THE ECONOMIC IMPACT OF THE COVID-19 PANDEMIC IN EU COUNTRIES OUTSIDE THE EUROZONE

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Abstract

The Covid-19 pandemic has had an impact on the economic and health systems of all EU member states, leading to economic recession and stopping the expansion of the Eurozone. It is for this reason that many of the EU member states outside the Eurozone have set Euro adoption dates far into the future, while some have not set a date at all. Thus, early 2021, the European Parliament has approved the Recovery and Resilience Facility, which entails grants and loans to be granted to EU member states, to support them in limiting the negative effects of the Covid-19 pandemic.

This paper presents the economic situation of the EU member states outside the Eurozone, during the pandemic crisis of 2020. It analyzes the economic indicators of the nominal convergence criteria, the evolution of GDP per capita, as well as the EU measures meant to stop this crisis.

Keywords: *Convergence criteria, GDP per capita, Euro area, Romania*.

JEL Classification: F15, F36, F43.

1. Introduction

On January 1, 1999, once the European Central Bank was created, the Euro was introduced as a virtual currency in 11 EU member states (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, Portugal, and Spain) for payment operations, and starting January 1, 2002, as banknotes and coins in the EU states that adopted it as their national currency.

The European Union now has 27 member states, 19 of which have adopted the Euro as their national currency. Apart from Denmark, who took the opt-out clause, the following seven EU member states have taken it upon themselves to adopt the Euro as well: Bulgaria, Czechia, Croatia, Poland, Romania, Sweden, and Hungary.

In order to join the Eurozone, each EU member state must first meet the nominal convergence criteria, which imply keeping certain economic indicators within certain thresholds. These convergence criteria refer to price stability, exchange rate stability, long term interest rate convergence and the sustainability of public finances.

Even though they were not specified within the Maastricht Treaty, like the nominal convergence criteria, the real convergence criteria also play an important part in evaluating the EU member state on their way to adopting the Euro. The most important indicator of real convergence is the level of the Gross Domestic Product (GDP) per capita in purchasing power standards (PPS).

2. Nominal convergence criteria

The nominal convergence criteria provisioned by the Maastricht Treaty refer to the economic indicators being kept within the following thresholds: the annual average inflation rate (HICP – Harmonized Index for Consumer Prices) should not surpass the average of the three highest performing member states by more than 1.5 percentage points, the annual average long term interest rate should not surpass the average of the three highest performing member states, in terms of price stability, by more than 2 percentage points, the budgetary public deficit should not be higher than 3% of the GDP, the public debt should not be higher

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than 60% of GDP and the state should successfully participate in the Exchange Rate Mechanism II (ERM II). ERM II entails maintaining the national currency against the euro exchange rate within a fluctuation band of ±15% compared to a fixed central exchange rate, over minimum two years.

Starting July 10, 2020, Bulgaria and Croatia have been accepted within the Exchange Rate Mechanism II, and on July 13, 2020, the Bulgarian leva and the Croatian kuna have been given fixed central rates of 1.95583 leva/Euro, and 7.53450 kuna/Euro, respectively. According to latest recommendations, all states that solicit participating in ERM II, must also accept participation within the Banking Union. Thus, Bulgaria and Croatia have been accepted both within the Single Supervisory Mechanism and within the Single Resolution Mechanism, which are the current main pillars of the EU Banking Union.

Table 1 shows four out of the five nominal convergence criteria. The exchange rate indicator was excluded from this analysis because five out of seven states are not participating in the ERM II yet, and Bulgaria and Croatia have not yet reached the minimum two-year period of participating in ERM II.

Table 1. Meeting the Maastricht Criteria – Eurozone candidate countries in 2020

Country/Indicators	**Inflation Rate** (%, annual average)	**Long term interest rates** (%, annual average)	**General Budget Deficit/Surplus*** (% in GDP)	**Public Debt*** (% in GDP)
Bulgaria	1.2 criterion: < 1	0.25 criterion: < 2	-3.4 deficit below 3%	25.0 criterion: ≤ 60
Czechia	3.3 criterion: < 1	1.13 criterion: < 2	-6.2 deficit below 3%	38.1 criterion: ≤ 60
Croatia	0.0 criterion: < 1	0.83 criterion: < 2	-7.4 deficit below 3%	88.7 criterion: ≤ 60
Hungary	3.4 criterion: < 1	2.22 criterion: < 2	-8.1 deficit below 3%	80.4 criterion: ≤ 60
Poland	3.7 criterion: < 1	1.50 criterion: < 2	-7.0 deficit below 3%	57.5 criterion: ≤ 60
Romania	2.3 criterion: < 1	3.89 criterion: < 2	-9.2 deficit below 3%	47.3 criterion: ≤ 60
Sweden	0.7 criterion: < 1	-0.44 criterion: < 2	-3.1 deficit below 3%	39.9 criterion: ≤ 60

Note: In 2020, the annual average inflation rate of the 3 highest performing EU member states with regards to price stability (Estonia, Ireland, Slovenia) is -0.5%, and the annual average interest rate in these 3 states is 0.0%.

