The EU Response to COVID-19: Implications for New Zealand Businesses

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I/ Context

On 13 May 2020, Lighthouse Europe hosted a webinar with New Zealand business and government officials to discuss the political and economic response of the European Union to the COVID-19 crisis. **Axel Voss**, Member of the European Parliament and Vice-Chair of the Delegation to Australia and New Zealand, gave a keynote address encouraging the participants and highlighting that the two sides need to work together to get through this crisis. He stressed additionally that New Zealand is a cherished partner of the European Union.

II/ The COVID-19 Crisis

COVID-19 was first identified **in December 2019** in Wuhan, China, and has since spread globally with **7.27 million cases and 413,000** deaths recorded as of **12 June 2020**. The EU has been one of the hardest-hit regions, accounting for almost a third of the global total, particularly in countries like Italy and Spain which have both seen very high case numbers. Like New Zealand, the response has been to lock down economies. But this has not been the case universally, and some Member States have had tougher restrictions than others. The five major EU economies, however, all have extensive lockdown measures in place that are now starting to lift according to their unique circumstances.

III/ The Economic Impact

From the economic perspective, the lockdown has been devastating. According to the European Union Office of Statistics, GDP has contracted 3.5% in the EU (3.8% in the eurozone) in the first quarter of 2020 - the sharpest decline since 1995. The latest economic forecast shows GDP shrinking 7.4% this year within the EU. Contraction will occur across the board, but will be uneven. French Finance Minister, Bruno le Maire, expects an 8% decrease in France, while German Finance Minister, Peter Altmaier, forecasts a 6.3% decrease for Germany. In addition, the rebound recovery will not be uniform across the EU and it is likely that there will be further divergences across the Union, accentuating distortions within the Internal Market. In terms of unemployment, the most recent data show that it will reach 9% across the EU, up from 6.7% in 2019. It is apparent that COVID-19 represents the greatest economic crisis since the end of World War II and will require significant resources to overcome.

IV/ Response of the European Union

IV.1/ COVID-19 Rescue Package

The response to COVID-19 in the EU, as compared to other countries, is unique to the extent that Member States delegate certain competencies to the EU, while other competencies remain exclusively within their control. For example, the European Union has exclusive competencies on customs matters and competition, whereas healthcare, social welfare, and borders remain exclusive competencies of the Member States. Therefore, depending on the specific area, it is important to review the actions of Member States in order to have a full understanding of the situation.

The response of the EU to the crisis has three primary goals:

- Ensure European markets have sufficient liquidity
- Save businesses from collapse
- Preserve as many jobs as possible

Unlike in 2008, the EU has been very swift to respond to this crisis, as a number of tools have been put in place in the past decade to allow a decisive response from the EU. The COVID-19 Rescue Package was agreed on April 9 and was the first stage of a larger plan for economic recovery. The **540-billion-euro** rescue package is divided into three sections.

- 240 billion through the **European Stability Mechanism**
- 100 billion for the **Support to mitigate Unemployment Risks in an Emergency program**
- 200 billion of loan guarantees through the **European Investment Bank**

IV.1.1/ European Stability Mechanism

The **European Stability Mechanism** (ESM) provides support for those member states who use the euro as their currency, with the aim of providing liquidity to states for direct and indirect responses to COVID-19. This package has been operational since **June 1** and, as a part of this package, Member States have committed to providing liquidity for sectors facing disruptions and companies facing liquidity shortages. The EUR 249 billion scheme consists of public guarantees and deferred tax payments, which are now estimated at 16% of EU GDP.

IV.1.2/ Support to Mitigate Unemployment Risks in an Emergency

The **Support to mitigate Unemployment Risks in an Emergency** (SURE) is an interim compromise that followed a debate on so-called 'corona-bonds'. It will allow for financial assistance of up to **EUR 100 billion** in the form of loans from the EU to affected Member States. The SURE program is available to all Member States of the EU, unlike the ESM, which is only available for Eurozone Member States. This program supports efforts to shore up labour markets and provide temporary workers' insurance. This program is intended for businesses, and is allocated through Member States' national administrations.

