THE IMPACT OF THE PUBLIC DEBT ON THE EUROPEAN UNION MEMBER COUNTRIES

Prof. Gheorghe MATEI, Phd,
University of Craiova
Faculty of Economics and Business Administration
Craiova, Romania
Lect. Luiza APOSTOL, Phd Student
University of Pitesti
Faculty of Economics
Pitesti, Romania

Abstract. Developed countries are faced with significant risks based on the problem of the increasing public debt. The most recent assessments bring to the forefront clear perspectives regarding the expansion of the period of economic uncertainty until 2020, which is why certain countries, especially those in the Euro area, were forced to resort to a number of austerity measures. However, it is unlikely that the countries in distress will easily restore, only by austerity, manageable public debt levels, especially under the current population aging conditions. This paper comprises an analysis of the countries in the Euro zone that were the most affected by the economic and financial crisis from 2008-2010. Besides these countries I also made an analysis of the Romanian government debt.

JEL classification: H63, G01

Key words: public debt; debt crisis; economic recession.

1.INTRODUCTION

The poor management of the public debt already present at global level and also the use of the borrowed amounts for consumption, along with the reticence of the policy decision factors to make changes on the tax burden and/or on the public spending volume were the main causes of the increase in the degree of indebtedness of the countries.

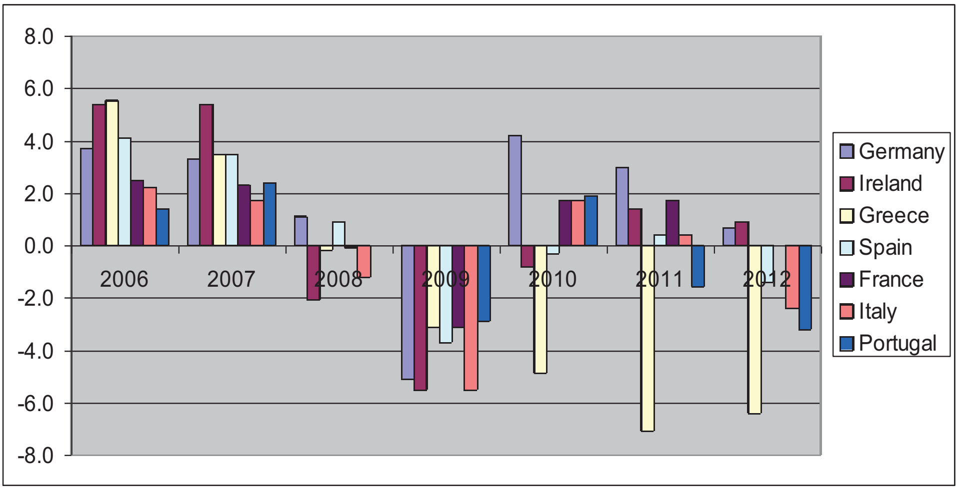
Amid the world economic and financial crisis, of the decrease or even cancellation of the economic growth paces, the countries were forced to resort to financial aid, borrowing from the domestic or foreign capital markets. Unfortunately, however, even beyond the peak of the economic recession, the concerns of the countries are focused on economic recovery financed from new loans and not on solving the already contracted debt-related problems. In these circumstances, in January 2012, the volatility of the world financial markets increased due to the tax fragility in most developed countries, leading to the increase in the public debt cost and to new assessments concerning the increase of the degree of indebtedness of the states until 2019. (Ferrarini, B. et al., London, 2012, p. 160)

In the long term, this trend of the governments to support the economic growth through public debt refinancing could be the start point of a new stage of global macroeconomic decline since, even in the countries undergoing economic recovery, where the stimulation measures were stopped, budget deficits continue to grow. The increase in the deficits is determined, to a significant extent, by the increase in social spending for an aging population (expenses related to health insurance schemes and pension schemes) and that are financed from budgetary resources. Consequently, even if the peak of the economic and financial crisis of 2008-2010 was overcome, increasing the indebtedness of the countries above the limits of the sustainability could lead the world economy to a new decline.