* ESA2010 methodology

Source: Eurostat

As per the data collected from Eurostat, we can ascertain that at the end of 2020, Sweden was able to best maintain its economic indicators, as its budgetary deficit was only slightly above 3% of GDP. In 2020, the pandemic crisis led to very high budget deficits

throughout the European Union. The highest was in Spain – 11% of GDP. Out of the seven EU member states who are now candidates for the Eurozone, Romania registered the highest budget deficit, as it rose to 9.2% of GDP in 2020. High budget deficits were also registered in Czechia (6.2% of GDP), Poland (7%), Croatia (7.4%) and Hungary (8.1%).

Hungary and Romania have some of the highest annual average long term interest rates in the European Union: 3.89% in Romania and 2.22% in Hungary, at the end of 2020.

Apart from Croatia and Sweden, the average annual inflation rate for 2020, for the other five member states outside the Eurozone, does not fall within the threshold imposed by the Maastricht Treaty. It surpasses the rate of the highest performing three member states by more than 1.5 percentage points. At the end of 2021, even higher inflation rates are predicted for these states, based on the strong increase in prices for gas and energy throughout the European Union.

The public debt of five EU states outside the Eurozone falls within the maximum threshold of 60% of GDP, but the very high budget deficits registered during the pandemic crisis will lead to an increase in public debt. Croatia, who recently joined ERM II, will have a difficult time getting accepted inside the Eurozone if it cannot decrease its public debt from over 88% of GDP to less than 60% of GDP during the next few years.

Regarding Bulgaria, if it succeeds in reducing its budget deficit and its inflation rate, which weren't very high at the end of 2020, it may be accepted in the Eurozone at the end of two successful years within ERM II.

3. Gross Domestic Product Analysis

Except for Sweden, the other six EU member states outside the Eurozone are emerging countries, and therefore their economies have higher growths compared to the developed states within the Eurozone.

In 2019, Poland, Hungary, Romania, and Bulgaria have registered the highest economic growths in the European Union. The real Gross Domestic Product (GDP) increased by 4.7% in Poland, by 4.6% in Hungary, by 4.1% in Romania and by 3.7% in Bulgaria, way over the European Union average of 1.6%, and 1.4% for the Eurozone.

In 2020, the pandemic crisis hurt the economies of many EU member states outside the Eurozone, but less so than the Eurozone states. Croatia's GDP dropped by 8% at the end of 2020, becoming the only one of the seven Eurozone candidate countries to have an economic decrease higher than the -6% EU average (Table 2).

Table 2. Real GDP growth rate (%)

geo/time	2019	2020
Poland	4.7	-2.7
Sweden	2.0	-2.8
Romania	4.1	-3.9
Bulgaria	3.7	-4.2
Hungary	4.6	-5.0
Czechia	3.0	-5.8
Croatia	2.9	-8.0
EU (27 states)	1.6	-6.0
Eurozone	1.4	-6.4

Source: Eurostat

The real convergence of a state is evaluated based on the level of the Gross Domestic Product (GDP) per capita in purchasing power standards (PPS).

Lithuania, the latest state to adopt the Euro on January 1, 2015, registered a GDP per capita in PPS of 76% of EU average (EU27), in 2014. This level can be taken as a benchmark for future states looking to adopt the Euro, but not a decisive one.

Croatia's real convergence indicator lies at 64% of EU average at the end of 2020, i.e., 1 percentage point higher than Latvia's level at the end of 2013, before it entered the Eurozone on January 1, 2014.

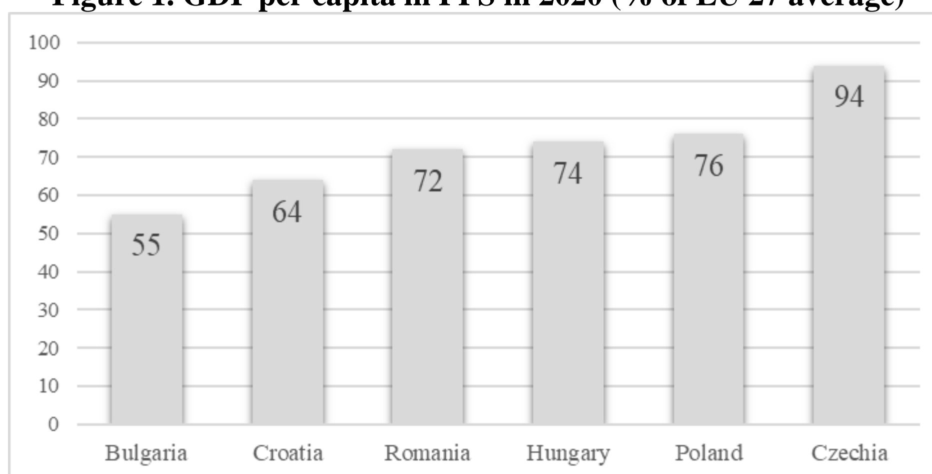
Croatia, who has a low population of only 4 million inhabitants, close to Lithuania's 3 million inhabitants, may consider the 76% GDP per capita in PPS registered by Lithuania before joining the Eurozone.

