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COMPARATIVE ANALYSIS OF THE ECONOMIC POLICY RESPONSE TO COVID-19 IN THE EU-27 AND REPUBLIC OF SERBIA

Komparativna analiza efekata programa ekonomske pomoći na COVID-19 u zemljama EU-27 i Republici Srbiji

Abstract

In response to the COVID-19 crisis, a wide range of short-term fiscal, monetary and macroprudential measures have been implemented. The aim of this research is to compare the effects of the package of economic measures implemented in the EU-27 countries and the Republic of Serbia in 2020 according to several criteria, starting from factors which had the impact on the amount of economic aid package to assessing short-term effects on economic activity, labour market and public debt. The results of the research showed that the financial value of the economic aid package in 2020 reflects, above all, the economic capacity and relative wealth of the country, rather than the depth of the crisis that the countries faced. A positive interdependence was found between the financial amount of the economic measures package and the amount of public debt as a percentage of GDP, while a negative interdependence was found between the change in unemployment rate and the volume of economic package aid as a share of GDP. Based on the available data, it is still not possible to determine the positive statistical impact of the economic package aid on economic growth. Such findings are also expected because the measures were primarily tailored to preserve the liquidity of the economy and employment. Besides, a certain period of time is needed for the measures to take effect, which may explain the discrepancy between the amount of aid and the depth of economic activity in 2020. The data showed that the Serbian economy, unlike the Eurozone, recorded moderate debt growth and adequate capitalized banking sector is resistant to credit risk growth.

Keywords: *COVID-19 crisis, public debt, unemployment, economic growth, indebtedness.*

Sažetak

Kao odgovor na COVID-19 crisis primenjen je širok set kraktoročnih fiskalnih, monetarnih and macroprudential mera. Cilj istraživanja je da uporedi efekte paketa ekonomskih mera koje su tokom 2020. godine primenile zemlje EU-27 i Republika Srbija po nekoliko kriterijuma, počev od faktora koji su uticali na obim pomoći pa do procene kratkoročnih efekata na dinamiku privredne aktivnosti, tržište rada i javni dug. Rezultati istraživanja su pokazali da finansijska vrednost ekonomskog paketa pomoći u 2020. godini odražava, pre svega, ekonomski kapacitet i relativno bogatstvo države, pre nego dubinu krize sa kojom su se zemlje suočile. Utvrđena je pozitivna međuzavisnost između finansijskog iznosa paketa ekonomskih mera i visine javnog duga kao procenta GDP-a, dok je između promene stope nezaposlenosti i obima ekonomskog paketa pomoći kao % GDP-a utvrđena negativna međuzavisnost. Na osnovu dostupnih podataka, još uvek nije moguće utvrditi pozitivan statistički uticaj ekonomskog paketa pomoći na ekonomski rast. Takvi nalazi su i očekivani jer su mere prioritetno bile krojene za očuvanje likvidnosti privrede i broja radnih mesta. Pritom, potreban je i izvestan vremenski period da bi se mere efektuirale što može objasniti prisutnu diskrepancu između visine pomoći i dubine pada privredne aktivnosti u 2020. Podaci su pokazali da je privreda Srbije, za razliku od Eurozone, zabeležila umereni rast zaduženosti i da ima adekvatno kapitalizovan bankarski sektor otporan na rast kreditnog rizika.

Ključne reči: *COVID-19 kriza, javni dug, nezaposlenost, ekonomski rast, zaduženost.*

Introduction

Due to the state of emergency caused by the COVID-19 pandemic, all EU member states (EU-27), except Ireland, had recorded a recession in 2020. However, the intensity of the decline in economic activity was uneven among countries due to a number of reasons - starting with the difference in the structure of the economy or the relative share of sectors most affected by the crisis (tourism and hospitality, transport, arts, entertainment, etc.), a lockdown strategy including a set of measures which restricted movement and harmed economic activity (for example, lockdown in Germany was less severe than in Italy, France or Spain, and hence Germany recorded a smaller decline in economic activity). Certainly, the final assessment of economic activity in 2020 must take into account the dynamics of economic activity in the first two months of the year, respecting the conjuncture with which the countries entered in the COVID-19 crisis or in economic inertia.

As response to the economic crisis, European countries have applied a wide range of short-term fiscal and monetary measures, as well as macroprudential policy responses most notably capital buffers and liquidity requirements, which stabilized financial markets in the short term [28].

In most of the EU-27 countries, as well as in Serbia, monetary policy measures were applied first. The European Central Bank approved longer-term refinancing operations (LTROs), set up the pandemic emergency purchase program (PEPP), and expanded existing asset purchase programs. Besides, new swap and repo lines were set up with national central banks [14]. Monetary policy measures included lowering of all basic interest rates, providing lines to additional liquidity to banks, approving suspensions in the repayment of debtors' obligations, providing more favourable conditions for loans under the guarantee scheme, etc. Central bank market interventions had an immediate effect on stabilisation of financial markets. Banks were favourably affected by flexible monetary financing, temporary easing of certain capital requirements and government credit guarantees. Thanks to that, in all EU member states, a rapid growth of loans to companies was recorded, with the majority of loans intended for liquidity and working capital, while investment loans decreased. This trend was recorded in Serbia as well – considering dinar and foreign currency indexed claims of banks in period from March to November, the balance of investment loans to the economy decreased by RSD 3.1 billion while the balance of liquidity and working capital loans increased by RSD 69 billion in the same period.

Fiscal policy measures included the so-called automatic stabilizers (automatic change of tax revenues and transfer payments, primarily in the form of unemployment programs) and discretionary fiscal policy measures (tax relief and / or reduction of tax rates, extraordinary expenditures, where a major part have incentives to preserve jobs and health care). The effect of discretionary measures on both the expenditure and revenue sides is immediate and direct for the budget. However, some tax measures adopted to increase a company's liquidity (such as deferral of taxes or social security contributions) may not have a direct effect on the budget if these amounts are settled at the end of the budget year. This is important to have in mind due to this fact further complicates the assessment of the overall economic aid package as well as fiscal implications during 2020. Also, as the crisis continues, the measures will be applied in 2021. As the pandemic crisis deepened, the set of measures and the financial amount of economic package expanded, increasing the level of public debt.

The aim of the paper is to compare the effects of economic measures to mitigate the negative consequences of COVID-19 crisis during 2020 in European countries according to several criteria, starting from the factors that influenced the volume of economic aid package to assessing short-term effects on economic activity, labour market and public debt. Since an explosive growth of corporate indebtedness has been registered in the EU-27 countries, set of adequate measures and alternative solutions to this problem will be discussed.

The European Court of Auditors (ECA) is the main source of data for quantification of the total amount of economic policy response to COVID-19 in 2020, while for Serbia the key source of data is the Ministry of Finance.

The paper is structured as follows: in the first chapter, the relationship between the scope of economic assistance programs and living standards in the EU-27

and the Republic of Serbia is analysed. The second chapter analyses the effects on public debt, unemployment and economic growth. The third chapter points out the problem of economic debt growth, and the fourth chapter discusses some of the solutions for restructuring the debt of the economy. Finally, summary conclusions are presented.

Economic policy response to COVID-19 in EU-27 and Republic of Serbia

According to Eurostat [20], the amount of economic policy response to COVID-19 in 2020 among the EU-27 member states countries ranged from 2.2% of GDP in Bulgaria to 43.3% of GDP in Germany (Figure 1). On the other hand, the Ministry of Finance of the Republic of Serbia announced that in 2020, the total economic package of aid for the rehabilitation of the negative effects of COVID-19 amounted 12.7% of GDP, which ranked Serbia on the first place among countries in the Southeast Europe.

