

POSITION PAPER: ERP Guidance note in view of the COVID 19 crisis with a special reference to the fiscal implications of structural reforms

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1. Introduction

1. 1. Background

- At this moment, COVID 19 is primarily a health crisis, but is being already translated into economic and financial crisis. It is generally assessed that Europe will face a deep recession this year with slow recovery in the following years.
- The top priority of policy makers all over the world over the following months will be how to mitigate immediate impacts of the crisis while then, over the period of at least a year or two, they will have to focus on how to design and implement effective recovery of their economies.
- There is no doubt that this priority will be clearly followed already in the two programming documents – Convergence Programs and National Reform Programs – EU member states present in April each year as part of the European Semester.
- Policy makers in EU candidate countries from the region will by and large follow a similar approach in addressing challenges associated with the COVID 19 crisis. It is obvious that mitigation of the crisis will be a subject of the ongoing dialogue between the region and the EU institutions taking place already this spring and will have to be reflected also in the ministerial policy recommendations scheduled for adoption in May 2020.
- Informal discussion with ERP coordinators confirmed that, at the moment, countries are focusing on short-term measures to address the impact of the COVID 19 crisis. This includes revising some of the ERP measures or activities to better address the current situation. While



being aware that reforms need to continue, the focus on current emergencies makes mid-term planning of fiscal frameworks and structural reforms very difficult.

- It is within this context that the substance of ERPs, as they represent the main document of a candidate country for its macro-fiscal dialogue with EU, will have to reflect blunt realities faced by the countries in view of the COVID 19 crisis. This refers also to the subject of fiscal implications of structural reforms addressed in ERPs' Chapter 5 and for which CEF provides assistance to the region through a multi-beneficiary IPA project.

1.2. Objective of the document

- The overall objective of this document is threefold.
 - *First*, to assess the existing ERP Guidance note from the point of view of the COVID 19 crisis and its implications on the document as whole, and to recommend adjustments to be introduced into the forthcoming ERP Guidance note for the 2021-2023 period.
 - *Second*, to discuss in more details the implications of the crisis on those segments of the existing ERP Guidance note that address fiscal implications of structural reforms and to recommend to be introduced into the forthcoming ERP Guidance note for the 2021-2023 period
 - *Third*, to discuss how the existing CEF Costing Guidance might need to be amended to address the increased level of fiscal risks in the crisis resolution period.
- At this point, the document is aimed to be a contribution for a conceptual discussion about the ERP Guidance note under the COVID 19 implications while specific drafting suggestions in the “track changes” form are not feasible at this point. This would make sense to be done at the next stage and only in case that the proposed recommendations are considered to go in the right direction.
- While it seems necessary to adjust the next ERP Guidance to the reality of the post COVID 19 period, the Guidance should at the same time leave the countries enough room for flexibility, as it is, at this time, almost impossible to predict how the situation will develop over the coming months.

1.3. Structure of the document

- In addition to this Introduction, the document consists of two main chapters. The overall subject of the second chapter is ERP Guidance note as a whole while the third chapter focuses on those segments of the ERP Guidance note that address structural reforms and their fiscal implications.
- Both chapters are prepared by following the same methodological logic. In the first part of both chapters, current state of affairs as articulated in the existing ERP Guidance note is presented and analysed within the context of the COVID 19 crisis. The main focus of the



second part of both chapters is to make recommendations how the forthcoming ERP Guidance note for the period 2021-2023 should be adjusted so as to reflect well the new reality caused by the COVID 19 crisis in the region.

