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The impact of COVID-19 on the fiscal policies of the Central European countries

Within six months of the announcement of the COVID-19 pandemic, the Central European countries spent nearly 10% of GDP on fiscal support. This decisive response by governments is mitigating the effects of the economic crisis, saving companies and preserving jobs. However, an increase in expenditure with lower budgetary revenues inevitably leads to a deterioration in the sustainability of public finances.

An unprecedented fiscal response. The current economic crisis caused by the COVID-19 pandemic is unprecedented for the emerging Central European economies. The final scale of the slowdown this year is not yet known, but the forecasts of the International Monetary Fund (IMF) in October indicate a decline of 5.5% (average for EU countries: Bulgaria, Croatia, Czech Republic, Estonia, Lithuania, Latvia, Poland, Romania, Slovakia, Slovenia, and Hungary). However, this is slightly less than predicted at the beginning of the pandemic. In April, the IMF predicted a decline of 6.4% in these countries.

Not without significance in the improvement of this forecast was another, equally unprecedented economic phenomenon during this crisis, a fiscal response – a record of both global and national levels. To stop the spread of the virus and save businesses and jobs, governments around the world have so far spent USD 11.7 trillion, or nearly 12% of global GDP[1]. In the Central European countries, it was USD 175 billion, representing less than 10% of their GDP. This amount includes direct fiscal expenditure – USD 78.5 billion, of which USD 11.3 billion was allocated to the healthcare system and USD 67.2 billion to people and businesses in difficulty due to the pandemic, for example, for allowances, grants, or tax reduction. It also includes supporting the liquidity of enterprises from the public sector – USD 96.1 billion, for example, loans, guarantees, and capital injections.

Nominally, the largest fiscal support was prepared by the largest economy in the region, namely Poland with almost USD 68 billion. Next was the Czech Republic with USD 48 billion, and Romania with USD 13.4 billion. However, in relation to GDP, the greatest support was provided by the Czech Republic with almost 20%, then Slovenia with 14.5%, and Poland with less than 12%, while the smallest countries that joined the EU the latest, Bulgaria, Romania, and Croatia, within 5–7%.

An unprecedented debt. However, the decisive government response to the pandemic's economic impact in the form of extensive fiscal measures, along with loss of revenues from falling output, leads to an increase in public finance debt.

In a non-crisis practice, according to *The Stability and Growth Pact* adopted in 1997, EU Member States are committed to budgetary discipline. They should keep the public deficit at a level not exceeding 3% of GDP, while public debt should not exceed 60% of GDP. Otherwise, an excessive deficit procedure is imposed on the Member State concerned in order to persuade it to take appropriate measures in this regard. After the debt crisis in 2012, another document was adopted to discipline the public finances of individual EU Member States – *The Fiscal Stability Treaty*, approved by the 25 EU countries at the time (except the Czech Republic and the UK). Both deficit and debt to GDP criteria have been maintained, while the way to respond to their excess has been strengthened, especially for countries in the Eurozone.

[1] IMF data as of September 11: International Monetary Fund (IMF), *Fiscal Monitor: Policies for the Recovery*, Washington, October 2020.

In May 2020, the European Commission (EC) announced that this year all the countries concerned would not meet the first criterion, and some of them would not meet the second criterion[2].

According to government plans, the public deficit will be on average twice as high as allowed by the EU – it will amount to 7.7% in relation to GDP. The highest was established by the authorities of the Baltic states, followed by Lithuania 11.4%, Estonia 10.1%, and Latvia 9.4%. On the other hand, at the end of the year, the public debt in relation to GDP would be at an average of 55% in the Central European countries, while in 2019, it was at an average of 43%. The EU's public debt level will then be exceeded in Croatia 86%, Slovenia 82%, Hungary 73%, and Slovakia 61% (near this value – Poland 55.2%, Latvia and Lithuania over 50%).

An unprecedented recommendation. Despite such disturbing indicators, the EC did not recommend that additional Member States should be subject to an excessive deficit procedure in May (only Romania is currently covered). A revision of this position was announced in the autumn, but no change should be expected. In the face of the current economic crisis, the EU institutions recommend that the Member States take all necessary measures to effectively tackle the pandemic and save the economy. Therefore, the fiscal rules were temporarily suspended and the rules on state aid were loosened.

Already on March 13, 2020, the EC announced a *Coordinated economic response to the COVID-19 Outbreak*, which, inter alia, gave Member States the opportunity to implement the necessary measures to stop the spread of the virus and to mitigate the negative socio-economic impacts of the pandemic. The IMF also pointed out that increasing levels of public debt are not the highest risk at present. The priority in the near future is to avoid early withdrawal of fiscal support.

At the same time, the EC emphasizes that, given the unprecedented fiscal packages adopted in the Member States and as a result of the increased role of the public sector in the economy, it is important that public administrations are effective and efficient. It should be borne in mind that in normal circumstances, as a rule, public financial support for private companies is prohibited, as it distorts competition within the free market. The support given in the face of the unprecedented crisis that we are experiencing today can also distort competition in individual markets and encourage abuse.

Conclusions. Since the beginning of the COVID-19 pandemic, the Central European governments have focused on reducing its consequences. Six months after the outbreak of the pandemic, fiscal measures taken by them are counted in hundreds of billions of dollars (with significant differences within individual countries, from the Czech Republic, which supported almost a fifth of its GDP, to Bulgaria, Romania, and Croatia, which have, by the same token, delivered only a fifteenth part).

This high level of support also results in an imbalance in public finances. In 2020, all governments in the region set a deficit higher normally acceptable to the EU. However, the problem of rising levels of public debt is not seen as a priority.

Given of the apparent increase in the number of infected countries in Central Europe and as a consequence of a number of decisions by governments to re-restrict various economic activities, public financial support will certainly continue. The EU institutions indicate this as a good way out of the current crisis. They, therefore, temporarily suspended fiscal rules and loosened the rules on State aid. However, this does not exempt governments from the obligation to provide such support on clearly defined terms and in transparent forms only.

[2] Data reported by national authorities on 31 March 2020; no data available for Romania.