BUDGET DEFICIT AND PUBLIC DEBT – THE GREAT CHALLENGES FOR THE EU MEMBER STATES

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Rezumat

Criza financiară a avut un impact puternic asupra finanţelor publice din ţările europene. Deşi au pornit de pe poziţii relativ puternice în 2007, atât deficitul bugetar cât şi datoria publică s-au deteriorat considerabil, atingând valori nemaiîntâlnite în ultima perioadă în Uniunea Europeană. Cu toate măsurile de stimulare a economiei, revenirea la o creştere economică care să readucă valoarea taxelor la nivelul anului 2007 este un scenariu foarte favorabil pentru majoritatea ţărilor. Cifrele agregate privind datoria publică şi deficitul bugetar tind să mascheze evoluţia diferită din statele Uniunii Europene. Deteriorarea puternică a indicatorilor fiscali este cauzată atât de efectul automat al productivităţii economice, cât şi de măsurile luate de guvernele ţărilor din Uniunea Europeană. Experienţele trecute pot ajuta în evaluarea măsurilor fiscale ce ar trebui luate pentru reducerea datoriei publice şi a deficitului bugetar, neexistând însă o reţetă universală pentru toate ţările. Foarte important este şi contextul în care măsurile luate urmează să fie implementate.

Abstract

The financial crises had a strong impact on the public finance sectors from European countries. Even if in 2007 they started from relative good fiscal positions, the public debt and the budgetary deficits considerably

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deteriorated and registered historic values in European Union. With all measures taken to stimulate the economy, is a very favourable scenario to return at the taxes level from 2007. The aggregate numbers regarding the deficit and public debt incline to disguise the different evolutions of the European Union member states. The strong deterioration of fiscal indicators is caused by the automat effect of the economic productivity and also by measures taken by the governments of the member states. The past experiences can help to evaluate the fiscal measures that must be adopted in order to reduce the public debt and the deficit, without having an universal solution for all countries. Very important is the existing context for the implementation of adopted measures.

Keywords: budget deficit, public debt, fiscal position, EU member states

JEL classification: E62, H87, O23

The financial crisis had a strong impact on the **public finance** of the European countries. Although they have started from rather strong positions in 2007, both the budget deficit and the public debt have deteriorated considerably, reaching unprecedented values in the European Union during the recent period. In 2009, the budgetary position of the Euro zone and of the European Union worsened for the second consecutive year, displaying significant deteriorations compared to the previous year. Many economists considered that the next crisis will be that of the sovereign debts and some said that the population of the western countries will feel this crisis for one generation.

The manoeuvring space which the fiscal policy has in order to help economic stabilization is strictly limited by the level of the budget deficit and by that of the stock of public debt recorded at the beginning of the economic crisis. The more precarious is the fiscal position, the more difficult will it be for the authorities to react adequately to the occurrence of adverse shocks.

If in 2007, the **budget deficit** was less that 1% of EU27 GDP, for 2010, the economic prognoses indicate a value in excess of 7%, which will decrease slightly in 2011.

The EU member states have the duty to keep the budget deficit below 3% of the GDP and the public debt below 60%. The Pact of Stability and Growth sets the procedures that have to be followed if these values are breached. In 2009, Greece, Latvia, Lithuania, Malta, Poland, Romania, Belgium, Czech Republic, Germany, Italy, France, Spain, Ireland, the Netherlands, Austria, Portugal, Slovenia and Slovakia entered the Procedure of Excessive Deficit, while Hungary and the great Britain received their first recommendations.

In 2010, the Council of Europe demanded Greece to take measures in order to correct the budget deficit until 2012. In 2010, Finland, Cyprus, Denmark and Bulgaria also entered the Procedure of Excessive Deficit.

In most EU 27 countries, the deficit recorded in 2009 exceeded the reference value of 3% of the GDP. Among the new member states, the only exception was Estonia, with a budget deficit of just -1.7% of the GDP in 2009; among the Euro zone member states, the countries with a deficit below or equal with 3% of the GDP are Finland (-2.5%), Germany (-3%) and Luxemburg (-0.7%). No country had surplus in this year.

A very strong negative impact was felt outside the euro zone, with severe deteriorations of the deficit (as percentage of the GDP) in Latvia (-10.2%), Lithuania (-9.2%), Romania (-8.6%) and Poland (-7.2%). A lower worsening was noticed in Hungary, Bulgaria and Czech Republic, with deficits of -4.4%, -4.7% and -5.8%, respectively.