2. ERP Guidance note in view of the COVID 19 crisis

2.1. Current state of affairs: the existing ERP Guidance note

- ERP predecessors have always been primarily macro-fiscal documents.
- Following the economic and financial crisis of 2008-2011, the focus on economic growth and competitiveness supported with structural reforms in EU member states – all this was codified in EU legislation – has trickled down to candidate countries in the form of ERP. In contrast to its predecessors, ERP has a much stronger focus on structural reforms. Chapter 5 is now significantly different from the corresponding chapters in the pre-crisis period
- Structural reforms under the existing ERP Guidance note are focused exclusively on those reforms that are directly aimed at increasing competitiveness and supporting inclusive growth and job creation in the medium-term. This means that short-term growth stimulus measures as well as growth enhancing infrastructural investments are excluded, if not explicitly than at least implicitly. ERP Guidance note does not cover reforms in other important areas, for example health, environment, judiciary, public administration, law enforcement and security.

2.2. What is being proposed for consideration for drafting ERP Guidance note 2021-2023

- Taking into account a huge negative economic impact the COVID 19 crisis will have on candidate countries, policy measures and actions aimed at mitigating the negative consequences of the COVID 19 crisis and supporting a rapid economic recovery will be in the forefront of national economic policies and will be prioritized over medium-term oriented structural reforms.
- In the context of enormous fiscal implications of the COVID 19 crisis, increased external vulnerabilities and highly uncertain macroeconomic outlooks, the immediate focus of economic policy will shift from medium-term reforms to restoring fiscal stability and economic growth.
- This should be reflected in the Guidance note 2021-2023. If ERPs aim to remain relevant within candidate countries themselves, then their substance will have to be adjusted to the real situation on the ground. At the same time, while focusing on the macro-fiscal framework and recovery measures, the continuity of key structural reforms should also be assured by adjusting them to the present situation.



- *General approach* for drafting the forthcoming ERP Guidance note 2021-2023
 - Taking into account that the COVID 19 will have dramatic implications on economic growth and consequently on public finances of candidate countries, it is necessary that these implications are systemically integrated into the forthcoming Guidance note 2021-2023.
 - The overall philosophy of the forthcoming Guidance note shall be based on the overall logic that the word “Reform” in the term ERP is replaced with the word “Recovery”. It is namely realistic to expect that similarly as in the EU member states the candidate countries will respond to the crisis with policy measures, aimed primarily at restoring economic recovery, which may not necessarily constitute structural reforms. Structural reforms, at least in the manner understood by ERPs in recent years, i.e. reforms to support growth, competitiveness and employment, will in the forthcoming period have to give way to policy measures aimed at keeping economy and society alive and able to embark on a recovery path.
 - The forthcoming ERP Guidance note 2021-2023 should reflect the subjects discussed in the ongoing dialogue between the region and the EU institutions as well as the ministerial recommendations scheduled for adoption in Spring 2020.
 - It would make sense that the forthcoming ERP Guidance note 2021-2023 is issued a bit later than in previous years so that it is really adjusted well to the changes caused by the COVID 19 crisis.
- *In more specific terms*, the following should be considered when drafting the forthcoming ERP Guidance note 2021-2023 in view of the existing COVID 19 reality
 - The Guidance note should have a special chapter at the beginning of the document where the candidate countries would present: (i) what is the overall philosophy of the policy response to the COVID 19 crisis, (ii) what they have already done within this context, (iii) what is the plan for the forthcoming period, (iv) how was the fiscal space created for funding of measures to address the COVID 19 crisis, and how has this affected funding of other government priorities including structural reforms, and (v) how the COVID 19 related measures will be separated from other measures and “tracked” in budgets as temporary measures, in order to restore “the normal times budgets” after the COVID 19 crisis is over.
 - The existing ERP chapter on macro projections should have a detailed explanation of COVID 19 macroeconomic implications in each of the chapter’s sub-chapters.
 - In the existing ERP fiscal chapter, special sub-chapter should be introduced that will provide a detailed presentation and analysis of COVID 19 fiscal implications as known at the time of drafting the document, including how they affected funding of structural reforms.
 - The link between the macroeconomic and budgetary frameworks and structural reforms should be strengthened. In the current situation, it is even more important that



all structural reforms are fully costed and funded, and that it is clearly demonstrated how they support the fiscal adjustment and economic recovery.

