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Article

COVID-19 pandemic and fiscal sustainability

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**O. Stepanova¹****COVID-19 PANDEMIC AND FISCAL SUSTAINABILITY**

The article deals with the impact of the COVID-19 pandemic on the financing of the health care system, and the main challenges to the stability of the financial mechanisms of post-pandemic health care development have been identified. The author substantiates the peculiarities of the crisis of health care financing in the conditions of the current pandemic, further economic recession and decreased fiscal sustainability. The global practice of fiscal response to the manifestations of the COVID-19 pandemic has been systematized and the volumes of the corresponding financing in the countries with insurance and budgetary systems of health care financing have been estimated.

The article identifies mechanisms for the transformation and expansion of the fiscal space in the context of expanded financing of the growing need for medical care in the face of new epidemic risks in different countries. Most often, the expansion of a country's fiscal space is carried out by: redistributing the existing amount of government expenditure for health care and redirecting funding flows from financing certain types of medical care to financing programs to overcome and combat COVID-19; changes in the priority of government health expenditure to combat COVID-19 compared to other budget expenditures on the social sphere and economic development; and using national reserve funds and emergency funds.

It has been found that in the field of health care, the vast majority of countries have reduced the economic and territorial deprivation of all population groups in access to the diagnosis and treatment of COVID-19. The author emphasizes the weaknesses of insurance based and decentralized health financing mechanisms to respond to the growing need for health care and financial stability during the pandemic. Substantiated the necessity to expand the fiscal space needed to cover the fiscal gap in Ukraine caused by the requirement to increase health care financing in response to new epidemic risks amid growing budget deficits, public debt and economic downturn.

Keywords: COVID-19, pandemic, fiscal sustainability, public finances, health care, fiscal space, health financing crisis, public health expenditures, fiscal gap, measures to combat COVID-19

The modern world is experiencing an unprecedented social crisis caused by the COVID-19 pandemic. The rapid spread of the virus has led to a historic collapse of

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the health care, exposing the systemic failures of its financing mechanism in most countries. In six months, there were about 8 million patients with COVID-19 [1], and their number continues to grow steadily. The crisis in the health care has triggered the most severe economic recession and unparalleled societal challenges over the past few decades. Previous epidemics of SARS, MERS, and Ebola did not have such a rapid global spread nor such an impact on the economy and society. Therefore, the vulnerability of society is currently globally significant not only because of the rapid infection and spread of the disease, but also because of the existing level of global relationships that do not allow to disregard individual countries and emphasize the value of health as a global public good.

At the same time, the public authorities of many countries were not ready to make the effective management decisions. The developed programs of government support, fiscal and monetary response and post-pandemic incentives did not often reach an expected recipient [2], and the health care became even more vulnerable. The economic recession, growing budget deficits and debt burdens reduce the potential for fiscal maneuver and limit the ability to increase funding for urgent and long-term health needs in both developed and developing economies.

Taking into account the profound changes at the global level, the question arises about the need to transform existing conceptual approaches and develop a new model of economic relations in health care and change its role in budgeting and economic policy – as a response to new epidemiological risks and as a measure to provide the necessary infrastructure and workforce of the health care. Ukraine has also suffered from the health crisis caused by the COVID-19 pandemic and the global economic crisis. For Ukraine, the current crisis will be too painful, as this country has been in the process of reforming its health care system for the past five years, which unfortunately critically weakened the workforce and infrastructure capacity of the medical sector in the pre-crisis period.

The expansion of the COVID-19 pandemic led to a state of uncertainty in economy and society [3], which made it impossible to accurately estimate the duration and dynamics of the pandemic, and to analyze the existing differences in macroeconomic and social forecasts [4], and the post-pandemic behavioral response. Nevertheless, the article attempts to systematize the impact of the COVID-19 pandemic on the financing crisis and changes in the fiscal space for health care in different countries, and to summarize the experience of fiscal response to the pandemic crisis and fiscal sustainability challenges.

The coronary crisis is transforming the global understanding of the central role of health in the economy and welfare. The initial conclusions about the short-term impact of the coronavirus pandemic on society today are refuted by the dynamics of the pandemic, which will have direct, indirect and induced long-term effects on health (Fig. 1).

