The Impact of Coronavirus Pandemic on Romania's Economic Development

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Abstract: - The world is passing through the most difficult exogenous crisis in the history, which severely affects its stability in the long term, risking an uncontrolled slide into uncertainty. Compare to 2008 global financial crisis generated by non-performing loans and their securitization, the new corona virus (COVID19), which appeared in China in late 2019 and turned into an epidemic since January 2020, has severely affected the entire world economy. The pandemic is imposing a heavy burden on individuals and societies and putting health care systems under severe strain. It is obvious that the pandemic will pass, especially in the context of COVID-19 vaccines authorised in the EU following the positive recommendation of the European Medicines Agency fora conditional marketing authorisation for the BioNTech and Pfizer vaccine, Moderna, Johnson and Johnson and Astrazeneca too, but it will leave behind a severe economic crisis. The study is trying to present the main causes and characteristics of the crisis, with special attention to its impact on Romania, which has witnessed an economic downturn in the first half of 2020, registering a decline in Hospitality industry, manufacturing, distribution (other than consumer goods) and transport. To deal with high budget, Romania issued 3,3 billion euros worth of bonds at the end of May 2020. But, in the long term, the external debt burden is increasing, the sustainable development of Romania facing new risks arising from both the global crisis and the internal vulnerabilities.

Key words: - international crisis, global recession, causes and effects of the crisis, anti-crisis remedies, external debt, sustainable development.

1 Introduction

By December 2020, in the first year of coronavirus pandemic, were affected almost all countries and more than 60 million people all over the world. It has governments operating in a context of confusion, and experienced with difficult trade-offs given the health, economic and social challenges it raises. By spring 2020, more than half of the world's population had experienced a lockdown with constraint measures.
The measures taken by states to reduce the effects of the health crisis have been severe, the most important being stopping non-essential activities, restricting travel and banning travel to and from certain countries and causing shocks in production and distribution chains, but also strong contraction of demand for a wide range of goods and services.

Beyond the health and human tragedy of the coronavirus, it is now widely recognised that the pandemic triggered the most serious economic crisis since World War II. Many economies will not recover their 2019 output levels until 2022 at the earliest[1]. All economic sectors are affected by disrupted global supply chains, weaker demand for imported goods and services, a drop in international tourism[2], a decline in business travel,

[1] OECD (2020), OECD Economic Outlook, Interim Report September 2020, OECD Publishing, Paris, https://dx.doi.org/10.1787/34ffc900-en
[2] OECD (2020), Covid-19: Tourism Policy Responses (as of 25 March 2020), https://read.oecd-ilibrary.org/view/?ref=124_124984-7uf8nm95se&title=Covid-19_Tourism_Policy_Responses.

and most often a combination of these. Measures to contain the virus' spread have hit SMEs and entrepreneurs particularly hard[3].

This paper highlights the strong territorial impact of the COVID-19 crisis. Romanian government was at the frontline of the crisis management and recovery plan. It reacted quickly, applying a place-based approach to policy responses, and implementing national measures for in response to the COVID-19 crisis. Also, this paper looks at the impact of the crisis on the main sectors, as Romania is facing new risks.

It is known that the first signs of the financial crisis of the last decade appeared in the second half of 2007, but it took a while for the crisis to spread globally, culminating in the bankruptcy of Lehman Brothers in September 2008.

According to OECD[4], the recovery of OECD regions after the 2008 global financial crisis took years. In more than 40% of OECD and EU regions, even seven years after the start of the crisis, per capita GDP was still below pre-crisis levels. In contrast, the crisis created by the new Corona virus started and spread globally in a very short time, just a few months.

COVID-19 proved unique in its generation of both a supply side and a demand side shock, and its impact on all sectors and global regions. Governments had to manage the economic recovery and to mitigate the impact of a second and in some regions, even the third wave of the virus.

The COVID-19 crisis had a strong territorial dimension with significant policy implications for managing its consequences[5] and two central considerations for policy makers were:

The regional and local impact of the crisis was highly asymmetric within countries. In economic terms, the impact of the crisis was differing across regions, at least in its initial stages. Differentiating factors include a region's exposure to tradable sectors, its exposure to global value chains and its specialisation, such as tourism.

