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Aspects of the Current Fiscal - Budgetary Situation in Some Euro Area Countries. Implications for Romania

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Abstract. The financial and economic global crisis has exacerbated some of the imbalances existent in all EU Member States, in particular the fiscal-budgetary imbalances. For some countries whose currency is euro, the fiscal and budgetary challenges seem to threaten even the stability of the euro area. Thus, in the context of financial and economic global crisis, this article aims at identifying a number of negative aspects of the fiscal-budgetary situation of some euro area countries, more seriously affected (Greece, Italy, Portugal, Ireland, Spain) and at revealing a series of possible implications of this phenomenon for Romania, thus giving originality of the conducted analysis. A fulcrum in this approach is the economic literature and the authors' research work in the field of European integration. Through a comparative approach, the authors have identified some weaknesses of the Romanian economy generated by the current situation of some euro area countries. Given the place of the theme within the frame of present interest researches, the article's results will be of interest for both academics and practitioners.

Keywords: economic global crisis; convergence criteria; European integration; economic stability

JEL Classification: E62, E63, G01

1. Introduction

In the present context of the financial and economic global crisis, a "thorny" angle of the macroeconomic imbalances is represented, more and more lately, by the fiscal-budgetary problem of the EU countries, and especially, of the euro area countries. The crisis, the anti-cyclical budget and fiscal measures adopted and the national banking systems rescue packages exposed, even more, the euro area countries to the risk of exceeding the budgetary limits from the Stability and Growth Pact (SGP). In this respect, it is particularly important for euro area countries which have registered excessive deficits to correct them in line with the deadlines set by the EU Council, and, after correcting excessive deficits, their strengthening is needed in order to become sustainable on the medium and long-term. Countries like Greece, Italy, Portugal, Ireland and Spain (GIPIS)[1] seem not so well anchored in the economic and financial architecture of the euro area, generating a series of problems for the overall stability of this monetary area. Therefore, this article aims at debating the GIPIS countries fiscal-budgetary issue, and the possible negative implications for our country.

2. Fiscal-Budgetary Problems – a Comparative Analysis among Some Euro Area Countries

Greece has constantly consistently exceeded the benchmark set in the Maastricht Treaty (before and after euro adoption) in both budget deficit and public debt criteria, the latest recording its higher growth after 2007 (see Figure 1). Thus, in 2009 Greece had a 270 billion Euros debt, respectively a 112.6% of GDP debt (around 100% of GDP over the period 2002-2008[2]). This has become a serious problem under current global financial crisis, when investors began to treat differently the debts[3] of euro area countries. However, we can see that Greek's problem refers mainly to the state debt, this country having a reasonable private debt level, which cannot be said, for instance, about Spain. Fears for Greek's ability to finance and to meet its creditors' obligations hit severely the financial markets in January 2009, when the Athens government announced that the budget

[1] Countries are ranked in descending biggest public debts order. The article is being concerned more about public debt slippages.
[2] AMECO Database
[3] Currently, Greece's CDS on sovereign debt is traded around 250, compared with 52 - for Germany, 62 - for USA, 120 - for the UK, and 178 – for Italy.

deficit increased to 12.7% in 2009[1], more than three times higher than official estimates. In these circumstances, Greece is forced to offer yields for its government securities approaching 6.5% in order to attract investors, with almost four percentage points higher than German government securities.

