EU REGULAR ECONOMIC REPORT 6

WORLD BANK REPORT
ON THE EUROPEAN UNION

Restarting Resilience

The impacts of the COVID-19 pandemic on inclusion in Europe

Overview

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1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

Cover design, interior design and typseting: Piotr Ruczynski, London, United Kingdom.

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Countries and Regions

Northern Europe (NE)	Denmark	DK
	Estonia	EE
	Finland	FI
	Latvia	LV
	Lithuania	LT
	Sweden	SE
Western Europe (WE)	Austria	AT
	Belgium	BE
	France	FR
	Germany	DE
	Ireland	IE
	Luxembourg	LU
	Netherlands	NL
Southern Europe (SE)	Cyprus	CY
	Greece	EL
	Italy	IT
	Malta	MT
	Portugal	PT
	Spain	ES
Central and Southeast Europe (CEE)	Croatia	HR
	Czech Republic	CZ
	Hungary	HU
	Poland	PL
	Slovak Republic	SK
	Slovenia	SI
	Bulgaria	BG
	Romania	RO

Abbreviations

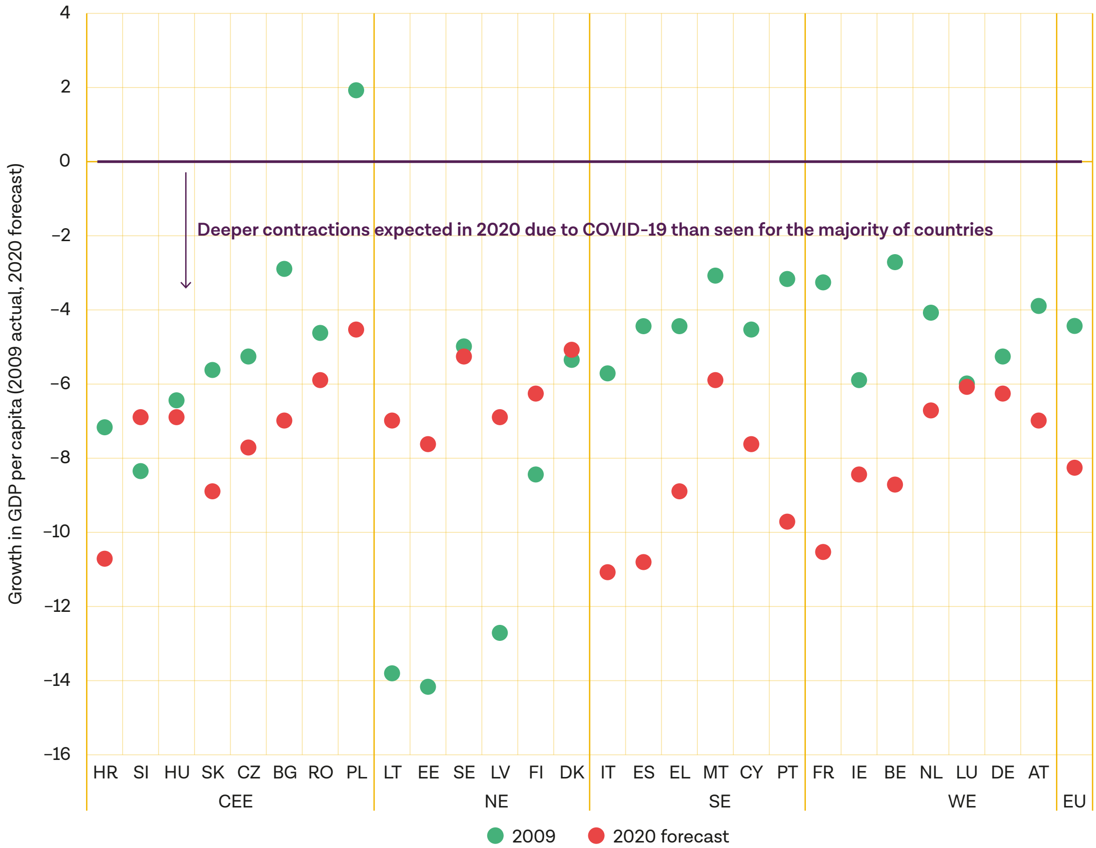
AMECO	Annual macro-economic database of the European Commission's Directorate General for Economic and Financial Affairs
ALMP	Active Labor Market Policies
AROP	At Risk of Poverty
EC	European Commission
ECB	European Central Bank
EPL	Employment Protection Legislation
ETUI	European Trade Union Institute
EU	European Union
EU-SILC	EU Statistics on Income and Living Conditions
EU-LFS	EU Labour Force Survey
GDP	Gross Domestic Product
GEP	Global Economic Prospects
IMF	International Monetary Fund
JRC	Joint Research Centre
NUTS	Nomenclature des Unites Territoriales
OECD	Organization for Economic Co-operation and Development
PMR	Product Market Regulations
PPP	Purchasing Power Parities
PPS	Purchasing Power Standards
RER	Regular Economic Report
WB	World Bank

Overview

Inclusive growth typically refers to economic expansions that are strong and shared across society. In times of contraction a society that is more inclusive is one that shields vulnerable households from the storm, to avoid the contractions from leading to long term deprivations. Earlier work by the World Bank (WB, 2019a) showed that the incomes of worse-off households were disproportionately affected by the global financial and euro-zone crises — contractions were amplified for the poorest twenty percent of the population compared to median households, and the incomes of these households also took longer to return to their pre-crisis levels.

Every EU-27 country is expected to see sharp economic contractions due to the COVID-19 pandemic. Considerable uncertainty has entered into future outlooks. GDP is forecasted to contract by approximately 8.3 percent in the European Union (EU) (EC, 2020b) and by 10.1 percent in the Euro Area (WB 2020c), for most countries this represents a far deeper annual contraction than seen during the global financial crisis in 2009 (Figure 1). The decline in output is driven by major drops in investment and private consumption across the EU, which has been only partially offset by the positive contribution of substantial support through national budgets.

Figure 1 The growth outlook is highly uncertain, but all forecasts point to a sharper contraction than seen in the first years of the global financial crisis



Source: 2009 (AMECO database, EC Directorate General for Economic and Financial Affairs). 2020 (Summer Interim forecasts, EC 2020b).

