CHALLENGES FOR FISCAL POLICY AFTER THE MITIGATION OF THE COVID-19 PANDEMIC

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Abstract:

The health crisis generated by the COVID-19 pandemic has severely affected the world economy and, implicitly, the efficiency of the fiscal policy implemented in many countries, both against the background of pre-existing fiscal tensions, and due to the deterioration of the deficit and public debt during the period of the widespread manifestation of the pandemic, through reducing revenue and massively increasing government spending. In this context, fiscal policy requires significant adjustments to restore its efficiency and the sustainability of public finances. In this, we consider the initial stage of fiscal policy, in some fiscal-budgetary indicators on health crises and analyze fiscal policy challenges, especially regarding its balanced orientation, between equity, growth and sustainability objectives. We anticipate some general and specific fiscal policy proposals that can be considered in making and substantiating decisions to ensure a positive and achievable fiscal policy projection after the health crisis generated by the COVID-19 pandemic.

Keywords: *fiscal policy, the COVID-19 pandemic, fiscal challenges*

JEL classification: *E62, H21, O23*

Introduction

The COVID-19 pandemic has generated a global health crisis, deeply disrupting the social environment and economic activity, a situation that humanity has not faced before in its recent history. In just a few months after the outbreak of the COVID-19 pandemic, the health crisis has turned into a global economic crisis, causing a greater decrease in global Gross Domestic Product (GDP) than that caused by the global financial crisis of 2008-2010.

In this context, the government authorities have initiated and implemented a series of measures to limit the spread of the virus, to limit the effects of the health crisis and to keep the economy "alive" and resuscitate it, through fiscal-budget policy measures and instruments, through fiscal mechanisms countercyclical to support the health sector and assistance to businesses and households, especially those affected by the pandemic.

The effort sustained by the fiscal-budgetary policy during the pandemic caused a significant deterioration of public finances, which requires a rethinking of it together with the economic

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recovery. The containment measures, the increase in government spending and the decrease in tax revenues led to an increase in budget deficits and public debt.

The literature on macroeconomic policies during health crises with a focus on fiscal policy is limited, but concerns have intensified and become more fertile with the onset and advance of the pandemic. We note the studies by Eichenbaum, Rebelo and Trabandt (2020) and Glover et al. (2020), who incorporated epidemiological models into real business cycle models to study optimal responses to prevent and combat the pandemic and found that severe recessions generated by agents' optimal decision to reduce consumption and hours worked help reduce severity the pandemic. Other studies by Elenev, Landvoigt and Nieuwerburgh (2020) found that fiscal support given to companies in difficulty during the pandemic was effective in preventing corporate bankruptcies.

Concerns regarding the analysis and results of the fiscal-budgetary policy have also intensified at the institutional level, the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD) and the European Union (EU27), where studies / reports have been developed in this regard. The results suggest that fiscal policy actions have been effective in stimulating economic activity, increasing confidence and reducing unemployment, but their effect varies depending on the type of measure and country characteristics.

In this paper, we intend to carry out a sequential analysis of the fiscal-budgetary policy before the outbreak of the COVID-19 pandemic, during it and its perspective in the context of the damage suffered during the health and economic crisis induced by it. For this analysis, we will follow the evolution of the main indicators of a fiscal-budgetary nature at the EU27 level, in the period 2019 - 2021 (revenues, expenses, deficit, debt, economic growth).

The evolution and analysis of fiscal policy indicators in the previous period and the outbreak of the COVID-19 pandemic

Total budget revenues include both tax revenues collected from direct and indirect taxation, as well as net social contributions, revenues from market production, capital transfers and other current revenues. The other current income category may include income from acquired property, other production subsidies and other current transfers.

