Economic Policies in Romania in the Context of COVID-19

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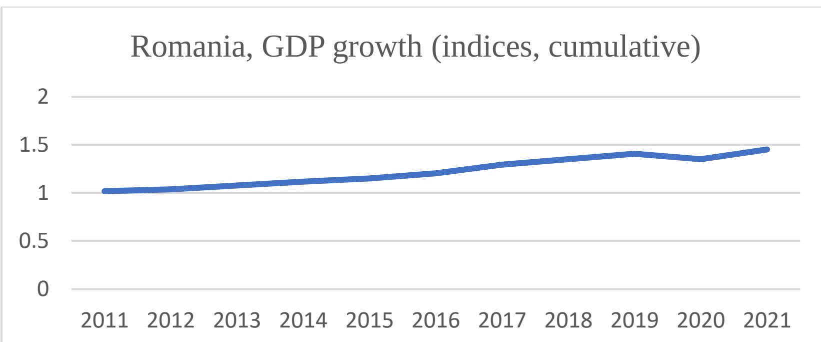
Introduction

Romania has experienced a sustained economic growth in the last decade, the average growth for the period 2011 - 2019 exceeding 4.5%. The process was abruptly interrupted by the COVID-19 crisis begun in 2020, which led to a 3.86% reduction in GDP, lower than the EU reduction of 6.1%. Romania's GDP increased in 2021 compared to 2011 by about 1.5 times, as shown in the following chart:

Figure 1. The GDP Growth in Romania, 2011 – 2021



Source: World Bank and European Commission, 2021; estimates for 2021

A short radiography of the economy for the period 2018 - 2021 highlights the overall impact of COVID-19 on the economy.

Table 1. Key Indicators for Romania, 2019 – 2022

Romania: Key Indicators		2019	2020	2021	2022
1	GDP growth (%, annual)	4.13	-3.86	6	4.8
2	Inflation rate (measured by GDP Deflator, %)	6.8	3.8	3.2	3
3	Unemployment (%)	3.9	4.8	4.8	4
4	Government deficit/surplus (%GDP)	-4.4	-9.2	-8	-6.2
5	Government consolidated gross debt (%GDP)	35.3	47.3	52.6	55.31
6	Current account balance (%GDP)	-4.88	-5.28	-4.98	-4.5

Source: World Bank (1,2,3,6), Eurostat (4,5), July 2021 for 2019 and 2020, IMF estimates (1,5,6), April, 2021, Ministry of Public Finance estimates (4), May 2021 and National Commission for Strategy and Prognosis estimates (2,3), Spring, 2021

The COVID-19 crisis has started to be felt in Romania in March 2020, so that the first quarter of that year was one with economic growth and has led to a decrease in GDP below the initial estimates of -5% (IMF, April 2020). The sectors that registered the largest decreases in 2020 were agriculture, with -16.2% and industry, with -9.1%, but for agriculture the main cause of decrease were the climate conditions, given the fact that the irrigation system in Romania is less developed. Branches such as Construction and IT&C have registered increases of over 10%, which was correlated with the increase of 6.8% of investments and 2.00% of public expenditures and have reflected the additional efforts to improve the living standards, infrastructure, and digitalization, and the state intervention to limit the effects of the pandemic. These interventions are the subject of the present paper.

Macroeconomic Policies in Romania during the Period 2020 – 2021

Romania has been enclosed in the European and world economic and social landscape by the implemented budgetary and monetary policies. Thus, the monetary policy measures consisted of the gradual reduction of the monetary policy interest rate, from 2.5% in February 2020 to 1.25% in January 2021, the gradual decrease of the minimum required reserves rate applicable to foreign currency liabilities from 8% to 5%, repo operations and purchase of government securities through open-market operations. In addition, the National Bank of Romania (NBR) has concluded an agreement with the European Central Bank on a repo line to prevent a liquidity crisis. Liquidity injection operations have been more cautious than the EU average due to inflationary pressures, extreme uncertainty, the current account deficit, and the budgetary deficit (Convergence Program, 2021). The actions undertaken by the NBR contributed to the stability of the exchange rate and of the Romanian financial system in general. On the other hand, monetary expansion has increased price instability and is likely to determinate Romania to exceed the inflation target in the latter part of 2021.

Romania's fiscal policy continued to be expansionary, although Romania was already the subject of the Excessive Deficit Procedure (EDP) in the EU due to the deficit of -4.4% in 2019, well above the 3% limit. The fiscal expansion from 2016 to 2019 reduced the limits of government intervention and contributed to the increase of public debt. Together with all the EU member states, Romania has benefited from the "general escape clause" from the provisions of the Stability and Growth Pact, so that it could adopt budgetary measures to combat the pandemic by violating the deficit target of 3% of the GDP. Direct taxes have generally remained unchanged, but multiple tax facilities have been granted, such as bonuses for early payment of taxes, extension of payment terms or tax reductions for certain categories of employees. Indirect taxes have slightly changed, among the most important changes being the reduction of excise duty on fuel and the extension of VAT facilities, such as the reduced VAT rate of 5% and the payment of VAT when collecting invoices. Public expenditures increased by over 23% in real terms in 2020, among the most important sources of expenditure being: the change of the state aid scheme for SMEs to increase both the level and period of financing, payment of compensation of employees being in technical unemployment, the increase of pensions, social benefits, and spending on health and education to fight the pandemic and to support online education. The total cost of support measures related to COVID-19 in 2020 was 4.85% of GDP, and in 2021 it is estimated at 3.81% of the GDP (Report on the macroeconomic situation for 2021).