The rapid policy response to the COVID-19 pandemic has given economies the breathing space needed to maintain employment, to keep viable firms afloat and has stemmed the immediate impacts on unemployment. However, household income drops are still anticipated. Even though the employment impacts have been minimized, income drops are still likely to be seen since wages are not fully covered by short-time work or furlough programs. In addition, coverage gaps are more likely to affect lower-wage segments rendering them disproportionately exposed to the impacts of the crisis.

This report explores the impact of the COVID-19 crisis from the perspective of inclusion. We present the results in three parts.

First, we examine the implications of the crisis on jobs.

- We find that one in eight jobs are at risk of employment and income impacts even as countries have emerged from lockdown, while 25% of jobs faced the strongest risk during the lockdown phase.

- We note that low-wage workers, women (who are twice as likely as men to be in higher economic risk occupations), those in non-standard or flexible work types and younger workers are likely to face the greatest risk of employment and income impacts.

- While the pandemic is still unfolding, the evidence suggests that inclusion has been increasingly compromised and that further support will be needed for heavily affected households. The impacts across workers, households and countries are likely to be highly uneven and will result in rising income and spatial inequalities.

Second, we explore how employment risk feeds through to household incomes and those at risk of poverty.

- We find that at least one in five households are likely to suffer income losses because of a reduction or loss of employment in the lockdown phase of the crisis. And, even as societies reopen, at least one in eight households may continue to face income losses due to restrictions in how work may be conducted.

- We estimate that the share of the population at risk of poverty could rise by 3 – 4 percentage points in 2020, from 14.7% of the population estimated to be at risk of poverty in 2019 to 17.7 to 18.7% in 2020. This is a 20 to 27% increase over the projected 2019 levels that pushes a further 10.9 to 14.6 million people into the risk of poverty.

- We anticipate a sharp rise in poverty, in particular in Southern Europe where the combination of pre-existing economic structures that leave countries more exposed to COVID-19 impacts (such as a heavy reliance on tourism, higher shares of temporary and informal workers, and less absorptive social protection structures) and limited fiscal space may leave these countries and populations more exposed to the economic impacts of the crisis and constrain policy responses.

- These estimates should be interpreted amidst the current uncertainty surrounding the impacts of the crisis. On-going and evolving national and EU level policy responses to the crisis, including the €750 billion recovery fund, can help to mitigate these impacts.

Finally, we examine resilience, notably considering the formal and informal institutional structures that support household and economy wide resilience. The uncertainty of the economic, health and policy outlook means that the need for the key institutions that support resilience has never been greater.

- We note that it is critical in these uncertain times for economic stakeholders to reach cooperative solutions in steering policy responses during the crisis. Countries in which mutual trust has been fostered through positive historical interactions may be better placed to navigate coordinated solutions but trust can evolve rapidly through positive reinforcement. As such, these ambitions apply for all.

During the global financial and euro-zone crises, some countries were more resilient and able to protect poorer populations more than others — a theme explored in greater depth in the fifth Regular Economic Report. Many of the institutions that supported resilience then remain relevant today. While the size of the shock facing a country clearly depends on the share of severely affected sectors, most notably tourism, travel, entertainment and restaurants, there are a number of features of labor markets, social protection systems and the social contract that affect the path that a country will take in navigating a crisis (World Bank 2019a, b). During the global financial and eurozone crises, labor market structures that allowed for rapid, coordinated responses across businesses, labor and government to support nominal wage reductions and minimize job losses were found to support economic resilience, at both the macro and household level (World Bank, 2019a). Fundamental in these transitions was strong trust in government to navigate the crisis while upholding inclusion, allowing for difficult decisions to be made during the reform process. The COVID-19 crisis, while requiring coordination among a wider set of actors, has highlighted the need for these same institutional underpinnings of rapid societal evolution in the face of the crisis. The extensive packages of support extended to households and firms have provided a breathing space for adjustment during the first phase of the pandemic. As the lasting damage to economies and societies becomes clearer and conditions remain highly uncertain, the ability of labor market structures to rapidly adjust in a coordinated manner to reduce employment impacts and needed adjustments will be important. Social protection structures will need to balance protection of those in need — helping households to navigate the impacts of the crisis — while also incentivizing work in sectors where demand is growing and supporting a more rapid economic recovery.

A bleak picture is emerging of the implications of the crisis for economically vulnerable populations across the EU

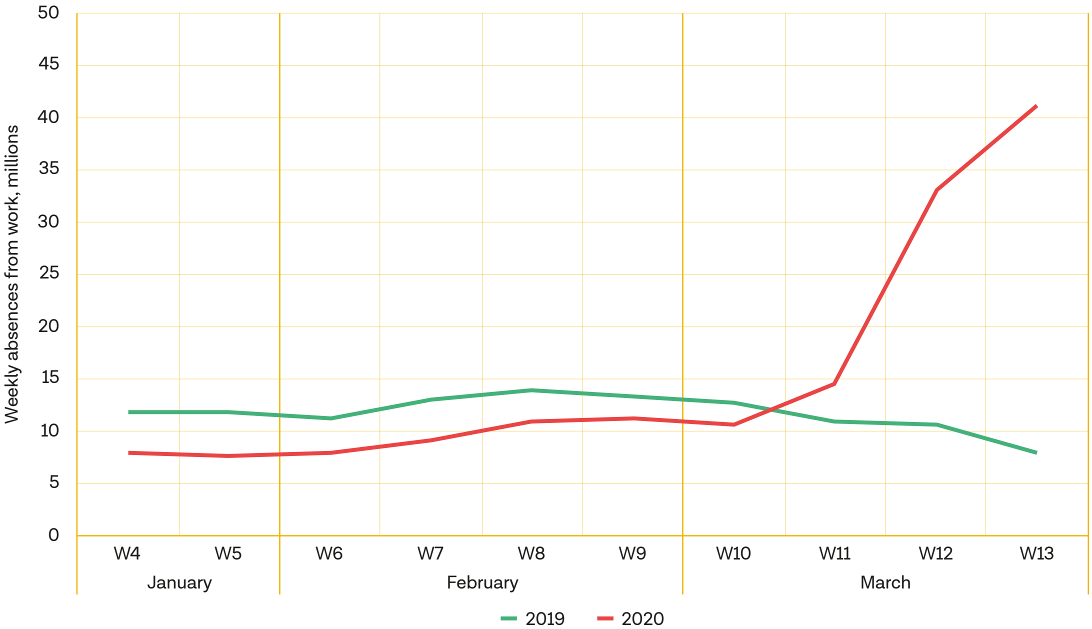
The COVID-19 pandemic requires countries to navigate a path between a rock and a hard place: the social distancing measures needed to reduce virus transmission and to maintain population health have had severe social and economic impacts and have required considerable financial support from governments. In the first phase of the epidemiological response, countries across the EU took strict measures to lockdown or limit movement and societal interactions in an effort to slow the spread of the virus; as countries gradually reopen, they do so with public health guidelines in place on how to continue to reduce virus transmission through limiting interaction. The human interactions are central to the functioning of economies; limiting human and physical interaction in this manner has required a fundamental pivot in jobs across countries.