Analysing the volume of economic aid packages in absolute amount and the amount of GDP per capita, it was shown that the volume of aid was determined, above all, by the wealth of the country, and not by the depth of the decline in economic activity. Thus, countries with higher GDP per capita have applied more generous fiscal aid packages so that the scale and content of the measures adopted reflect the relative wealth of member states rather than necessarily the estimated reduction in economic activity (Figure 2).

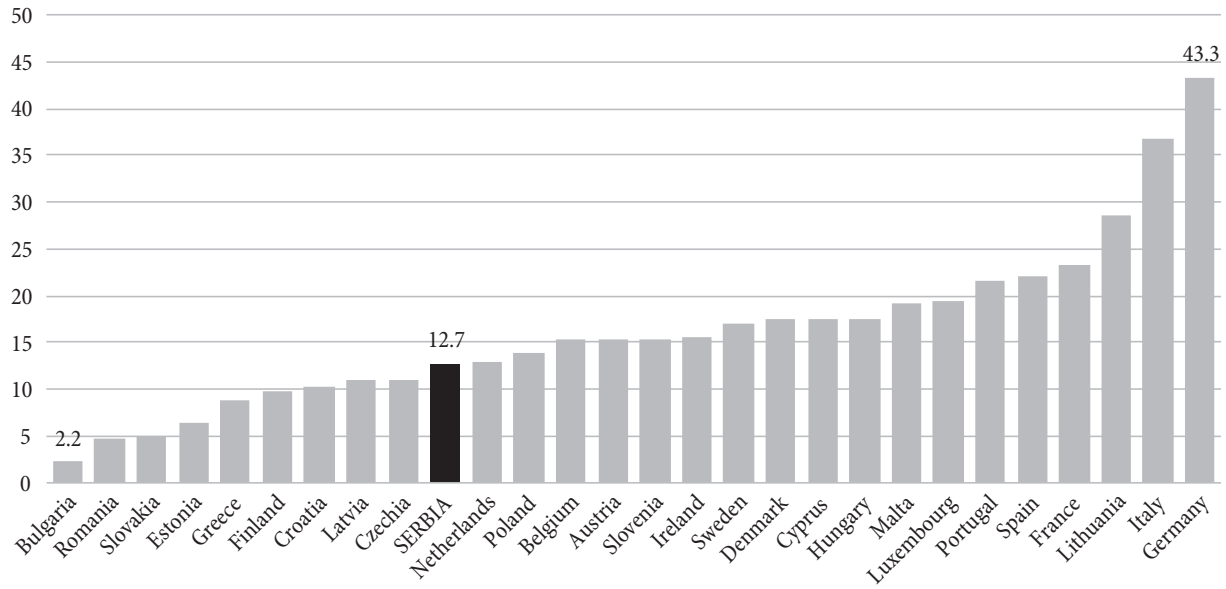
The regression line perfectly approximates this data set although the coefficient of determination is almost 70%. In that sense, if this approximation is taken as a measure of the "optimum" of state aid in the fight against the pandemic, then it is simple to calculate the degree of deviation, i.e. the success of the calibration of aid by countries. Figure 3 shows that the closest to the "optimum" were Cyprus and Luxembourg; and there are also Denmark, Sweden, Slovenia, Malta, Hungary, Poland and Serbia.

It should be noted that the "optimal" amount of aid, according to this account, for Serbia is 745 EUR per capita. While the economic aid package, according to the Ministry of Finance, reached the value of 841 EUR by the end of 2020, the deviation upwards is exactly 96 EUR (that is, the value corresponding to the payment of one-time aid of 100 EUR to all adult citizens of the Republic of Serbia at the end of April).

Effects of economic response on public debt, unemployment and economic growth

According to the latest Eurostat data for the EU-27, at the end of the third quarter of 2020 in comparison to the third quarter of 2019, the government debt to GDP

Figure 1: Economic policy response to COVID-19 in 2020 (% GDP)



Source: ECA data for EU countries and Ministry of finance RS for Serbia.

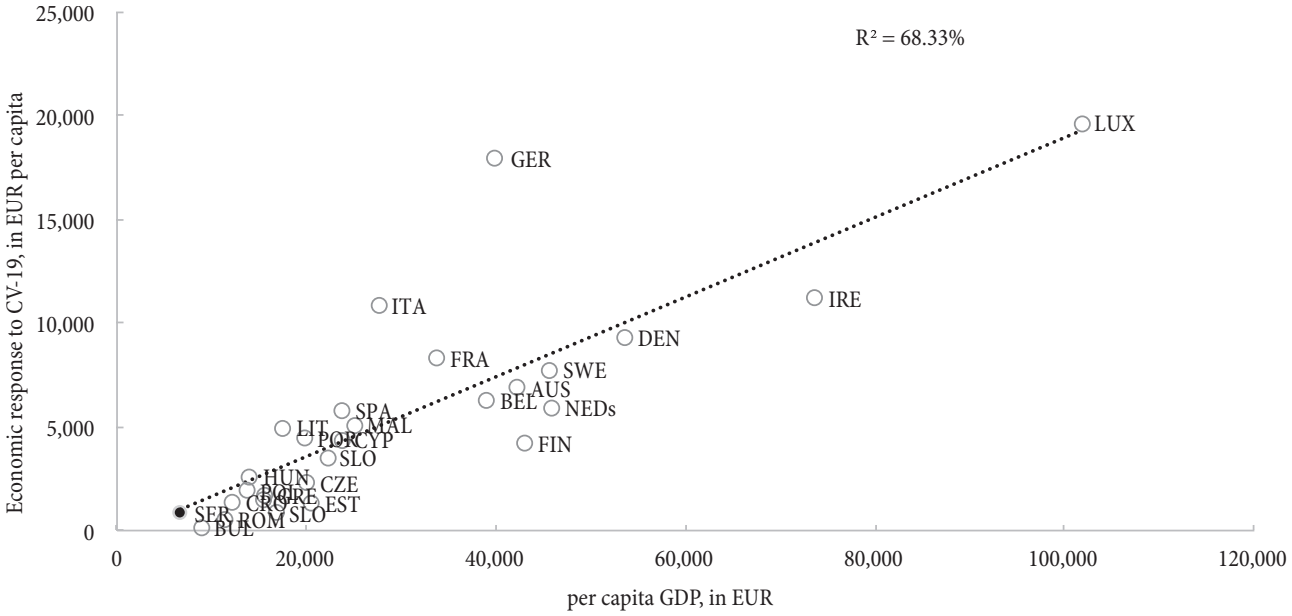
ratio increased from 79.2% to 89.8%. The highest ratios of government debt to GDP were recorded in Greece (199.9%), Italy (154.2%), Portugal (130.8%), Cyprus (119.5%), France (116.5%), Spain (114.1%) and Belgium (113.2%), and the lowest in Estonia (18.5%), Bulgaria (25.3%) and Luxembourg (26.1%). At the same time, Serbia recorded ratio of government debt to GDP 56.7%.

Analysing the volume of state aid and the amount of public debt as percentage of GDP in the EU-27 and Serbia, a positive interdependence is recorded (Figure 4).

At the same time, due to the current economic situation, there are pressures to further increase of the projected deficit and public debt (Figure 5).

