THE IMPACT OF THE COVID-19 CRISIS ON PUBLIC FINANCES COMPARED TO THE PREVIOUS CRISIS

MATEI Elena-Florentina
Doctoral School Economy I, Bucharest University of Economic Studies, Bucharest, Romania
matei.elena96@gmail.com

Abstract: *The start of a crisis, whether it is a financial, health, or any other crisis, is a negative macroeconomic phenomenon, with consequences for both the entire world and the European Union. The coronavirus epidemic manifested itself in European countries in the spring of 2020, leading to the emergence of economic imbalances amid slowing and shrinking economic activity. The measures taken by European states are unprecedented compared to those adopted in the previous crisis, ranging from financial support to individuals and legal entities, deferral of taxes and other debts, legislative changes, and the acceptance of work from home in more and more branches activity, which until this period was not possible. This paper aims to study and analyze the evolution of public debt and budget deficit in the European Union, but also the measures taken by the Member States in the context of COVID-19 compared to those during the financial crisis in 2009. In addition to this analysis, in this paper, I intend to identify the growth rate of public debt in the Member States in 2009/2008 compared to 2020/2019. To compile this paper, I will use statistical data taken from the Eurostat website on public debt and budget deficit, but also data taken from the European Commission`s AMECO database, section "Economic and Financial Affairs" which includes forecasts on public debt for the year 2020. Regarding the research method used, it consists of both descriptive analysis, dynamic macroeconomic analysis using graphs, and comparative analysis according to the objectives pursued throughout the research. Comparing with the way the information is presented in the bibliography used and found at the end of the paper, in this paper are found only the essential aspects, the particularities of the chosen research topic, which finally provides the overview.*

Keywords: *crisis; public debt; budget deficit; Covid-19; measures; evolution.*

JEL Classification: *H12; H30; H62; H63.*

1. Introduction

The onset of the 2008 financial crisis, as well as the current health crisis, had a strong effect on public finances, more precisely by restricting economic activity which led to a decrease in revenues and an increase in public spending, respectively to a considerable increase in the public deficit and debt.
The financial crisis of 2008 had a strong impact on the European Union and implicitly on the Member States and subsequently led to a slow and long-lasting recovery. The spread of the financial crisis in 2008 was achieved through credit channels and foreign trade, leading to a sharp increase in foreign capital outflows and declining exports, which subsequently led to a widening of macroeconomic imbalances. All

these unfavorable situations have severely affected European countries with a lower level of development, which subsequently led to economic imbalances and the accumulation of a high level of debt. This paper aims to study and analyze the evolution of public debt and budget deficit in the European Union, but also of the measures taken by European states in the context of the financial crisis of 2008 and the current health crisis generated by COVID-19.
This paper is structured in five distinct parts, as follows: (i) the first part includes the introduction, (ii) in the second part the level of knowledge, (iii) in the third part the research methodology, (iv) in the fourth part the analysis of public debt and deficit, the increase of public debt 2009/2008 and 2020/2019 for two categories of countries, the most affected and the least affected, but also a comparative analysis of the similarities and differences regarding the measures taken by the authorities in response to the financial crisis from 2008 compared to the current health crisis from 2020, (v) and the last part contains the conclusions.

2. The level of knowledge

This paper started from the consultation of several bibliographic references relevant to the research area, with a significant impact on it.
The rise of a global or regional crisis is a recurring phenomenon and we need to learn how to build new market regulation reforms so that we can mitigate repeated occurrences. (Ellert, 2019).
One of the distinguishing features of the financial crisis of 2008 is the sudden collapse of global credit as a result of the cessation of interbank lending amid uncertainty and exposure to high debt. (Roubini și Mihm, 2010).
The outbreak of the COVID-19 pandemic has created many challenges at the global and European level, leading to the adoption of large-scale fiscal measures due to decisions to increase public spending and the granting of several tax exemptions to both individuals and companies during an unfavorable economic situation. Even if this new health crisis generated by COVID-19 disappears, its effects will be felt in the long run, because many states will face high debts due to the promotion of permissive fiscal policy. (NBER, 2020).

3. The research methodology

This paper is based on a mixed methodology, as it includes both the method of descriptive analysis, used to achieve the stage of knowledge, and a dynamic macroeconomic analysis used to perform the analysis of public debt and budget deficit, which are highlighted in the form of time series, more exactly the graphics. This paper also includes a comparative analysis of the measures taken by the authorities at the level of the European Union according to the economic context, focusing on the onset of the financial crisis of 2008 and the current crisis, generated by COVID-19.
To realize this paper I used the database taken from the Eurostat website on public debt and the budget deficit in the European Union and the Member States, for the period between 2008q1-2009q4 and 2019q1-2020q2, but also the AMECO

database of the European Commission for the forecasts regarding the public debt from 2020.