Poland and Romania, who have large populations compared to Lithuania, should not only try to reach a GDP per capita in PPS as high as possible, but they should also try to reduce the economic disparity between the regions of the country.

From the real convergence standpoint, Czechia seems to be best prepared to join the Eurozone, as it has a 94% of the EU average GDP per capita in PPS, but it does not intend to join very soon (Figure 1).

The Czech Prime Minister said that, even though Czechia is prepared to join the Eurozone, it chooses not to take this step now, as it awaits the implementation of certain EU governance reforms (Prague Morning, 2021).

Figure 1. GDP per capita in PPS in 2020 (% of EU 27 average)



Source: Eurostat

4. European Union economic recovery measures

The negative effects of the pandemic on the European economy have led to the activation of the *general escape clause*, which allows EU member states to depart from the fiscal framework, without them being placed under the excessive deficit procedure. This clause is provisioned in the Stability and Growth Pact (SGP), and it was introduced in 2011 through the "Six-pack". It can be activated only when the economic situation deteriorates following the effect of external factors, out of the state's control.

To stop the Covid-19 pandemic, starting the second half of 2020, the European Commission has signed agreements with vaccine producers, in order to purchase anti-covid-19 vaccine doses to be distributed to each EU member state.

Through the *Emergency Support Instrument*, the European Commission has financed a pharmaceutical company with 70 million Euros to produce and supply the EU with doses of Veklury, also know commercially as Remdesevir, while 2.7 million Euros was an advance payment made to vaccine producers for supplying future vaccines. The *Emergency Support Instrument* of the European Commission has offered financial support to many EU member

states during the pandemic crisis of 2020, and 150 million Euros were allotted for supporting the transportation of medical staff to the most affected states, for the transport of medical equipment, individual protection equipment and of tests within the European Union (European Commission website: *Emergency Support Instrument*).

Starting February 19, 2021, the instrument called Recovery and Resilience Facility – RRF entered into force within the EU, as the central piece of the NextGenerationEU program, which was created to the purpose of allowing the European Commission to collect funds to be shared among the EU member states, to easily get ahead of the economic and medical crisis brought about by the Covid-19 pandemic. The Recovery and Resilience Facility (RRF) has 723.8 billion Euros (in current prices), which will be granted to EU member states as loans and grants, in order to support the national investments and reforms by December 31, 2026 (European Commission website: *Recovery and Resilience Facility*).

RRF's purpose is that the states who access its funds will make sure to largely invest in climate and digital change, as well as make reforms and investments for the creation of new jobs and economic growth.

Funds will be accessed based on *national recovery and resilience plans*, which will entail all the reforms and investments that each EU member state undergoes it will implement by the end of 2026. The first step means presenting the *National recovery and resilience plan* to the European Commission. The Commission will analyze the respective plan for two months, and based on the Commission's proposal, the Council will adopt it within four weeks. Within two months of the adoption of the plan, EU will grant the respective state an advance financing of 13% of the total funds requested and approved through the *National recovery and resilience plan.*

By the end of October 2021, all seven EU member states who are candidates to join the Eurozone have submitted their own national recovery and resilience plans. Bulgaria was the last one to submit, on October 15, 2021.

So far, the European Commission has positively evaluated 22 national recovery and resilience plans, including those of Croatia, Czechia, and Romania.

In July 2021, the European Commission has endorsed the national recovery and resilience plans of Croatia – for 6.3 billion Euros in grants, and of Czechia, for 7 billion Euros, also in grants.

On September 27, 2021, the European Commission has adopted a positive assessment of Romania's recovery and resilience plan, which paves the way for the EU to disburse 14.2 billion Euros in grants and 14.9 billion Euros in loans to Romania. Once the plan is also approved by the Council, within 2 months, Romania will be granted pre-financing of 3.8 billion Euros (European Commission, 2021a).

The evaluation of the Polish and Hungarian plans is still unfolding, as the European Commission is waiting for the 2 states to first apply its recommendations regarding the rule of law.

5. Conclusions

The pandemic crisis of 2020 led to a standstill in the expansion of the Eurozone, as the economic indicators of all European Union member states were affected.

Diminishing the pandemic effects on the population health and on national economies will be obtained only if each member state successfully manages the vaccination process against Sars-Cov-2. In the Eastern-European countries, where the vaccination campaign hasn't yet gained the trust of the citizens, the governments have an obligation to convince the majority of the population that vaccination is the best way to save lives and recover economically.

EU member states outside the Eurozone must urgently implement a series of structural reforms, to reduce the economic gap to the Eurozone average, by reaching a high and

sustainable degree of nominal and real convergence. Beside the EU funds available through the 2021-2027 Financial framework, they should also access the funds within the Recovery and Resilience Facility, which was created for the stimulation of national economies affected by the Covid-19 pandemic.

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