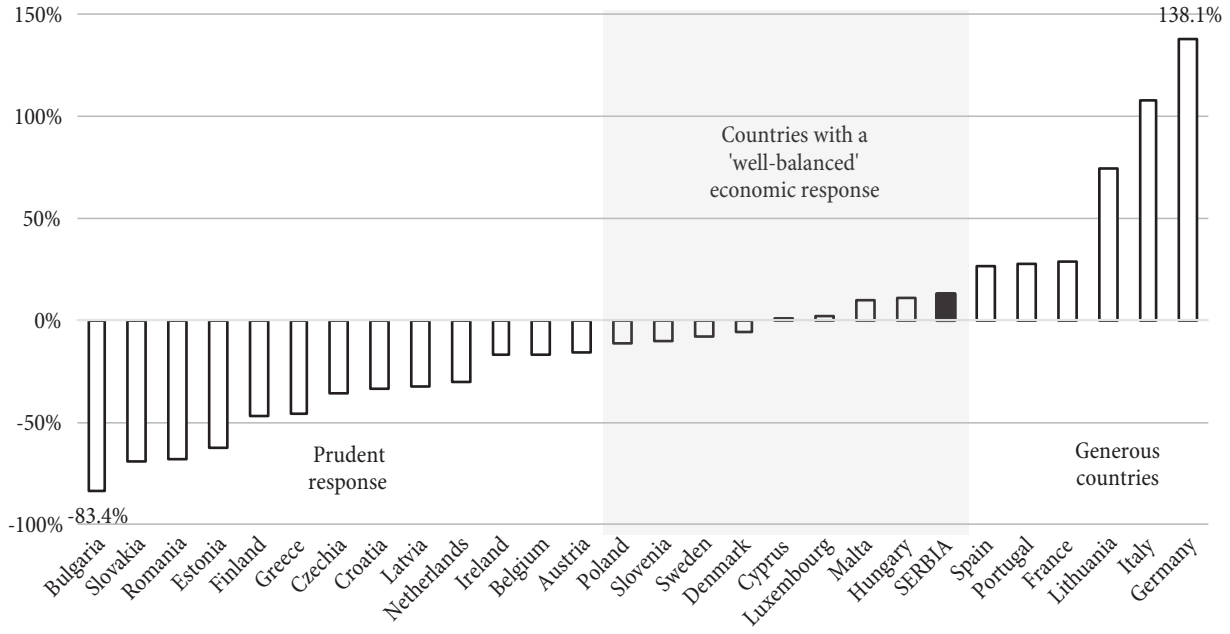
COVID-19 crisis and great lockdown, have caused an unprecedented level of economic uncertainty which

Figure 2: Economic response to COVID-19 (€ per capita) vs. per capita GDP, in 2020



Source: Calculated on the basis of EUROSTAT and ECA data.

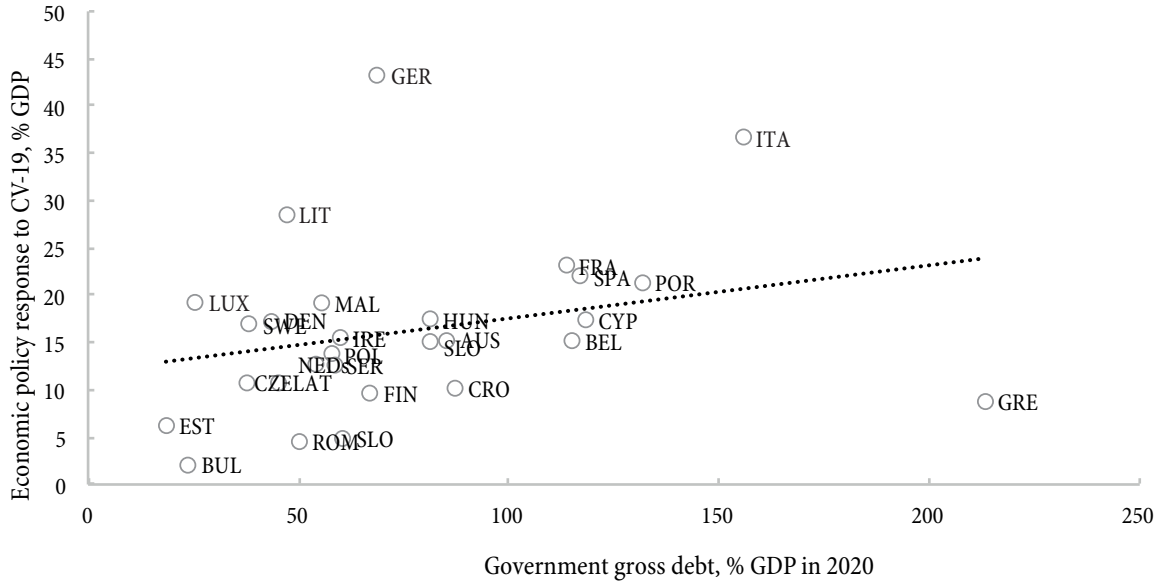
Figure 3: Assessing the success of the calibration of economic response package in 2020 (% deviation from the 'well-balance' response defined by the regression line in Figure 2)



Source: Calculated on the basis of EUROSTAT and ECA data.

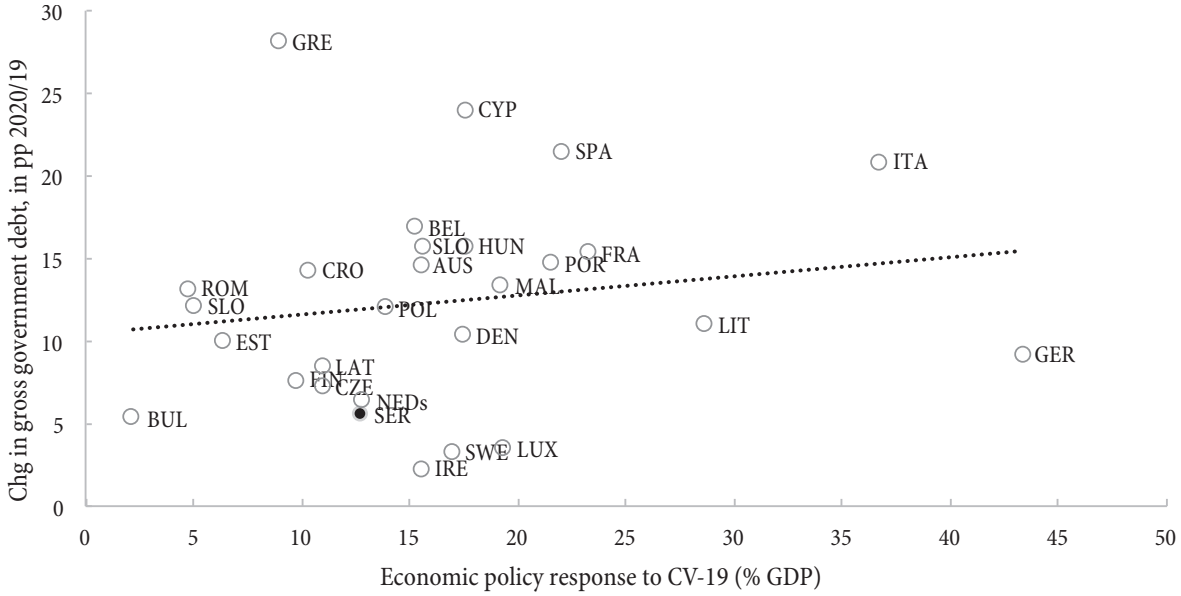
is similar or even higher than during the Great Recession of 2007-2009. Facing with overall economic anxiety, EU member states adopted different policy measures, such as short-time working schemes [38]. Besides, in March 2020 the EU adopted Temporary State Aid Framework to support the economy in the current COVID-19 outbreak [19]. In that way, a direct support for the EU member states included subsidies of EUR 500,000 per company, state guarantees for loans and subsidized interest rates. Most of the state aid measures were aimed at preserving jobs and alleviating the insolvency of the economy, which is in line with the economic policy guidelines that the European Commission sent to the member states on March 13 [18]. The document states that fiscal measures should be aimed at households and companies, in order to strengthen the liquidity of companies and prevent mass layoffs. The plan was implemented operationally, mostly through part-time programs, where companies faced with difficulties in temporarily reducing the number of working hours received compensation from the state for

Figure 4: Economic response to CV-19 vs. public debt in 2020, % GDP



Source: Calculated on the basis of IMF (WEO April 2021) and ECA data.