4. Evolution of public finances

Public debt and the budget deficit are two of the nominal convergence criteria that assume that the debt should not exceed 60% of GDP, and the deficit 3% of GDP to ensure the sustainability of public finances, according to the provisions of the Maastricht Treaty. In the period 2008q1-2009q4 according to Chart 2, the level of public debt registered an upward trend as a result of the measures adopted by the authorities at the level of European states, which mainly aimed at increasing consumption and public spending, contracting new loans to cover debt financing needs and the budget deficit, a much lower production capacity compared to the level of investment. At the level of many European countries, there has been a slowdown in public debt growth after this period amid measures taken by the authorities, which aimed mainly at recovering the economy and fostering economic growth by closing the gap between the Member States, as shown in Chart 1. The major deepening of the public deficit in 2008-2009, but also in 2010, is mainly due to the overheating of the economy of several European states amid net inflows of other investments, which were in the form of external loans requested by both the banking sector and the non-banking sector. This situation has led to a significant deterioration of the net international investment position in more and more European countries, which have subsequently faced several significant economic problems.
Regarding the period 2019q1-2020q2, we can see the trend of improvement of public finances in 2019 at the level of the European Union as a result of the measures taken by the authorities, which focused mainly on the implementation of structural reforms, efficient management of investment and the promotion of responsible fiscal policies. Actions taken at the European level have also contributed to this favorable situation, including the Investment Plan for the European Union, which has significantly influenced stability and prosperity. However, the onset of the current health crisis has led to a reduction in activity and thus a deterioration of public finances in the first months of 2020, amid declining budget revenues as a result of a delayed payment of more tax obligations due by economic agents, increasing investment spending and subsidies, which subsequently led to an increase in debt and a budget deficit.
The public deficit registered a downward trend, in the sense of reducing it, in 2019 compared to 2020 in the context of registering a favorable economic situation in most European countries. Romania is an exception to this situation, as it recorded a high level of the public deficit, which led to the launch of the excessive deficit procedure in April 2020 amid the promotion of a relaxed fiscal policy in the context of improving macroeconomic indicators. In 2020, the deficit increased significantly due to the increase of public expenditures and the contracting of new loans in the context of the onset of the health crisis generated by COVID-19.
In this situation, European states are facing a series of new challenges amid the pandemic that has led to the introduction of measures of isolation and stopping economic activity in several industries, which will ultimately materialize in much

lower revenues and much higher government spending. Also, the severity of the COVID-19 crisis can be measured by declining production, the number of deaths, rising unemployment and poverty, declining incomes, and rising spending on social assistance. To meet these new challenges, the authorities have resorted to a series of loans to cover social protection expenditure and other expenses.

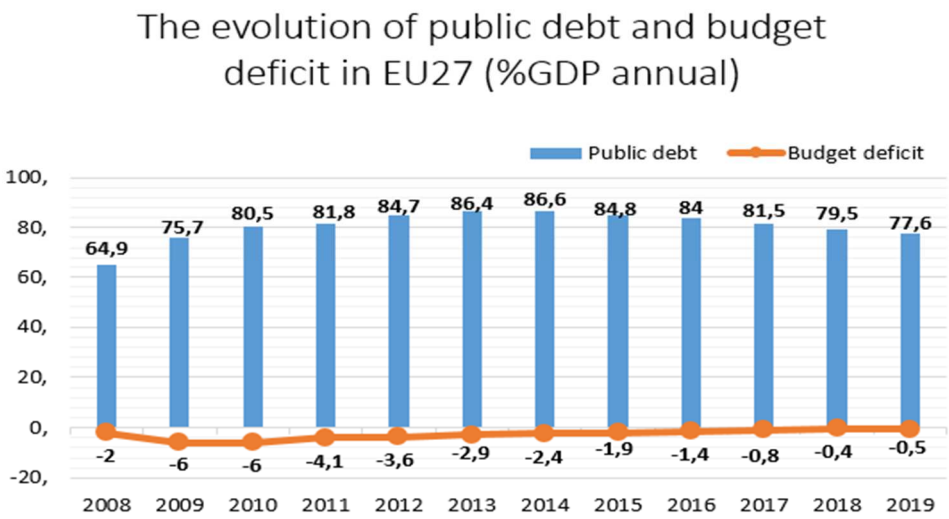

Figure 1: The evolution of public debt and Budget deficit in EU (%GDP annual)
Source: Eurostat, https://ec.europa.eu/eurostat/web/covid-19/economy#