No sector or segment of the workforce has been left unchallenged. Across all sectors of the economy, restrictions to social and economic activity have affected the nature and location of work, affecting how people work for extended periods of time. Demand patterns have shifted as consumers adjust to the new circumstances under which consumption can occur. The shocks are also unprecedented due to the abrupt onset of the pandemic; the need to close large segments of society and economies; and the policy and business climate uncertainties generated that impact hiring and investment choices. Finally, the global nature of the crisis, which has unfolded simultaneously across countries, has limited offsetting channels of economic advancement.

Workers and firms have had to quickly accommodate social distancing restrictions to reduce virus transmission. As movement restrictions were put in place, some jobs and sectors were able to pivot to new working conditions, while other sectors and activities ground to a halt. The share of workers absent from work nearly quadrupled in the space of three weeks, from 11 million at the beginning of March to 41 million at the end (Figure 2). Beyond the immediate impact from the initial lockdown, a potential prolonged impact of the COVID-19 crisis is anticipated as societies gradually and steadily reopen, and as contractions in demand and shifting consumption patterns unleash a second channel of impact on labor markets.

Figure 2 The number of workers absent from work quadrupled in the space of 3 weeks

Number of people absent from work in the EU-27, by week; 2020 compared to 2019

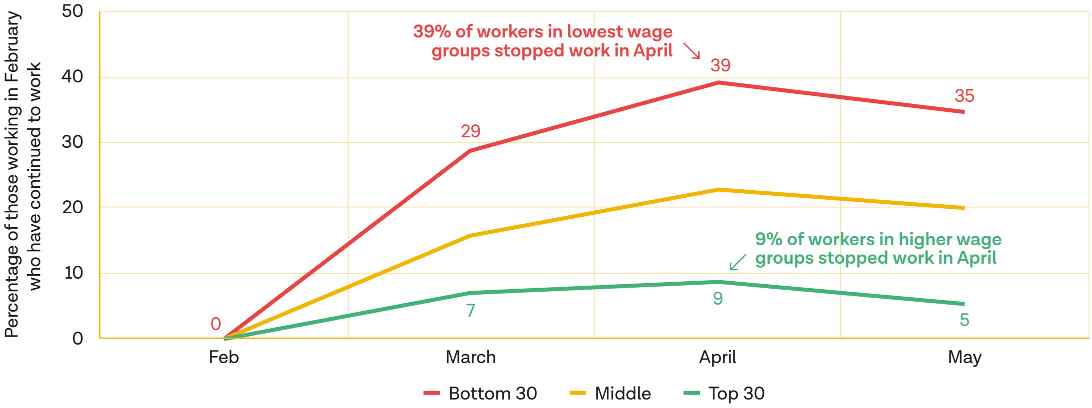


Source: Eurostat, Weekly absences from work, by sex and age — weekly data and in the realm of experimental statistics [lfsi_abs_w].

A quarter of the workforce is likely to have faced substantial work and income disruptions in the lockdown phase of the COVID-19 public health response[1]. As economies gradually reopen, one in eight workers are anticipated to face continued disruptions. Our analysis suggests that 38% of the workforce are in essential occupations that can continue operations throughout the COVID-19 response[2]. While some 15% of workers can shift more readily to home-based work, given the tasks they need to perform in their jobs, nearly half of the workforce faced a risk of employment disruption. Overall, we find that 25% of workers face the most substantial risk of disruption and income impacts during the lockdown phase[3]. In the gradual reopening of economies, approximately one in eight workers (11% of the workforce) are in occupations that may be difficult to continue working in given the nature of their work and continued social distancing needs.

The labor market impacts are occurring in a highly uneven manner and are disproportionately affecting already economically vulnerable segments of the population. Although the effects of the crisis have not yet been fully realized, early indications suggest that labor market restrictions that limit movement and societal functions are disproportionally affecting workers already considered to be economically vulnerable. This includes lower-wage workers, those with non-standard and less-secure contract types, those in blue-collar occupations and younger segments of the labor force. Since the duration and epidemiological curves of the crises are still to manifest, we can simply point to the groups that are at-risk, but the ultimate impact will depend on the policy responses to the crisis and for how long and where these circumstances persist.

Figure 3 Pulse estimates of those whose work has been stopped since February in Romania by month, by point in the monthly wage or business income distribution



Source: World Bank Rapid Assessment survey of COVID-19 impacts (wave 1). Respondents were asked to report whether they did any work for a wage, salary or any other pay or do any kind of business, farming or other activity to generate income even if only for one hour during the last week of February, the third week of March (starting March 16th), the third week of April (just after Easter, starting April 23rd) and during the week before the conduct of the survey (which was conducted from May 6th to 19th).

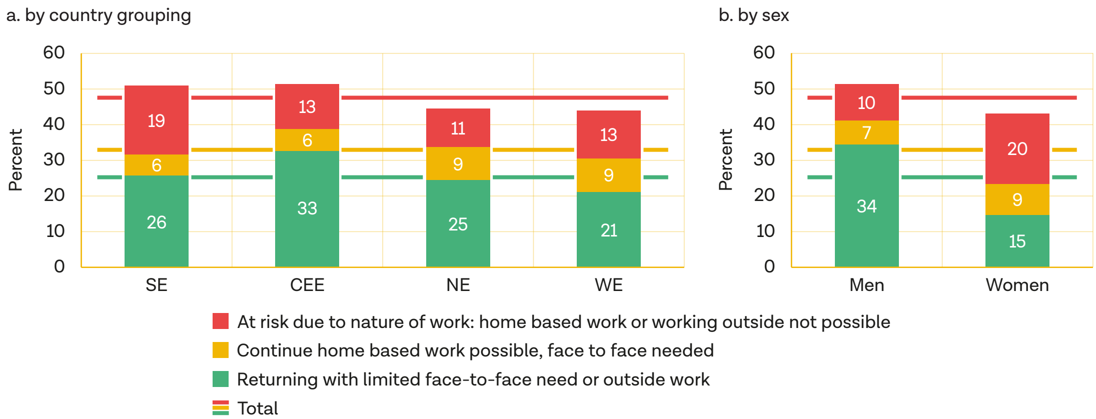
As such, the crisis has the potential to further exacerbate existing inequalities and to widen labor market disparities. Labor market inequalities have been rising in Europe since the 1990s (World Bank 2018, 2019a,b); these trends were intensified during the global financial crisis as the recession accelerated the longer-term changes underway in the labor market[4]. Both labor market and societal inequalities are likely to rise as a result of the COVID-19 crisis, due to the interplay between deeper predicted impacts in lagging regions, the longer-term technological changes underway and the asymmetric impacts of the crisis. Technological change was already rewarding more educated and skilled workers adapting to shifts in the nature of work. These existing trends are being accelerated by the labor market shifts seen in the COVID-19 pandemic, where workers most engaged in occupations that require extensive personal interactions have been most severely affected.