Figure 5: Public debt growth in 2020



Source: Calculated on the basis of IMF (WEO April 2021) and ECA data.

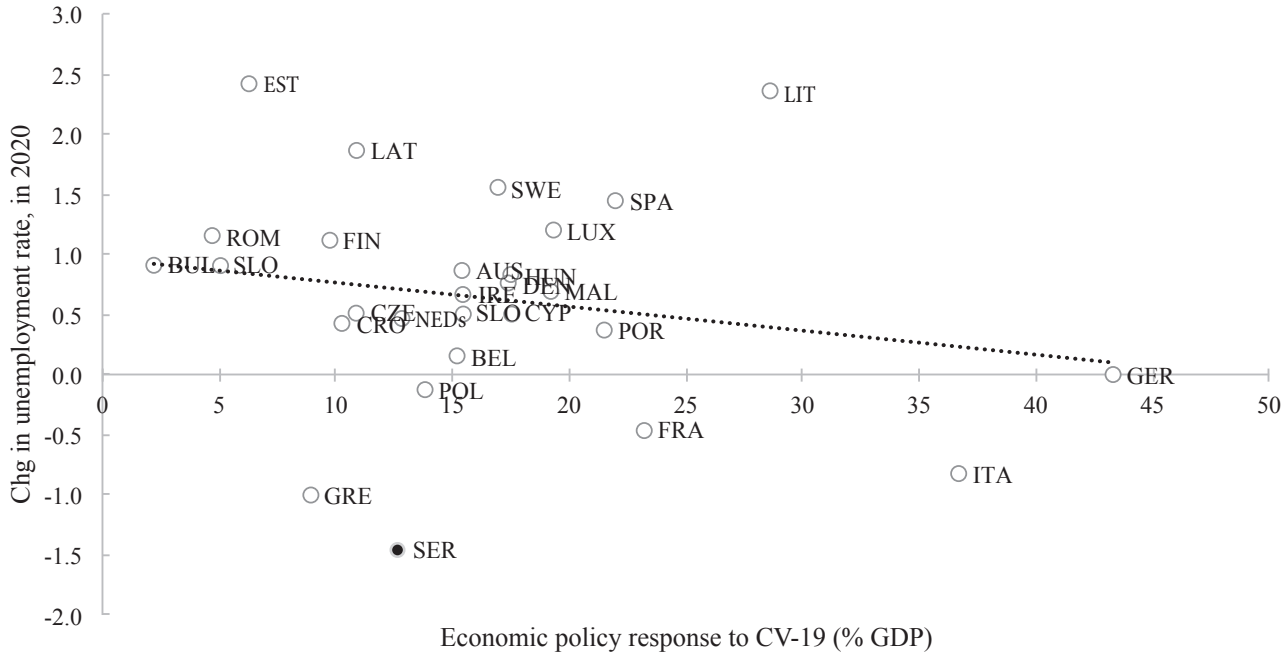
hours not worked, while maintaining a high level of wages for workers. For example, at the height of the pandemic, during April, more than a quarter of the total EU workforce was covered by this support program [29].

It should not be forgotten that Western European countries had already been faced the problem of external migration which already generated not only a high unemployment rate, but also an additional pressure on social programs in these countries. However, external migration can sometimes have positive consequences on their origin countries (e.g. South East European countries) where there is evident shortage of labour in some specific sectors such as constructions, manufacturing industry, etc. [3]. Analysing the increase of the unemployment rate in 2020 compared to 2019 in percentage points (Sep-Oct 2020 compared to April 2020) and state aid as percentage of GDP, an expected negative interdependence between the unemployment rate and the relative amount of state aid can be noticed. Countries where aid was more restrictive on average recorded a higher increase in the unemployment rate during 2020 (Figure 6). The European program in this segment was more efficient than the one in the USA, where only the period of payment of unemployment benefits was extended. That is why the unemployment rate in the United States grew much faster [25].

Based on the available data, it is still not possible to determine the positive statistical impact of state aid on GDP growth. Moreover, Figure 7 shows a different relation - higher relative state aid in the fight against the consequences of the COVID-19 pandemic resulted in a deeper fall in GDP. There is no significant difference in the conclusion whether data are considered for the whole year (the estimation of real GDP decline was taken from the November projection of the European Commission, except for Serbia where according to the Republic Statistical Office the decline was 1.0%) or the quarterly dynamics is analysed (growth of economic activity in the third in relation to the second quarter). Thus, in both cases, a better GDP result is not positively correlated with a larger economic aid package.

This paradox can be explained, above all, by the different economic situation at the time of the escalation of the crisis. Along with Ireland, Serbia has been at the very top of Europe in terms of GDP growth since the third quarter of 2019 (convincingly the best in the last quarter of 2019). By inertia, that economic growth will have a positive effect in 2020 as well. In addition, the effect of the economic structure is important. The largest decline in GDP is in countries where the dominant share of services (tourism, hospitality, transport) and where demand has

Figure 6: The unemployment impact of COVID-19 in 2020

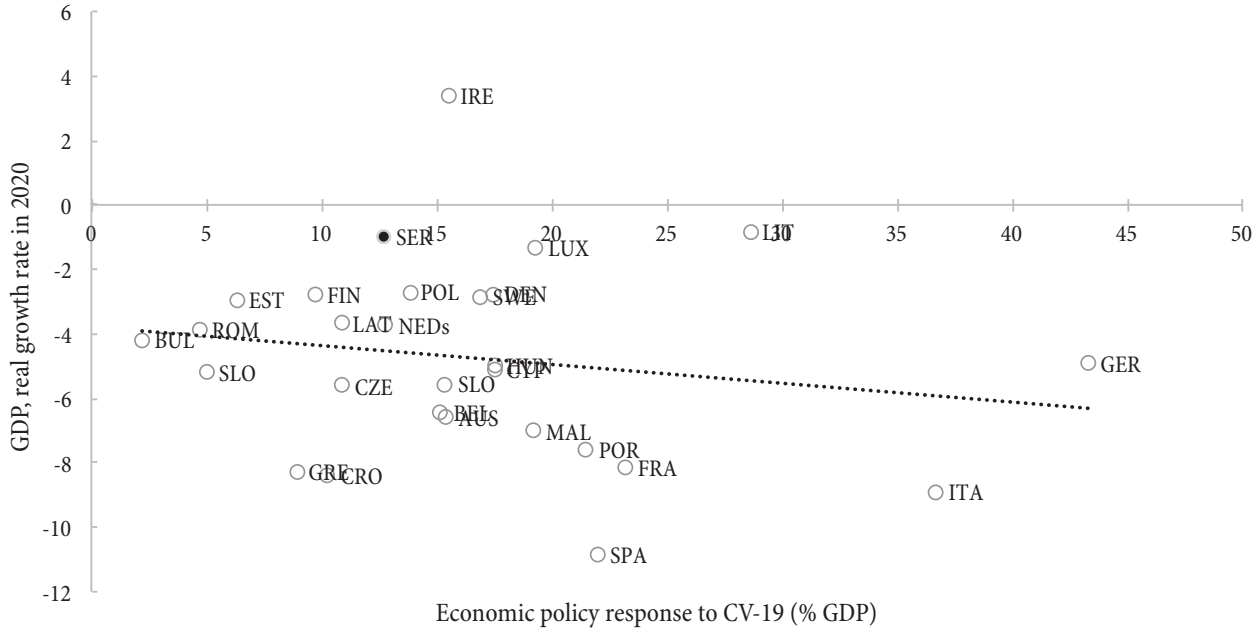


Source: Calculated on the basis of IMF (WEO April 2021) and ECA data.

dropped dramatically due to limited mobility of people. Above all, it is possible that the negative slope of the regression line in Figure 7 comes from simple regression, without controlling for other factors (such as structure of the economy or rigidity of containment measures).