2. ECONOMIC RECESSION AND THE DEBT CRISIS IN THE EUROPEAN UNION

The economic and financial crisis had a negative impact on most European countries, but the most severely affected were Greece, Italy, Portugal, Ireland, and Spain.

Before the crisis, Ireland, Greece and Spain have the highest economic growth rates in the Euro area, ahead of countries like Germany and France.



Source: data supplied from www.bbc.co.uk/news/business processed by the authors

Figure 1. Percentage change in the GDP compared to the previous period for Germany, Ireland, Greece, Spain, France, Italy, Portugal

According to data from the Organization for Economic Cooperation and Development (http://stats.oecd.org/), between 1998 and 2007, in Greece, the labor productivity growth outpaced the wage growth. While the labor productivity grew on average it Greece, by 2.21%, in France, the average recorded was only 1.88 % and 1.47% in Germany. Regarding wages, they were indexed during 1998-2007 by 1.39%, a level comparable with France, but higher than in Germany (1.26%).

The divergent trends of the unitary salary costs in Europe seem to be the most important problem at the level of the monetary union. Eventually, these persistent differences cause big commercial imbalances, leading to the accumulation of net foreign debt of the weak countries from the southern outskirts and net external claims of other countries that are more competitive, such as Germany.

The increase in the unit salary costs in the countries of the south of the continent was, however, partially induced, in the period of the current financial crisis, by a dysfunction of the capital market. Initially, with the implementation of the single currency, by the elimination of the risk premiums and the spectacular in crease of investments in Southern Europe, the difference between the interest rates in the Eurozone the differences compared to Germany largely disappeared. The capital in flux and its low cost facilitated the increase in the salary costs within these national economies, which growth was not supported by a long-term productivity increase.

When the interest rate differences occurred again in recent years and the cost of the borrowed capital increased, big part of the previously made investments no longer proved to become profitable. Even in the absence of the fiscal debt, the increase in the private external debt in the non-competitive economies occurs when the private sector borrows too much compared to its capacity to generate salary incomes and profits. In the absence of the exchange rate adjustment mechanism this situation is substantiated in the accumulation of external debts, independent of the deficits in the public sector.

Despite these developments, the Treaty of Maastricht, which imposed strict limits on the maximum deficit (3% of the GDP) and the public debt (60% of the GDP) in order to ensure " the maintenance of sound financial positions within the Monetary Union", had already been violated during the first decade of the adoption of the single currency. (Lachman, D., Cato Journal, vol. 33, no. 2 , 2013, p. 234)

The mere overcome of the limits required by the Maastricht Treaty was not the only cause that generated the public debt crisis in the European Union. A major imbalance took place on the real estate market in Spain and Ireland, at a level "at least comparable to that in the United States of America". (Lachman, D., Cato Journal, vol. 33, no. 2 , 2013, p. 236)

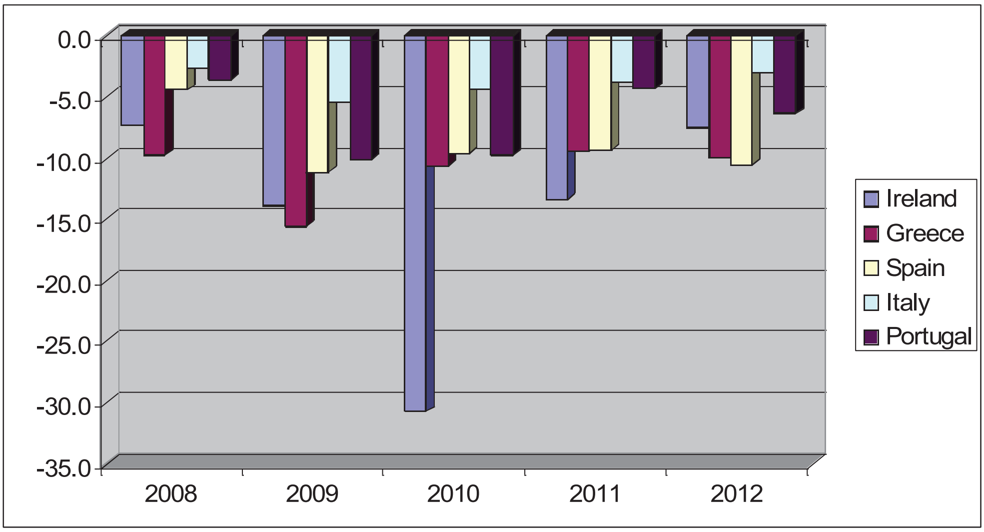
While the United States 'real housing bubble' increased prices by about 80 % between 2000 and 2006 in Ireland and Spain, the easy access to credit, and also the extremely low interest level, gave rise to a 300 % growth. In these circumstances, the significant proportion of the labour employed in constructions (6% in Ireland and 18 % in Spain in 2005) seemed justified.