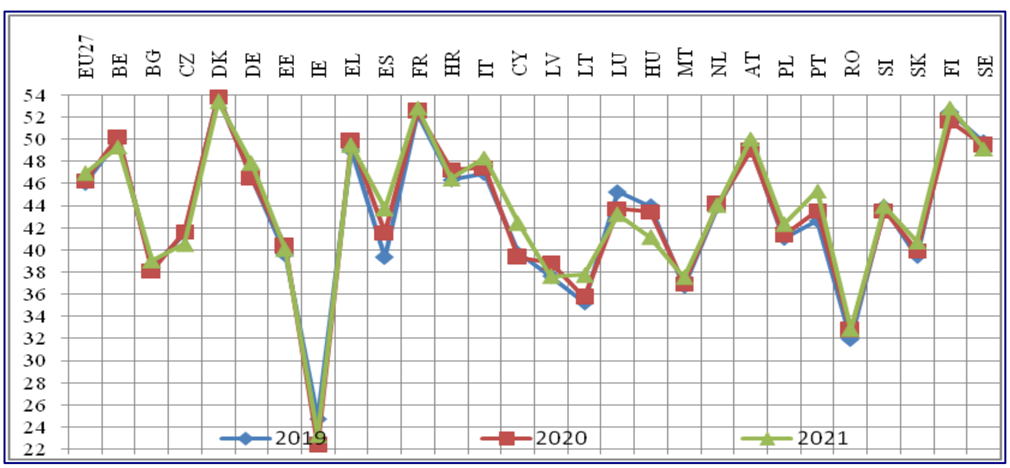

Figure 1. The size and evolution of total budget revenues in the EU27 member countries in the period 2019 – 2021 (% of GDP)

Source: https://ec.europa.eu/eurostat/databrowser/view/tec00021/default/table?lang=en

Analyzing the data presented in figure 1 and their evolution, we can see that the evolution in most countries reflects reduced oscillations of approx. ± 1 pp, including at the level of the EU27 average, where an increase of 0.9 pp is recorded in 2021, compared to 2019, but although there is this relatively close evolution between countries, each of them has its specific economic and fiscal peculiarities .This aspect is also confirmed by the difference between the maximum weight (DK, approx. 53%) and the minimum (Ireland, approx. 23%) aspects that reflect the importance that governments give to fiscal policy and the role of the state, through their size.

The countries with the highest share of total budget revenues in GDP are those that have emphasized direct taxation (France, Denmark, Belgium, Austria) and those with progressive taxation systems (Italy, Germany, Poland, Spain). At the opposite pole, in addition to Ireland, there are countries with tax systems oriented towards indirect taxation, with low and unique income tax rates located in Eastern Europe (Lithuania, Latvia, Bulgaria and Estonia).

Romania has a low share of total budget revenues in GDP, approx. 32% annually, with fluctuations in said margin. Their dynamics were not greatly affected by the COVID-19 pandemic, the trend being slightly positive, but the small size of their weight in GDP can negatively influence derived indicators that we are going to analyze further.

Government spending represents a financial anchor between the state, on the one hand, and citizens (individuals and legal entities), on the other hand, the former having the formal right to use the financial resources collected for the purpose of its duties and functions. Their structure aims to cover the mentioned purpose, transposed into governmental objectives of an economic, social, cultural nature, in the short, medium and long term. In addition to the total resources collected from taxes, fees and other revenues, government loans can be accessed that are generally aimed at financing public investment projects, with fiscal multiplier effects to ensure in the medium and long term additional fiscal resources used for debt repayment, but also for other objectives.

In the mechanism of state intervention in the economy, in the social environment or in combating the effects of some crises, the modification of government spending represents a major fiscal policy tool that can be used in an expansionary form (which involves increasing government spending or decreasing taxation). In the context of our work, the fiscal policy used by most governments has expansionist characteristics, being also theoretically appropriate for stimulating savings during economic crises.

At the EU 27 average level, the share of government expenditure in GDP increased from 46.6% in 2019 to 53% in 2020, and in 2021, compared to the previous year, they decreased by 1.5 pp. In the structure of the member countries, countries such as France, Finland, Belgium, Sweden, Austria, Italy, Germany, Greece, Spain and Denmark can be distinguished, with spending weights close to the EU average and the same evolution of significant growth in 2020 and slight relaxation in the year 2021.