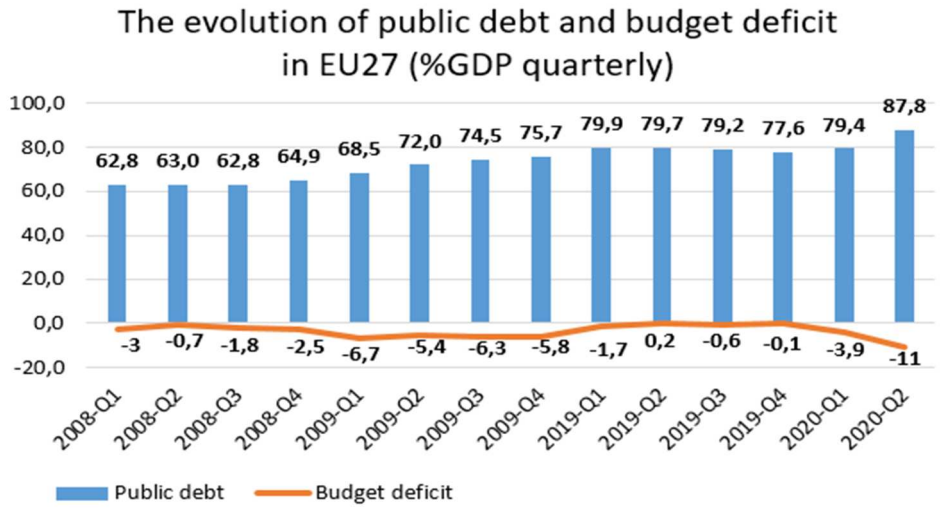

Figure 2: The evolution of public debt and Budget deficit in EU (%GDP quarterly)
Source: Eurostat, https://ec.europa.eu/eurostat/web/covid-19/economy#

Thus, the growing need of the governments for financial resources in recent times will lead to rising deficits and debt to finance short-term activity. All these actions taken during this period to alleviate the economic costs of the recession and to form the first line of defense against debt sustainability concerns will lead to a stronger and longer-lasting recession that may lead to medium-term debt sustainability risks.

4.1. Increase of public debt 2009/2008 and 2020/2019 for two categories of countries, the most affected and the least affected

The determination of the growth rate of the public debt from 2020/2019, respectively 2009/2008 was made based on the forecasts found in the AMECO database of the European Commission, section “Economic and Financial Affairs”. The increase in public debt in the European Union in 2009/2008 and 2020/2019 can be seen in Chart 3 below. Following the analysis, it can be seen how a large part of European countries that recorded an increased rate of public debt in 2009/2008 managed to register a much lower rate in the period 2020/2019. Following the economic crisis of 2008, the European economy showed signs of recovery due to the strategic and effective measures adopted, and their coordination in the context of the "European Economic Recovery Plan" had the ability to avoid financial collapse and loss of confidence. However, against the background of high uncertainty and the existence of risk between the real economy and the financial sector, many European countries have faced economic losses and a high level of public debt over a longer period of time.

At the same time, the orientation of budgetary policies towards removing the economy from recession, together with the granting of discretionary fiscal incentives, have led to the improvement of the economy and the deterioration of public finances. Thus, registering a growth rate of the public debt of 16.54% in 2009/2008 (public debt was 64.94% in 2008 compared to 75.68% in 2009).

The European Union countries with the lowest public debt growth rate in 2009/2008 are the Netherlands (3.8%), Bulgaria (4.9%), and Luxembourg (5%). , 1%), Poland (6.6%), Belgium (7.6%), Malta (8.1%), Sweden (8.5%), Hungary (8.9%) and Italy (9.8) %), the rest of the European states registering a growth rate of over 10%. The most affected European countries according to the public debt growth rate in 2009/2008 were Latvia (98.2%), Lithuania (91.9%), Romania (76.6%), Estonia (59.8%), Slovenia (58.5%), Ireland (45.1%) and Spain (34.1%), while the rest of the European countries recorded a growth rate of less than 30%. Regarding the European countries least affected in terms of the public debt growth rate of 2020/2019, these include Greece (11.2%), Portugal (11.7%), Austria (12%), Ireland (13.1%), and Hungary (13.1%), while the other European countries recorded a growth rate of over 15%.