Alongside with monetary and budgetary measures, general measures aimed at the social protection of the population such as the postponement of the payment of utilities and rents and the postponement of the payment of bank obligations have been adopted. The purpose of these measures was to ensure social stability. There were, however, negatively affected organizations, for instance banks, building owners and utility providers.

In conclusion, beyond the cost of increasing public debt and deepening macroeconomic imbalances that already existed before the pandemic - the budget deficit and the current account deficit - the measures adopted between 2020 and 2021 allowed limiting the negative effects of the COVID-19 crisis.

The National Recovery and Resilience Plan: Focusing on Digitalization

In 2020, the Recovery and Resilience Facility (RRF) was approved at European level to facilitate the European economies' recovery from the economic consequences of the Covid-19 crisis. Romania benefits of an allowance of 29.9 billion Euro, out of which 14.2 billion Euro grants, based on the Romanian Recovery and Resilience Plan (PNRR). The document has been submitted to the European Commission to be further evaluated. It covers the period 2021 - 2026 and is based on 6 pillars:

Table 2. The Romanian Recovery and Resilience Plan

Pillar	Components	Budget (billion Euro)
Green Transition	Water and sewerage system management	1.88
	Forest and biodiversity	1.37
	Waste management	1.2
	Sustainable transport	7.62
	Renovation Fund	2.2
	Energy	1.62
Digital Transformation	Government cloud and digital public systems	1.89
Smart, sustainable, and inclusive growth	Fiscal reform and pension reform	0.482
	Support for business, research, development, and innovation	2.36
Social and territorial cohesion	Local fund for the green and digital transition of territorial administrative units	2.1
	Tourism and culture	0.2
Health and economic, social and institutional resilience	Health	2.45
	Social reforms	0.167
	Public sector reform, increasing the efficiency of justice and strengthening the capacity of the social partners	0.155

Policies for the next generation and youth	Educated Romania	3.6

Source: PNRR, 2021

Digitalization is a common component of all the pillars, as the Covid-19 crisis highlighted the vulnerability of the Romanian economy, placed on the 26th position in the EU from the perspective of the Digital Economy and Society Index (DESI). Romania performs poorly on 4 out of the 5 components of this index: human capital, use of internet, integration of digital technology and digital public services. According to DESI (2020), Romania performs well on Connectivity dimension, "thanks to the high take-up of ultrafast broadband and the wide availability of fixed very high-capacity networks, especially in urban areas" (DESI, 2020). Over 20% of Romanians have never used the Internet and less than 30% have basic digital skills. Regarding the integration of digital technology, in 2018 (latest available data), 12% of enterprises used big data, and 18% used cloud computing. According to the European Investment Bank Survey (2019), for the manufacturing sector, from the total enterprises, less than 20% used 3D printing, around 30% integrated robotics and internet of things and less than 10% used big data and AI. The Covid-19 crisis has led to an increase in the use of digital technologies for 29% of companies (EIBIS, 2020). For the digital public services, 82% of internet users used e-Government in 2020, while Romania is characterized by the lack of interoperability of the IT systems in the public sector. In 2020 The Authority for The Digitalization of Romania (ADR) was established to coordinate and monitor the digital transformation of Romania. Given the low level of digitalization in the public sector, the digital transformation pillar provides investments for government cloud, digital public systems, IT infrastructure and training expenses for civil servants.

Digitalization is supposed to support the fiscal reform, and it is also correlated with the schemes for research, development, and innovation in pillar 3. Romania ranks last in the EU in terms of innovation, being considered an emerging innovator, which explains the importance given to this component.

Concerning the fifth pillar, among the most important measures are the followimg: increasing the number of medical units, implementing the minimum inclusion income, streamlining public procurement, and restructuring and depoliticizing state-owned companies. The sixth pillar is centered on the reform of the education system, the modernization and expansion of the material base, and the digitalization of education.

Grant allowances from the Recovery and Resilience Mechanism for Romania represent approximately 6.5% of GDP and the big challenge will be to absorb these funds that would allow the implementation of the PNRR.

Conclusions

Romania has responded to the Covid-19 crisis by relaxing monetary and budgetary policies without historical precedent. The positive effects were quickly visible: the resumption of economic growth in 2021, maintaining the unemployment rate at a low level and the increase of investments. The price of these achievements consisted of inflationary pressures and the sharp increase in the budget deficit and public debt.

The latest financial crisis has taught the world that abundant liquidity leads to low interest rates and the orientation of investors towards risky assets, but with high returns, causing financial instability. It has also demonstrated that the rising of the commodity prices, over-savings and abundant liquidity which accompanies the COVID-19 crisis nowadays are risk factors for the global economic stability. Risk reduction involves structural reforms focused on the circular economy and digitalization. Romania starts from unfavorable premises in this restructuring process: large budget deficit, low digitalization and innovation, outdated health and education system. PNRR is ambitious and can turn the pandemic into an opportunity for Romania. Its successful implementation would mean changing the way the state operates, changing the structure of the economy, important steps in the digitalization of the public sector and changes in the business models of companies. Success depends on the state commitment, simplifying bureaucracy, and political stability. From this perspective, Romania's recent history is not encouraging, and uncertainty remains high.

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