



DG ECHO CONTRACTS & FINANCE SOLUTIONS

DEALING WITH INFLATION¹ IN ECHO'S GRANT AND CONTRIBUTION AGREEMENTS

What is the Problem?

- The **war of aggression against Ukraine** (February 2022) has caused high energy, fertiliser, and food prices and increased the inflation trends already triggered by the **COVID-19** global pandemic (March 2020).
- Even if general inflation rates within the EU are hoped to decrease in 2023, it is expected that travel, accommodation, equipment, and energy costs will remain higher than they were in the pre-2020 period, affecting DG ECHO's **civil protection** operations in the EU and neighbouring areas.
- Many of the countries in which DG ECHO Partners implement **humanitarian aid actions** are likely to continue seeing general high inflation rates increasing the costs of humanitarian aid implementation, as more frequent climate change related disasters and macro-economic instability aggravates existing complex problems. Inflation negatively impacts the broad aid-delivery spectrum, reducing the purchasing power of affected communities and humanitarian actors, alike. Therefore, the impact of inflation is comparable whether actions are implemented through **vouchers and cash transfers**, or through the distribution of **commodities, medical and relief supplies**, and the impact also extends to all related operational costs (salaries, procurement, transport, and logistics). There are however specific considerations for cash transfers, which are elaborated upon in a separate internal note².
- Since it is **impossible to offer financial top-ups to all actions** whose operational outputs will be negatively affected by inflation, DG ECHO Staff and Partners need to be aware of the existing contractual and financial solutions³, to deal with the problem of inflation.

What is the Financial Solution?

- **New and future grants** should reflect increased costs in the budget proposals with their grant applications. Anyway, the costs will only be reimbursed based on the costs actually incurred (verifiable in an *ex post audit*).
- Regarding **unit costs for travel and accommodation**, on 26 July 2023 the European Commission updated the unit costs set for the reimbursement of travel costs⁴, in order to increase the rates for return air and rail travel above 400km by 25%. This increase is intended to give immediate financial relief to beneficiaries, including beneficiaries of the **Union Civil Protection Mechanism (UCPM)**, negatively affected by the **extreme inflation in air travel since 2021**. Other unit costs, e.g. for accommodation and subsistence costs, remain under review, and may result in further amendments to the Decision.

¹ For the purpose of this Note "Inflation" refers to an increase in prices of goods and services in an economy over a given unit of time, regardless of the root-cause of that price increase. This means it also covers the effects of monetary policies, including official exchange rates, which result in exchange rate losses and have the same effect as devaluation or depreciation in terms of increasing prices (e.g. of imports) and/or reducing purchasing power.

² Internal Technical Issue Paper: *ECHO-funded cash assistance in contexts of high inflation and currency depreciation*

³ This note draws upon the internal "*Guidance for addressing impact of unforeseen inflation on grants*" circulated by DG BUDG in January 2023 but is adapted to the needs and context of DG ECHO and its activities.

⁴ Commission Decision of 26.7.2023 amending Commission Decision C(2021)35 authorising the use of unit costs for travel, accommodation and subsistence costs under an action or work programme under the 2021-2027 multi-annual financial framework. Brussels, 26.7.2023, C(2023) 4928 final.

- Feedback compiled by DG BUDG indicates that inflation is impacting types of cost categories in an uneven way, meaning that achieving the initially intended operational results may still be largely possible **by re-targeting or re-prioritising the use of available budget** (although, in certain cases, a reduction in the outputs/results of the Action may be necessary, see below).
- The available **budget flexibility existing in DG ECHO agreements should be used to the maximum possible**. This budget flexibility allows transfers, without a formal amendment, between cost categories (budget lines) in grant and contribution agreements. So, for example, if exchange rate fluctuations have caused currency exchange gains - these could be re-distributed within the action's budget to try to counter-balance the negative effects of inflation.
- Where certain cost categories (e.g. travel and transport costs, certain commodities, particular implementation methods) are known to be significantly more expensive than existing substitutes or equivalent methods, DG ECHO Partners should strive to reduce those costs. **Cost mitigation measures** are not appropriate or possible in all cases and never justify sourcing lower quality supplies (especially for food and medical supplies).
- Cost mitigation measures could mean **adapting the inventory of supplies** (e.g., by opting for a less expensive, more homogeneous logistics approach) to bring more value-for-money that is still to the benefit of the final beneficiaries. It could also mean **adapting the procurement strategy** and, teaming up with other entities to avoid many small procurement contracts and to benefit from economies of scale and better wholesale prices.
- Although financial top-ups cannot be used systematically to address inflation (unsustainable approach) the possibility of **top-ups** remains, subject to a careful needs-based approach - balancing the overall funding available and emerging operational priorities. Where all other approaches have failed or been inappropriate, or where the only option would be to reduce outputs or results linked to critical lifesaving activities, to the detriment of final beneficiaries, these cases need to be flagged carefully by the ECHO Partner to the ECHO desk officer to launch an objective assessment of whether some financial reinforcement may be available.

What is the Contractual Solution?

- Where the significantly increased implementation costs are likely to continue, the DG ECHO Partner may request a **reduction in the action's duration**⁵ through a modification request and subsequent amendment. The reduced action's duration will avoid stretching field office, staff and implementation costs over the full intended period but, if key activities can be expedited, should still allow the Partner to achieve meaningful results by e.g. delivering the intended supplies to the final beneficiaries or communities. This step should be launched by the DG ECHO Partner in good time (i.e. at least 30 days) before the Action's planned end-date (and at the very latest before the submission of the Final Report) to allow a proper follow-up of the request
- If, despite best efforts, it still looks like the intended results of the action will be negatively impacted, the DG ECHO Partner could request to **amend the description of the action and/or to remove or reduce activities** that can no longer be realistically implemented with the available funding. In such cases, the outputs of the action (e.g. number of final beneficiaries assisted), might need to be revised (reduced), where inflation has affected the costs of the action. This step is a last resort but, to allow a proper follow-up, still should not be introduced at the very last minute. The modification request should be launched in as good a time as possible before the Action's planned end-date (and at the very latest before the submission of the Final Report).

ECHO's **Contracts and Finance Solutions** seeks to address issues in contract management by identifying existing solutions and adapting them to the needs of ECHO's Partners and the nature of ECHO's activities and principles. It does not create new rules but just applies the existing ones, including available exceptions, in an operationally-relevant way. For further questions please contact ECHO-LEGAL-HELPDESK@ec.europa.eu (reserved for DG ECHO staff) or <https://www.dgecho-partners-helpdesk.eu/helpdesk> (open to all ECHO Partners).

⁵ In more limited cases, an extension of the Action's duration might also be appropriate.