With the onset of the financial crisis of 2008-2010, the economic situation of these countries deteriorated. The unemployment phenomenon was mainly seen in the building sector, certainly contributing to the current levels, 15 % in Ireland and 25% in Spain. Amid the unemployment, both the financial effort of the states and the level of the public debt increased, leading to deficits, so to public debt.

Over the last decade, the too lax monetary and fiscal policies among certain Member States (Portugal, Ireland, Greece and Spain) led to the increase of the salary level and of the inflation. Consequently, the competitiveness of these states decreased significantly, and at the same time to the increase in the external current account deficit.

The worsening of the economic situation of these countries increased public spending and decreases incomes and thus to the increase in the budget deficits. The reduction of the budgetary revenues for all the member countries led to the need for additional resources that could only be obtained at the expense of the public debt, and the increase of the demand on the capital market influenced interests by increasing them. The PIIGS countries did not succeed in applying adequate economy control and stability mechanisms, cumulating deficits and a significant public debt.

By analysing the data presented in Figure 2, the highest deficit rate was recorded in Ireland in 2010. i.e. 31,3%. Ireland was the first country in the EU that officially entered recession in 2008 and especially its banks were strongly affected by the collapse of the real estate market. This led to 85 billion euros, bailout from the IMF and the EU, in exchange for austerity measures.

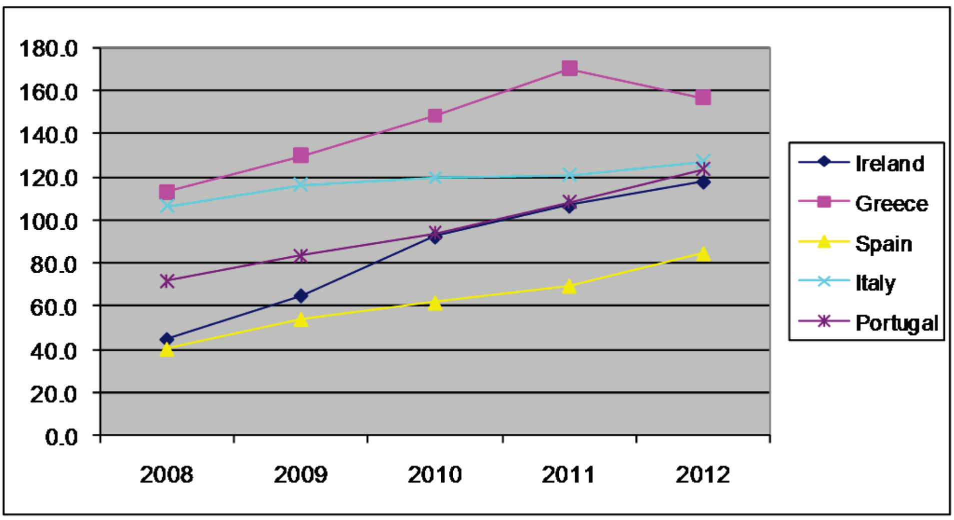


Source: data supplied from www.bbc.co.uk/news/business processed by the authors

Figure 2. Result of the budget execution in the Ireland, Greece, Spain, France, Italy, Portugal between 2008 and 2012 (% of the GDP)

Under the pressure of the economic recession and of the rising public spending, the PIIGS countries preferred foreign loans in order to save their banking systems.