The crisis also risks stalling economic convergence across Europe: lagging and poorer regions in Europe are anticipated to suffer some of the worst losses. Although some of the poorest regions may be able to navigate the crisis better due to having a greater share of workers in agriculture, many of the jobs at greatest risk have been concentrated in worse-off regions (Sanchez et al. 2020). An assessment of labor market impacts using the Labor Force Survey found that European regions that are already economically disadvantaged — due to having lower GDP per capita or a higher share of low-wage workers — are also most heavily affected by labor market transition risks and associated income and employment losses. On average, a 10 percent decrease in regional GDP per capita is associated with a 0.5 percentage point increase in jobs at risk. There are notable exceptions linked to the economic sectoral structure of the regions: poorer regions with a larger focus on agriculture, such as North-East and South-West Romania, have a higher share of workers in this essential sector, and are thus less likely to suffer as extensive direct labor market implications of restrictions.

As the crisis shifts to a second phase, government policies will be needed to cushion the household income losses and to support the labor market adaption of the 14% of workers that continue to be vulnerable despite the gradual reopening of societies and economies. As of early May 2020, countries across Europe entered the second phase of their public health response, progressively allowing for greater mobility of populations, expanding public interactions and resuming economic activities in line with public health guidelines[5]. However, even as activities resume, we estimate that nearly one in seven workers will have difficulty resuming their activities fully since they require extensive inter-personal contact to conduct their work and additionally cannot shift to home-based work. While short-term support will be needed to cushion the incomes of these workers, a medium-term or longer-term adjustment will be needed to adapt these workers to expanding sectors.

More women face a greater risk of not resuming work due to the nature of their work[6]: one in five women is considered to face difficulty returning to work compared to one in ten men. Women face a greater risk of resuming work due to the sectors and occupations they are found in. Surveys of impacts suggest that they have been more likely to lose their jobs in the UK, US and Romania (Adams-Prassl et al, 2020a; Badiani-Magnusson et al, forthcoming) even within the same occupations as men; while this may partly be linked to spending more time on child-care and homeschooling, it is also linked to a lower ability to conduct tasks from home (Adams-Prassl et al, 2020b).

Figure 4 Nearly half of all jobs are likely to have faced difficulty transitioning their tasks to home based work. Workers in Southern Europe (panel a) and women (panel b) are more likely to face difficulty transitioning



Source: Authors calculations using EU-SILC. Badiani-Magnusson et al, forthcoming.

Despite the substantial and unprecedented support policies extended to reduce employment losses, the household income impacts are expected to reach into the pockets of typically less vulnerable groups, resulting in a greater share of households at risk of poverty

While early indicators of job loss from the first phase of the pandemic suggest that unemployment in most EU-27 countries has barely inched above the figures seen at the turn of 2019, further job losses are expected as the crisis continues. Even as supply side restrictions are eased, the recovery may be dampened by weak consumption and investment on the demand side. As such, unemployment is expected to increase over 2020. The European Commission's Economic Forecast for Spring 2020 predicts a steep rise in EU unemployment levels from 3.7% in 2019 to 9.2% in 2020, with effects persisting into 2021 (EC, 2020a).

The limited short-term rise in unemployment partly reflects employment protection legislation as well as the success of short-time work in supporting the retention of workers which have provided the breathing space needed by firms and workers in adapting to lockdowns. As of end-April, applications to these programs covered approximately 25% of the EU-27 workforce (Müller and Schulten, 2020). During the 2008 economic crisis, short-time work schemes were found to protect those workers with permanent contracts (Hijzen and Venn, 2011); since many of the workers at greatest risk that have been identified in this study are on temporary contracts or self-employed, these workers are less likely to be covered by these schemes[7]. The minimal impact on unemployment partly reflects the extensive short-time work and furlough schemes that have been established across countries to reduce employment losses. An estimated 40.2 million applications for short-time work or furlough schemes had been submitted by the end of April 2020, ranging from 47 – 48% of employed workers in Italy and France to 3 – 5% in Poland, Bulgaria, Slovakia, Finland, the Czech Republic and Portugal (Müller and Schulten, 2020). In mid-May 2020 nearly 10% of employed workers in Romania had suspended employment contracts and were being supported by temporary unemployment relief[8].

However, early indicators from Pulse labor market assessments and of labor demand indicators puts forward a sobering perspective of impacts on household wellbeing: while workers are not being laid-off, declines in earnings have fed through to reductions in incomes and bank account balances. Rapid assessments from the UK, Germany (Adams-Prassl et al, 2020a), Romania and Poland (World Bank, forthcoming) show an extensive impact on the number of hours worked, temporary employment stoppage (which is not reflected in unemployment figures) and on reductions in labor income. Approximately a third of households in Romania and Poland (34 and 39% respectively) report declining incomes in early May and, among those that report declines, income was reported to have declined by 36% and 35% compared to February 2020. Similarly, bank account deteriorations were reported by 29 and 45% of households in Romania and Poland respectively, as households with savings use these to cushion income falls. In this early phase of the pandemic, the consumer demand channel predominantly reflects social distancing restrictions, as sales decline most heavily in sectors where transactions have been discontinued such as hospitality and tourism.