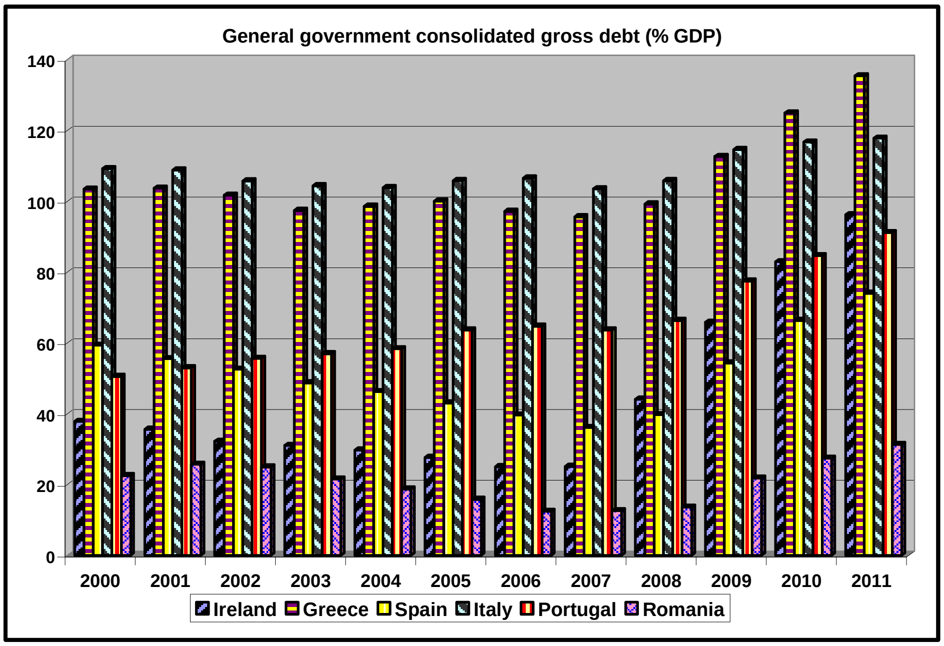

Figure 1. General government consolidated gross debt as a percentage of GDP

Source: Eurostat and European Commission, European Economic Forecast - autumn 2009, European Economy 10/2009

The public debt cost of Greece reached the highest level since the euro introduction because of the difficult situation, and also due to the uncertainties that surround the public finances of the Greek state. In 2001, immediately after Greece was admitted into the European Monetary Union, Goldman Sachs helped the Athens government, quietly, to borrow billions. The understanding, hidden from the public eyes, helped Athens to meet European standards in terms of deficit, continuing to

[1] AMECO Database

spend beyond its means. The agreements concluded in the last 10 years by Wall Street banks raise many questions about the role played by Wall Street in the last major financial drama in the world. These less correct agreements, similar to those which generated the sub-prime mortgage crisis, have led to the widening of Greece financial crisis and resulted in undermining the European currency, allowing the European governments to hide their growing debts from the "eyes" of budget supervisors from Brussels. Derivatives have played an important role in increasing Greece debt, just as it happened in the sub-prime crisis in America and in the implosion of American International Group (AIG), based on loans in exchange for future government payments. Greece, for instance, gave in exchange for this money the rights over the fees charged by airports and over the lottery profits[1], classifying these transactions as sales rather than loans. This type of business has stirred controversy in government circles for many years. Since 2000, EU finance ministers debated whether derivative transactions using "creative accounting" should be made public. Despite the negative response, in 2002, EU bodies required the disclosure of business which did not appear in the balance sheets, forcing governments to treat them as loans rather than sales. Greece did not see fit to do so, because its transactions were made before the amendment of this rule (in 2002).

Critics argue that, if they are not recorded as loans, such arrangements lead to a wrong track both the investors and the regulators regarding the problem of a country's debt. Swap agreements, even if they were legal, contributed to the increase of instability, creating the impression of a false economic equilibrium.

Even when the crisis was near its peak, at the end of 2009, the banks were seeking ways to help Greece to conceal its debts by using financing instruments that would have pushed the debt of this country's health system in the distant future, in a similar way to the completing of the second mortgage, in the case of troubled owners from the mortgage market.

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[1] These agreements had mythological names:
Aeolos SA (2001) - a securitization worth 355 million euros, guaranteed by Greece with the airport taxes due to Greece by the airlines companies. The business was managed by Morgan Stanley, Alpha Bank and EFG Eurobank, according to an article in EuroWeek, 2001.
Ariadne SA (2000) - a business of 650 million euros, guaranteed by state lottery profits. This business was dealt by Morgan Stanley Dean Witter, Schroder Salomon Smith Barney, UBS Alpha Bank and Commercial Bank, according to an article in EuroWeek, in 2000.
Atlas Securitization SA (2001) - a business of 2 billion euros guaranteed by European Commission payments in a Greece developing plan. This was managed by BNP Paribas, Deutsche Bank, EFG Eurobank and NBG International, according to an article in EuroWeek, 2001.