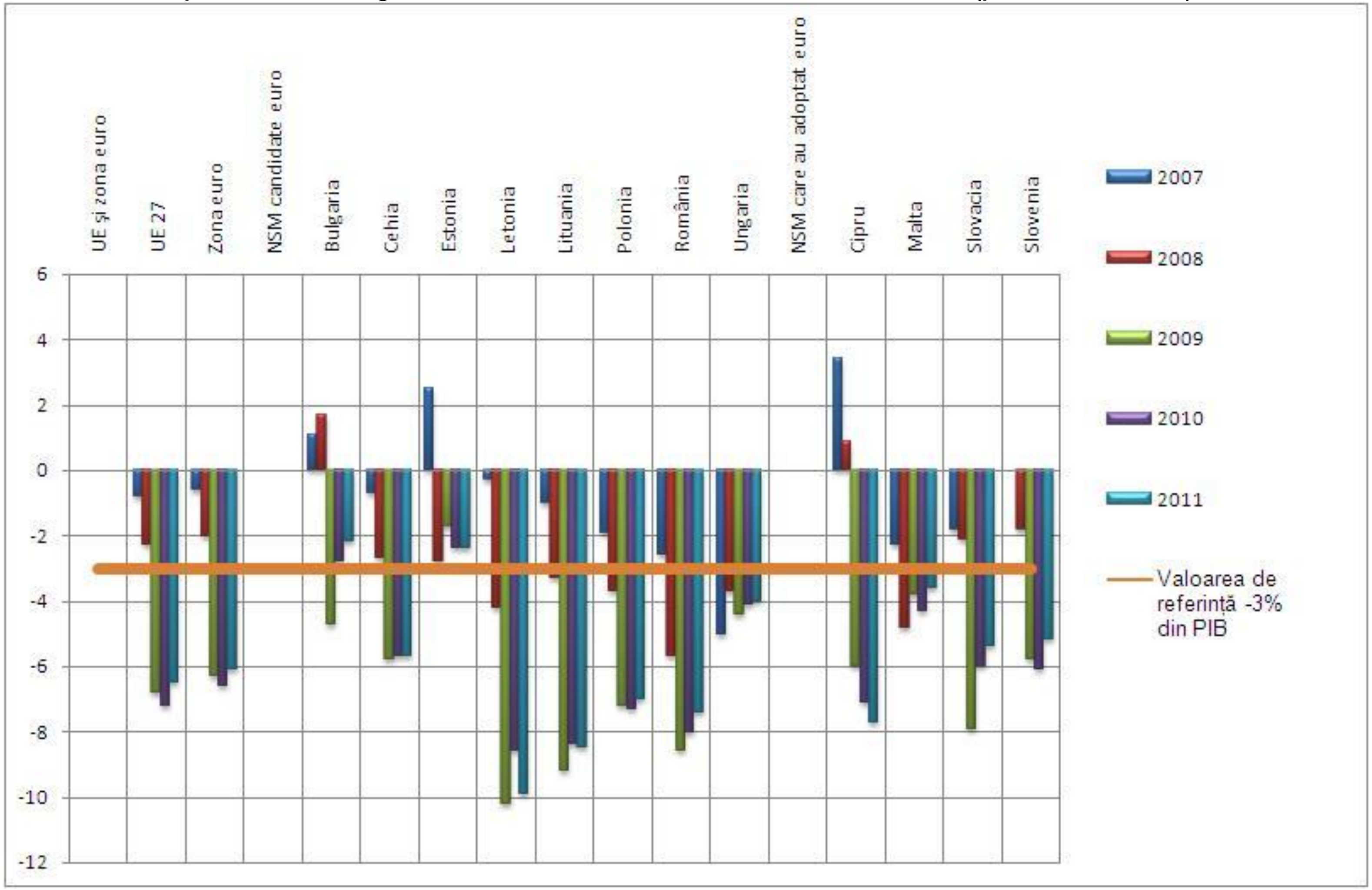
The European Commission increased by 0.3 percent points the estimated values for the deficit of Romania according to ESA 95 methodology for 2008 and 2009, to 5.7%, and 8.6% of the GDP, because it reclassified some state companies as belonging to the budgetary domain of the state. At the same time, for 2008, Eurostat reclassified a financial transaction as non-financial transaction, measure which also changed the estimation of the budget deficit. Previously, the statisticians of the European Commission estimated the deficit of Romania to 5.4%, and 8.3% of the GDP, according to ESA 95 methodology.

