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EXTENT OF THE CRISIS AND POST-CRISIS CONSOLIDATION OF PUBLIC FINANCES IN GREECE, ITALY, BELGIUM AND PORTUGAL IN 2009 – 2018

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ABSTRACT

The subject of this paper is an analysis and evaluation of the consequences of the financial and economic crisis in 2008-2009 for the public finances in the euro area members which in 1998 (during the qualification to the common currency area) had not fulfilled the treaty criterion of public debt. Their debt ratio to GDP was close to or surpassed 100%. This pertained to: Belgium, Greece and Italy. The research also covers Portugal as after the introduction of the euro and since the recession of 2001-2003 the country also surpassed the allowed government deficit threshold and had an increasing ratio of public debt. The evaluation includes the effects of post-crisis public finance consolidation in the aforementioned countries. The basis of the assessment is the budget deficit and debt in 2009-2019 and comparison of consolidation paths of selected countries with scenarios of diminishing public debt constructed by Ad van Riet in 2010. The analysis allowed to draw a conclusion that the largest cost of the crisis in the form of declining GDP and growing public debt occurred in: Greece, Portugal and Italy. Confrontation of the chose paths of diminishing debt with the scenarios of public finance consolidation constructed by Ad van Riet in 2010 led to the following conclusions: 1) the path in Belgium was close to the moderate scenario (blue), 2) the paths in Greece and Italy were partly similar to the pessimistic scenario (red), except since 2016 their debt ceased to grow and even slightly declines and the scenario foresaw an increase of debt until 2030. 3) the Portuguese path does not fit any of the three scenarios, the peak of the debt was in 2014 and since than it has been declining, but slower than foreseen in the moderate scenario.

keywords: crisis of 2008-2009, euro area, Southern countries, collapse of public finances, consolidation.

INTRODUCTION

Public finance stabilization was a priority criterion within the creation of the common currency area in the European Union. Its fulfillment was a big obstacle for many candidate countries to the Economic and Monetary Union after the time of expansive budget policy in the 1980s. As a result of signing the Maastricht Treaty (1992) and undertaking the preparations to the introduction of the common currency, EU countries significantly diminished their budget deficits, in particular after 1995. If in 1992-1998 a nominal ratio of government deficit was on average around 5% of GDP in the euro area countries, in 1998 it dropped to a little over 2% of GDP [2]. The situation in this respect was varied among the countries. The highest deficit occurred in Greece -4,3% of GDP, Spain - 3,1% of GDP, Portugal - 3% of GDP and Italy - 2,8% of GDP [4].

Nevertheless, the deficit was not the main problem with the fulfillment of the EMU criteria - it was government debt. According to the Maastricht Treaty budgetary criteria were: 3% of GDP in the case of deficit and 60% of GDP in the case of debt. Two basic factors shaped the budgetary situation of the EU members - GDP growth rates and budget discipline. In this respect, countries can be divided into two groups: 1) countries with budget balance or just a slight deficit and fulfilling the debt criterion or with just a small overstep, 2) countries suffering from difficulties with maintaining the stable budget balance and exceeding the allowed debt threshold almost twofold. The second group included: Greece, Italy and Belgium. Portugal initially fulfilled the public debt criterion but after the 2001-2003 recession its economic and budgetary conditions worsened. From 2001 until the crisis of 2008-2009 Portugal had not regained the ability of economic growth and was continuously covered under the excessive deficit procedure. The country realized expansionary budget policy since the 1970s. Budget deficit was declined in 1986 -1989 form 5% of GDP to 3% of GDP [5]. During the first half of the 1990s budgetary situation of Portugal worsened again mostly due to the economic slowdown, decline in public income and an increase in public expenditure. On the other hand, in 1996-1998 budget policy was focused on the fulfillment of the treaty EMU criteria and as a result of intensive adjustment processes Portugal managed to join the euro area. However, the attributes and structure of the economy were the reflection of the vast technological gap and low competitiveness of trade in industrial products as a result of domination of traditional sectors and low labour productivity. In 2004-2006 (after the 2001-2003 recession) the worst budgetary situation in the euro area occurred in Greece, Portugal and Italy. Average deficit in the euro area ranged between 2,9% of GDP (2004) and 1,4% of GDP (2006) [3]. Against this backdrop the three countries appeared particularly adversely: Greece with 7,5% of GDP (2004) and 5,7% of GDP (2006), Portugal - from 3,4% of GDP (2004) and 4,1% of GDP (2006) and Italy - from 3,5% of GPD (2004) and 3,4 % of GDP (2006) [3]. Italy and Portugal managed to temporarily decrease the deficit (2007-2008), but in the case of Greece after the decline of 2,3 p.p. it began to climb dangerously and it reached 9,4% of GDP in 2008 [3].