Amid these already existing debts, the intervention of the EU and of the International Monetary Fund through the rescue packages further amplified the pressure of indebtedness. As we can see in Figure 3, between 2008 and 2012 the trend of the public debt was to be amplified.



Source: data supplied from www.bbc.co.uk/news/business processed by the authors

Figure 3. Evolution of the public debt in the Ireland, Greece, Spain, France, Italy, Portugal between the years 2008 and 2012(% of the GDP)

The European sovereign debt crisis emerged at the end of 2009 and the beginning of 2010, when investors became concerned that the level of the public debt in Europe became unsustainable. Therefore, they began to seek higher yields to compensate for the increasing bankruptcy risk.This has led to higher interest rates for the governments with problems and the beginning of a vicious cycle.

The most significant increase was recorded in Greece in 2011 when the public debt amounted to 170.3 % of the GDP as shown in Figure 3. Greece declared false economic data in order to align to the requirements of the Monetary Union. But in the end, the truth came out and the country was forced to accept a bailout package of 110 billion euros in May 2010 in exchange for the implementation of harsh austerity measures.

Portugal became the third member of the EU that requested a bailout in 2011 after it came close to bankruptcy.

The debt crisis in Europe evolved from being a local threat to putting pressure on the overall macroeconomic stability.

Between 2011 and 2012 in the EU there were many discussions related to the possible solutions to get out of the crisis of the Euro area. The pooling of the debt of the countries in the Euro area (by launching on the market the so- called Eurobonds) was indicated by some European leaders as a possible way out of the crisis.

However Germany openly opposed such measures, invoking the responsibility of each government for their own decisions and the need to take responsibility for the social and economic consequences by the nations that created those debts.

Although some states were reluctant to the prospect of keeping a supranational structure that tends to become more rigid and less conducive to economic growth efforts by committing unlimited budget deficits, however, in March 2012, 25 of the 27 European countries, including Romania, signed the Treaty on Stability, Coordination and Governance (TSCG) within the Economic and Monetary Union (http://european-council.europa.eu/media/639164/18_-_tscg.ro.12.pdf).

The treaty aims at strengthening the fiscal discipline by introducing penalties applied automatically and a stricter surveillance. The document sets out the structural deficit threshold limit of 0.5 %. The Member States are required to implement "a balanced budget rule" in the national budget law, preferably at constitutional level. The deadline for the fulfillment of this obligation is at most one year after the entry into force of the document, i.e. 1 January 2014, since the Treaty entered into force on January 1, 2013 after its ratification by Finland, the 12th state in the Euro zone that adopted the treaty.

If a country's public debt is significantly below 60 % of the GDP and there is no risk related to the long-term sustainability of the public finance, the structural deficit can be negotiated up to 1% of the GDP, the maximum cyclical budget deficit plus the structural one being within the limit of 3 % of the GDP.

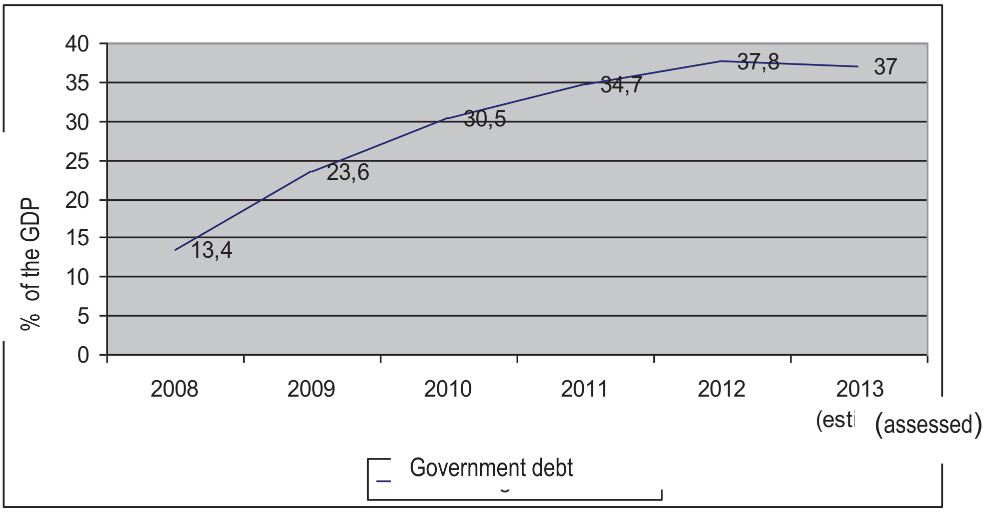
According to TSCG, if deviations from these levels are noticed, an automatic correction mechanism will penalize the State in question at a rate of up to 0.1% of the GDP.