The old member states, outside the Euro zone, Denmark and Sweden, also reported deficit, compared to the surplus declared the previous years (-2.7% and -0.9%, respectively), but they still were below the reference value of 3% of the GDP. In the United Kingdom, the deficit increased dramatically to -11.34% of the GDP.

A low budget deficit, or even a budget surplus, may hide the existence of large misbalances when the outcome was the result of a favourable conjecture, when the high revenues to the budget are the result of an overheated economy.

The deficit of the consolidated budget taken as such is not a very suitable indicator for the evaluation of the fiscal policy, because it reflects both the influence of some permanent factors, and the influence of some transient factors, without being able to make the difference between them, which involves costs given by the insufficient or excessive action on the fiscal policy levers, with expansionist or contractive implications, at improper moments of the economic cycle. The permanent factors which influence the budget deficit refer to the stable elements of the public revenues and expenditure, while the transient factors are influenced by the economic cycle.

Chart 3
Proportion of the budget deficit within the GDP in the new EU member states (percent of the GDP)



Source: Eurostat (retrieved on 25 October 2010). Prognoses 2010-2011 – European Commission, spring prognosis.

The **public debt** in EU27 was of about 59% of the GDP in 2007, and for 2010 it is estimated to get close to 80%. Although, even before 2007, many EU member states didn't meet the Maastricht criteria on the limitation of the public debt to a maximum of 60% of the GDP, the financial crisis caused a dramatic increase of the public debt, despite the efforts of many countries to keep the expenditure under control.

This increase of the debt is not without a precedent in the European Union. Similar increases were recorded in some European Countries after the oil crisis of the 70s and during the 80s. Because those increases didn't reverse totally, and because the EU member states experienced several such episodes, the actual increase started from a higher level of the public debt, as it happened almost every time.

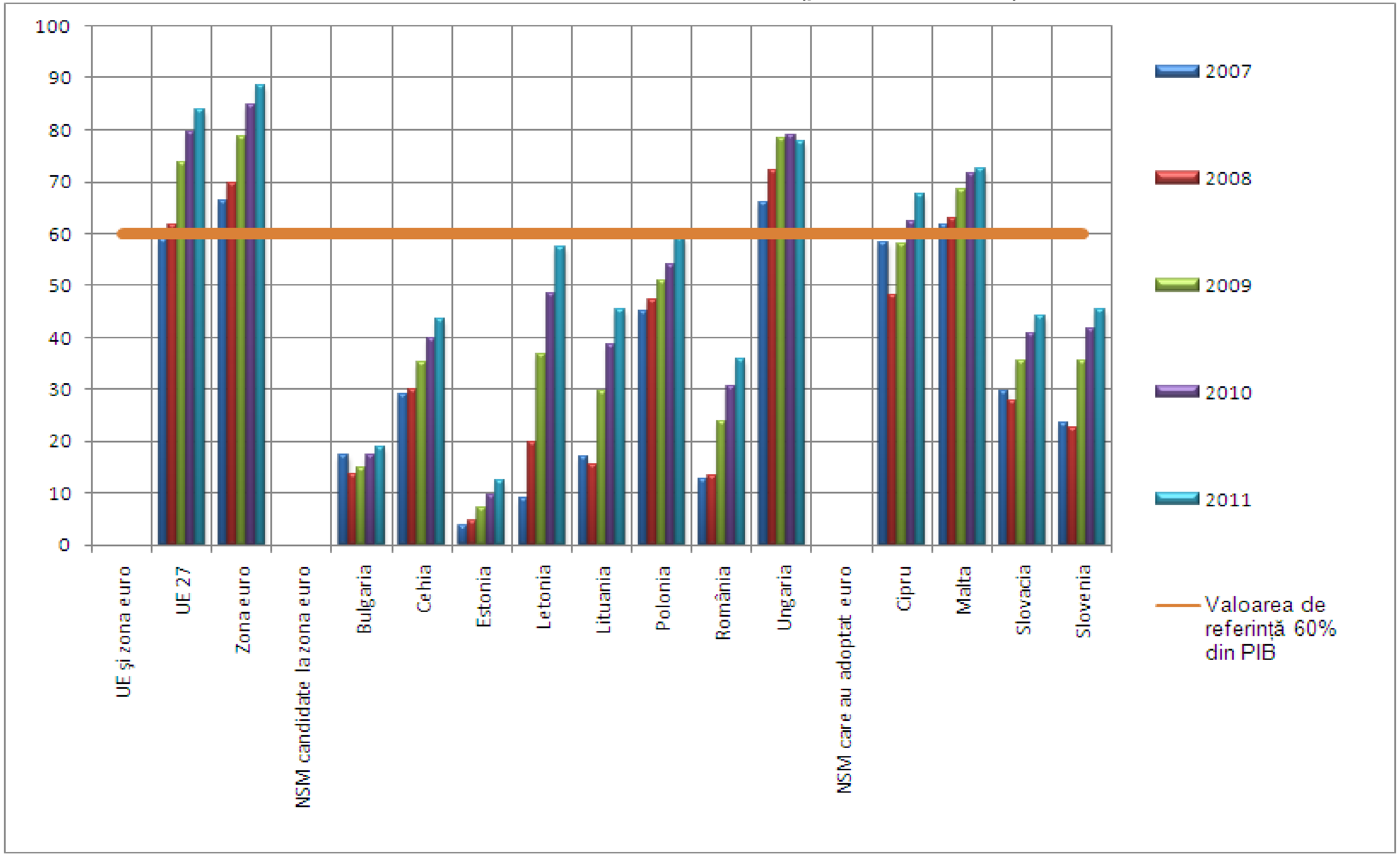
Most probably, the public debt will continue to increase after 2011 too. Despite the measures to stimulate the economy, the return to economic growth which will bring the value of the taxes back to the level of 2007 is a very favourable scenario for most countries. In 2009, the public debt increased by 9% in the euro zone compared to the previous year, reaching 78/7% of the GDP. This increase can be partially accounted for by the increase of Spain's debt from a rather low level (39.8% in 2008) to 53.2% in 2009. The bulk of this debt belongs to the euro zone.