Subnational governments were responsible for critical aspects of containment measures, health care, social services, economic development and public investment, putting them at the frontline of crisis management, coordinated effort being critical.

2 The impact of the economic crisis engendered by COVID-19

The economic impact of the COVID-19 crisis is different across countries, depending on its exposure to tradable sectors and global value chains. Countries with economies that are heavily dependent on tourism such Greece, Italy, France etc. will be more affected by the coronavirus than other regions.

In the US for example, analysis of county-level infection by Brookings and economic data shows that the nation's COVID-19 case load not only remains heavily concentrated, but that the hardest-hit counties and metropolitan areas constitute the very core of the nation's productive capacity. According to Brookings, the 50 hardest-hit US counties "support more than 60 million jobs and 36% of its GDP"[6]. CARES, the Coronavirus Aid Relief and Economic Security Act, adopted by Trump, contains $560 billion that directly benefited individuals in the form of cash payments of up to $1,200. The legislation also expands unemployment and paid sick/family leave benefits, offers forbearance on federally backed mortgages, waives penalties on some early retirement withdrawals, and offers student loan relief and protections for renters. The aid package is the largest in U.S. history, dwarfing the $800 billion pumped into the economy by the American Recovery and Reinvestment Act of 2009.That money helped the country emerge from the Great Recession, but the rebound also cracked open a much larger wage gap.

All subnational government transactions[7] are likely to be highly affected by the crisis in the short and medium terms. A detailed analysis of the expected impact on expenditure, revenue, debt management and access to new borrowing permits identifying their contribution to changes in subnational government finance (see Figure 1).

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[3] OECD (2020), Covid-19: SME Policy Responses (as of 16 March 2020), https://www.oecd.org/cfe/leed/COVID-19-Italian-regions -SME-policy-responses.pdf.

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[5] Ibidem 4

[6] Muro, Whiton and Maxim (2020), "COVID-19 is hitting the nation's largest metros the hardest, making a "restart" of the economy more difficult", *The Avenue, Brookings*, https://www.brookings.edu/blog/the-avenue/2020/04/01/why-it-will-be-difficult-to-restart-the-economy-after-covid-19/?utm_campaign=brookings-comm&utm_source=hs_email&utm_medium=email&utm_content=85726548

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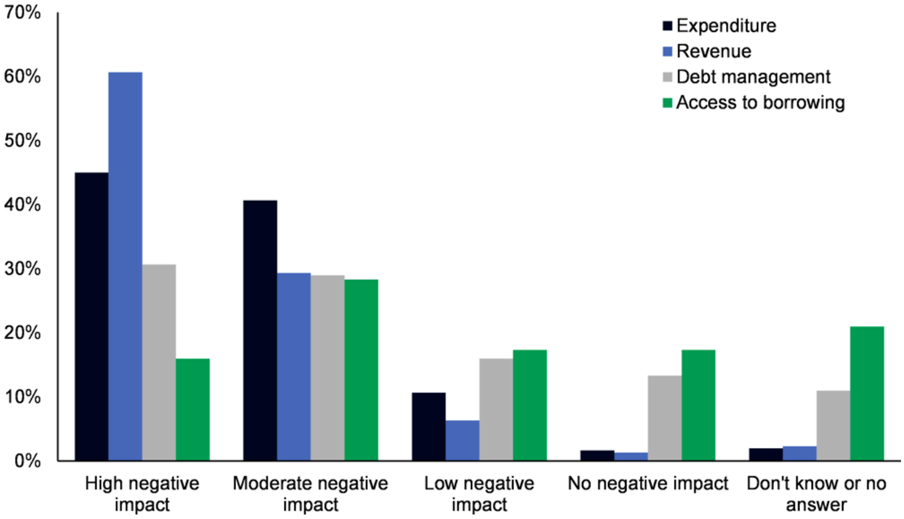

Figure 1: Source OCDE

Romania implemented restrictive measures in the spring of 2020 and had to reinstate some of them in the second and third wave in November 2020 and March 2021. Romania's national government faces strong pressure on expenditure and reduced revenue, thus increasing deficit and debt. While the crisis has already put short-term pressure on health and social expenditures and on different categories of revenue, the strongest impact is expected in the medium term.