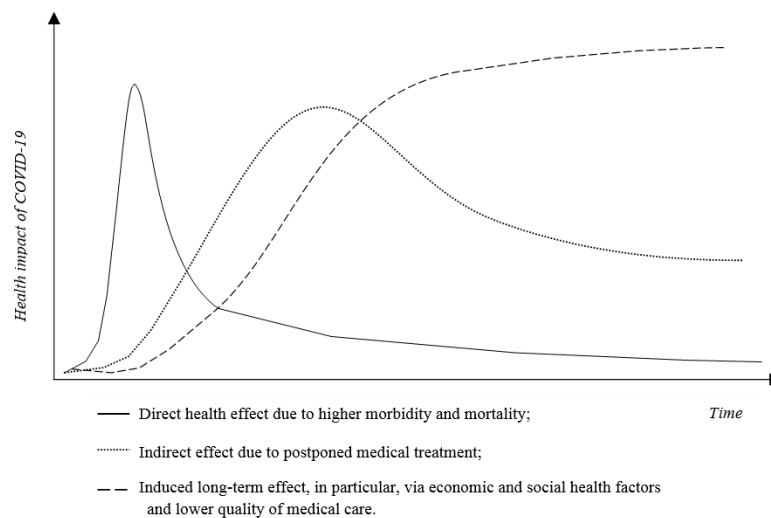


Fig. 1. The health effects of COVID-19

Source: [5].

The COVID-19 pandemic has led to the transformation of the fiscal space for health care. There are major stages in the creation of fiscal space: collection of financial resources, their accumulation and distribution. Thus, most countries intensified efforts to expand the fiscal space to finance measures to overcome the consequences and combat COVID-19, including additional expenditure for the health sector and other sectors of social sphere, as well as supporting the economy as a whole (Fig. 2). Systematization of international experience in the implementation of these measures helps to group them in the following areas:

- worked out and implemented measures during the expansion of pandemic aimed at financing actions to combat COVID-19 and support social justice and economic activity;
- measures to restore the functioning of the health care after the crisis, stimulate economic growth and ensure the sustainability of public finances;
- contingency measures to respond a pandemic outbreak (implemented by only a small number of countries).

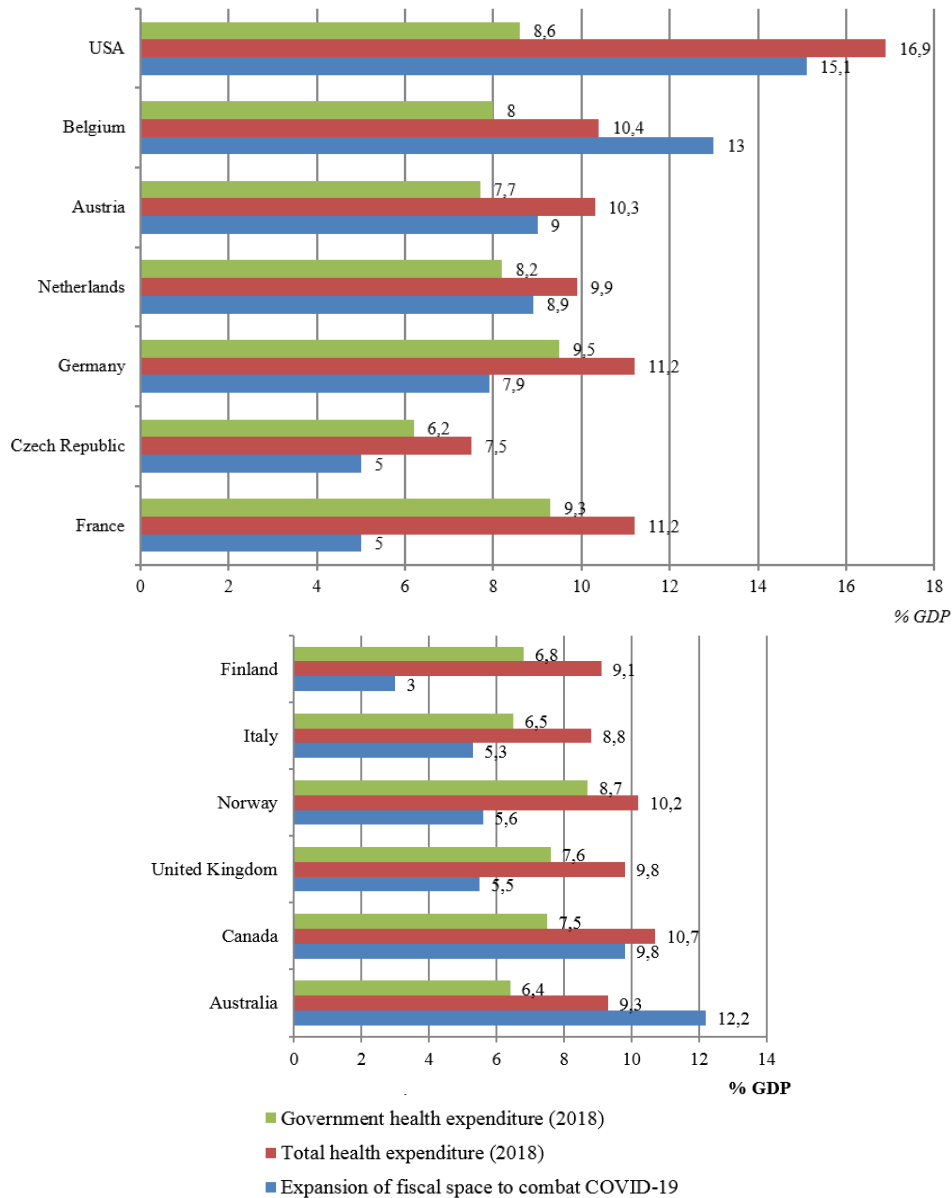
According to the International Monetary Fund (IMF), the total amount of fiscal measures to combat the COVID-19 pandemic in all countries will be about 10 trillion US dollars [6].