3 EVOLUTION OF THE GOVERNMENT DEBT IN ROMANIA

Regarding Romania, this country underwent a new type of micro-transition in the crisis years, from an economy based on increasing the consumption of resources borrowed heavily (the years 2007–2009), to an economy based on one hand on austerity (unemployment increase, restriction of social protection, reducing the incomes of the population) and on the other hand on the increase in the sectors with exportable productions (the years 2010–2012).

Thus, at least in the short-term, Romania remained afloat, avoiding social and economic deviations like those in Greece or Portugal.

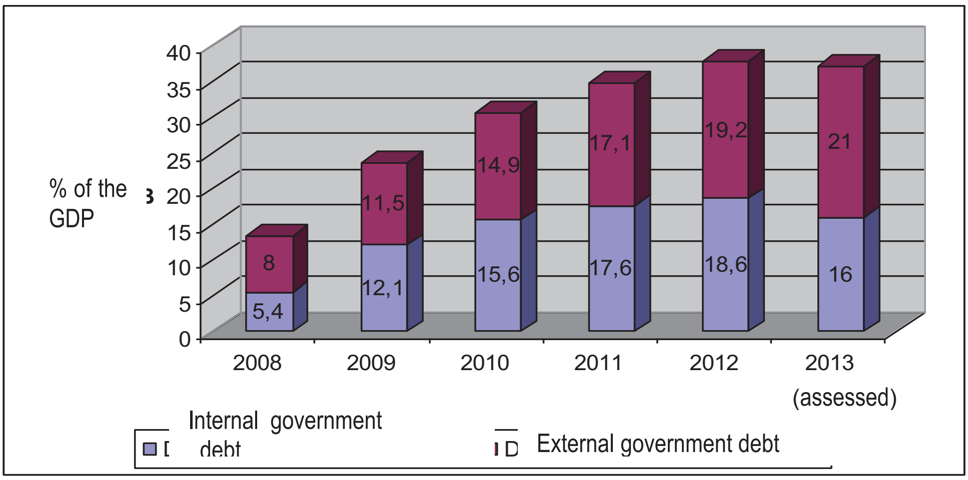
However, Romania was deeply affected by the crisis both at economical and at social level. As a result of the global economic recession, the government debt rose from 13.4% of the GDP in 2008 to 37.8% of the GDP in 2012, as apparent from Figure 4.



Source: data processed by the authors from the Ministry of Public Finance, Report on the public debt, May 2013, p. 1, http://discutii.mfinante.ro/static/10 /Mfp/buletin/ executii /Rap_datpub_ mai2013ro.pdf

Figure 4. Evolution of the government debt in Romania between 2008 and 2013 (% of the GDP)

A further difficulty in terms of exposure to the currency risk is the fact that since 2012 the proportions were reversed between the external debt in the GDP and the internal debt in the GDP, the share of the external debt in the GDP increasing.