- Details about adjustments in the structural reform chapter of ERPs, especially about their fiscal implications, are presented in the third chapter of this document

3. Structural reforms in ERP and their fiscal implications

3.1. Current state of affairs: the existing ERP Guidance note

- The framework for identification and prioritization of priority measures as well as for quantification of their fiscal implications applied within the structural reforms chapter of ERPs has served reasonably well its overall purpose. It has provided a good testing ground for the candidate countries in their preparation for the European semester and more specifically for preparation of their National Reform Programs.
- In order to focus their work in the area of structural reforms, countries of the region were asked each year via the ERP Guidance Note to identify and articulate between 15 and 20 priority measures that should decisively contribute to achieve inclusive growth, employment and competitiveness objectives. With the assistance of OECD, the countries of the region have made significant advancements in their capacity to identify major obstacles to economic growth and international competitiveness, and to prioritise and monitor structural reforms.
- With the assistance of CEF, the countries of the region made last year also a significant progress in quantifying fiscal implications of the selected priority measures. CEF Costing Guidance was developed to complement the ERP Guidance note.
- There is still room for improvement, for example with a more exact definition of a structural reform and the difference between a structural reform and a priority measure; the scope (breadth) of a priority measure, and an effective limit on the number of priority measures and activities within measures. Having this in mind, this note remains focused on implications of the current economic and social crisis.
- Dramatic implications of COVID 19 crisis on economies of candidate countries end this “normal situation” for at least a year, but more probably for the next medium-term period. This new reality will have to be reflected clearly in ERPs the countries will be working on from this autumn onwards.

3.2. What is being proposed for consideration when drafting ERP Guidance note 2021-2023



- The main objective of the structural reform chapter should be redefined. The chapter should focus on structural reforms and measures aimed at (i) rapid economic recovery and (ii) addressing the social effects of the health and economic crisis.
- The existing sub-chapter on obstacles should be redefined in line with the revised focus of the chapter, and linked closely with the special chapter on policy responses to the COVID 19 crisis (as proposed in 2.2. above). It should also be explained how human and financial resources for implementation of structural reforms in 2020 and 2021 were affected by the health and economic crisis.
- It is clear that, to address the post COVID 19 economic crisis, structural reforms will need to be substantially re-prioritized and focused on possible complementarities (synergies) between structural reforms and short-term economic recovery measures. The prevalent practice of rolling-over most structural reforms from the most recent ERP should be discouraged, as it does not provide enough room for addressing the most pressing economic and social challenges in the crisis period.
- *In more specific terms*, a possible guidance for re-prioritization of structural reforms could follow these principles:
 - existing reforms should be reconsidered and redesigned so that their implementation will achieve the dual goal of supporting economic recovery in the short-term and still achieving a structural change in the medium-term. For example, general business support reforms could be refocused on providing immediate support to those affected by the crisis, coupled with additional support for a more thorough and strategic business restructuring. Similar thinking could be applied to some sectoral and trade-related reforms, and possibly to labour market and social protection reforms.
 - existing reforms which cannot be redesigned in such a way, for example market liberalization, deregulation, or education reforms, and which will be difficult to implement under the present circumstances, should be postponed to a later ERP update, that is not rolled-over into the ERP for 2021-23.
 - short-term measures to speed up economic recovery or alleviate the social consequences of the crisis should be introduced in place of reforms that will be postponed, even when such measures do not constitute a structural reform in terms of addressing an underlying obstacle to inclusive growth or competitiveness.
 - Initial informal exchange with ERP Coordinators identified initial discussions with respective line ministries about re-prioritization, and strong interest for peer-to-peer knowledge-exchange on re-prioritization efforts across the region. Examples of re-prioritisation in this note illustrate a possible approach, but are not meant to suggest that some areas of structural reform are more relevant in this situation than other areas. Re-prioritization should be considered at the level of measures and not policy areas.