Another group of countries, mainly from the center and west of Europe, register lower shares of expenses than the EU average, located in the middle area of the hierarchy, between 42 - 48% (Poland, Portugal, the Netherlands, the Czech Republic, Hungary) comprised between 43 and 49%, as well as the countries located at the bottom of this hierarchy, with weights ranging from 35 to 42%, such as Romania, Bulgaria and Latvia. As well as the situation and the size of total revenues, Ireland has the lowest share in the EU, between 24-27% of GDP.

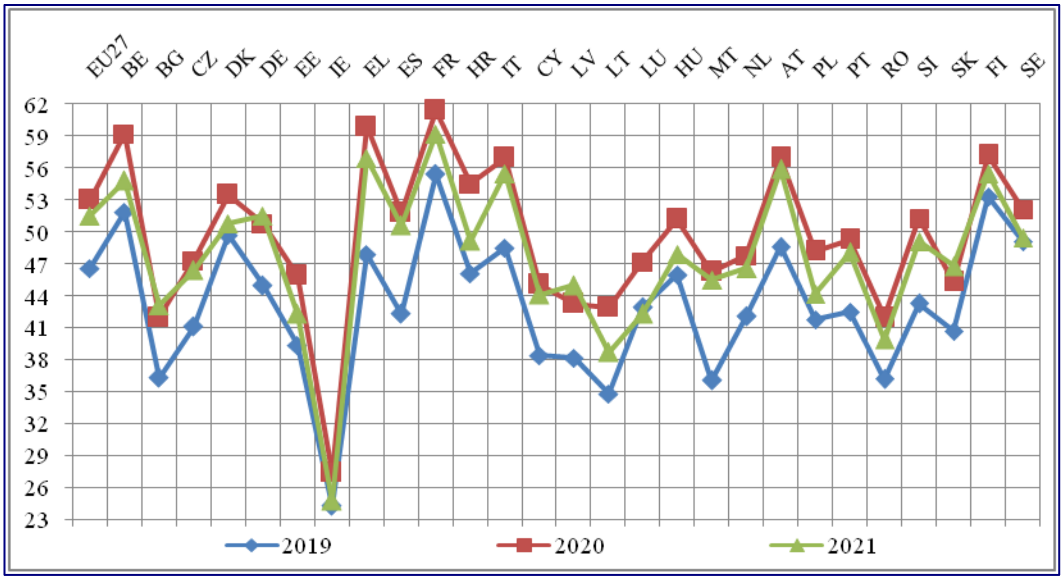

Figure 2. The size and evolution of total government expenditure in the EU27 member countries, in the period 2019 – 2021 (% of GDP)

Source: https://ec.europa.eu/eurostat/databrowser/view/tec00023/default/table?lang=en

Romania is in penultimate place, surpassing Ireland and Lithuania, but being much lower than the EU average, with a share of government expenditure in GDP lower by 10 – 11 pp, with a significant increase of 6 pp in 2020 and 4 pp in 2021, compared to 2019.

Based on these dynamics of budget expenditures, we can appreciate the financial dimension of the packages of discretionary fiscal-budgetary measures implemented at the level of the EU27, but also at the level of the member countries. Thus, at the EU27 average level, the approximate size of the economic stimulus packages through fiscal-budgetary instruments in 2020 was 6%, and within the EU27 there are countries that have implemented fiscal measures of approximately 8-12% of national GDP, such as Greece, Malta, Italy, Croatia, Austria or Slovenia, and in 2021 the size of the fiscal measures packages has decreased slightly in most countries. In this context, Romania is at the level of the EU27 average.

This dynamic evolution of government spending, analyzed in relation to a certain stationarity of total revenues recorded by Romania in the same period, but also in other countries, will be found in the size of the budget deficit and, by way of consequence, in that of the public debt, in terms of their negative impact, but also in a positive evolution of economic growth, at least from 2021.

The conventional budget balance, an indicator that presents the state of public finances of a country, at certain times, usually annually, represented the indicator on which the economic effects of the health crisis had the strongest impact, an aspect confirmed by its evolution, both at the level the EU27 average, where the deficit increased by more than 6pp, as well as in member countries, especially in those where the fiscal-budgetary measures packages recorded higher financial dimensions, in accordance with the previous mentions.