However, such large-scale fiscal measures only allow a limited "temporary fiscal space"; this potential has been exhausted in many countries today.

Instead, the shortcomings of existing approaches to shaping government expenditure on health and social protection are highlighted - as these expenditures protect not only those vulnerable populations who are traditionally considered beneficiaries, but society as a whole. The COVID-19 pandemic has confirmed that as long as someone in society suffers from highly contagious diseases, the whole society remains in danger [8].

The restrictive fiscal post-crisis policy of the last decade caused a chronic underfunding of the health care. Even in European welfare states, the concept of fiscal policy began to dominate, focusing primarily on fiscal consolidation. Such a policy of traditional fiscal consolidation at the expense of underfunding the social protection and health care systems and holding back their growth today proves its fallacy and reduces the capacity of the health care system to respond the pandemic. Because of these actions, the developed countries such as Italy, [9], Great Britain, and France, optimized health care facilities, reduced the number of hospital beds and medical staff, and underinvested in health research and development

(R&D). Therefore, all the above-mentioned measures reduced the health system's potential capacity to respond to pandemic outbreaks, leaving millions vulnerable to COVID-19[10].



Countries with government health financing schemes

Fig. 2. The expansion of fiscal space in the context of the COVID-19 pandemic, % of GDP

Source: data compiled and calculated by the author [7, 6].

As Joseph Stiglitz noted, COVID-19 is not an "equal opportunity virus" [3]. One of the many inequalities identified because of the pandemic was a significant difference in the scope of fiscal measures to combat COVID-19 [8]. In the pre-pandemic period, the difference in government health expenditure in developed and developing countries was a significant factor that reduced the state's capacity to respond to the medical needs of the population and

epidemic challenges and, as a result, induced inequality in the investment in health capital. The current pandemic will exacerbate inequalities in health capital between countries and between subgroups within the general population.

At the same time, the vulnerability of a country's population increases due to the government's weakness and low level of fiscal sustainability. The constraints that prevented many countries from increasing the fiscal space for the health sector in the context of the pandemic outbreak to the required level were the high levels of budget deficit and public debt in the pre-pandemic period. However, the socio-economic consequences of the pandemic are causing a rapid deterioration in fiscal sustainability (Fig. 3), due to falling budget revenues and the implementation of fiscal expansion policy in 2020. These challenges will have a significant negative impact on medium-term fiscal sustainability.