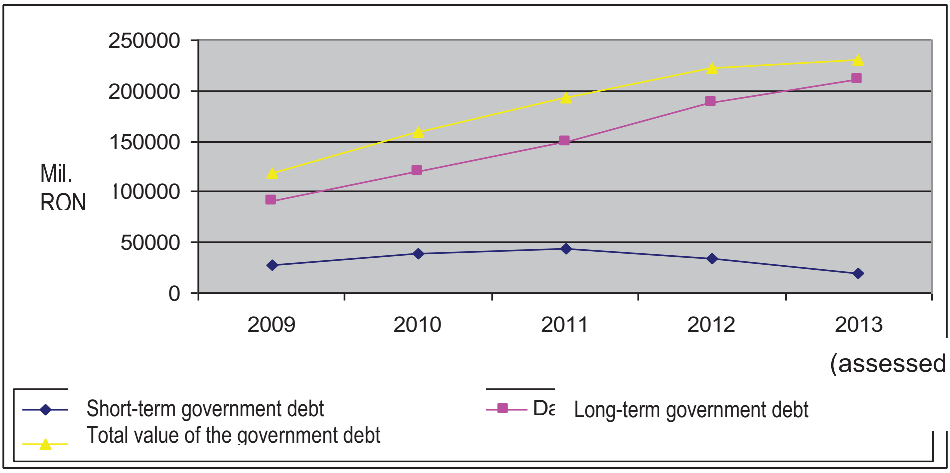


Source: data processed by the author from the Ministry of Public Finance, Report on the public debt, May 2013, p. 1, http://discutii.mfinante.ro/static/10/Mfp/buletin/executii/ Rap_ datpub _mai2013ro.pdf

Figure 5. The structure of the government debt in Romania between 2008 and 2013 (% of the GDP)

On 31 May, 2013 the share of the debt in RON in total government debt was 41% and the remaining 59 % was distributed as follows: the share of the debt in Euro in the total government debt (47%), in USD 7% and in other currencies of 5%.

From a positive perspective, in terms of maturity, government debt is mostly long-term contracted and as shown in Figure 6, starting with 2011, the amount of short-term government debt began to decline in favour of increasing long-term debt.



Source: data processed by the author from the Ministry of Public Finance, Report on the public debt, May 2013, p. 1, http://discutii.mfinante.ro/static/10/Mfp/buletin /executii/Rap_datpub _ mai2013ro.pdf

Figure 6. Structure of the government debt from the point of view of the maturity in Romania between the years 2009 and 2013

Based on the analyzed data we conclude that the evolution of the government debt was spectacular as a consequence of the world economic recession. The fast increase of the external debt especially, in a very short time, as happened in the case of Romania, p may affect the exchange rate and may contribute to the worsening of the growth prospects in the coming years. The real causes that led to the accelerating need for external financing can be attributed to the unstable macroeconomic environment, the fiscal policy inconsistencies and the existence of trade deficit. In our opinion, the real solutions to ensure favorable economic prospects in Romania on long-term, but must come from a fundamental change of the view of the governments concerning the commitment of the development policies, so that the indebtedness level decrease gradually, and the development be mainly based on economic competitiveness factors and less on external loans.

4.CONCLUSIONS

The current international economic context requires not only the need for a careful follow-up of public debt problems and of the prospects for its sustainability, but also a set of measures that can lead to the effective management of the public debt. The high levels of budget deficits / public debts must be addressed firmly and promptly through adequate policies meant to provide, beyond the financial balance, the sustained economic growth.

Romania should circumscribe European trends and of coordination and governance on economic and tax level, in order to ensure favorable prospects for long term growth.

REFERENCES

1.	Ferrarini, B. Jha, J. Ramayandi, A.	Public debt sustainability in developing Asia, Routledge, London, 2012
2.	Lachman, D.	Lessons from Europe's Debt Crisis for the United States, Cato Journal, vol. 33, no. 2 , 2013, p. 234
3.	Matei, Gh. Apostol, L.	Dezechilibrele actuale şi principalele mecanisme de aplanare în cadrul Uniunii Monetare Europene, în vol. Finanțe provocările viitorului, anul XIII, nr. 15/2013
4.	* * *	http://stats.oecd.org/
5.	* * *	http://european-council.europa.eu/media/639164/18_-_tscg.ro.12.pdf
6.	* * *	http://discutii.mfinante.ro/static/10/Mfp/buletin /executii/Rap_datpub _ mai2013ro.pdf
7.	* * *	www.bbc.co.uk/news/business