A C T A   U N I V E R S I T A T I S   L O D Z I E N S I S
FOLIA OECONOMICA 239, 2010

*Eugeniusz Gostomski**

REMEDIAL MEASURES FOR PUBLIC FINANCE IN THE EUROPEAN UNION COUNTRIES

1. Introduction

Since the explosion of the global economic and financial crisis until today, in the countries of Euroland as well as in other developed countries, the situation in the field of public finance is getting worse. The situation has been like that in consequence of economic recession in those countries, one that indicates less activity on the part of economic subjects and consumers, and therefore leads to the decline of tax revenues to the state budget (see: table 1). At the same time there has occurred a huge increase of budget spending on rescuing banks facing bankruptcy and the realization of the government anti-crisis programmes (see: table 2). There are also to be noticed general reasons for national debts of EU countries, which are: living beyond one's means and diminishing competitiveness of their economies in the international markets.

Table 1. Decrease of budget revenues of selected EU countries in the years 2008–2009

Country	Decrease of budget revenues (% GDP)
Germany	–1,5
France	–1,4
Italy	–0,2
Spain	–3,8
Great Britain	–2,4
EU – 27	–0,8

Source: OECD

* Professor of University of Gdańsk

Table 2. Government's expenditure on the suport of financial sector in the global financial crisis (2008–2009) w % GDP

Country	Dokapitalizowanie banków	State credits or purchase of assets	Government guarantees without bank deposit guarantees
France	1,4	1,3	16,4
Spain	0,0	4,6	18,3
Germany	3,7	0,4	18,0
Great Britain	3,9	13,8	51,1
Italy	0,8	0,0	0,0

Source: MFW

The growth of national debt in the EU countries is entailing the danger of rising inflation in those countries, which threatens the stability of Euro in the internal market and has negative effect on its position in the international financial markets. What is essential in that situation is a reduction of budgetary deficit and hindering of the growth of national debt in the Euroland countries.

2. Treaty regulations concerning budgetary policy of the EU countries

As soon as before the introduction of the common European currency, its advocates were warning the EU countries against financial extravagance of the governments for the sake of its stability. Germany, in particular, was emphasizing that excessive budgetary deficit resulting in high national debt would threaten Euro stability and lead to the worsening of economic situation in the EU countries. That fear was fully justified. Budget deficit and necessity of service of national debt require borrowing financial means by the governments in the monetary market and capital market, which leads to "sucking" money from the market and in turn to the growth of interest rates of credits. Therefore there occur limited possibilities of gaining capital by enterprises on realization of development and innovative projects, which in turn causes weakening of dynamics of economic development in the excessively indebted countries. At the same time the trust of investors placed in those countries is decreasing. In order to be able to sell government securities needed to cover the budget deficit, individual governments must raise the exchange premium for foreign investors, which even more charges the state budget. Having that under consideration, what the EU member countries accepted in the Treaty of Maastricht (1992) and then confirmed in the Stability and Growth Pact agreed at the peak of EU in Amsterdam in 1997 and reformed in 2005, is the fact that budget deficit in particular countries should not exceed 3% GDP, and national debt 60% GDP[1]. The solution was meant to prevent the excessive debt of the EU countries.

The deficit of public finance sector in the European Union is considered to be a sum of net loans taken out in a given year by the subjects of public financial economy, that is a difference between the increase in gross debt and the increase in liabilities and other assets of public sector. In other words the deficit of public finance sector is a negative difference between the public revenue, enlarged by non-returnable means coming from foreign sources and public expenditure in a given accounting period. The deficit is a broader concept embracing not only the state budget deficit but also a deficit of other subjects of public sector – territorial government, special funds including especially national insurance funds and other units counting into public finance sector. However the national debt is a sum of non-settled debts from the former periods. The most important reason for the debt occurrence lies in taking out loans by public authorities (state and local authorities) for covering of the budget deficit[2].

In the Economic and Monetary Union the budget policy, unlike the monetary policy, is under administration of member states due to political aspects and because of the necessity of it considering special needs of particular countries. It does not mean, however, that the Euroland countries may freely shape their budget policy. That could not be easily combined with the existence of the common currency though, and that's why there has been agreed a certain coordination of national budget policies. That coordination concentrates on the observance of fiscal criteria of convergence, which concern 3% of the limit of budget deficit and 60% of the limit for national debt, calculated in relation to the gross domestic product.