High rank European officials, led by the European Commission, decided to work closely with the Greek authorities in order to implement concrete measures to reduce the budget deficit and the Athens authorities have undertaken specific commitments and must report regularly on the progress made, the first time on March 16, 2010, the second time in mid May and then, every three months. Greece has also agreed to provide additional economic measures, if it will be necessary, in order to reduce the budget deficit by four percentage points in 2010 and to end the crisis, because the risks, related to macroeconomic developments and market evolution, are real.

In an attempt to force a decision from the euro area partners, Greece announced that it considers an appeal to the International Monetary Fund (IMF), if the EU will not provide her the needed financial assistance, solution quickly disapproved by European Central Bank (ECB) President. While Germany recommends that Greece should have a combination of aids from the IMF and EU, as an emergency measure, if it will be extremely necessary, France sees the IMF aid, lender with headquarters in Washington, as a political humiliation for the euro area.

On the other hand, Standard & Poor's and Moody's threatens to revise downwards the country rating for Greece with one or two steps in a few months due to its high budget deficit and to the pressures from the banking sector, if it deviates from its austerity plan. The risks over Greece's economic development will make necessary, perhaps, a wider fiscal consolidation, raising questions on the feasibility of the budget deficit reduction program. For Greece it is important to have a good country rating, because only in these circumstances the ECB will provide collaterals for its bonds, guarantees that Greek banks can use in order to obtain loans. As the European Central Bank will tighten its rules at the end of the year, Greece needs at least an A rating to be eligible. Greek banks have used more government securities as collateral, through the European Central Bank, than any other country in the euro area, and rely on this form of financing.

For Greece, there is not a theoretical possibility of country bankruptcy, as the European authorities cannot afford to attend helpless to such a global shock wave, the country being too important to enter into economic collapse without serious consequences for the financial and monetary stability of the euro area. Thus, investors' fears concerning Greece's ability to refinance its debts have affected lately the euro exchange rate, contributing to its depreciation against the U.S. dollar. Also, an additional pressure on the euro exchange rate was represented and it is still represented by the hedge funds behavior, funds which have made significant profits from transactions with securities issued by Greece and which have offered insurance against the risk of the Greek state default, further complicating Greece's financial situation. Athens committed to bring the budget deficit from 12.7% of GDP in 2009 to below the threshold of 3% of GDP by 2012, although official forecasts[1] show the maintaining of the deficit at almost the same level (see Figure 2).

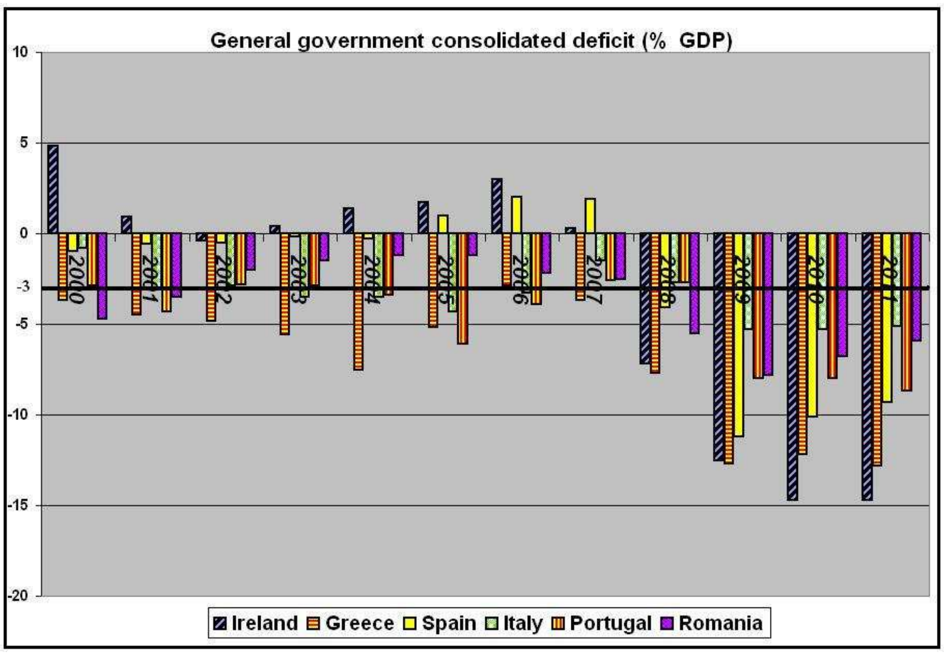

Figure 2. Net borrowing/lending of consolidated general government sector as a percentage of GDP