The European countries that will face a major public debt growth rate in 2020/2019 according to AMECO forecasts are Estonia (146%), Denmark (34.6%), Lithuania (33.7%), and Romania (31%), while the rest of the European countries will register a growth rate of less than 30%. However, there are European states that recorded a high rate of increase in public debt in 2009/2008, and in 2020/2019 will manage to record a much lower rate compared to other European states that before this period had much better results.

Among these states are Latvia (16.8% in 2020/2019 compared to 98.2% in 2009/2008), Lithuania (33.7% in 2020/2019 compared to 91.9% in 2009/2008), Romania (31% in 2020/2019 compared to 76.6% in 2009/2008) and Slovenia (26.6% in 2020/2019 compared to 58.5% in 2009/2008). Among the countries most affected by the public debt growth rate will be Estonia (146.3% in 2020/2019 compared to 59.8% in 2009/2008), the Netherlands (27.8% in 2020/2019 compared to 3, 8% in 2009/2008), Bulgaria (25.2% in 2020/2019 compared to 4.9% in 2009/2008), Poland (27.2% in 2020/2019 compared to 6.6% in 2009 / 2008) and Germany (26.6% in 2020/2019 compared to 11.4% in 2009/2008).
This unfavorable situation in 2020 occurred amid rising budget deficits as a result of rising public spending and declining government revenues. A significant impact on this negative situation was given by the onset of the health crisis generated by COVID-19, which led to a major increase in the indebtedness of European countries, but also of other non-European states. In this context, increasing public debt can be an obstacle to a sustainable and sustained recovery in economic growth.

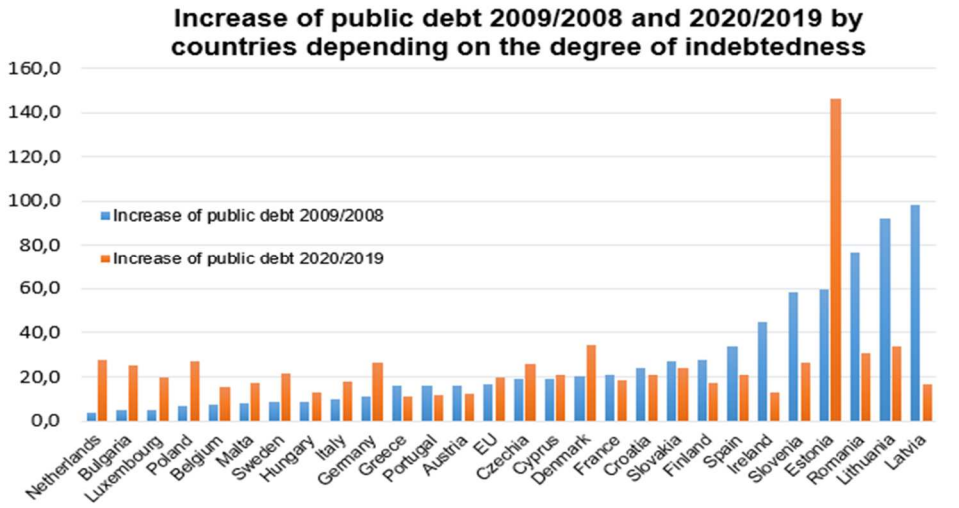

Figure 3: Increase of public debt 2009/2008 and 2020/2019 for two categories of countries, the most affected and the least affected
Source: European Commission, Economic and Financial Affairs, https://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm

4.2. Similarities / differences from the previous crisis

The main difference between the current health crisis from the previous financial crisis is the cause that determined it. Specifically, the financial crisis of 2008 arose due to a lack of regulation and supervision, which led to the existence of unfavorable financial management. Thus, a financial crisis was created which subsequently led to the onset of an economic crisis, and its intensity was reduced with the help of measures taken by central banks and governments. As for the current crisis, it did

not arise due to the economic context, but against the background of the COVID-19 pandemic. This leads to a paradigm shift and many new challenges and uncertainties. However, even if the cause of the two crises is different, both have significantly affected public finances and the economy.
There are also other differences between the two crises, including the existence of more capitalized and robust financial systems in the developed countries, a prudent fiscal policy in the European Union that has led to lower deficits and public debt over time. Moreover, a large part of the European states registered a downward trend of debt and budget deficit until the onset of the COVID-19 pandemic, which means the recovery of previous losses.
Another difference between the two crises is the speed of spread, as the crisis of 2008 gradually began in the US and later in Europe and other countries, while the current crisis has spread much faster globally, affecting more and more countries in a short period of time.
As for the similarities between the two crises, they are not many due to the context in which they broke out. However, an important similarity is related to the impact of global economies, by worsening macroeconomic indicators and increasing indebtedness.