The aggregate figures tend to mask the different evolution of the EU member states. There are some member states which had low or very low debts before the crisis, which are now increasing dramatically. This group of countries includes Ireland, Spain, Latvia, Lithuania and the united Kingdom. The public debt from other three countries from the euro zone – Italy, Belgium and Greece – will probably exceed again 100% of the GDP in 2011, reaching 118.9%, 100.9% and 133.9% of the GDP.

From the new member states candidate to the euro zone, Hungary is the only which exceeded the reference value of 60% of the GDP, from 2005 to 2009, when it had 78.4%. The prognosis for the next two years shows a constant level for 2010 and even a slight decrease in 2011. From the new member states which had joined the euro zone, Malta is the only which exceeded the reference value in 2009, with 68.6% of the GDP.

The strong deterioration of the fiscal indicators is caused both by the automatic effect of the economic productivity, and by the measures taken by the governments of the EU member states. The reduction of the economic growth to -4.9% in 2009, lead automatically to the decrease of the revenues and to the increase of the expenditure as percentage of the GDP. The measures introduced in support of the aggregate demand and of the financial sector have generated additional pressure on the public finances. If the monetary policy had reached the lower limit by introducing very low interest rates, the interventions brought by the fiscal policy helped the economies to stabilise.

Chart 4
Public debt in the new EU member states (percent of the GDP)



Source: Eurostat (retrieved on 25 October 2010). Prognoses 2010-2011 – European Commission, spring prognosis.

On the background of the increasing public debts and budget deficits, the crisis from the euro zone deepened, the spreads of Spain's, Italy's and Belgium's bonds reaching a historic all times high level since the creation of the euro, and the central bank of Portugal warned that the banks from Portugal will be confronted with intolerable risks if the government will not consolidate the public finances. Euro depreciated at the end of November below the threshold of 1.3 USD for the first time in mid September, despite the attempts of the European leaders to calm the markets.

It seems that this crisis started from very different causes in each country: fiscal problems in Greece, a collapsed banking system in Ireland, budget deficit in Portugal, the fall of the real estate market in Spain, the huge public debt from Italy or an aged social assistance system in France, and the common denominator is the Euro currency.

The past experiences may be of help to evaluate the fiscal measures to take in order to reduce the public debt and the budget deficit. If the past increases of the public debt/GDP ratio started the fiscal consolidation, these episodes didn't reduce the debt significantly.

Although the past experiences can be a guide to choose the correct measures, there is no universal solution. The past experiences have shown that many times, the fiscal consolidation is done to the detriment of the public investments, which affects the economic growth which is vital for the reduction of the debt. The level of the economic growth, the evolution of inflation and of the interest rates, the level of the debt and of the deficit, of the expenditure and cashing, all of them influence the type of measures to be taken by each individual country. Similarly important is the context in which these measures are to be implemented.

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