Source: Eurostat and European Commission, European Economic Forecast - autumn 2009, European Economy 10/2009

The fiscal-budgetary imbalance's problem of the GIPIS states can be translated not only into a mismanagement of budget deficits and external debt, but especially into a manifestation of asymmetric shocks, that has always been known to be a

[1] AMECO Database and European Commission, *European Economic Forecast - autumn 2009*, European Economy 10/2009.

problem, which deepened in the current crisis context. This can be said also about Spain.

The origin of the difficulties that Spain is facing today can be found in real estate speculations having taken place for years, which caused huge growth in houses prices, attracted large capital inflows and allowed countries like Germany to record huge surpluses, while Spain and other "peripheral economies" had deficits. Therefore, large capital inflows have increased Spanish demand for goods and services, leading to substantially higher inflation than Germany and other countries with surpluses, and when "housing bubble" exploded, Spain had an extremely low domestic demand, no so competitive compared with the whole euro area as a result of the increases in prices and costs of the labor market. As Spain could not appreciate the "currency" at the moment of the real estate boom, nor could she depreciate it after that time, the country faces now and will face, also, in the future the consequences of losing exchange rate flexibility: namely deflation and high unemployment, large budget deficits and massive public debt. In order to solve these problems, euro area countries should consider all available methods for increasing the integration of the taxation/fiscality and labor market.

For Spain the risk was, along with the loss of monetary policy independence (the cost that was felt in time by all countries of the euro area periphery), the development of the real estate market at an unsustainable pace. This development was stimulated by several factors: low interest rates of ECB compared with higher yields in Spain, high rates of growth of disposable income, easier access of households credit, population dynamics, with increased flows of immigrants, taxes preferential treatment for owners and foreign demand for holiday houses in this country. Spain's experience stresses the existence of a risk of asset markets overheating during the convergence process within a currency area.

Doubts concerning the budgetary situation of Spain and its ability to finance the huge deficit recorded (over 11.2% of GDP in 2009, compared with only 4.1% of GDP recorded in 2008) creates, as in Greece's case, tensions on the euro exchange rate. The deterioration of the Spanish fiscal outlook is driven by persistent revenue deficit, by the strong increase in social spending and by the projected impact of cyclical developments. To these aspects, it can be added the discretionary measures adopted in 2007-2008, namely: tax reform (2007), a package of incentives (early 2008), additional incentives (late 2008 and early 2009).

In early 2010 Spain announced the implementation of an austerity program, trying to show the markets that it will not have the same financial problems as Greece. Despite this measure, the Spanish executive had to revise upwards the deficit forecasts for 2010-2012. Thus, the forecast for 2010[1] shows a deficit of 10.1% of GDP, in 2011 - 9.3% of GDP and in 2012 - 5.3% of GDP[2]. Under this program, all government spending and policies will be reduced, except for state aid, such as unemployment benefits and investments in research and development, expenditure on education, foreign aid and the fight against terrorism. There are still doubts about how the government will succeed to reduce costs, given that the unemployment rate reached 18% in 2009[3], one of the largest in the euro area, as it is the level of household indebtedness.

Analysts expect the Spanish public debt as a percentage of GDP to be close to double in 2011 (74%) compared with 2008 (39.7%)[4], increasing fears that the country could face financial problems similar to those of Greece and Portugal.

Italy's economy has not been experiencing spectacular growth after 1999, annual average rate of real GDP being about 1.5%. Moreover, in 2009 it suffered the largest decline after the Second World War, while the budget deficit increased from 2.7% of GDP in 2008 to 5.3% of GDP in 2009. Inefficiencies from microeconomic level, applying a fiscal policy directed towards spending and the rapid growth of domestic wages (pressing toward the increase of unit labor costs) have affected the competitiveness and hence have generated inflationary pressure. In addition to these features, there is, also, a certain rigidity of the internal products market shown by the existence of price controls, administrative charges and the barriers imposed over ownership. Labor market is, also, one of the most rigid in the euro area. Italy's unsustainable fiscal policy and also the public debt are risk factors for the market perception of the Italian economy. There is a penalty risk from the market by increasing the risk premium regarding Italy's debt, which is one of the highest[5] in the euro area, and growing[6]. Although public expenditure reached in