We estimate that at least one in five households are likely to suffer income losses because of a reduction or loss of employment in the lockdown phase of the crisis. And, even as societies reopen, at least one in eight households may continue to face income losses due to restrictions in how work may be conducted. Over a third of households — 36% — have at least one member that is in a vulnerable job that is not highly amenable to home-based work. For those households that have more than one breadwinner or who have other sources of income, the COVID-19 welfare impacts are more likely to be cushioned since some members may be able to continue earning even though others are temporarily unable to. However, for those whose income sources are less diversified or that have only one member working in a severely disrupted occupation, the sudden impacts of the crisis are likely to be especially detrimental to household wellbeing. We estimate that one in five households falls into this category, since their labor market income sources are concentrated in employment types that are of greatest risk of employment or income loss. While the extensive support packages that have been extended across Europe will help reduce these impacts, the level of the allowance is typically less than 100% of original wages and capped at an upper-limit (Müller and Schulten, 2020).

Figure 5 **Poorer households are more likely to get income from occupations that are subject to the greatest employment and income risk in Southern, Western and Northern Europe. In Central and Eastern Europe, a higher share of income from agriculture among the poorest 20% of households shields these households from the crisis compared to other income groups.**

Income sources by risk type among households with working members

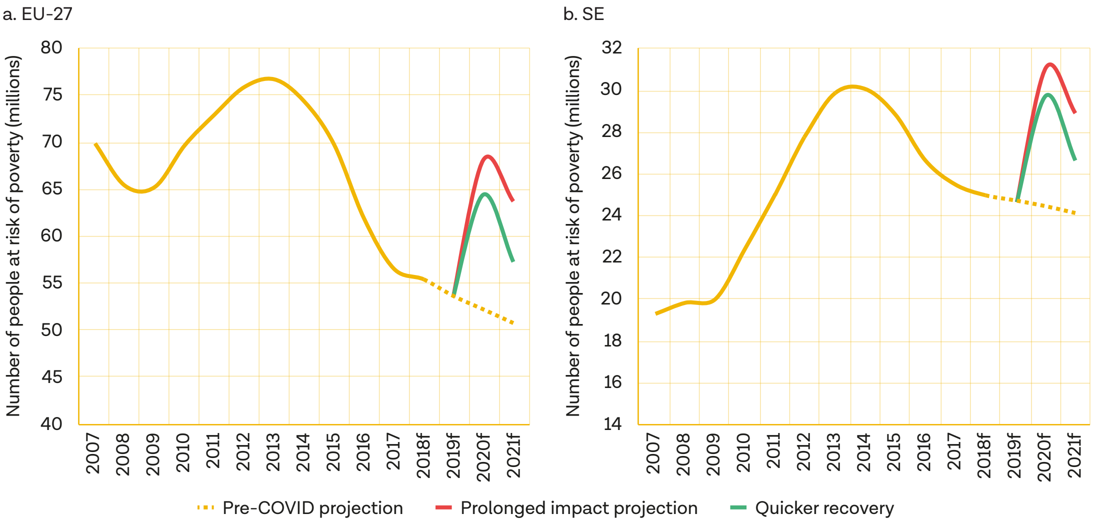
Source: Authors calculations using EU-SILC data. The methdology is described in further detail in Badiani-Magnusson et al, forthcoming.

And unlike the global financial and euro-zone crises, during which income drops were most amplified for the poorest households in multiple countries, the impact of the COVID-19 crisis is likely to be felt more broadly. Poorer households are less likely to be integrated into labor markets, particularly in Northern and Western Europe, and are thus "shielded" from the immediate employment and income loss of the crisis (although they will be affected in the longer-term due to facing a greater struggle getting onto the job ladder). The poorest 40 percent of households and middle-class households more broadly have fewer workers able to pivot as effectively to home-based work than better-off households, and also have fewer financial buffers to draw from in times of need. And while these households were protected through the fiscal policy responses rolled out across Europe, their incomes are not entirely protected due to restrictions in the magnitude of wage compensation that varies by country (Müller and Schulten, 2020). The incomes of these households — which are typically not vulnerable to poverty using national concepts — are therefore likely to decline.

We estimate that the share of the population "at risk of poverty" increased from 14.7 percent in 2019 to between 17.7 and 18.7 percent in 2020. The crisis is also expected to lead to a rise in income inequality[9]. We combine household micro-data (the EU-SILC) with GDP projections from the Summer Interim economic forecast from the European Commission and the economic forecasts from the OECD Economic Outlook (double-dip projection)[10] to estimate the impact of the COVID-19 crisis on the share of the population at risk of poverty. We use the national relative monetary concept of the population at risk of poverty, that is the proportion of individuals with income below 60% of the median adult equivalized income in each country anchored in the 2016 income year[11],[12].

Figure 6 **Immediate sharp increases in poverty are expected as a result of the COVID-19 crisis. In comparison, the effects of the global financial crisis on poverty were less stark and occurred with some delay.**

Projected increase in the population at risk of poverty, using two different scenarios



Source: WB Staff calculations using OECD forecasts, EC Summer Interim forecasts and EU-SILC data. The prolonged impact projection is modeled using the double-dip forecast of the OECD (OECD, 2020) and the quicker recovery is modeled using the Summer Interim Forecasts (EC, 2020b).

This may imply that an additional 10.9 to 14.6 million people may be at risk of poverty, taking the estimated number of those at risk of poverty from a projected 53.5 million in 2019 to between 64.4 and 68.1 million people in 2020. Regional variations in the impact of the crisis are evident. As a result of the pandemic heavily impacting Southern European countries, we estimate an additional 5.1–6.4 million people at risk of poverty in 2020 in these countries as compared with 2019.

Southern Europe is anticipated to see the greatest rise in the share of the population at risk of poverty rising from 19.0 percent in 2019 to between 23.0 and 24.0 percent in 2020 corresponding to an increase of between 5.1 and 6.4 million people (from 24.6 million people to between 29.8 and 31.1 million). The projected increases in the poverty rate in Southern Europe mirror the heavy impacts seen during the global financial crises. This reflects the extensive growth impacts expected in Spain, Italy and Greece due to the high share of GDP coming from tourism, which has been heavily impacted by the pandemic. It also reflects the higher shares of non-standard workers (self-employed and temporary workers) and more limited coverage of social assistance countries in multiple Southern European countries (World Bank, 2019; Eurofound 2020b).

With the caveat that the effects of the COVID-19 crisis are still unfolding and that the depth and duration of contractions are currently unclear, comparisons can be made between the evolution of poverty in the immediate years following the global financial and eurozone crises. Current projections suggest that the COVID-19 pandemic will have a larger impact on poverty than initially seen in the global financial crisis. Taking 2008 as the base year for the global financial crisis and 2019 as the base year for the pandemic, a sharp increase in poverty relative to base year poverty is projected at the onset of the COVID-19 pandemic. However, in the case of the global financial crisis, notable increases in poverty relative to the base year were not evident until year two of the crisis. This sharp increase at the EU-27 level is mirrored in sharp increases in projected poverty relative to base year poverty particularly in Southern Europe at the onset of the COVID-19 crisis followed by an expected decline in year two of the crisis.