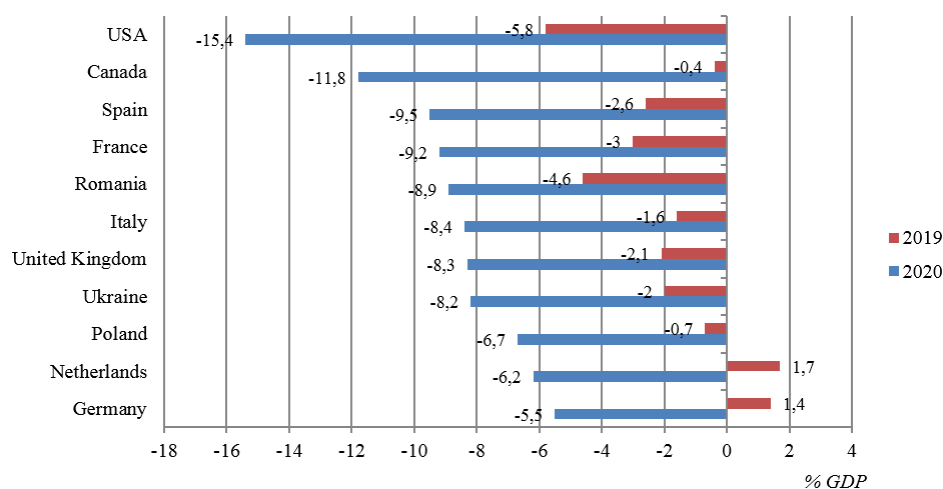


Fig. 3. The impact of the COVID-19 pandemic on the budget deficit in some countries

Source: data compiled and calculated by the author [5].

The need to expand the fiscal space for health and social protection according to the needs of the population is extremely urgent and vital today. According to the ILO, 200 countries have implemented measures in the field of social protection and healthcare during the pandemic COVID-19 (Fig. 4). Of all the measures implemented, only 9,9% were in the field of health care [11]. The most common types of measures implemented in OECD countries to combat COVID-19 in health care are shown in Fig. 5.

However, these measures have different levels of effectiveness in counteracting the pandemic in different countries, due to factors such as: different levels of economic development and readiness to respond to this crisis; the potential of the fiscal space and the sustainability of the public finance system; speed of development, the adoption of the corresponding system of measures; the level of health care development in general and the public health care and epidemiology in particular; the degree of rigidity of lockdown measures and social distancing; the level of development of medical science and manufacture of medical supplies and medical equipment in the country; health workforce and the development of medical institutions network; the difference between demographic and gender-sex structure; and the level of urbanization and population density in the country.