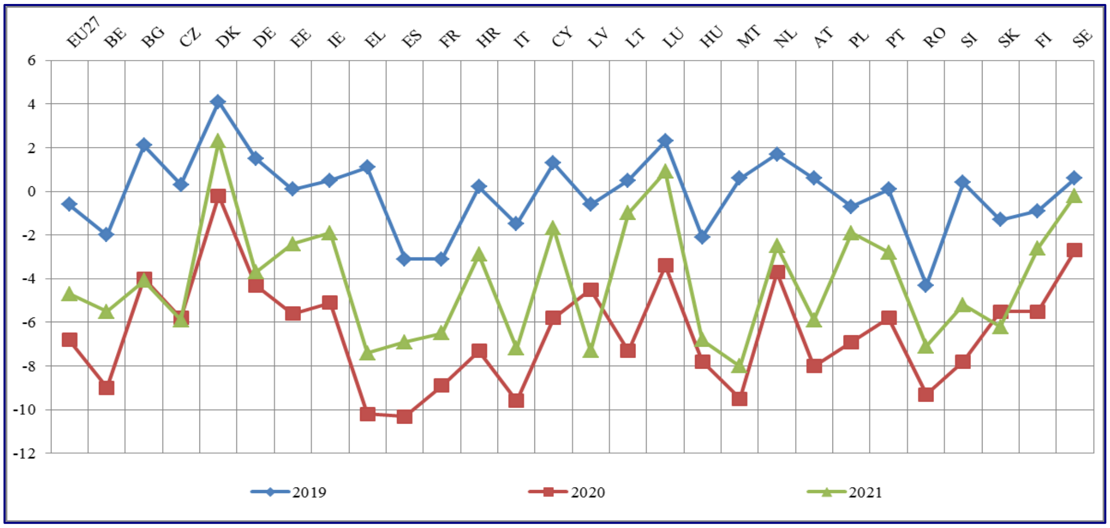

Figure 3. The size and evolution of the conventional budget balance in EU member countries, in the period 2019 – 2021 (% in GDP)

Source: https://ec.europa.eu/eurostat/databrowser/view/gov_10dd_edpt1/default/table?lang=en

In Romania, the budget deficit also increased significantly in 2020, by approx. 5 pp, against the background of an initial deficit of over 4% of GDP, the largest in the EU27, an aspect that limited to a certain extent the fiscal space for the implementation of a stronger / stimulating package of fiscal measures.

The public debt, like the budget deficit, represents an important indicator of analysis and evaluation of the state of public finances in a country, being most often a consequence of acute budget deficits, a solution to the recovery of crisis situations, economic, social, etc., but and a frequently used alternative to increasing taxation, by transferring the repayment of some present government expenditure to future generations.

In figure 4, we present its evolution at the level of the EU27 average and at the level of each member country. Thus, at the level of the EU27 average, an important increase can be observed in 2020, compared to 2019, of over 13 pp and over 11 pp, in 2021, a situation that reflects the financing of the budget deficit by contracting loans.

Within the EU27, there are countries whose debt increased in 2020, by more than 20 pp, namely Greece, Spain, Italy, Cipru or Portugal. At the opposite pole there are countries, such as Ireland and Luxembourg, with increases of 1.2 and 2.5 pp. There is also a significant group of countries with increases of over 10 – 15 pp, a range in which Romania is also included, with an increase of approx. 12 pp in 2020 and over 13 pp in 2021, compared to 2019.