According to the Treaty of Maastricht the EU member states could not take out any loans for covering the budget deficit neither in the European Central Bank, nor in their own central banks. They could not obtain any financial means form those institutions through selling securities to them. On the strength of the Treaty Constituting European Community (art. 102 TWE), what also was forbidden was privileging of public authorities of the EU member states in their access to financial institutions. It meant that all the budget deficits in those countries could be financed only from the financial means coming from the market and on market conditions. According to art. 103 TWE the Community and member countries were not liable for the commitments of governments or other public authorities from other EU countries, nor did they have to take over their liabilities. The exception was only concerning mutual financial guarantees

[1] See: Michałowska – Gorywoda K., Podejmowanie decyzji w Unii Europejskiej, Wydawnictwo Naukowe Scholar, Warszawa 2002, s. 70 i nast.

[2] See: Chojna – Duch E., Polskie prawo finansowe. Finanse publiczne, Wyd. Prawnicze PWN, Warszawa 2001, s. 132 – 137.

applied in the case of realization of joint projects. It was the European Commission[3] that was held responsible for the supervision of the development of the budget situation in the EU countries and for undertaking proper action in case an excessive budget deficit occurs in them.

According to the Stability and Growth Pact the observance of fiscal criteria of convergence from Maastricht is not only a condition for accepting an EU member state in the Economic and Monetary Union, but also it applies to all the countries after introduction of euro. In practice it means that first of all they shouldn't exceed the threshold value of budget deficit (3% of GDP), and in the period of economic growth they should be aiming at generating budget surplus in order to reduce the national debt. Not observing the budget discipline by an EU state results in initiating of multi-stage and complicated excessive deficit procedure. As part of that procedure the Council (ECOFIN) in entitled to summon a given country and make it undertake certain action in a defined period aiming at the reduction of its budget deficit. In the case of any country failing to accommodate itself to the Council's recommendations, it must be prepared for being imposed sanctions including being imposed by ECOFIN a fine of 0,2 – 0,5% GDP depending on the level of budget deficit. It must be emphasized, that the sanctions do not embrace the countries remaining beyond the euro zone, but in the case of them maintaining public finance deficit on the level higher than 3% GDP, they are in danger of losing part of remedial means from the EU funds.

In 2005 there were modifications made to the Stability and Growth Pact, meaning in fact obscuring its function in the range of keeping budget discipline in the Euroland countries. It was about accepting of more flexible interpretation of excessive budget deficit and introduction of softer rules of restoring an allowed deficit level in the case of European Commission recognizing it as excessive. There were allowed many exceptions to the rule that the deficit should not exceed 3% GDP. What was considered a special case were as follows: transitional deficit, fall of real GDP in a given country by over 0,75%, occurrence of stagnation over a longer period or low economic growth. If already basing on the report of European Commission, ECOFIN recognizes a budget deficit in a given country as an excessive one, it may then recommend taking action by the government in order to reduce it. It was considered a desirable solution to make the structural budget deficit every year reduced in the annual scale by at least 0,5% GDP[4].

Subsequent changes concerning the procedure of excessive budget deficit were introduced by the Treaty of Lisbon through increasing the competence of European Commission in this field. Once it recognizes that such a situation is

---

[3] See: Oręziak L., Finanse Unii Europejskiej, Wyd. Naukowe PWN, Warszawa 2004, s. 46–53.

[4] ECOFIN (2005): Specifications on the implementations of the Stability and Growth Pact. ECOFIN – Dokument. 11. October 2005, Brüsel.

highly likely in the near future, then it directs its opinion not only to the European Council (ECOFIN), but also to the country concerned. The decision of the Council recognizing the occurrence of excessive deficit in a given country must also be preceded by a proper motion of European Commission. The same system was introduced in the range of taking further decisions, including those concerning imposing of sanctions referring to a country embraced already with the procedure of excessive deficit[5].