[1] AMECO Database.
[2] In the previous estimate, the Spanish authorities forecasted a deficit of 8.1% of GDP in 2010, 5.2% of GDP in 2011 and only 3% of GDP in 2012.
[3] AMECO Database.
[4] According to the AMECO, in absolute terms, Spain's public debt was 570 billion in 2009, in 2011 forecasts showing an increase to 792 billion.
[5] 1757 billion euros in 2009.
[6] According to the European Commission (*European Economic Forecast - Autumn 2009, European Economy 10/2009*), public debt increased to 105.8% of GDP in 2008, to 114.6% of GDP in 2009 and will increase in 2011 to 117.8% of GDP.

2009 52.5% of GDP and the revenues have contracted, in crisis context both on direct and indirect taxes, in the next period it is expected the return of indirect tax revenues as the consumption will improve in 2010 and 2011.

Data on economic development and those related to budget deficit are consistent with the analysts' expectations, many of them considering that Italy has limited better than other GIPIS countries the recession impact on public finances.

Euro adoption has boosted the consumption and the investment in Portugal's economy by reducing (real) interest rates and liquidity constraints. Booming credit activity from the expansion period was based mainly on non-tradable sector and on the rigidity of labor and products markets, rigidity that hampered the process of real economic convergence. Poor performance of the economy in the aftermath of euro adoption can be explained by the fact that during the expansion it was not encouraged a strategy to increase productivity and competitiveness, and the conduct of fiscal policy has not helped to mitigate cyclical fluctuations. Primary budget expenditures increased significantly, mainly reflecting increased personnel costs. Fiscal policy has emphasized the fundamental imbalances, first by enhancing the expansion phenomenon (boom), led by domestic demand, and later, by limiting the possible reactions to the phenomenon of recession or economic downturn. If the booming growth in the late 1990s has allowed an improvement in government budget to facilitate euro adoption, after this moment, slowing economic activity revealed the vulnerability of Portugal's fiscal position.

A sharp increase in the share of budget deficit to GDP occurred in 2009 compared to 2008 (to 8% from 2.8%[1]). The share of public debt to GDP was 77.4% in 2009[2]. Fiscal slippages from 2009 reflect the severity of the strong economic downturn. For 2010 it is forecasted that the budget deficit will remain at the same level, with an increase in 2011.

Portugal intends to adopt austerity measures designed to reduce the budget deficit from 8.3% in 2010 to 2.8% in 2013. The program is considered essential in order to convince the markets that Portugal will solve the budget deficit and debt issue and will not have problems like those in Greece.

These measures include a comprehensive privatization plan for transport, energy, insurance or mail, which should limit the government's debt deepening. Under the government plan, public debt would reach 86% of GDP in 2010, and will increase

[1] AMECO Database.
[2] AMECO Database.

by 2012 up to 90.7% of GDP, after that it will begin a slight decline in 2013, to 89.8% of GDP.

Before entering the euro area, Ireland had the highest economic growth rate in Europe, increase determined by the favorable perceptions of investors about the business environment in Ireland: lower cost of labor, communication easiness because of the English-speaking population, lower prices in the housing market and lower taxation. These factors, and also the prospects for European monetary integration have boosted economic growth and appreciated the national currency. After joining the EMU, until 2007, Ireland's economy continued to grow at accelerated rates, but it was affected by the loss of monetary independence, whereas the ECB has adjusted interest rates downwards to stimulate large economies facing a recession (Germany, France), having an adverse effect on countries that already had low interest rates (Ireland, Portugal, Spain, Greece). As a result, strong demand in Ireland has created upward pressure on prices and wages, eroding competitiveness. The particular evolution of the Irish economy is explained by the readjustment of the economy to shocks. Besides the interest rate initial shock (in 1998-2000) related to the euro zone entry, which was combined with a pro-cyclical fiscal loosening, the Irish economy was influenced by specific shocks of the euro area, caused by the differences between trading partners, the structure of economic branches or the sectorial specialization.