IV.1.3/ European Investment Bank Liquidity Injection

Finally, the **European Investment Bank (EIB) Group** has set up a guarantee fund of **EUR 25 billion**, which will support up to **EUR 200-billion** of financing for companies throughout the EU, with a focus on SMEs. Access to this financing is through national promotional banks in Member States. Thus, while the two previous programs are directed toward Member States, the EIB gives access through the European banking sector.

IV.2/ Additional Measures

In addition to the 540-billion-euro package, the European Union is taking a range of actions in specific policy fields and through instruments established since the last economic crisis.

IV.2.1/ European Central Bank

The **European Central Bank** (ECB) will support liquidity and financing conditions to households, businesses and banks, which will help to preserve the smooth provision of credit to the economy. On **18 March**, the ECB launched a **EUR 750-billion Pandemic Emergency Purchase Programme** (PEPP) to expand the range of eligible assets under the corporate sector purchase programme (CSPP), and to ease collateral standards. This is on top of the **EUR 120-billion** purchasing program decided previously. Purchasing of assets will continue at least until the end of the crisis and, at the very least, until the end of 2020. According to the Spring Forecast released on **6 May**, these liquidity measures amount to 22% of EU GDP.

A caveat to this is a recent ruling from the German Constitutional Court which has challenged the ECB's quantitative easing measures. The ruling applies to past quantitative easing, since 2015, and not the present crisis, but it could have an impact in the future if the ECB does not comply with the ruling. Effectively, the ruling will make it impossible for the ECB to purchase German government-bonds, which could push countries like Italy, who are most reliant on ECB bond purchases, into a tailspin. This developmeent could have a lasting impact in Europe and should therefore be monitored in the future.

IV.2.2/ Stability and Growth Pact Put on Hold

Fiscal rules set by the **Stability and Growth Pact** (SGP) will also be relaxed. The EU fiscal framework was established following the last financial crisis with a set of rules designed to ensure that countries in the European Union pursue sound public finances. On **23 March**, Ministers of Finance agreed that the conditions for use of the **general escape clause** in the **fiscal framework** were met. This clause offers the flexibility necessary for national budgets to support the economy and respond in a coordinated manner to the impact of COVID-19. Overall fiscal guidance will be provided within this framework and as part of a streamlined **European Semester** exercise. With the general escape clause, Member States are free to run their deficits up past the **maximum threshold of 4% of GDP**. This will cause aggregate government deficits in the euro zone to surge from just 0.6% of GDP in 2019 to around 8.5% in 2020.

IV.2.3/ State Aid Rules Loosened

State aid rules, which are an exclusive competence of the European Union, have also been loosened to expedite public support to companies. So far, the Commission has cleared the way for over EUR 1.9 trillion of state aid across 126 schemes. Germany accounts for over half of these. A concern with this policy is its potential to distort competition, as some Member States have a greater capacity to support their industries than others.

IV.2.4/ Expanded European Union Budget

Finally, the **Multiannual Financial Framework** (MFF) is also being adjusted. The MFF is the EU budget, decided as part of a seven-year budgetary cycle, that determines how resources are allocated to the various European programs, such as the Common Agricultural Policy (CAP), which is still the largest line item. The Commission is seeking to expand the budget to **2% of EU GDP** and set aside a **EUR 750 billion** recovery fund. This recovery fund will be financed by the European Commission borrowing money from the financial markets and offering it to Member States at a preferential rate. This fund will be targeted to those Member States who have less capacity within their government finances to support their economies.