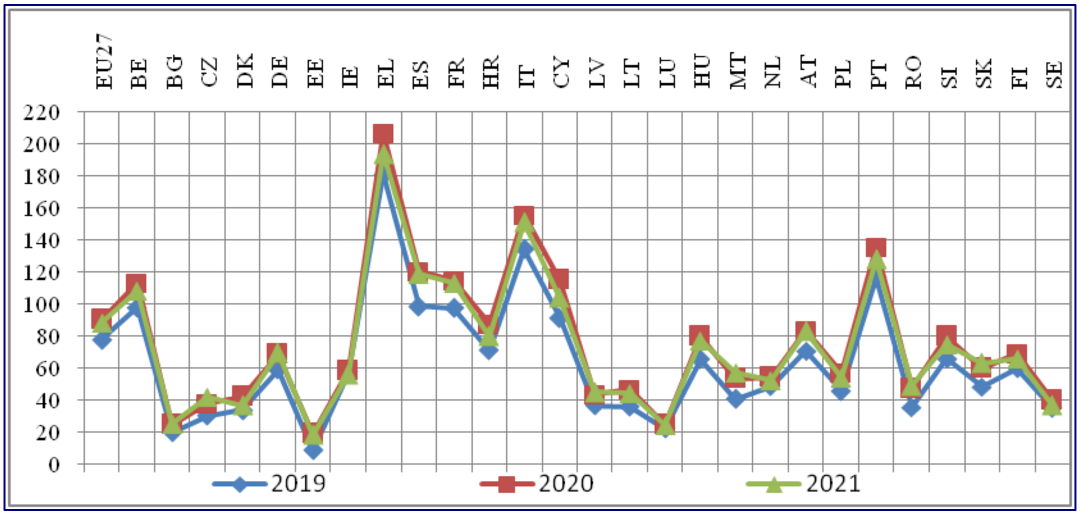

Figure 4. The evolution of public debt in the EU27 and member countries, in the period 2019 – 2021 (% in GDP)

Source: https://ec.europa.eu/eurostat/databrowser/view/gov_10dd_edpt1/default/table?lang=en

The general evolution of the share of public debt in GDP in all countries is of significant increase in 2020, the most difficult year of the COVID-19 pandemic, in which governments faced an unforeseen and unique situation, so far, and the panic created led to the contracting of massive loans, an aspect that in 2021 moderated in relation to the evolution of 2020, with most countries entering a downward trend, but there are also situations in which the rise from 2020 continued in 2021, with intensity less, such as Romania, Bulgaria, the Czech Republic or Slovakia.

Economic growth is an indicator by which the efficiency of fiscal-budget policy measures implemented by governments can be evaluated and even measured, in general, but especially in periods of economic crisis or with negative effects on the economy, through the multiplier effects that they have generate in the short, medium or long term.

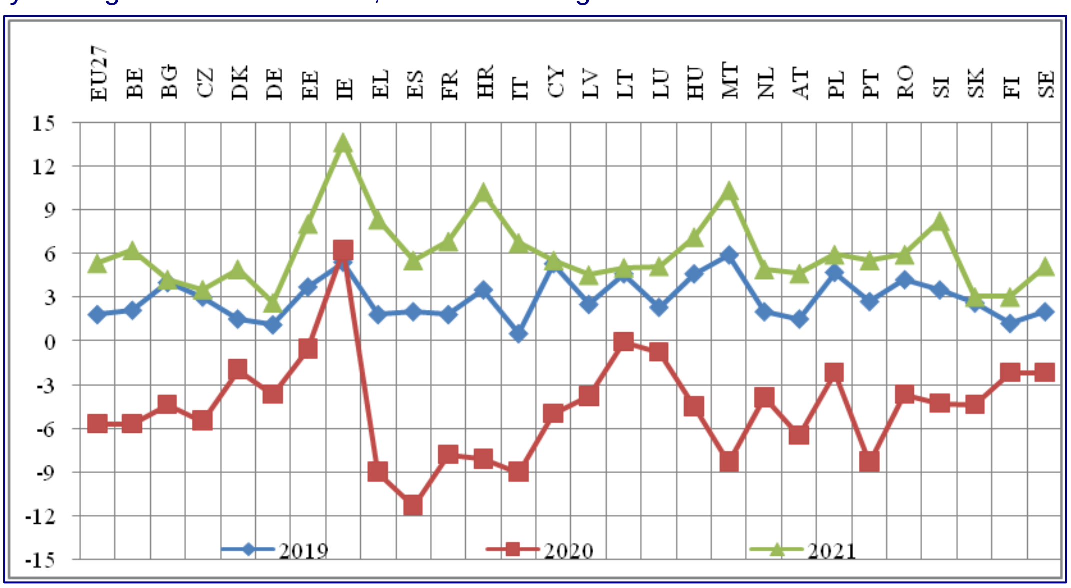

Figure 5. The evolution of the annual GDP growth rate compared to the previous year, in the member countries, in the period 2019 – 2021