After the triggering of the global financial crisis, Ireland - the country that before this moment was considered a successful example of euro adoption - is in a great difficulty, showing the vulnerable elements of its development: the accumulation of debt, but also the inflow of foreign direct investment towards fragile sectors, particularly construction, in a period of real estate market expansion. The crisis, manifested aggressively in Ireland[1], is not only economical, but also political. Given the harsh reactions that occur inside the country concerning the policy pursued by major European countries, exists the danger that Ireland to withdraw from the EMU, if it is not helped. Normally, the adoption of the euro means taking responsibility at both levels: by national political institutions and by those who make euro area policy. No policy change will indebt even more Ireland, whose

[1] The crisis in the real estate market has affected this country more severely than other European countries that have recorded expansion in this area.

public debt has reached in 2009 66% of GDP[1]. Since 2008, Ireland recorded a budget deficit whose share in GDP almost doubled in 2009 (12.5% vs. 7.2%)[2].

3. Some Implications for Romania

In 2007, Romania has fulfilled the criterion on the budget deficit, but since 2008 the budget deficit target, set at 2.3% of GDP, has been exceeded. According to the IMF, the government deficit in 2008 reflects: extremely optimistic forecasts on budget revenues, significant slippages of current spending (in particular with public sector wages and benefits) and, to a lesser extent, a sudden drop of revenues collected in the fourth quarter of 2008, due to economic slowdown, phenomenon which recorded an even more decreasing trend in 2009. The budget deficit from 2009 was caused not so much by the crisis, but by the poor fiscal and budget execution. In other words, the increasing of budget deficit in 2009 is more the result of the crisis that we created and which is extending also in 2010. In the globalization, European integration and global financial and economic crisis context, the economic relations between Romania and EU countries, including those in the euro area, have widened, leading to multiple interdependencies, which have become the transmission channels for the problems of the partner countries.

For Greece, the contagion effect on Romania can occur primarily through the financial channel, given the insignificant bilateral trade and that Greek banks (Bancpost Romanian Bank, Piraeus Bank Romania, Emporiki Bank, Alpha Bank, Romania ATEbank and Marfin Popular Bank) hold 20% of the Romanian banking market. A possible withdrawal of funds from subsidiaries in Central and Eastern Europe, therefore including Romania, would be justified by the need of increasing Greek deposits in a much faster manner than if the parent banks in Greece would resort to loans. Moreover, these banking institutions can get in a position to delay the credit process (already very hit by the crisis!) on the Romanian banking market and even in a position to stop granting new loans. However, the Romanian authorities consider that Greek banks are solid capitalized and the foreign reserves of the National Bank of Romania are an effective buffer against possible market volatility.

[1] AMECO Database.
[2] AMECO Database.

As for Italy, with which Romania has extensive trade relations, the crisis may cause a reduction of our country's exports to this destination, and therefore can lead to Romania's economic downturn.

The economic problems of Spain, Italy and Portugal may spread over Romania particularly through the labor channel (by reducing inflows of current transfers and income from work).

In the context of the financial and economic global crisis and of the currently problems of the euro area, we believe that there are necessary prudent fiscal-budgetary policies, under a balanced mix of macroeconomic policies. These, together with long-term reform programs, should correct the current imbalances and keep budget deficits under control.

4. Conclusions

With all its advantages, the euro area entails some risks. For example, Italy and Greece have entered into the monetary union with deficits higher than allowed by the Maastricht Treaty, and the governments of these countries have preferred to reduce deficits artificially, using financial instruments such as derivatives, rather than to increase taxes or cut spending.

The problem of fiscal-budgetary imbalances of the GIPIS states can be translated not only into a bad management of external debt, but especially into a problem of asymmetric shocks manifestation, thing that has always been known as being a problem and which deepened in the current crisis context.

The results registered over the years by the euro area countries show that a politically forced membership, of those countries that are not yet economically prepared to face, on long term, the rigorous and super-regulated euro area climate, determines major disturbance in the functioning of their economies, and also in the euro area.

Therefore, the GIPIS countries' deficit and debt issue is a significant challenge for the economic unity and for the European currency stability within the euro area and the EU, as a whole.

The above analysis shows that even under the euro "umbrella" a country's economy is not safe as long as its structure is not appropriate for a long-term sustainable development, if that economy is perceived by the investors as being risky.

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