IV.3/ Travel Restrictions and Flow of Goods

In addition to the economic response, there are a number of other measures, including travel restrictions, that have been designed to coordinate with the lockdown. In this area, legal competencies are shared between the Member States and the EU, and therefore the response, although coordinated, is a patchwork; it is primarily within the control of individual Member States to open their borders. On **March 16,** The Commission invited Member States to introduce a temporary restriction on *non-essential travel to the EU* for an initial period of 30 days. This was renewed again until at least 15 May, and again until 15 June. All EU Member States (except Ireland) and non-EU Schengen countries have since then taken national decisions to implement this travel restriction. Internal border controls will only be lifted on a country-by-country basis. Bordering Member States will closely coordinate their approach. The Commission and Member States are each exploring digital solutions, such as contact tracing and warning apps, to help track the virus once borders are reopened.

Goods are still able to cross borders in accordance with the guidelines for border management. This has been a particularly successful area for the EU to ensure goods flow freely between Member States, although Personal Protective Equipment (PPE) is still subject to export authorisation. Even so, pressures are felt in sectors reliant on seasonal workers, including **non-EU citizen seasonal workers**. The Commission has asked that travel restrictions on seasonal workers be lifted and for these workers to be classified as essential. However, it is not clear at this stage whether this has been effective.

V/ A Glimpse at European Member States

The Member States of the European Union are also acting in the fight against the economic impacts of COVID-19. Due to the constitutional framework of the European Union, Member States retain large areas of competency that fall outside the remit of the European Union. This entails differentiated responses from Member States to the crisis, both economically and socially. For detailed information on **all Member States' situations** please refer to the new European Commission website Re-Open EU**.**

V.1/ Germany

Germany has cut its estimate for GDP growth this year by -6.3%, but expects the recession to bottom out in the second quarter and economic activity to pick up again thereafter, provided a second wave of infections can be avoided. The rebound in the economy should be felt in 2021 with an expected expansion of +5.2%. The German government has approved an initial rescue package worth **750 billion euros** to mitigate the impact of the coronavirus outbreak, with the government this year taking on new debt for the first time since 2013.

The first package agreed in March comprises a supplementary budget of **156 billion euros** and a stabilisation fund worth **600 billion euros** for loans to struggling businesses. **100 billion euros** of this fund is intended to be used to take direct equity stakes in companies, to stop foreign takeovers and protect German businesses.

For businesses with logistical issues, the Federal Ministry of Economy and Energy has set up a **Supply Chain Contact Point**. It handles all issues related either to the production and delivery of component products or to the supply of raw materials in general. Companies experiencing problems with regard to international supply chains should contact kontaktstelle-lieferketten@bmwi.bund.de.

V.2/ Italy

Meanwhile, Italy is the country that has been acutely affected by the crisis, perhaps disproportionality more so than other regions. The forecast for Italy is a GDP drop of -9.5%. Besides looking at the GDP fall exclusively, it is also important to analyse consumption trends in the “full lockdown” phase and governmental measures in the “relaunch” phase to understand how this will impact the domestic economy and trade with third countries. As a preliminary observation, **the most productive areas of the country** (Lombardy, Veneto and Emilia Romagna, which together account for **40% of Italy’s GDP**) **are also the worst hit regions**.

Many sectors, including all non-essential goods and services, stopped production once “full” confinement began on 8 March. However, the agri-food supply chain did not stop production. While consumption trends in the agri-food sector have shifted, overall consumption has increased during confinement. Yet, fresh products such as milk and other dairy products, in particular, have seen decreased consumption. Products most drastically affected are specialty geographical products (DOPs), since demand for these products is driven by the food services sector.

From 4 May, Italy started re-opening its economy in a wide variety of sectors. In the meantime, the government is planning an economic recovery plan. The draft package is a 55-billion-euro initiative that will focus on sectors that have been irreparably harmed, such as tourism and hospitality. Included in this package is a 1-billion-euro emergency fund for agriculture, fisheries and aquaculture.

In the coming weeks, subject to the epidemiological developments, the government will increasingly allow the economy to open. Starting from 18 May, differentiated measures have been taken on a region-by-region basis. In this way, it will be increasingly important to **examine each region rather than the country itself** to know the exact situation on the ground.