The country with the highest public indebtedness at the time of the euro area accession was Belgium. In 1998 its public debt was 117% of GDP while in Italy it was 114,9% of GDP and in Greece - 112,4% of GDP. As a consequence, average public debt to GDP ratio for the euro area (12) was significantly higher than the treaty criterion and surpassed 73% of GDP [4]. In 1998-2007 budgetary situation within the reviewed group of countries changed, but only Belgium managed to make a great progress in consolidating its public finances bringing down its debt ratio to 84,2% of GDP in 2007 [3]. Italy and Greece were able to decrease their debt for a short period by around 10 p.p. In Portugal public debt kept growing since the 2001-2003 recession.

The goal of the paper is to present the budgetary consequences of the financial and economic crisis of 2008-2009 for the euro area countries with the worst public finance condition during the qualification to the EMU, in particular due to the public debt surpassing 100% of GDP as a consequence of expansionary budget policy. The evaluation also includes the effects of post-crisis public finance consolidation. The basis of the assessment is the budget deficit and debt in 2009-2019 and comparison of the consolidation paths of selected countries with the scenarios of diminishing public debt constructed by Ad van Riet in 2010 [10]. The countries under review are: Greece, Italy, Belgium and Portugal.

THE EXTENT OF THE CRISIS AND THE PUBLIC FINANCE CONSOLIDATION

Consequences of the last financial and economic crisis for the budgets of the countries under analysis were varied. In terms of the deficit increase - dramatic worsening of budget balance occurred in Greece and Portugal. Greek deficit in 2009 exceeded 15% of GDP and in Portugal it drew near 10% (tab. 3) Nevertheless, the extent of the public finance crisis was much more serious in Greece. Average annual deficit in 2009-2013 was 11,74% of GDP. In Portugal an initial increase in deficit to 11,2% in 2010 was followed by a considerable decrease in the subsequent three years though distorted by a substantial increase in 2014 when a decline in income and increase in public expenditure occurred (tab. 1). Impact of the crisis on the deterioration of the budget balance in Belgium and Italy was moderate, with an increase in deficit in 2009 to 5,4% of GDP and 5,2% of GDP respectively, they stood out in a positive light since the average budget deficit in the euro area was higher by around 1 p.p. Italy managed to reach the treaty criterion of budget deficit as early as 2012 and Belgium followed suit a year later (tab. 3). Seeking an answer to a question on the extent and consequences of the 2008-2009 crisis in Greece and Portugal, one needs to point out that they were a result of the very low (the lowest in the euro area) fiscal discipline and a weak competitiveness of exports that stemmed from the structural attributes of the economies. These were: low productivity, technological gap and increase in the real effective exchange rate after the introduction of the euro. Additionally, since 2000 Portugal suffered form long term economic slowdown. The research shows that Greece and Portugal used new credits to increase wages in the public sector. In 2000-2008 they grew by 80% in Greece and 30% in Portugal, while in Germany - only by 10%. In the same period, employment in the public sector in both countries increased by 16% and in Germany it decreased. Greece and Portugal experienced a consumption boom and the debt grew at a higher rate than GDP [9]. During the recession many industrial sectors collapsed in the Southern euro area countries, what weakened the opportunities for exports growth and an earlier economic revival. In Greece industrial production in 2013 was lower by 31% compared to its pre-crisis levels, in Spain - by 30%, Italy - 23% and Portugal - 11% [9].

The extent and consequences of the 2008-2009 crisis for the area of public finances can by evaluated based on the size of the deficit, but mostly based on the increase in the public debt. The condition of country's public finances remains under scrutiny of the financial markets that assess the credibility of the government bond issuers and the risk level. The analysis is focused in particular on the budgetary situation of countries with high deficits and considerable especially rapidly growing public debt. Prior to the crisis the divergence in interest rates of government debt securities was slight. At the end of 2008 the increasing divergence in the budgetary situation was accompanied by a growing spread of government bonds yields resulting from the increased risk of insolvency. Within the euro area the highest risk occurred in the case of: Greece, Portugal Italy, Belgium, Ireland and Spain [8]. The highest debt in Greece and Italy was registered in 2016 and it was 180,8% of GDP and 132% of GDP respectively. The third country in terms of the highest debt was Portugal - its peak level of indebtedness was 130,6% of GDP in 2014. The least serious consequences of the crisis pertained to Belgium (tab. 2). The public debt increased to 107% of GDP in 2014 and has been declining since. Among the countries that prior to the financial and economic crisis had balanced budgets and low debt it is worth pointing to those that suffered from such considerable collapse in their public finances that they landed in the group with highest risk of insolvency. These were Ireland and Spain. The cause for the rapid increase of budget deficit in Ireland up to over 30% of GDP in 2010 was the rescue aid for the financial sector. While in the case of Spain it was the result of a decrease in budget revenues due to the extended recession (until 2014) and an increase in public spending for rescuing the banking sector, boosting economic growth and social expenditure resulting from a high unemployment (surpassing 25%). Public debt growth in Ireland and Spain was very high compared to the situation before the 2008-2009 crisis (around 120% of GDP in Ireland and 100% of GDP in Spain) and that is why this change in the condition of their public finances was considered a crisis (tab. 2). The biggest budgetary problems occurred in those countries that had low economic growth rates, poor budget discipline, increase in employment and wages in the public sector, deindustrialization, consumption boom and a decline in exports competitiveness. These factors were particularly strong in Greece and Portugal.