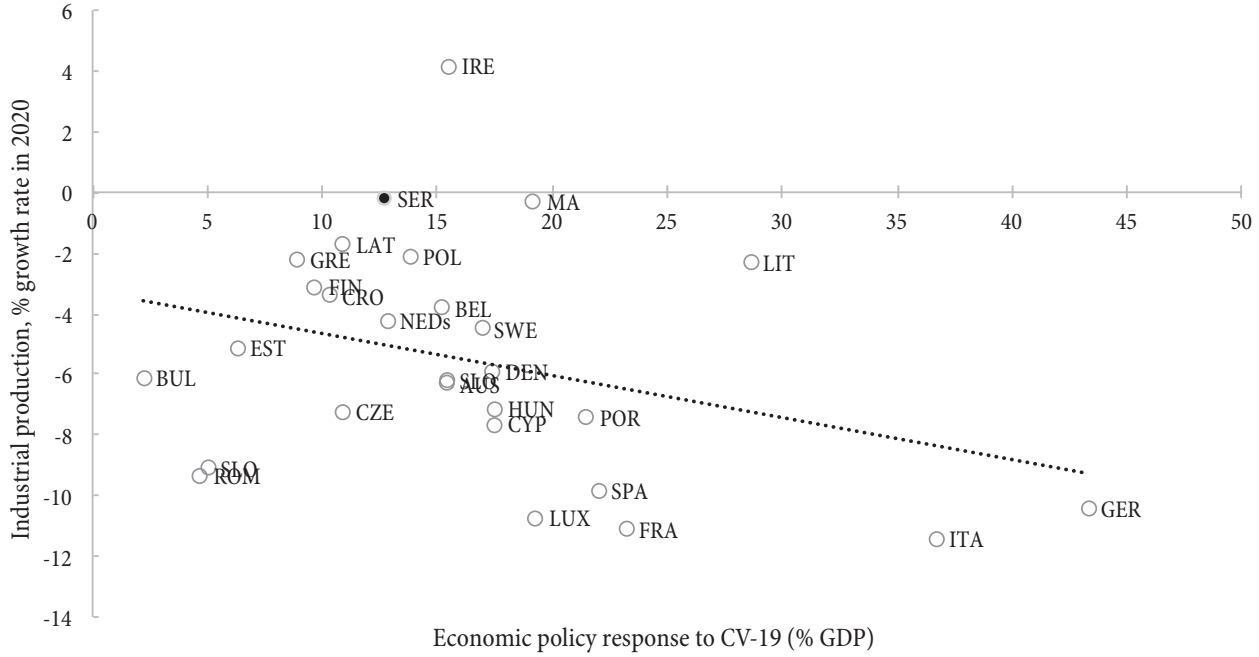
Considering structure of fiscal support, fiscal measures in the EU-27 in 2020 were predominantly directed to the non-financial business sector of the economy (84%), followed by households (8%) and other sectors. Despite the fact that at the end of autumn 2020, industrial production and retail trade are recovering faster in countries that have chosen a more generous package of assistance to the economy, by completing the data for the whole year we got the same result as for total economic activity measured by GDP. Thus, in the short run, the significant positive statistical impact of economic aid packages and

Figure 7: Economic response to COVID-19 vs GDP growth in 2020



Source: Calculated on the basis of Eurostat and ECA data.

Figure 8: Industrial production, % increase (average Sept-Oct 2020 compared to April 2020)



Source: Calculated on the basis of IMF (WEO April 2021) and ECA data.

industrial production (Figure 8) as well as retail trade turnover (Figure 9) still cannot be captured.

The previous finding is probably unexpected for the creators of support measures. It also requires a more cautious interpretation, given the fact that despite the clear interdependence, it cannot be claimed whether a less valuable aid package would keep economic activity at the level recorded during 2020. In particular, whether the decline would be much deeper in that case.

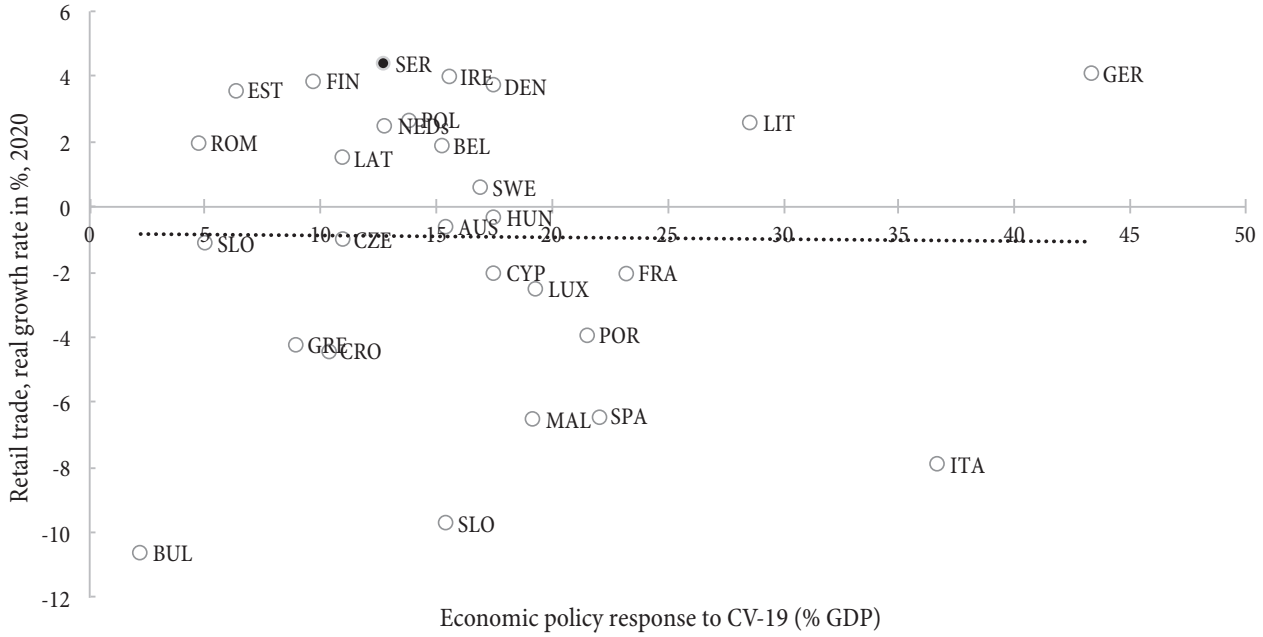
The effects of the COVID-19 crisis on the indebtedness of the economy

Corporate sector indebtedness recorded a record-high levels at the time of the outbreak in early 2020. Companies which entered the COVID-19 crisis with high levels of overhang had slower or even negative growth. The economic shutdown and revenues contractions, which were most severe in tourism, leisure and related industries, additionally got worse companies' cash flows and increased a high risk of bankruptcy [21, 37]. In addition to the mentioned sectors, SMEs companies are especially exposed in terms of massive job losses and other economic scars, as well as in terms of rising market power among dominant firms as they emerge even stronger while smaller rivals fall away [23].

Analysing corporate indebtedness, Baines showed that the respond from large and small companies is not the same. Empirical data showed that large non-financial companies experienced leverage increase, while their debt servicing burdens decreased. Contrary, smaller companies experienced sharp deleveraging alongside increasing debt servicing costs [4]. Empirical data showed that SMSs sector is particularly hit by decline in profitability, which together with a sharp rise in the financial pressure undermine and their solvency [6]. Even though cash holdings are expensive for companies (considering opportunity costs), the COVID-19 crisis highlighted the importance of precautionary cash holdings for firm value [35].