V.3/ United Kingdom

The UK's economic response has been more delayed than other Member States. As a part of their response, the British government has set up a 42-billion pound **Coronavirus Job Retention Scheme**, a program to pay 80 precent of workers' salaries. All UK employers can access this support, which is available for at least three months (backdated to 1 March) and will be extended for longer if necessary. The government will also defer the next quarter of **valued-added tax** (VAT) payments. All UK businesses are eligible. The deferral applied from 20 March 2020 will continue until 30 June 2020. The deferral is automatic with no application required.

The government is ensuring that loans are available to help businesses stay afloat through a new, temporary **Coronavirus Business Interruption Loan Scheme** (CBILS), delivered via the **British Business Bank**. The government will provide lenders with a guarantee of 80% on each loan and the government will not charge businesses or banks for this guarantee. The Scheme will support loans of up to 25 million pounds in value.

On 7 May, the **Bank of England** voted to keep the official interest rate at **0.1%**. Since January, the Bank of England has injected a further **200 billion pounds** into the UK economy through quantitative easing. Despite these actions, unemployment is likely to hit 10%, from its current 3.9% rate, before easing to around 7.3% by the end of the year.

Brexit

The United Kingdom officially left the European Union on 31 December 2019 and the two parties have now entered a withdrawal period until 31 December 2020. Negotiations on the future relationship are ongoing. According to the terms of the withdrawal agreement, EU law still applies in the UK.

VI/ Summary Conclusions

An uneven recovery will dampen future growth and demand in the EU. EU GDP is forecast to contract by about 7.5% this year, far deeper than during the Global Financial crisis in 2009, and to rebound by only 6% in 2021. This rebound will leave the European economy, at the end of this forecast horizon, about 3% lower than the output level implied by the autumn 2019 economic forecast. Thus, it will not be until at least 2022 that Europe will recover from this crisis. Moreover, certain Member States will recover faster than others due to their greater room of manoeuvre to provide public stimulus. The incomplete recovery of one Member State has the potential to spill over to others due to their strong interdependencies, dampening future growth. The unevenness of the recovery will be exacerbated by the fact that spending on travel and recreational activities will lag behind other areas of the economy due to ongoing travel restrictions. This fact is especially concerning when one considers that almost a third of new growth since the last crisis came from tourism. Countries with significant tourism sectors like France, Italy, Spain and Greece are particularly at risk. The EU has released a package to deal with transport, tourism and borders.

The second implication for New Zealand businesses is potential future access restrictions to the EU market due to a steep drop in prices for agricultural products such as beef, lamb and dairy. French cheesemakers are warning that the closure of foodservice channels is resulting in a **60% slump in international sales** of cheeses like Camembert to Roquefort. The result is farmers switching production to better preserved products, such as **butter** and **milk powder**, leading to a sharp fall in prices for **skimmed** and **whole milk powder.** The European Commission has stepped in to pay for the **storage of 18,000 tons of cheese**, to keep it off the market during the crisis. This will continue to put downward pressure on prices, even as demand picks up. The effects are also being seen in the **red meat marke**t. The reduced income of consumers has affected what product is chosen, resulting in a **sharp and unprecedented fall off in lamb prices**, driven by the **closure of French wholesale and open retail markets** where lamb is traditionally sold. Moreover, the agricultural industry should pay close attention to state aid, since this will allow individual Member States to subsidize their agricultural sectors on top of existing CAP funding, potentially creating further distortions in the market.

Globally, the pandemic has triggered discussions about drastic and permanent changes in attitudes towards **global value chains** that would particularly affect open economies such as New Zealand. While these concerns have always been prevalent within certain circles of the EU, COVID-19 has raised the profile of this issue significantly on the political agenda. In the long term, European trade and industrial strategies could shift in this direction, and NZ risks being caught in a net of policies that are aimed at “strategic rivals” of the EU. Tensions between the United States and the EU only amplify these pressures. **The NZ-EU FTA is therefore critical to mitigate this risk**.

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