Source: https://ec.europa.eu/eurostat/databrowser/view/tec00115/default/table?lang=en

At the EU27 level, the annual economic growth rate recorded a fluctuating evolution, from 2% in 2019, to approx. – 6% in 2020 and a return above expectations in 2021, when it recorded approx. 5%. In the structure of the member countries, in 2019 they all recorded positive growth rates, in 2020, they recorded negative growth rates (with the exception of Ireland), and in 2021 they returned to positive growth rates, much higher compared to the year 2019.

The generous financial dimension of the packages of fiscal-budgetary measures implemented in 2020 generated immediate and extensive economic effects in most member countries. Thus, at the EU27 level, a budgetary effort of approx. 6% of GDP in 2020, stimulated GDP growth, which registered an increase of approx. 5% in 2021. Similar situations are found in most member countries, including Romania, where the size of the package of fiscal-budgetary measures had an effect of approx. 6% of GDP in 2021.

In 2021, the financial dimension of the packages of fiscal-budgetary measures was significantly reduced compared to that of the previous year, an aspect that will be found to a certain extent in the GDP dynamics of 2022.

Conclusions

In the period before the COVID-19 pandemic, the state of the fiscal-budgetary policy at the EU27 level, analyzed through the lens of the two mentioned indicators (the budget deficit and the public debt, in relation to the budgetary frameworks implemented at the community level) was relatively stable in most member countries, recording -se. - there are budget surpluses or deficits below 3% of GDP and levels of public debt below the 60% threshold of GDP, with some exceptions regarding the level of debt to GDP in the cases of Greece (180%), Italy (134%), Portugal (116%) and regarding this budget deficit, the case (-4.3% of GDP).

The effective reaction of the fiscal-budgetary policy to the COVID-19 pandemic to reduce the negative impact on the economic and social environment at the EU27 level was a farm, of an unprecedented scale in the history of the community, materializing in over 1,000 fiscal-budgetary measures, with their total financial dimension estimated at 6% of GDP in 2020 and 4% in 2021.

Among the countries, the suspension of the Community fiscal-budgetary frameworks and the funds made available by the EU through various programs and supported and stimulated the implementation of financially consistent fiscal-budgetary packages, aimed both at preventing and combating the spread of the virus, and to combat the negative economic and social effects generated by the pandemic.

The fiscal-budgetary effort made by the EU member countries in 2020 significantly damaged the state of public finances, reflected by the evolution of the analyzed indicators, with revenues registering decreasing or stagnant tendencies, budget expenditures increased significantly and led to an increase in the budget deficit, as well as to the increase in loans to finance them, amplifying the growth rate of the public debt. Economic activity decreased in 2020 by approx. 5-6% compared to the previous year, an unfavorable context for fiscal recovery.

The effects of the pandemic continued to have a negative impact on the state of public finances in 2021 as well, but to a lesser extent, with favorable developments in the analyzed indicators, a strong economic impulse, a situation that predicts a short-term return of the economy to the state from before the pandemic. The situation of public finances after passing through the COVID-19 pandemic is slowly recovering, but with significant accumulations in terms of public debt.

In the year 2022, a slow and easy improvement of all the analyzed indicators is expected, the prerequisites for this being the economic growth rate recorded at the level of the first semester / 2022 in the EU of over 2.5%, a similar situation in Romania.

Beyond the worrying aspects related to the COVID pandemic, its negative environmental and social impact and the deterioration of the state of public finances in several countries, an increase in concerns about the adoption of measures that are not specifically related to the health crisis is expected, but the design of some fiscal-budgetary strategies to ensure the moderation of government expenses, which were not compensated by additional revenues, the increase of revenues and the placement of public finances on a trajectory of reconsolidating deficits and public debt.

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