Europe's resilience is being heavily tested — and the institutions needed for rapid, cooperative and inclusive adaption to changing circumstances are more critical now than ever

Coordinating the health, economic and social responses needed to navigate a pandemic is one of the most complicated challenges a society can face. The response has required a rapid national mobilization of health care capacity, and international coordination for testing treatments and vaccine development. Businesses need to pivot their functions and cooperate with public health officials, and epidemiologists need to work with economists and social scientists to rapidly shift human behavior while protecting the vulnerable in society. The public needs to have confidence in the messages conveyed by its leaders and to adapt their behaviors rapidly.

Resilience at both the country and household level is being tested. The uncertainty of the economic, health and policy outlook means that the need for the key institutions that support resilience has never been greater. During the global financial and eurozone crises, labor market structures that allowed for rapid, coordinated responses across businesses, labor and government to support nominal wage reductions and minimize job losses were found to support economic resilience, at both the macro and household level (World Bank, 2019).

A heatmap of the existing institutional environment and projected growth shows the variation in social protection, labor market structures and trust in institutions across countries. Experience from the earlier crises showed that some combinations of structures were more conducive to supporting household resilience than others. The heatmap is shown in Figure 7. The *size* of the projected economic shock (shown in the far-left hand column of the heatmap) is in some sense unrelated to institutional structures, due to the way this particular crisis propagates through pre-existing economic structures. However, how societies react to these shocks will depend on their existing labor market structures, regulatory environment and coordination structures (columns 2 through 7) and the extent to which social protection structures are well targeted, responsive and adequately cover poorer households (columns 8 through 12). An indicator capturing reported trust in government is shown in the final column.

The pandemic is showing the importance of societal trust and cooperation between businesses, government and trade-unions to navigate the crisis and instill solutions that reduce worker suffering. This was a pillar of resilience highlighted in the fifth Regular Economic Report (World Bank, 2019a). In the first phase of lockdown measures, short-time work or furlough programs required structured agreements between businesses and unions to coordinate on changes in worker status and pay. As societies reopen, the same structures are needed to support the reopening of businesses while adhering to public health protocols and occupational health and safety standards. The importance of the coordinated response will rise if the crisis is prolonged and government support packages become more targeted towards viable sectors. Resilience can be strengthened if stakeholders can agree on the challenges that need to be overcome and cooperate to find a solution.

As tough trade-offs emerge between the fiscal costs of lockdown support programs and the need to devote resources to recovery efforts, populations will need to have confidence in their governments to support inclusion while navigating the needed reforms and difficult decisions. If waves of infections continue to occur or if demand in some sectors continues to be muted, countries with rising public debt and high fiscal deficits will have to make increasingly difficult choices. This may include supporting only those sectors that show the greatest long-term growth potential and financial viability. Workers in the firms or even sectors that may not qualify will need support to retrain and relocate to sectors showing expansion, requiring scaled up training and active labor market programs. Protecting and supporting workers during these transitions will require both the need to rally and coordinate partners and also strong trust in societal structures (including government) to navigate the crisis without leaving groups behind.

While the pre-existing economic structure and duration of the crisis will determine the extent to which each country will be exposed to the crisis, the quality of a country's labor market institutions and existing social protection mechanisms will play an important role in determining how the crisis affects its citizens. The extensive packages of support extended to households and firms have provided a breathing space for adjustment during the first phase of the pandemic. As the lasting damage to economies and societies becomes clearer but conditions remain highly uncertain, the ability of employers, unions and workers to rapidly adjust in a coordinated manner is vital. Social protection structures will need to balance protection of those in need — helping households to navigate the impacts of the crisis — while also incentivizing work and supporting a more rapid economic recovery.

Appropriately targeted safety nets that catch those who fall outside of unemployment benefits, and short-time work or related programs are urgently needed to avoid prolonged economic suffering. This is especially relevant for countries whose current social security systems offer limited coverage to these households, for example where unemployment benefits programs do not extend to self-employed workers or where contribution durations result in effective gaps. While increasing the size of transfers to existing social assistance beneficiaries can be done in a straightforward manner to protect working-poor households covered by existing programs, it is unlikely to be a sufficient response to the crisis: our analysis shows that many of those at risk of significant employment impacts are not existing beneficiaries of these programs (Badiani-Magnusson et al., forthcoming). This is particularly the case in countries with low coverage of existing social assistance programs (Figure 7, columns 8 through 12). Widening access to social assistance programs to cover those that are not caught by furlough or short-time work programs needs to be done in manner that is consistent with the existing identification and payments infrastructure, and in consideration of the logistical challenges that arise with social distancing (which limit, for example, the home visits needed for enrollment into multiple last-resort programs across EU countries).

An opportunity is presented in the reopening phase to enhance the crisis preparedness of social protection systems. This can be done both through strengthening the ability of systems to rapidly mobilize and through addressing coverage gaps. The temporary expansion of sick-leave, health and unemployment benefits to non-standard workers done in some countries during the crisis should be dovetailed into schemes that not only offer greater protection to these workers but also address the underlying causes of involuntary non-standard work structures and informal employment (Packard et al. 2012). System wide reforms that support the integration and interoperability of social registries, labor and other relevant databases can provide a strengthened platform for responding to future crises and can also strengthen the targeting of activation policies. Investing in alternative targeting and enrollment methodologies and infrastructure, including using big data, can improve the speed of response in times of need. Furthermore, country level assessments and reforms are needed to learn lessons both from a coverage and delivery perspective (for those who were left behind due to being unable to adapt to new application approaches).

Active labor market policies will need to be rapidly deployed to support strong job matches and to avoid unemployment hysteresis. In the Fifth Regular Economic Report, greater spending on labor market measures–either active or passive–was associated with an increase in household income resilience. The ability of labor market institutions to facilitate the adaptation of labor demand and labor reallocation that occurs during a crisis is key to minimizing the adverse employment effects of the crisis. Active labor market policies should be used as short-time work schemes are rolled back, in combination with income support in the job search period. They will need to be quickly activated to reduce the risk that labor market attachment drops, and training programs and requalification schemes will be particularly needed for those in sectors face the greatest risk. The effect of active labor market programs in supporting job relocation is of course contingent on responsive labor demand. World Bank (2019a) showed that spending on active labor market programs was most effective in boosting resilience when combined with more flexible approaches to employment protection. Countries with stricter employment protection may see fewer initial layoffs in sectors that are increasingly non-viable in the recovery phase, but the same restrictions could delay the reallocation process towards expanding sectors needed for the recovery and can foster dualistic labor market structures.