4.3. Measures taken at the EU level against COVID-19 versus the financial crisis of 2008

The measures adopted by the authorities amid the onset of the financial crisis in 2008 aimed at implementing financial incentive packages by increasing public spending, investment, tax cuts, state aid, and income tax cuts. Subsequently, several austerity measures were adopted to reduce the budget deficit and public debt, which consisted of reducing total and staff costs. These austerity measures have had a significant impact on the economic, financial, and social level, which have led to a worsening of the living standards of the population and the emergence of social vulnerabilities.
About the current crisis, European countries have taken many measures, both fiscal, social, and economic, to provide support to companies and citizens, but also to reduce the risk of an economic crisis. Among the most common measures taken are an implementation of state aid for low-income companies due to the pandemic, legislative changes, the flexibility of the legislative framework, allocation of European funds, granting more fiscal facilities to individuals and companies, suspension of the obligation to pay certain taxes, duties and installments, the granting of the unemployment aids, but also others.

5. Conclusions

Internal public debt can be a vicious circle of the government deficit in the budget process if it is not managed properly due to the need to cover it. Thus, according to the analysis, it can be seen how the onset of the financial crisis of 2008 and the current health crisis led to the registration of macroeconomic imbalances, more precisely to the deepening of the budget deficit and public debt.

The financial crisis of 2008 has highlighted the fact that many European countries are facing various fundamental problems and unsustainable long-term trends that can lead to significant risks. This crisis has emerged amid low regulations in the financial system, more specifically at the level of the credit sector, which has managed to accumulate effects on a global scale. The impact of the crisis on Europe has been strong and has led to a slow recovery of the gap.
Concerning the current economic context, together with the need to identify the measures needed to reduce the effects of the pandemic caused by COVID-19, it is recommended that further research on the subject be recovery to be a fast one. The significant increase in recent indebtedness both globally and in Europe could lead to a new crisis, which will further affect states. At the same time, the pandemic generated by COVID-19 exerts major pressure on the state budget, which is facing the accumulation of much lower public revenues due to the restriction of economic activity.
The measures taken by the authorities are also unprecedented compared to 2008, as they have allocated much more money to reduce the effects of the current crisis. All these actions have led to a considerable deterioration of public finances and an increase of risks to their long-term sustainability.

References

1. Cassim, Z., Handjiski, B., Schubert, J. and Zouaoui, Y. (2020), *The $10 trillion rescue: How governments can deliver impact*, McKinsey&Company, Public&Social Sector, [Online], Available: https://www.mckinsey.com/industries/public-and-social-sector/our-insights/the-10-trillion-dollar-rescue-how-governments-can-deliver-impact#.
2. Commission of the European Communities (2009), *Long term sustainability of public finances for a recovering economy,* Brussels, [Online], Available: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52009DC0545&from=ro.
3. Gopinath, G. (2020), *Coronavirus Pandemic Research. Fiscal implication of COVID-19*, National Bureau of Economic Resarch, [Online], Available: https://www.nber.org/.
4. Gordon, T., Dadayan, L., Rueben, K. (2020), *State and Local Government Finances in the COVID-19 Era*, National Tax Journal, Washington, [Online], Available: https://apps-webofknowledge-com.am.e-nformation.ro/full_record.do?product=WOS&search_mode=GeneralSearch&qid=2&SID=E17PrNVUItJId4HCGMr&page=2&doc=20&cacheurlFromRightClick=no.
5. Ellert, J. (2019), *Anticipating the Next Global Financial Crisis and Recession,* [Online], Available: https://iedc.si/blog/single-blog-post/iedc-wisdoms/2019/08/20/anticipating-the-next-global-financial-crisis-and-recession.
6. Luis de Guindos (2020), *Foreword*, European Central Bank, [Online] Available: https://www.ecb.europa.eu/pub/financial-stability/fsr/html/ecb.fsr202005~1b75555f66.en.html#toc11.
7. Roubini, N. and Mihm, S. (2010), *Crisis Economics. A crash course in the future of finance*, The Penguin Press, New York, [Online], Available: https://kuangaliablog.files.wordpress.com/2017/04/mihm-stephen_-roubini-nouriel-

crisis-economics-_-a-crash-course-in-the-future-of-finance-penguin-press-2010.pdf.