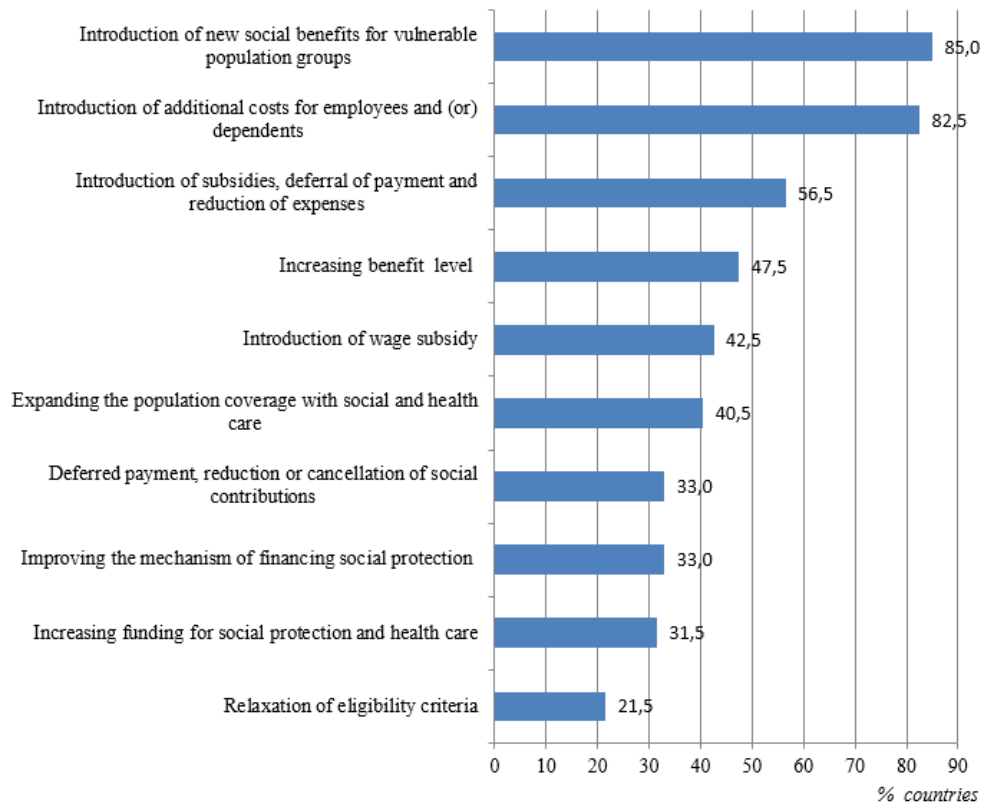


Fig. 4. World practice of implementing measures in the field of social protection and health care services during the pandemic COVID-19,
% countries that implemented such measures

Source:[11].

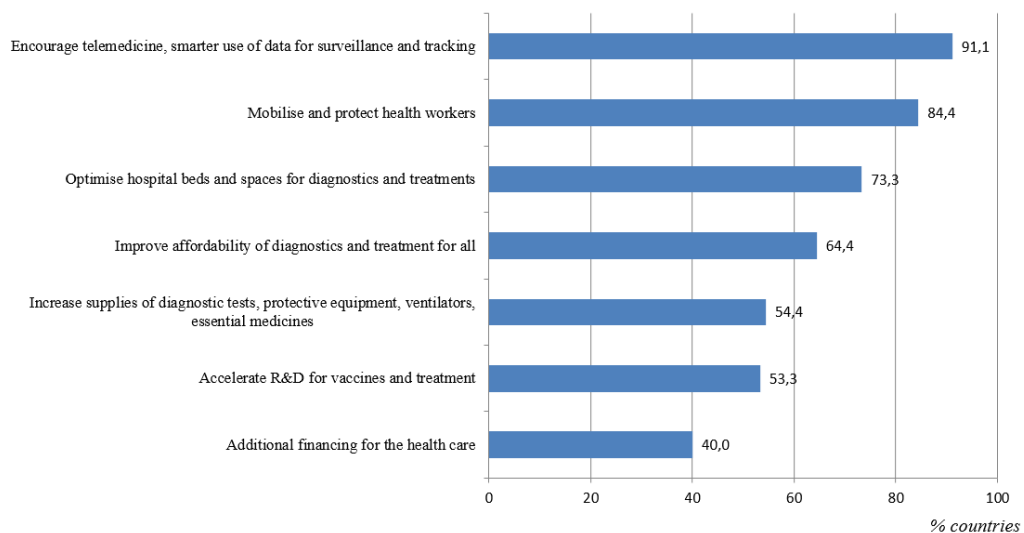


Fig. 5. The most common health policy measures to combat COVID-19 in OECD countries,
% of countries that implemented appropriate measures

Source:[12].

The pandemic encouraged the reassessment and rethinking of the importance of government health spending [13]. Expansion of the fiscal space for health care in the context of the COVID-19 pandemic [14, 15] was carried out by the following mechanisms:

- redistribution of the existing amount of government health expenditure and redirection of financial flows from the financing of certain types of medical care to the financing of programs to overcome and combat COVID-19;
- changing the priority of government health expenditure to combat COVID-19 relative to other budget expenditures on the social protection and economic development;
- use of national reserve funds and emergency funds as a result of the adoption of the relevant legislation and recognition of emergency conditions;
- debt instruments and mechanisms for deficit financing of additional health care expenditure caused by the COVID-19 outbreak;
- increase in transfers from the state budget to local budgets, organizations and health care providers to finance medical care;
- healthcare donation funding to combat COVID-19;
- formation of new funds to finance the fight against COVID-19 with the involvement of funds from international organizations, financial institutions and private enterprises.

Along with changes in the financing mechanisms for health care, most countries made changes to the budget process, as well as regulations that changed the limits and thresholds of individual items in the health care expenditures and public procurement, which allowed:

- to increase medical care funding for the growing needs of patients with COVID-19 and for the increased burden on health care providers;
- to accelerate public procurement of critical medical goods, medicines and medical equipment;
- to accelerate the financial flows to health care providers and other organizations;
- to provide financing for the wages of increased personnel in the industry;
- to ensure flexible financing and modify the distribution of functions and powers of health care providers who are able to respond quickly to deficit and shortages of medical supplies, medicines and medical equipment.

