, i.e. the Member States.[27]

6. CONCLUSIONS

This article focused on the financial assistance provided by the European Union to mitigate the negative effects of the COVID-19 pandemic. Loans are currently available under the Pandemic Crisis Support, the temporary Support to mitigate the Unemployment Risks in an Emergency (SURE) and the Pan-European Guarantee Fund.

Governments should not rely solely on EU assistance but should also focus on developing a strategy based on investment promotion. However, in order to "restart" their economies, they can participate in financial assistance mechanisms. One of the permanent mechanisms of financial support is the European stability mechanism. The ESM is a fund established only for euro area members. The Eurogroup decided to allocate about EUR 240 billion to fight the effects of the coronavirus crisis. Euro area members should be able to borrow an amount which must not be higher than 2% of their GDP with a maximum average maturity of 10 years and with an interest rate 0.1%.

The Czech Republic and Poland are not euro area members, but it seemed appropriate to mention their participation in the individual mechanisms of SURE and Pan-European Guarantee Fund. We want to show that even non-members of the ESM (and therefore non-members of the euro area) are facing the consequences of this crisis too. If we take a closer look at the estimated impact of the current crisis on public finances (see Table 3), the governments will suffer from a significant decrease in GDP. For example, the Czech Republic was expected to have a general government deficit and debt of 6.7% and 38.7% of gross domestic product respectively by the end of the year. According to the European Commission's interim forecast, the Czech Republic's GDP is projected to decrease by 7.8% in 2020. We see that euro area members (Greece, Italy and Spain) have figures around 10%, but they also have much higher debt in terms of a percentage of GDP.

Table 3. Estimated impact of COVID-19 outbreak on public finances in 2020.

Country	General government deficit and debt	GDP decreased by
Czechia	6.7%, and 38.7% of GDP	7.8%
Greece	6.4%, and 196.4% of GDP	9%
Italy	11.1% and 158.9% of GDP	11.2%
Poland	9.5% and 58.5% of GDP	4.6%
Spain	10.1% and 115.6% of GDP	10.9%

Source: authors (based on the Commission's 2020 Spring and Summer forecasts).

Loans can help economic recovery. High sovereign debt, however, is likely to adversely affect economic growth.[28] As already mentioned, some loan recipients are also countries that have previously participated in the ESM (or its predecessors) and are therefore still repaying their debt. We must ask whether the recipients of this aid will be able to meet their obligations and repay these loans.

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