In Romania, the effect of fiscal measures taken during emergencies and alert on the public budget for the budget is almost 1.5% of GDP which is added over the budget deficit of 4.6% in 2019 as a result of poor revenue collection budget, the high share of rigid expenditures in tax revenues, but also a lower collection of dividends from state-owned companies and the payment of state debts to private companies. The widening of the deficit from 2.8% of GDP in 2018 to 4.6% was determined by a decrease in total revenues of 0.1 percentage points and an increase in total expenditures by 1.7 percentage points. The increase of the budget deficit has been one of the main drivers of the deepening of the current account deficit in recent years, fiscal easing leading to an increase in household income over domestic supply capacity.

The government deficit increased due to a higher cost of public officials' wages and an increase in old-age pensions. Due to this this expansionary fiscal policy, in the first eleven months of 2020, Romania's general government debt went up by 24% (EUR 18.4 bln) to EUR 95.2 bln at the end of November 2020. The public debt to GDP ratio rose by 9.1pp to 44.4% of GDP at the end of November, from 35.3% at the end of 2019.

In April 2020, the excessive deficit procedure[8] was initiated on the one hand due to the breach of the budget deficit limit of 3% of the Treaty on the European Union on the entire forecast horizon, and on the other hand due to the lack of introduction of a fiscal consolidation following the warnings received from the European Commission. So, the EU Council issued a recommendation in April 2020 to close the procedure excessive deficit by 2022, a structural adjustment being proposed0.5% of GDP in 2020 and 0.8% of GDP in 2021 and 2022, respectively. Taking into account the exceptional situation and the measures taken leading to significant increase in the budget deficit, the European Commission decided to suspend provisions on the budget deficit target[9], to allow Member States to implement appropriate fiscal measures aimed at economic recovery[10].

To provide the liquidity needed to cover government spending, the central bank reduced its monetary policy interest rate to 1.25% and conducted repo operations as well as purchases of government securities on the secondary market. The reduction of the monetary policy interest rate, in three stages, confirmed the decrease of inflation in the medium and long term, at the end of 2020, the annual inflation rate being 2.1%, the lowest in the last three years.

The state also issued bonds worth 3.3 billion euros at the end of May, the highest amount obtained through an external bond issue, but the interest rate was about 1.6 percentage points higher than the issue of

[8] www.bnr.ro, Raport asupta stabilitatii financiare, An v (XV), nr.9 (19), pag.27

[9] „Communication from the Commission to the Council on the Activation of the General Escape Clause of the Stability and Growth Pact", COM (2020) 123 final.

[10] https:// ec.europa.eu/info/sites/info/files/economy-finance/letter_accompanying_the_launching_of_the_edp_for_romania_signed_evp_dombrovskiscssr_gentiloni.pdf.pdf.

January bonds, indicating an increase in risk aversion by investors. Although the rating agencies kept the evaluation of the Romanian public debt in the investment category, the outlook was changed to negative.

Regarding the evolution of GDP, except for the economic performance in the first two months of 2020, the impact of the pandemic and the state of emergency established by the Romanian authorities since March was felt, thus canceling that strong start. The first quarter of the year brought an economic stagnation (-0.04%, revised data) compared to the level of GDP in the last quarter of 2019.

According to the National Institute of Statistics, the second quarter of 2020 was the worst affected by the pandemic, bringing a record economic decline of 12.2 compared to the first quarter. This figure represents the largest decrease in the quarterly GDP of the Romanian economy, also exceeding the negative quarterly records of the economic-financial crisis of 2008-2009.

After this record decrease, the Romanian economy grew by + 5.6% in the third quarter compared to the previous quarter. Thus, in annual terms, Romania's GDP accumulated a decrease of 5.7%, both on the gross series and on the seasonally adjusted series, compared to the third quarter of 2019, which is at the same time a decrease below the national average. EU (-4.3%).