- The suggested number of priority measures could remain 15 to 20, but they should be apportioned between the “new” measures aimed at rapid economic recovery and “traditional” structural reforms.
- Articulation of measures
 - measures within the “new” group; They should be left largely to the candidate countries. These measures will have large fiscal implications, so strong cross reference with the fiscal chapter is necessary.
 - measures within the “traditional” group; They should be articulated by and large the same way as in the existing ERP Guidance note, but with some room to deviate from strict drafting requirements. For example, monitoring of implementation and providing meaningful Key Performance Indicators might be very difficult in the current situation, as well as detailed planning of activities for three years ahead.
- Policy areas (sectors) of structural reforms
 - measures within the “new” group; As this will be short-term measures aimed at economic recovery, they should be presented in one block and not divided by policy areas.
 - measures within the “traditional” group; They should remain organized by policy areas, but with a clear indication that this time structural reforms are not necessarily expected in all areas. The definition of policy areas in the ERP Guidance Note should remain unchanged from the previous Guidance Note to support continuity and clarity.

3.3. What is being proposed for consideration regarding the CEF Costing Guidance

- The economic shock of the COVID 19 pandemic will increase the need for policy responses to address increased vulnerabilities of countries' external and fiscal positions. The size and impact of these vulnerabilities will need to be estimated and discussed as part of macro-economic projections and budgetary outlooks.
- Increased vulnerabilities will have significant implications for costing and funding of reforms. There are two general implications that will affect structural reforms as a whole: (1) reduction of funding or postponement of some reforms, (2) reallocation of funds towards those reforms and short-term measures which will be perceived as the most important for stimulating economic recovery. We propose that these effects on reforms as a whole are explained and discussed in the introduction to Chapter 5 and not as part of costing of individual reforms.
- For costing of individual reforms, the existing Costing Guidance methodology remains applicable. It was developed and introduced as a general methodology that could be applied to a very different set of measures. It can thus be applied to costing of structural reforms for both groups of measures in the next ERPs, as discussed above (the “new” group and the “traditional” group).



- The main challenge for costing of reforms in the next ERPs will be addressing the increased uncertainty or riskiness of costs and available funding. This is a matter of application of the Costing Guidance and not a matter of adjusting the methodology itself. A set of recommendations for addressing these risks could be developed and applied through support provided to countries for costing in the Autumn training events, for example:
 - *consider carefully the implementation risks.* Human resources and institutional capacity for implementation of reforms will be limited in 2021, which should be reflected in realistic planning of implementable activities and thus in a realistic (not inflated) planning of costs,
 - *consider carefully the risks to funding availability.* Existing methodological recommendations related to including in the tables only funds that are already firmly secured, and to avoid using the 'to be determined' category, should be strictly respected,
 - *develop a contingency scenario for reforms which require substantial funding,* in the sense of planning in advance which activities would be implemented as priority in the case that not all the planned funding will be available. This is important because, even if the funding will be secured in budgets or in agreements with donors at the time of ERP approval, the risk that some of these funding will not be provided will be exceptionally high during the 2021, due to the fiscal implications of the COVID 19 crisis,
 - *proactively explore the 'room to manoeuvre' to secure additional funding for reforms and measures that will be considered the most important for economic recovery.* The line ministries, together with the Ministry of Finance and the ERP coordinator, should actively explore the possibilities to secure required funding already ahead of the costing exercise. The 'room to manoeuvre' to provide the necessary funding may include re-allocation of funds within the budget from less important activities, or repurposing of donor support provided through projects which are already ongoing or are in the pipeline,
 - although this is outside the scope of the Costing Guidance as such, a more realistic planning of budgetary funding for structural reforms would be greatly facilitated by *a closer alignment of ERP and budget preparation and approval calendars.*
- Another challenge with costing of the next ERPs is related to a potentially sizeable number of newly introduced reforms and measures. This may require a more extensive approach to trainings on the use of costing methodology in the Autumn 2020 period than originally planned.