3. Increase of budget deficit and national debt in the EU countries

When creating the concept of functioning of Economic and Monetary Union it was assumed that all the member states should observe the agreed fiscal criteria of convergence. Before the introduction of EMU in 1999, the countries interested in belonging to the euro zone took intensive action in order to fulfill those criteria. When shaping the first group of Euroland in 1998 what was considered was the state of public finance of EU countries in 1997. Two countries were evaluated positively – Spain and Portugal, which had the budget deficit exceeding 3% GDP, and for political reasons also Belgium and Italy, where the relation of national debt to GDP was in double excess over the referential value of 60% GDP (see: table 3).

Table 3. State of public finance of candidate countries to the euro zone in 1997

Country	Budget balance in % GDP	National debt in % GDP
Belgium	–2,0	124,8
Germany	–2,7	61,0
Greece	–4,0	108,2
Spain	–3,2	66,6
France	–3,0	59,3
Ireland	–1,4	65,0
Italy	–2,7	120,2
Luxemburg	–3,2	6,1
The Netherlands	–1,1	69,9
Austria	–2,0	64,7
Portugal	–3,6	59,1
Finland	–1,3	54,0
Euro zone	–2,6	75,4

Source: Statistical Annex of European Economy, SPRING 2003, European Commission, ECOFIN/156/2003.

[5] See: Traktat Lizboński. Główne reformy ustrojowe Unii Europejskiej, red. J. Barcz, IKIEiP, Warszawa 2008, s. 223–226.

Table 4. Situation of public finance of EU countries in 2007–2009

Country	Balance of the budget in relation to GDP			National debt in relation to GDP		
	2007	2008	2009	2007	2008	2009
Belgium	–0,8	–1,2	–6,0	84,2	89,8	96,7
Bulgaria	0,1	1,8	–3,9	18,2	14,1	14,8
Czech Republic	–0,7	–2,7	–5,9	29,0	30,0	35,4
Denmark	4,8	3,4	–2,7	27,4	34,2	41,6
Germany	0,2	0,0	–3,3	65,0	66,0	73,2
Estonia	2,6	–2,7	–1,7	3,8	39,9	45,4
Ireland	0,1	–7,3	–14,3	25,0	43,3	64,0
Greece	–5,1	–7,7	–13,6	95,7	99,2	115,1
Spain	1,9	–4,1	–11,2	36,2	39,7	53,1
France	–2,7	–3,3	–7,5	63,8	67,5	77,6
Italy	–1,5	–2,7	–5,3	103,5	106,1	115,8
Cyprus	3,4	0,9	–6,1	58,3	48,4	56,2
Latvia	–0,3	–4,1	–9,0	9,0	19,5	36,1
Lithuania	–1,0	–3,3	–8,9	16,9	15,6	29,3
Luxemburg	3,6	2,9	–0,7	6,7	13,7	14,5
Hungary	–0,5	–3,8	–4,9	65,9	72,9	78,3
Malta	–2,2	–4,5	–3,8	61,9	63,7	69,1
The Netherlands	0,2	0,7	–5,3	45,5	58,2	60,9
Austria	–0,4	–0,4	–3,4	59,5	62,6	66,5
Poland	–1,9	–3,7	–7,1	45,0	47,2	51,0
Portugal	–2,6	–2,8	–9,4	63,6	66,3	76,8
Romania	–2,5	–5,4	–8,3	12,6	13,3	23,7
Slovenia	0,0	–1,7	–5,5	23,4	22,6	35,9
Slovakia	–1,9	–2,3	–6,8	29,3	27,7	35,7
Finland	5,2	4,2	–2,2	35,2	34,2	44,0
Sweden	3,8	2,5	–0,5	40,8	38,3	42,3
Great Britain	–2,8	–4,9	–11,5	44,7	52,0	68,1
EU 27	–0,8	–2,3	–6,8	58,8	61,6	73,6

Source: Eurostat „Euroindikatoren" 55/2010, 22. April 2010.