Regarding the longer-term economic outlook, UBB[11] researchers forecast that the full recovery of the economy in terms of performance in the run-up to this crisis will take about 2.5 years. The most likely scenario at the moment shows that Romania's GDP will return to the level before the pandemic during 2022, this return being conditioned by the production and efficient delivery of the vaccine against Covid-19 throughout the country, respectively the wise use of substantial EU economic support funds. For the time being, the vaccination strategy adopted at the country level has proved to be effective, considering that Romania is in the top five countries in terms of the vaccinated population until the beginning of February 2021.

Economic recovery will be mainly supported by the rebound in household consumption which accounts for 63% of GDP. Due to social distancing measures and declining incomes, it fell by 7% in 2020. Unemployment increased from 3.8% in 2019 to 7% at the end of 2020 due to loss of jobs. This rebound in household consumption has been encouraged by the government's support plan with 75% of short-time working being covered by the government and the freezing of water, gas and electricity prices. In 2021, it is expected to rebound by 3%, driven by the relaxation of health measures, but will remain constrained by lower wage growth and an increase in the unemployment rate, barring favourable provisions in the 2021 budget.

Even if the construction sector recorded a stagnation, investments concerning infrastructure and residential construction are expected to grow by 5% in 2021 and benefit from the Next Generation EU recovery plan, under which Romania will receive EUR 33 billion by 2023 (12 billion had been paid into the fund).

According to the National Institute of Statistics, Romania's trade deficit has worsened in the first 11 months of 2020, given that imports fell by 7.7% and exports fell even more by 11%. Between 1 January and 30 November 2020, exports totaled 57.1 billion euros, 11% less than in the same period in 2019.
Imports amounted to 73.5 billion euros, so that the trade deficit in the first 11 months of 2020 was 16.4 billion euros, higher by 908.7 million euros than in the same period last year.

Therefore, foreign trade fell in 2020, but will pick up again, even if its contribution to growth remains negative due to exports. Exports are expected to pick up in 2021 thanks mainly to exports of telecommunications and IT, machinery and vehicle exports. In 2021, the recovery in external demand is expected to exceed domestic demand and therefore, the trade deficit will narrow again. Also, remittances (3% of GDP) are expected to pick up when activity in the countries of expatriation resumes, in particular, Spain and Italy.

As a whole, the financial system has faced, in the context of the COVID-19 pandemic, a significant increase in uncertainty and a rapid adjustment of risk premiums in the financial markets. In the context of limiting the spread of the virus, the measures taken have generated supply chain bottlenecks and strong contraction in demand, while financial markets have faced significant increases in volatility and significant adjustments in financial asset prices.

After this virus spread globally and was declared a pandemic, the next day European stock markets reported declines of more than 10 percent, the maximum cumulative losses being over 35% in the first four months of 2020. These were similar corrections. those recorded during the financial crisis of 2007-2008. By the end of April, more than a third of these losses had already been recovered. Stock price volatility indices reached or even exceeded historical highs recorded during the 2007-2008 crisis. The oil segment was most affected by the decrease in consumption generated by the cessation or substantial slowdown of large economic activities consuming petroleum products and the introduction of social distance measures.

[11] https://news.ubbcluj.ro/perspectivele-economiei-romanesti-in-contextul-pandemiei-pe-baza-analizelor-efectuate-de-cercetatorii-ubb/

Regarding the Bucharest Stock Exchange, the BET[12] index decreased by about 30% by the end of March, following the evolutions of the main international indices, such as the S&P 500, DJIA, FTSE 100 and DAX, which experienced decreases of around 35%, recovery of losses in a percentage of approximately 80% - 85% taking place in the next 2 months. During this period, the Bucharest Stock Exchange was in the same trend of high volatility, in correlation both with the number of new cases of illness and as an effect of reducing the activity of enterprises in most fields of activity. The same strongly negative correlation, of - 0.81, was found in the case of the evolution of the BET index compared to the evolution of the number of new cases of diseases in China. On the other hand, the analysis of the correlation between the BET index and the number of new cases in the USA resulted in a moderate negative correlation of -0.46, which decreased as the number of new cases of diseases decreased. Thus, the reaction of the local stock market was in the general context of the evolution of international stock exchanges that reacted to the first signs of pandemic in China, the effects of pandemic transmission later in the US being already absorbed by capital markets.