In the current COVID-19 crisis, scientific and practical circles [14, 9, 16, 17, 13, 18, 5, 10, 19] discussion resumed on the relative effectiveness of responding to new epidemic challenges in health care systems with different financial mechanisms, such as budget and insurance based ones. It should be noted that due to the pressure of the pandemic crisis, health insurance mechanisms have become more vulnerable, due to a number of reasons. An insurance system for financing the health care can cover risks only if the economy is close to full employment. According to S. Thompson, a WHO leading expert in the field of health financing [20], compulsory health insurance contribution are more in line with the "labor tax". The COVID-19 pandemic has led to rising unemployment, which in turn reduces the amounts in the pools raised by insurance funds to finance health care. In some countries, the unemployed lose access to health care. During the pandemic, in countries with high labor migration and large informal sector, it is extremely difficult for insurance funds to accumulate necessary financial resources.

The pandemic identified risks and weaknesses in the decentralized systems of organization and financing of the health care, which failed to quickly accumulate the necessary funds and distribute functions and responsibilities among relevant actors and service providers in the face of the need to cover new expenses, which hinders rapid response to the crisis.

In Ukraine, the Fund to Combat the COVID-19 Acute Respiratory Disease Caused by the Coronavirus SARS-CoV-2 and Its Consequences was established due to the global disease outbreak. According to the Law of Ukraine "On the State Budget of Ukraine for 2020", the amount of its funding is 64,7 billion UAH [21], which was intended to: providing financial assistance to the elderly due to negative consequences of the spread of COVID-19 on the territory of Ukraine; providing one-time financial assistance to family members of medical and other health care workers who died of the Coronavirus Disease 2019 (COVID-19); taking measures to prevent the occurrence and spread, localization and elimination of outbreaks, epidemics and pandemics of COVID-19. In addition, the Law of Ukraine "On the State Budget of Ukraine for 2020" provides for a 15,4 billion USD increase in the funding from the Ministry of Health of Ukraine for the program of state guarantees of medical care. These budget expenditures to combat COVID-19 are much lower than similar funding in the countries that we analyzed above.

Taking into consideration the above-mentioned facts, we conducted scenario estimates of the potential impact of rising health care costs under the pressure of the COVID-19 pandemic outbreak on Ukraine's fiscal sustainability risk against the background of the fiscal gap caused by the economic recession, declining budget revenues, and growing budget deficit. Fiscal measures can save lives, protect the most vulnerable groups and economic actors from the economic consequences of a pandemic, and prevent the health crisis from turning into a profound and prolonged downturn [22]. Thus, the developed scenarios provide for an assessment of fiscal sustainability with a one-time (one-year) increase in the expenditures of the Consolidated Budget of Ukraine to combat COVID-19 (in 2020) in accordance with the similar expenditures of OECD countries. In the moderate increase scenario, expenditures should expand by 3,1% of GDP in 2020, and in the maximum increase one – by 8,1% of GDP. The indicator of public finance sustainability risk is calculated according to the EU methodology [23]. For the assessment, indicator S1 is chosen, which is the most common to estimate the risks to public finance sustainability. Indicators of GDP growth rates, interest rates on public and state-guaranteed debt, and structural primary balance are determined according to the IMF forecasts for Ukraine until 2022 [24]. The calculation of risk indicators for public finance sustainability is based on the assumption of unchanged fiscal policy, in other words, the primary structural balance is assumed to remain constant.

The results of the calculations of risk indicators for public finance sustainability in Ukraine in the maximum and moderate scenarios are shown in Fig. 6.

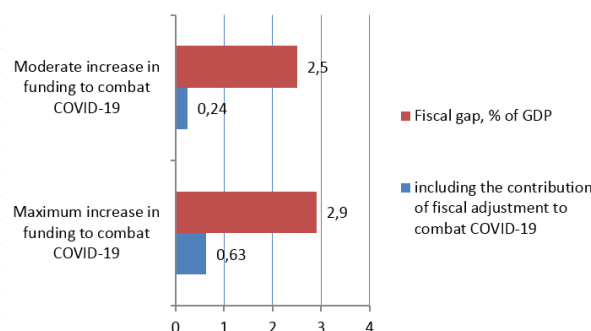


Fig. 6. Results of the risk assessment of medium-term public finance sustainability in Ukraine in the context of the COVID-19 outbreak and the potential increase in costs

Source: author's calculations.