Based on data for 6,000 companies in 56 countries during the first quarter of 2020, it is recorded that companies with greater hedge fund ownership performed worse, while those with larger non-financial corporate ownership performed better [39]. According to estimations [30], COVID-19 generated cumulative net revenue losses for EU companies in the range of 5.4% to 10.0% of assets. Companies already entered the COVID-19 crisis having high leverage, while the pandemia has significantly increased the insolvency risk and debt levels [22]. There are BIS estimations that if 2020 revenues fall by 25%, then in the absence of any rollover, debt service and operating

Figure 9: Turnover in retail trade, % increase (average Sep-Oct 2020 compared to April 2020)



Source: Calculated on the basis of IMF (WEO April 2021) and ECA data.

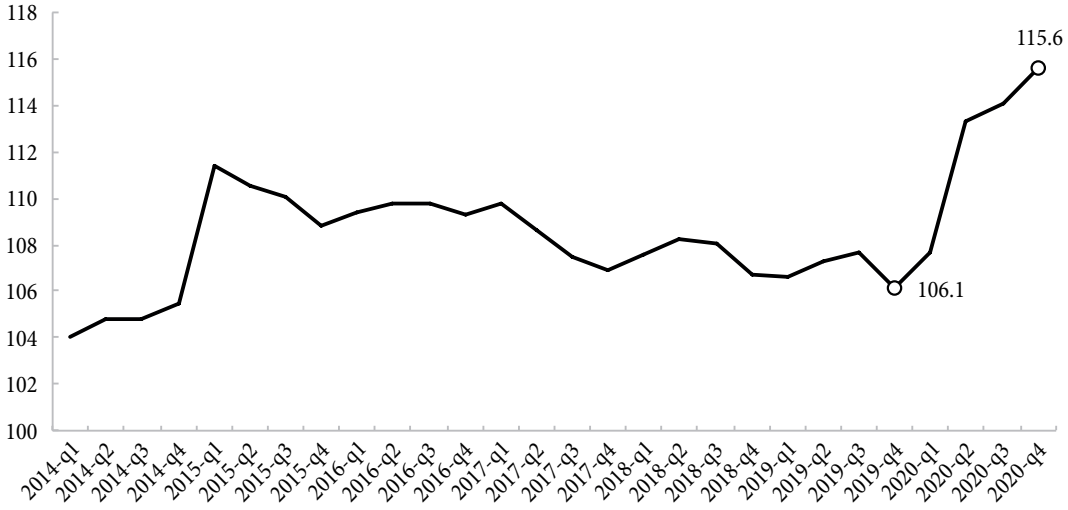
expenses will exceed cash buffers and revenues in more than half of the firms sampled [5]. Based on data for the first half of 2020, there is estimation that the combination of high prior debt overhang and revenue contractions lead companies in the most affected industries to grow 10% percent more slowly than in a Great Recession crisis [7].

Eurozone hase registered an exponential growth of corporate sector indebtedness since March 2020. Thus, the share of corporate debt of the non-financial business sector in GDP increased by 9.1 pp, from 106.3% of GDP at the end of 2019 to 115.4% in the fourth quarter 2020 (Figure 10). Additionally, as a result of the considerable associated uncertainty, equity prices felt by more than 30% from February to mid-March 2020 and began to recover after the announcement of the pandemic emergency purchase program [2].

It is expected that companys' demand for loans or drawing of credit lines will increase during this year while banks tightening their credit standards to companies without government guarantees reflecting rising risks. Especially there is a very strong net increase in demand for loans or credit lines with government guarantees, which is driven by companys' need to make precautionary liquidity buffers and to cover acute liquidity needs [15].

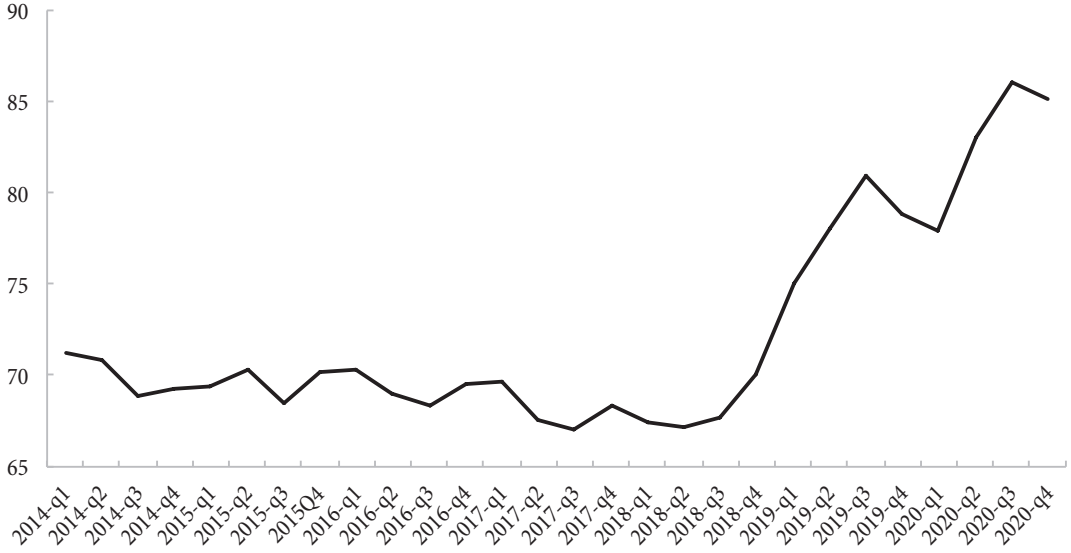
The ratio of total indebtedness, which expresses the relative share of debt in total sources of financing (higher ratio of financial leverage means higher risk for the creditor) is higher by one fifth (Figure 11). The final

Figure 10. Corporate debt-to-GDP ratio in Eurozone, %



Note: Corporate debt = Debt securities + Loans; Source: calculation based on Eurostat, Financial balance sheets.

Figure 11: Leverage ratio of non-financial sector in Eurozone



Source: Calculated on the basis of ECB data [16].

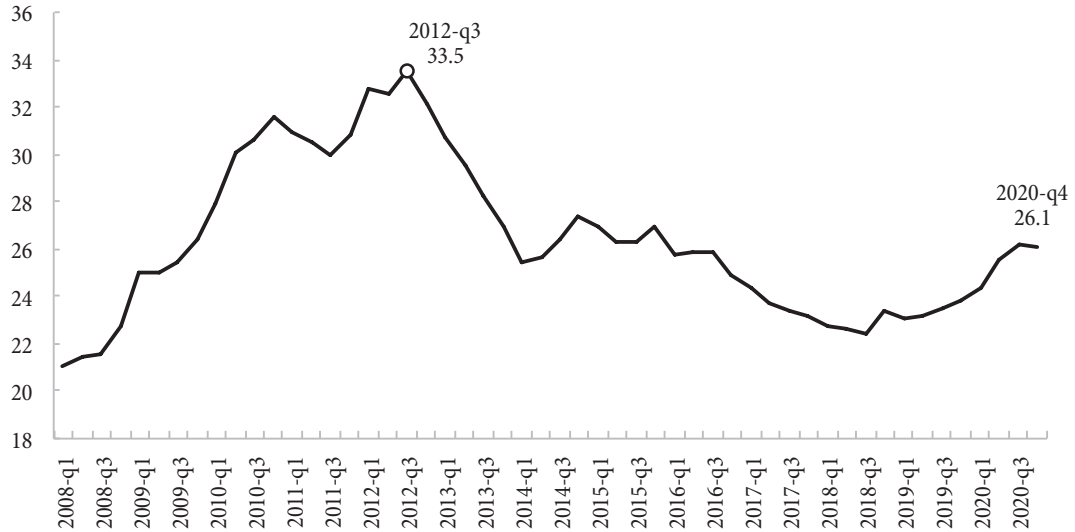
balance will be even more unfavourable when the results for the beginning of 2021 arrive. Excessive debt will significantly limit investment and non-performing loans (NPLs) will increase. In comparison with the 2008 crisis, the COVID-19 crisis was not preceded by a credit boom. Even though today banks have higher capital, they are less profitable. Compared to 2008, most European countries have significantly higher public debt, so credit losses from corporate distress will rise and could overwhelm banks, further complicating NPL resolution [36]

Corporate debt in Europe reflects long-term trends of falling interest rates, expansion and compressed credit spreads. During the COVID-19 crisis, corporate cash flows are deteriorating and collateral values are falling which resulted in a rapid deterioration in credit quality. It is obvious that corporate leverage and problems in business cycle, needs urgent debt restructuring measures which can include reducing capital requirements for banks that write down excessive debt burdens or accept debt-for-equity swaps and offering tax inducements for debt write-downs [8]. However, if the government is involved in corporate debt restructuring, this interventions can have effects on public finances. Since the existing literature provides only a partial view of corporate debt as it usually focuses on specific markets and borrowers, it seems that is needed a more detail analysis on the levels and composition of corporate debt across economies [1].