Overall, the evolution of capital markets was in V, respectively in broad reductions in stock market indices, followed by a fairly rapid recovery, which does not take into account the long-term economic fundamentals, highlighting the decoupling of stock markets from the real economy.

3 Conclusions

The economic recovery, after the crisis of 2008-2009, was generated mainly by consumption, and investments remained at a modest level. In this sense, capital inflows are vital to adequately stimulate the transition from economic growth based on stimulating aggregate demand to one based on lasting growth of aggregate supply, by significantly improving the performance of factors of production. Public debt can only fuel economic growth if the total amount of revenue generated by debt is higher than the total debt balance. If the public debt increases as a result of financing current budget expenditures, there will be negative effects in the medium and long term in the economy.

This increased public debt will soon turn into a higher financing cost for our country. Country risk will be felt in the prices of treasury securities and CDS. An economy in dire need of financing will face limited access to primary markets and high interest rates. As such, dynamic economic growth must be doubled by the adoption of structural reforms and fiscal consolidation.

With regard to encouraging SME entrepreneurship, additional measures are needed. According to the Country Report launched by the European Commission in 2018[13], “SMEs in Romania would benefit from a larger capitalization, simplification of the insolvency framework and mobilization of additional private sources of financing, supported by the financial instruments of EU. It is estimated that an initiative signed with Romania by the Commission and the European Investment Bank will generate approximately EUR 500 million in the form of new loans to SMEs on favorable terms”.

“Given the increasingly dynamic ecosystem in which it operates, the expansion of start-ups remains a challenge. Despite increased public support through the Start-up Nation program, the expansion of existing companies is hampered by a lack of clear legislation, an administrative burden, a lack of qualified staff and a low level of innovation.

The percentage of Romanian companies with an accelerated growth rate is among the lowest in the EU. Entrepreneurs who have set up a company do not have access to business mentoring, and school curricula are not aligned with the needs of future entrepreneurs”. The challenges of the business environment affect investment, among which are the sustained political uncertainty and the unpredictability of new policies.

The main barriers to investment are: although public investment spending is relatively high, poor infrastructure quality is a brake on investment. The development of a quality infrastructure is slowed by:

- low absorption of EU funds;
- inefficiencies in project preparation, prioritization and implementation of projects and limited efficiency and poor corporate governance legislation applicable to state-owned companies. The adoption of the General Transport Master Plan of Romania in 2016 was an important step towards improving strategic investments in road infrastructure, but so far progress is slow.

Investments are affected by inadequate labor supply. Continued labor migration and labor shortages, lack of skilled staff and lack of skills correlation, low innovation in the business environment, lack of basic digital

[12] https://www.economistul.ro/stiri-si-analize-business/prof-univ-dr-dan-armeanu-ase-impactul-covid-19-asupra-pietelor-de-capital-18037/

[13] http://cnipmmr.ro/2018/03/14/pozitia-cnipmmr-privind-raportul-de-tara-din-2018-pentru-romania/

skills of a large part of the workforce lead to a reduction in the supply of skilled workers, which affecting investment decisions.

Poor governance and inefficiency of public administration continue to affect the business environment. Investments may be hampered by the maintenance of administrative and regulatory burdens, inefficiencies in public administration and public procurement, lack of predictability of legislation and lack of timely and effective stakeholder consultation.

Another structural challenge refers to the need to avoid the middle-income trap, by looking for solutions to increase the added value produced in the economy, including by stimulating innovation. In order to realize the potential for economic growth, solutions are needed in terms of the demographic problem and inequalities in society. In this sense, we also mention the need for the role of banks in financing the economy to increase, but prudently, the financial intermediation in Romania being on the last place in the EU.

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