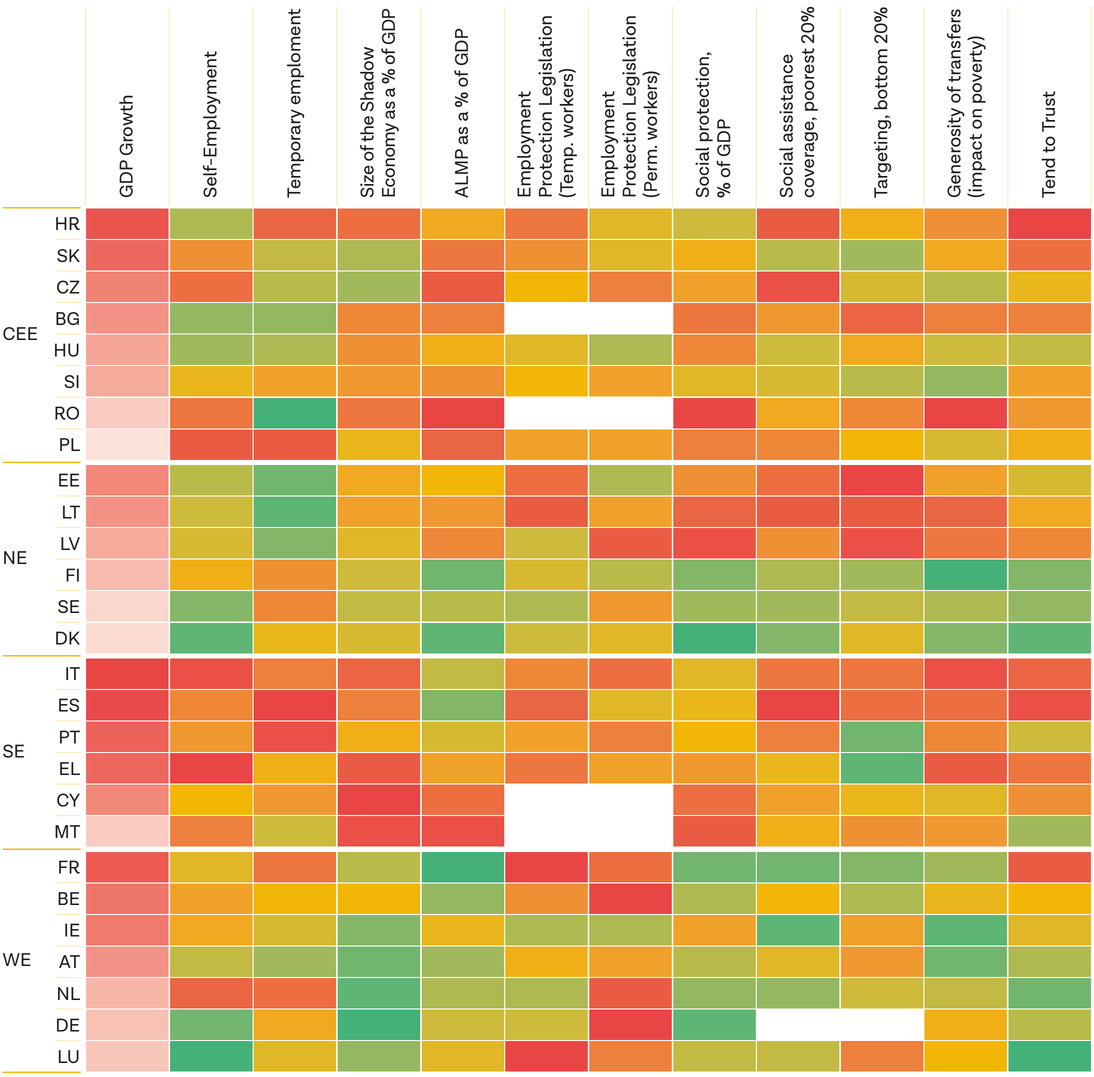
The substantial government support to households and firms is already placing a strain on national budgets in many countries. Governments will have increasingly difficult choices between those in need as the crisis is prolonged. These choices are expected to be particularly stark in countries with elevated public debt and limited fiscal space for public support measures. Additional support through EU budgets is also anticipated to mitigate unemployment risks and to support recovery, notably through the temporary Support to mitigate Unemployment Risk in an Emergency (SURE) programme and through the Next Generation EU fund, which puts forward an additional EUR 750 billion to support recovery. As debt across EU countries remains at elevated levels, it is going to be vital to use scare resources efficiently in the recovery phase.

A critical element of a resilient recovery is allowing the flow of resources to more efficient companies. This will take time given the unprecedented economic support measures put forward by many governments, and there are risks that in the post-crisis period many unviable firms and obsolete industries might survive as a result of these sizeable packages. In some cases, further streamlining regulations for business entry and operation would facilitate entry and growth of more productive firms. Economic packages put forward by governments to support the recovery should incentivize a switch to more sustainable production processes, incentivizing economic agents to adopt and adapt to digitalization. Regulatory and institutional framework could also be more conducive to innovation. Matching grants and technical assistance can support firm innovation capabilities and technology adoption, including in health and education, facilitating and expediting the recovery while building resilience to future crises.

As the economic recovery sets in, the broad-based fiscal stimulus provided in the initial stages of the crisis can be gradually and smartly withdrawn. Tax incentives can shift towards promoting investment and innovation (i.e. accelerated capital depreciation). To incentivize labor force retraining in heavily affected sectors, where economic scarring might be more prevalent, tax deduction for expenses in worker training could be used. Given the development of the digital economy, tax reforms should contemplate measures tailored for the taxation of the digital economy and address challenges to tax administration and tax enforcement, in particular those related to the higher compliance risks usually associated with tax avoidance schemes.