Up to now, state aid and incentive policies (such as loan guarantees and moratoriums, along with capital relief) have resulted in preventing a liquidity crisis by about half and short-circuiting the doom loop between corporate and financial sector fragility [13]. This is indicated by a sharp increase in the value of the liquidity ratio (a measure of a company's ability to meet its short-term obligations with the most liquid assets) that reached its highest level in 12 years at the end of the third quarter. Similar conclusions arise when looking at the value of the current ratio (the relationship between current assets and current liabilities). For example, in the EU, in the case of medium-sized companies, the value of that ratio increased from 1.3 in fourth quarter 2019 to an estimated 1.4 in third quarter 2020 [31]. State aid has enabled companies to finance working capital and compensate for reduced revenues. Thus, the insolvency tsunami was stopped, permanent damage to production capacities was avoided, as well as mass layoffs.

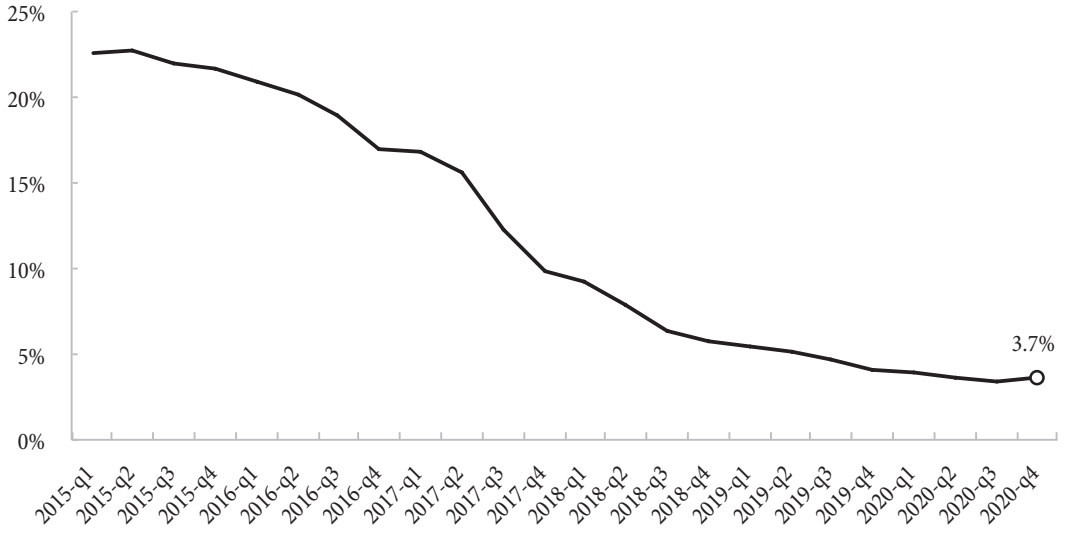
Unlike the Eurozone, according to the National Bank of Serbia, the Serbian economy recorded a moderate growth of indebtedness in 2020. The share of corporate debt in GDP at the end of last year compared to the fourth quarter of 2019 increased by only 2.3 percentage points, to 26.1% (Figure 12). The debt of the real sector of economy is still almost a quarter lower in comparison to the highest level of indebtedness recorded in the third quarter of 2012.

Figure 12: Corporate debt of Serbian non-financial sector, % GDP



Source: National Bank of Serbia.
Note: claims of the domestic banking sector include newly introduced corporate bonds from the third quarter of 2020. *Source*: author's calculation based on the National Bank of Serbia database.

Figure 13: Non-performing loans to total gross loans in Serbia



Source: National Bank of Serbia.

The debt of the economy expressed in this way refers to the exposure of companies (public and private companies) to domestic banks, i.e. on the total claims of the domestic banking sector from public companies and companies in the Republic of Serbia, which include corporate bonds, as a new type of financing the economy that began in September 2020. At the same time, nothing in the conclusion would change if we increased this debt for foreign borrowings of the company (cross-border) nor accrual of stock of enterprises external debt. Vicelike, total amount of enterprises external debt increased by EUR 1,032.5 million (at a level of EUR 12,001 million, as of December 31, 2020) or only 1,96 percentage points of GDP in 2020.

Available data indicate that in 2020, Serbia maintained high efficiency of the financial market, credit activity and support to the economy (Figure 13). The banking sector is adequately capitalized and resilient to credit risk growth due to the still unfavourable macroeconomic trends caused by COVID-19. This is evidenced by the share of NLP in total loans, which at the end of last year was reduced to the lowest level since the beginning of the implementation of the Strategy for resolving NPL issues.

Debt restructuring - potential options

The sovereign credit default swap (CDS) market has grown rapidly during the past three decades and become one of the main financial instruments to manage credit risk. Based on daily observations for 77 countries in the first half of 2020, there is empirical evidence that COVID-19 crisis has had a significant impact on sovereign CDS spreads across all countries, while the adverse effect is more pronounced in advanced economies [10].

Historical experience points to the conclusion that the public sector must be an active participant in solving the problem of debt growth - it should proactively provide the necessary incentives and enable coordination between creditors and debtors. In time of COVID-19 crisis, solving debt problem will correspond to a speed and effectiveness of policy measures [27]. Given the intensity of the shock and the role of public guarantees as part of the debt, the imperative for an active government response is even greater. The European Commission and the Member States need a clear joint action plan in order to take full advantage of the set of tools available and carry out the necessary restructuring. Current discussions in the EU are again focused on the issue of resolving NPLs and the importance of freeing the balance sheet of banks for new loans. The proposed solutions range from generating networks of asset management companies (AMCs) to reliance on strengthened bank capital reserves and encouragement of NPLs sales on secondary markets [32].

These are feasible and tried-and-tested solutions. The focus on banks and their balance sheets again masks and widens the macroeconomic impact of over-indebtedness.

The advantage of AMC is that, as a rule, it owns easily marketable assets. However, Europe is currently facing an increasing number of companies, especially in the SME's segment, which do not have adequate collateral. Even if banks can dispose of NPLs through AMC and the secondary market, it remains questionable whether a solution to hard-to-collect receivables will be sought in the restructuring or liquidation of companies, even sustainable ones.

One of the solutions mentioned is the introduction of the European deposit insurance scheme, which should ensure the stabilization of depositors, as well as help prevent further increases in public debt to GDP in the event that national deposit guarantee funds are exhausted or when there is very little space for the application of measures in fiscal policy [11].

If we consider political will, there is still no agreement in the European Council about the so-called "instrument to support solvency" economy. Attitudes are ambivalent because the EU member states have already generated huge fiscal costs in order to mitigate the negative effects of the pandemic. There are even suggestions that some costs should be allocated to the parts of the private sector that can best bear it with minimal adverse effects. Although injections of public capital will certainly be needed during this year, there is a growing opinion that in this way the costs would be reduced and much better economic results would be achieved.