While during the first two years of functioning of the euro zone, due to the favourable economic situation, there was an improvement in the state of public finance, then since 2001 the budgetary situation of all the member states (except for Luxemburg) began to worsen. In the years 2002–2003 there was initiated a procedure concerning the excessive budget deficit in Portugal, Germany and in France. In 2004–2007 there was observed an improvement of budget situation in the Euroland countries – the budget deficit calculated for the whole euro zone decreased from 3,0% to 0,6% GDP, and the national debt in that period fell from

75,8% to 70,9% GDP[6]. That favourable tendency was turned away in 2008 due to the explosion of the global economic and financial crisis. In many euro zone countries as well as in other EU states there was a real explosion of budget deficit and national debt. The reason for that was the already mentioned declined tax based revenues and a growth of public spending in the countries touched with economic recession due to the necessity of the state supporting the financial sector, higher expenditure for unemployment benefits and stimulating of investments and consumption. The budget deficit calculated for EU16 in relation to GDP rose from 0,6% in 2007 to 2% in 2008 and 6,3% in 2009, however for EU27 it rose from 0,8% in 2007 to 2,3% in 2008 and 6,8% in 2009. At the same time the national debt in the entire EU increased from 58,8% in 2007 to 61,6% in 2008 and 73,6% in 2009[7].

The situation in the range of public finance in EU countries was very diverse (see: table 4).

The consequence of the high deficit and national debt in particular EU countries is introducing the procedure of excessive deficit. Among the euro zone countries in the middle of 2010 it referred to 13 countries (see: table 5).

Table 5. Euro zone countries encompassed with the procedure of excessive budget deficit

Country	Budget deficit in 2009 (% GDP)	Beginning of public finance consolidation	Recommended annual reduction of deficit (% GDP)
Belgium	–6,0	2010	0,75
Germany	–3,3	2011	≥0,5
Ireland	–14,3	2010	2,0
Greece	–13,6	2010	≥3,5
Spain	11,2	2010	>1,5
France	–7,5	2010	>1,0
Italy	–5,3	2010	≥0,5
Malta	–3,8	2010	0,75
The Netherlands	–5,3	2011	0,75
Austria	–3,4	2010	0,75
Portugal	–9,4	2010	1,25
Slovenia	–5,5	2010	0,75
Slovakia	–6,8	2010	1,0

Source: DB Research, Schuldenbremsen für Euroland, EU – Monitor 74, 19.5.2010.

According to forecasts, further growth of budget deficit is inevitable in many EU countries. In the euro zone the national debt will reach the peak level in 2013 (90,9% GDP), and then it will be systematically decreasing to the level

[6] OECD Economic Outlook,No 86, November 2009
[7] Eurostat – „Euroindikatoren" 55/2010, 22 April 2010

of 60% in the year 2023. It is assumed that Euroland countries will be healing their public finance mainly through the budget expenditure. Until 2015 the public spending should not rise and after that time they will be rising by 1% more slowly than GDP[8].

4. New approach of EU countries to the reduction of budget deficit and the national debt

Keeping the budget deficit and national debt at the high level in the majority of Euroland countries and other EU states means that the regulations directed at providing stability of public finance contained in the Treaty of Maastricht and the Stability and Growth Pact failed. The costs of financing of budget deficit and service of national debt become for those countries more and more difficult to bear. Moreover financial markets do not accept the situation in the euro zone, in which there is one monetary policy realized by the European Central Bank and 16 national budget policies. If euro is meant to be stable and strengthen ist position on international markets, then what is inevitable is better coordination of budget policy at the European level, and in the future even its centralization.

The main instrument of financing of the budget sector deficit is issuing of government bonds. While before the crisis the span of interest rates of the bonds of euro zone countries did not exceed 0,3%, then in April 2010 it was 5%. Profitability of the government bonds reflects the credit risk and in the case of the states with a high risk it is remarkably higher than the profitability of German bonds treated as benchmark. In April 2010 interest rates of German bonds were 3,09% and Italian bonds 3,8%, Spanish ones 3,9%, Portugese 4,8%, and Greek over 8% (in the period of the height of their sales the profitability of 10-year Greek bonds exceeded 12%).

High costs of the service of the national debt speak for the necessity of its reduction. The examples of fiscal policy of Denmark and Ireland realized in 1980s indicate that it is possible. Due to a drastic saving programme (remmuneration cuts in the public sector, reduction of social expenditure) as well as raising taxes and health insurance fees, the Danish national debt decreased from 77% GDP in 1984 to 27% in 2007. However Ireland managed to lower the national debt from 120% in 1987 to 25% in 2007 due to reduction of budget spending and high dynamics of economic growth. However in the following years it rose again[9].

At the turn of 2009/2010 Greece found itself in a dramatic financial situation. The budget deficit grew to 13,6% GDP, and national debt reached 115%

[8] Heise M., Optionen für eine künftige Krisenprävention, „Die Bank“ 5/2010, s. 12

[9] See: Heise M., op. cit. s. 10 – 11.