Over the longer-term, fiscal imbalances that have opened and were aggravated by the crisis will need to be addressed to ensure fiscal sustainability. This may also provide a good opportunity to broaden or introduce fiscal policies to address climate change. This would involve reprioritization of public spending, increased efficiency in public spending and a mix of revenue and tax administration measures to ensure higher tax revenues. Fiscal policy can incentivize the switch to renewable energy by increasing taxation of fossil fuel and providing tax relief for and/or subsidizing renewables and energy efficient technologies. Tax policy levers can be used to incentivize sustainable or green investment that enhances productivity and is critical for generating employment and income opportunities.

Figure 7 **Heatmap showing structures and institutions that have been found to be linked to output, employment and household income resilience to the effects of the global financial crisis in the Fifth Regular Economic Report (updated to the latest data to show the structures in place as economies were entering into the COVID-19 crisis)**



Source: Described in Annex Table 1.

Notes

[1] The assessments produced by World Bank teams use a similar methodology to that used by Fasani and Marza (2020); Pouliakas and Branka (2020); Fana et al. (2020); Palomino et al (2020) and Sanchez et al (2020). An overview of the methodological approaches and results from these other analyses can be found in Badiani-Magnusson et al, forthcoming). Fana et al. (2020) estimate that 10% of workers are in sectors that are non-essential and closed for containment purposes, and a further 20% is in non-essential and inactive sectors, while Pouliakas and Branka, 2020 estimate the risk group in the wave to be 45 million workers. Sanchez et al. (2020) estimate that 30% of workers in the EU are at highest risk.

[2] Essential workers include the health-care workers that have been central to the public health response for the crisis, and also include critical societal functions such as teachers, social workers, police and water, sanitation and energy sector workers, as well as those in critical industries such as food supply, distribution and retail.

[3] These workers are identified as being at greater risk due to not being able to shift to home-based work, due to having a contract type that makes dismissal easier or due to being less integrated into social protection systems.

[4] Recessions have been shown to accelerate the disruption of jobs due to the automation of jobs, by creating the ideal conditions for firms to adopt technology and adjust their workforce due to lower adjustment costs (lower forgone profits and relatively cheaper factors of production), a heightened focus on efficiency or changes in the costs and benefits from making layoffs (Hershbein and Kahn, 2018). In fact, Jaimovich and Siu (2018) show that most of the loss of jobs that involved routine tasks occur during recessions, with 88% of these job losses occurring within a year of recessions.

[5] The response of each country has varied in the segments that can reopen, but a common approach is to shift towards a new normal mode of interaction that brings back non-essential businesses that are able to pivot towards the distancing needs required to keep transmission rates low.

[6] This gender dimension of potential closure was also highlighted in Fana et al (2020) who use a sector-based approach to consider which activities are closed.

[7] Although a number of short-term work schemes covers registered self-employed workers, the volume of the allowance and the duration of support can vary significantly from the general scheme resulting in this segment of the labor market still facing a more considerable income risk than those on permanent employment contracts.

[8] Press releases found at http://www.mmuncii.ro/ combined with data from the LFS of Romania (INSSE).

[9] Simulations based on the EuroMOD model (JRC, 2020) show that household's disposable income would fall by 5.9% on average in the EU in 2020 compared to 2019. In the absence of policy changes, the analysis estimates that poverty would increase from 16.8% to 21.4%, an increase of 4.6% percentage points of 27.4%, but would only increase by 1.8 percentage points including policy changes. These increases are consistent with the range of estimates in this analysis. Palomino et al. (2020) estimate the rise in the share of the population at risk of poverty to increase by just under 30 percent using a scenario of 2 months of lockdowns combined with partial closures subsequent to the lockdown.

[10] We use projections from the Autumn 2019 and Summer interim 2020 forecasts (EC 2020b, EC 2019), as well as the double-dip forecast from the OECD June Economic Outlook (OECD, 2020a).

[11] This analysis is based on national concepts of the population at risk of poverty (AROP), which uses a poverty threshold of 60 percent of contemporary median equivalized income. The EU-27 population excludes Germany due to data restrictions.

[12] Initial and experimental estimates from rapid assessments in Romania and Poland suggest similar initial impacts to those projected through simulation approaches.

Annex Table 1

No	Variable	Source	Year of Data	Comments
1	GDP per capita growth	EC Summer Forecast 2020	2019/2020	Gross domestic product at 2015 reference levels per head of population
2	Self-Employed as a % of Employment	Eurostat	2019	Self-employment by sex, age and educational attainment level (1 000) [lfsa_esgaed]/Employment by sex, age and educational attainment level (1 000) [lfsa_egaed]
3	Temporary Employees as a % of employment	Eurostat	2019	Temporary employees by sex, age and educational attainment level (1 000) [lfsa_etgaed]//Employment by sex, age and educational attainment level (1 000) [lfsa_egaed]
4	Size of the Shadow Economy as a % of GDP	Medina and Schneider (2017)	2015	IMF Working Paper WP/18/17 Shadow Economies Around the World: What did we Learn Over the Last 20 Years, Medina and Schneider (2017)
5	Expenditure on Labor Market Policies as a % of GDP	Eurostat	2018	LMP expenditure by type of action - summary tables [LMP_EXPSUMM]. Greece and France (2017).
6	OECD Temporary EPL	OECD EPL	2013	Except Slovenia(2014), Croatia and Lithuania (2015). Excludes Romania, Malta, Cyprus, Bulgaria
7	OECD Permanent EPL	OECD EPL	2013	Except Slovenia(2014), Croatia and Lithuania (2015). Excludes Romania, Malta, Cyprus, Bulgaria
8	Social Protection Expenditure as a % of GDP	Eurostat	2017	Social protection expenditure as a % of GDP [spr_exp_sum]
9	Social assistance coverage of bottom 20%	Computations based on EU-SILC.	2018	Percentage of households in the bottom 20% of the disposbale income distribution that receive social transfers (excluding pensions). Ireland and Slovakia (2017).
10	Social Assistance targeting to bottom 20%	Computations based on EU-SILC	2018	Percentage of all resources for social transfers (estimated in the EU-SILC) that are received by the bottom 20% of the disposable income distribution. Ireland and Slovakia (2017).
11	Generosity of transfers (impact on poverty)	Eurostat	2018	Percentage decline in the at-risk-of-poverty rate using 60% threshold before and after social transfers, using ilc_li02 and ilc_li10. Pensions are excluded from social transfers.
12	Tend to Trust Institutions	Eurobarometer	2019	I would like to ask you a question about how much trust you have in certain media and institutions. For each of the following media and institutions, please tell me if you tend to trust it or tend not to trust it: the (Nationality) government

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