No matter how much the restructuring of companies that are able to continue doing business is theoretically the optimal option, for private creditors the end result may be something completely different. In practice, it happens that the restructuring process is accompanied by short-sighted, non-cooperative and harmful decisions of creditors, with the aspiration to settle as quickly as it possible, even if a sustainability of company is questionable.

Institutional factors and efficient bankruptcy procedure play an important role in this regard. For example, bankruptcy proceedings in Europe are significantly more rigid than in the United States, which many see as an important reason for the slower recovery of the European economy [9]. There are empirical studies suggesting that institutional factors related to corporate debt are crucial for economic recovery [24]. Even now, out-of-court proceedings and mediation are proposed as effective alternatives.

The fact is that in Europe, bankruptcies can last for years, but also that the practice differs between member states and that some reforms have already been implemented. For example, a mechanism for imposing a reorganization or restructuring plan on a cram down mechanism has been introduced, although it also has certain weaknesses. Imposing against the will of creditors makes this institute problematic, because restructuring implies the cooperation of all relevant parties, and it is quite justified that a key creditor, alone or in cooperation with other creditors, can obstruct the restructuring. Another argument against this mechanism is that it implies a significant role of the court, and wrong court decisions and a significant extension of the procedure are possible, which can make the whole procedure completely meaningless [34]. Although the number of preventive out-of-court restructuring is growing, formal procedures that usually end in liquidation still prevail [33]. The outcome of which the largest number of European businessmen are afraid of.

For this reason, an urgent, joint and consistent European response to these challenges is needed. Perhaps in the form of a new strategy, with a precise action plan to, on the one hand, accelerate the necessary restructuring. Before that, companies were brought to the edge of insolvency, and at the same time the conditions for 'fair play' were imposed on everyone, without exceptions.

The regulatory basis for action would be the "Directive 2019/1023" on restructuring and insolvency [17] and its unconditional implementation. Self-initiated restructuring and all possibilities of 'out-of-court' reaching a compromise solution, before declaring formal insolvency, will be encouraged. The whole process must be provided with adequate resources (time boundaries and money restrictions are present, and there is no monitoring and control of the implementation of restructuring without appropriate institutions and professional staff). No matter how much institutions are strong and independent, the political leadership must be engaged in the process of persuading creditors to accept reorganization and restructuring plans. This is a very interesting proposal,

despite the fact that it is attributed only to solving the problems of the largest systems and strategic companies. In support of this option, the Ministry of Finance of France (The Comité Interministériel de Restructuration Industrielle) is given as an example of institution which actively arbitrates in negotiations that are important for the country's economy [26].

The forthcoming action of mass restructuring is burdened by numerous dilemmas. The key question is who should be restructured? The answer is that only sustainable companies or those that have a long-term development perspective should be restructured. Otherwise, the principle of competition is violated and resources are misallocated. But it is not easy to determine who is sustainable and who is not. Will structural business changes during a pandemic (such as work from home) be reflected in companies in the future? Common guidelines could ensure that 'temporary' tolerance does not mask support for firms that do not need to survive, all to the detriment of new business models. Besides, it is possible that business conditions before the pandemic will never return, so it would be completely wrong to follow the estimates based on cross-sections from the earlier period.

Having in mind size, fixed costs, capital structure, and diversity of SME's, the next challenge is their treatment. In earlier economic crises, the burden of large-scale restructuring fell on the shoulders of the SME sector. The problem is their diversity and number, which makes it difficult to locate the most endangered. That is reason why the economic package of aid now must be more comprehensive and flexible, which again cannot be realized without more serious state incentives. Here, it will probably be necessary or inevitable to offer a one-time debt write-off, perhaps for tax liabilities and obligations to mandatory social insurance organizations.

The dilemma is also how to deal with debt from the pre-COVID 19 period. Debt incurred during a pandemic should not be a moral hazard. However, this debt cannot be substantially separated from the inherited debt from the pre-crisis period. Successful restructuring and further survival is possible only if the debt is treated uniformly.

Additionally, there is dilemma of debt-to-equity conversion. Namely, in order to strengthen the European capital market, the European Commission launched an initiative in 2015 called the Capital Markets Union. The initiative included measures aimed at creating a truly integrated single capital market by 2019. Obviously this has not been realized, but it is still believed that it can contribute to increased investment, GDP growth and job creation.

The capital market should play a more significant role in financing the European economy, especially in the period after the COVID-19 crisis. Accordingly, the Action Plan is updated and supplemented with new priority measures. Restructuring is a chance to strengthen the capital market, especially in area of debt conversion into capital. The whole process should certainly be specified and priorities should be determined, which would be acceptable for creditors as well. This is an area where even European asset management companies (AMCs) can operate effectively. They would take over and manage the assets of the original owners, which would help the financial consolidation of banks, but also maximize the recovery rate of problem loans. The assets could be sold on the secondary market or transferred to a larger state investment fund.

Certainly policy makers need to find some solution between prematurely ending of support and providing too long comprehensive support. Although debt financing is an option in the case of resolving current liquidity constraints, a solution may also be to recapitalize a company that (e.g. preferred stocks) which reduces corporate debt. Policymakers may consider establishing legal conditions that favour new financing for firms in need (e.g., prioritizing unsecured existing creditors), promoting a pre-insolvency framework, and adopting special procedures to facilitate SME debt restructuring [12].

Conclusion

European countries have applied a wide range of short-term fiscal, monetary and macroprudential measures in response to the COVID-19 crisis. The results of the research showed that the financial value of the state aid package reflected, above all, the economic capacity and relative wealth of the countries, and not how much the

crisis hit them hard. Thus, the most generous economic aid package was implemented in Germany (as much as 43.4%), while in Bulgaria the share of the economic package was only at the level of 2.2% of GDP. Compared to the EU-27 member states, Republic of Serbia is ranked in the middle with about 12.7% of GDP.

Contrary to the Eurozone, Republic of Serbia recorded a moderate growth of indebtedness in 2020. Republic of Serbia also had an adequately capitalized banking sector resistant to credit risk growth, which can be supported by the fact that the share of NLP in total credits at the end of 2020 was the lowest since the beginning of the implementation of the Strategy for resolving NPL issues.

The COVID-19 crisis will further exacerbate economic inequalities between European countries in the coming years. At the same time, the prospects for the growth of economic activity have changed. With all the previous limitations, the new unfavourable circumstances are different economic policies that, through fiscal instruments, seriously distort the current market competition, although countries have different capacities to implement economic policy response during the crisis. Differences are also growing due to rising unemployment, cut down on investment flows and risks in the area of financial stability, which could occur if the problems spread to the financial sector. Increasing public debt and concerns about its sustainability could consequently limit the fiscal capacity to adequately respond to future crises and implementation of long-term sustainable EU development strategies. Therefore, there is a risk that new national financial constraints will be introduced in the coming period. At the same time, the high degree of uncertainty regarding the further economic outlook, the decline in corporate income and the growth of their indebtedness over the past year may induce a significant reduction in private investment as well.

Consequently, it is obvious that the future European economic recovery will depend on the efficient and effective resolution of excessive corporate debt, which escalated during the COVID-19 pandemic. Part of the remediation must inevitably stem from self-initiated private restructuring even though the fiscal system is overstretched. Bankruptcy procedures have been gradually improved over the last decade, but additional public policy action is needed. Europe must jointly provide the resources, guidance and coordination necessary to carry out the giant corporate restructuring that follows. Otherwise, the outlook is bleak. The economy would enter a period of protracted crisis, with the bankruptcy of many companies, even sustainable ones, with sound business models, while the economic recovery would be permanently blocked.

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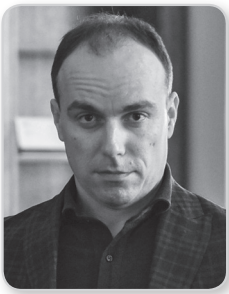

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