GDP. The interest rates on the national debt themselves ate up as much as 11,2% of all state budget revenues in 2009, which was almost twice as much as is the average of the euro zone. The country faced loss of liquidity. The nosediving prices oft he Greek debt and rising costs of insurance against the country's insolvency not only cut Greece off from the inflow of finances from the financial market, but they also pulled down the quotations of government bonds of Spain, Ireland and Italy, threatening also with the loss of solvency of other countries from the PIIGS group, and even a split of the euro zone.

In such a situation, at the beginning of May 2010, the countries of Euroland and MFW decided to give Greece credits of total value 110 mld euro until the year 2012 for the reform of public finance. The decision actually means abandoning of the former rule that every country of the euro zone is itself responsible for its debts and cannot charge other countries with them. The remedial measures that Greece received were hedged with the country's fulfillment of drastic conditions in the field of public finance. The government had to agree to reduce the budget deficit until 2014 to the level below 3% GDP. In consequence the necessary step was to raise goods and services tax by 2% to 21% and also increasing the excise on spirits, cigarettes and petrol, additionally reduction of budget spending through reducing public sector remuneration and extending of the retirement age[10].

On 10th May 2010 finance ministers from Euroland countries, having considered difficult budget situation of Spain, Portugal, Ireland and Italy – countries facing loss of financial liquidity in the future, made a decision concerning initiating of liquidity mechanism of the value 750 mln €. The sum is constituted by borrowing fund of 60 mld € and guarantees of the euro zone countries to the sum of 440 mld euro as well as loans from MFW of total sum of 250 mld €. They announced to create a special purpose vehicle (SPV), which baising on the governments' guarantees shall deal with obtaining finances from the capital market on possible remedial action fort he countries requiring financial support. Parallelly in the case of a fall of profitability of bonds of a given country, ECB may take intervention in the capital market through their buy-out. That way, the Euroland countries prepared themselves to be able to repulse the attack on the stability of euro[11].

If the euro zone is meant to survive in the future, then there must be prepared a new Stability and Growth Pact. The currently binding Pact has become obscured in 2005 as a result of introducing a long list of exceptions to the application of the procedure of excessive budget deficit. According to Jürgen Stark, the main ECB economist, the first sanctions on the country failing to

[10] Internationaler Rettungsplan für Grichenland beschlossen, „ FAZ" z 3.05.2010

[11] Europa spannt gigantischen Rettungschirm über Währungszone,"Börsen – Zeitung", 11.05.2010.

observe the payment discipline should be introduced immediately after it exceeding 3% limit of the budget deficit. It should mean withholding of financing of certain EU projects. As long as the period of budget deficit is prolonged and extended, the sanctions should be stricter, depriving the given country of the right to vote in the European Union organs[12].

What is of significant meaning for the healing of public finance in the euro zone countries is the improvement of competitiveness of their economies through such operations as increase of innovation in macro- and micro-economic field, reduction of enterprises‘ social insurance fees, making job market flexible etc. There is also a call fort he introduction of legal restraints oft he increasing national debt in the Euroland countries, e.g. obliging EU member states to keep balanced budgets until 2016. The solution should be completed with transparent rules of public spending e.g. their increase should be 2% lower than GDP growth. It must be emphasized that Germany in 2009 entered a constitutional regulation, that from the year 2016 the country’s budget deficit should not exceed 0,35% GDP, and the union member states cannot take out any new loans from the year 2020 onwards. It is highly likely that other Euroland countries will accept similar legal solutions.

Eugeniusz Gostomski

(Summary)

The subject of this article is an attempt to find effective remedial measures to reduce problems concerning public finances in the European Union countries. As a result of the global financial crisis, budget deficit and national debt is boosting in these countries significantly. In most of them the fiscal requirements established by the Treaty of Maastricht and the Stability and Growth Pact are not obeyed. This situation shows that some decisive steps should be taken to inhibit further growth of public debt in the European Union countries.

---

[12] „Offene Flanke”. Inetrview mit Prof. Dr. Jürgen Stark, Chefvolkswirt der EZB „ Wirtschaftswoche“ 31.05.2010.