The results of the analysis of the obtained indicators of medium-term public finance sustainability show the amount of fiscal space that should be created in Ukraine to overcome ("to close") the existing fiscal gap. According to the EU fiscal sustainability thresholds, implementation of the scenario of maximum funding to combat COVID-19 will have a high risk to public finance sustainability. In the moderate scenario, this risk can be defined as medium.

Therefore, we can conclude that financing measures in response to the pandemic crisis in today's conditions is a complex and unique task for any country.

In Ukraine, in order to implement further measures to overcome the medical and socio-economic consequences of the COVID pandemic, which are urgently needed in order to improve the infrastructural, human and logistical potential, it is advisable to ensure the formation of appropriate fiscal space, while fulfilling all other obligations and expenditures.

Conclusions

Thus, the COVID-19 pandemic highlighted the systemic problems of the modern paradigm of health care financing in conjunction with the dominant principles of fiscal policy. This could mark the beginning of a new era of change in government expenditure on social functions and shift the focus towards the need to increase expenditure on health and social protection. Against the background of these problems, the mechanisms of collecting financial resources, their accumulation and covering the expenditures of health care financing need to adapt to the "new reality" and pandemic challenges. First of all, there is a need to: increase the role of government expenditure on health care, as well as the priority of budgetary resources in financing health care relative to insurance during pandemic and post-pandemic periods; creation, at the stage of the annual budgeting, of a fiscal space for the health care system in the amount sufficient to satisfy crisis-related medical and socio-economic needs; develop a new approach to fiscal risk management taking into account potential epidemiological threats; change the inefficient per capita based methods of healthcare expenditure in the treatment of infectious diseases to the method of global budgeting for healthcare institutions; formulate regulations with a clear division of functions and powers between all agencies engaged in the collection of financial resources, their accumulation and healthcare financing; and elimination of financial and territorial barriers to people's access to diagnostics and treatment.

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Степанова О.В.²

ПАНДЕМІЯ COVID-19 ТА ФІСКАЛЬНА СТІЙКІСТЬ

Досліджено процеси впливу пандемії COVID-19 на фінансування системи охорони здоров'я, виявлено основні виклики стабільності фінансових механізмів постпандемічного розвитку охорони здоров'я. Обґрунтовано особливості кризи фінансування системи охорони здоров'я в умовах розгортання поточної пандемії, подальшої економічної рецесії та зниження фінансової стійкості. Систематизовано світову практику фінансового реагування на прояви пандемії COVID-19 та проведено оцінку обсягів відповідного фінансування у країнах зі страховими та бюджетними системами фінансування охорони здоров'я. Визначено механізми трансформації та розширення фінансового простору, за допомогою яких здійснювалося прискорене фінансування зростаючої потреби у медичній допомозі в умовах нових епідемічних ризиків у різних країнах. Найбільш часто розширення фінансового простору країни здійснювалося шляхом: перерозподілу існуючого обсягу державного фінансування охорони здоров'я та переспрямування фінансових потоків із фінансування окремих видів медичної допомоги на фінансування програм подолання та боротьби з COVID-19; зміни пріоритетності державного фінансування охорони здоров'я для боротьби з COVID-19 порівняно з іншими видатками бюджету на соціальну сферу та розвиток економіки; використання фондів національних резервів та фондів надзвичайних ситуацій. Виявлено, що у сфері охорони здоров'я переважна кількість країн зменшували економічну та територіальну деривацію усіх груп населення у доступі до діагностики та лікування COVID-19. Акцентовано увагу на слабкості страхових та децентралізованих механізмах фінансування охорони здоров'я щодо реагування на зростаючі потреби у медичній допомозі та фінансового забезпечення стабільності її надання в умовах пандемії. Обґрунтовано необхідність збільшення фінансового простору, який потрібний для подолання фінансового розриву в Україні, викликаного потребою потенційного збільшення фінансування охорони здоров'я в умовах реагування на нові епідемічні ризики при зростанні бюджетного дефіциту, державного боргу та економічному падінні.

Ключові слова: COVID-19, пандемія, фінансова стійкість, державні фінанси, охорона здоров'я, фінансовий простір, криза фінансування охорони здоров'я, державні витрати на охорону здоров'я, фінансовий розрив, заходи боротьби з COVID-19

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