The highest spread between budget revenue and expenditure occurred in Greece and was maintained until 2013. In Portugal a collapse of public finances as a result of a dramatic increase in public expenditure was less pronounced and since 2012 a gap between expenditure and revenue started to diminish. Public finance crisis in Greece was the most serious problem in the functioning of the euro area. Its extent was not only a threat to the country's economy but was perceived by the financial markets as a crisis for the entire euro area. Nevertheless, Greece was not the only country unable to refinance its public debt. Two more countries found themselves in need of aid - Portugal and Ireland. The crisis of the public finances in these three countries was contained with the financial aid of the European Union (*European Stability Mechanism* of the European Central Bank) and the International Monetary Fund.

In conclusion, the highest costs of the crisis were incurred by the Southern countries of the euro area, but the extent and course of the Greek crisis was significantly more dangerous than budgetary problems in Portugal, Italy or Spain. The deepening of the crisis in Greece occurred at the end of 2009 when the new government revealed the forgery of the statistical data committed by the former government officials and announced further increase in the deficit. This information contributed to the increase in the Greek government bond yield and an escape of capital. Greece was surrendering to the crisis, but it took six months and the tarnishment of the reputation of the entire euro area to convince the remaining countries to agree upon an aid package for Greece [6]. Amongst the analyzed countries, Belgium was in the best situation since it went through the crisis without a serious detriment to the budget balance and only slightly surpassed the treaty threshold for deficit as early as 2013 and an increase in debt was small. Detailed data on the condition of public finances in Greece, Italy, Belgium and Portugal as well as in the euro area were presented in tables 1 - 3 and figures 1-3.

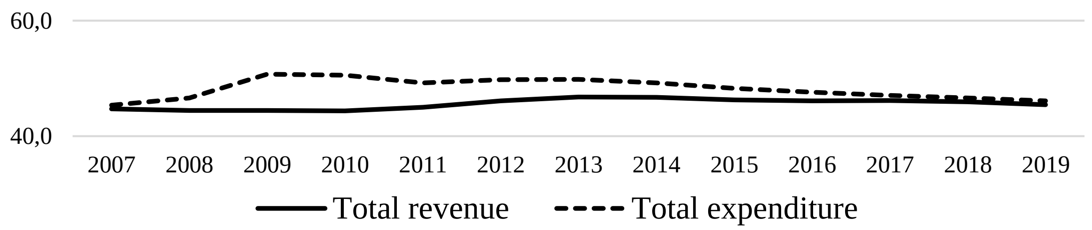

Figure 1. Total revenue and total expenditure (general government) in the euro area in 2007 – 2019 (% of GDP)

Source: [1]

Table 1. Total revenue and total expenditure (general government) in 2009 – 2019 (% of GDP)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Euro area											
Revenue	44,5	44,4	45,0	46,1	46,8	46,7	46,3	46,1	46,2	46,0	45,5
Expenditure	50,7	50,6	49,2	49,8	49,8	49,2	48,3	47,6	47,1	46,6	46,1
Greece											
Revenue	38,9	41,3	43,8	46,9	49,1	46,6	48,2	50,2	48,8	49,0	47,6
Expenditure	54,1	52,5	54,1	55,7	62,3	50,2	53,8	49,5	48,0	48,6	47,4
Italy											
Revenue	45,9	45,7	45,7	47,9	48,1	47,9	47,7	46,9	46,6	46,4	45,9
Expenditure	51,2	49,9	49,4	50,8	51,1	50,9	50,3	49,3	48,9	48,0	47,6
Belgium											
Revenue	48,8	49,3	50,3	51,6	52,7	52,1	51,3	50,8	51,2	50,7	50,4
Expenditure	54,2	53,3	54,5	55,9	55,8	55,2	53,8	53,2	52,2	51,8	51,8
Portugal											
Revenue	40,4	40,6	42,6	42,9	45,1	44,6	43,8	43,0	42,9	43,2	42,9
Expenditure	50,2	51,8	50,0	48,5	49,9	51,8	48,2	44,9	45,9	44,1	43,5

Source: [1]

Table 2. General government consolidated gross debt in 2009 – 2019 (% GDP)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Euro area	79,2	84,8	87,3	91,7	93,9	94,2	92,1	91,1	88,8	86,5	84,1
Greece	126,7	146,2	172,1	159,6	177,4	178,9	176,8	180,8	178,6	177,8	170,3
Italy	112,5	115,4	116,5	123,4	129,0	131,8	131,5	132,0	131,8	130,7	129,7
Belgium	99,5	99,7	102,6	104,3	105,5	107,0	106,1	105,9	103,1	101,5	100,2
Portugal	83,6	96,2	111,4	126,2	129,0	130,6	128,8	129,9	125,7	122,5	119,5

Source: [1]

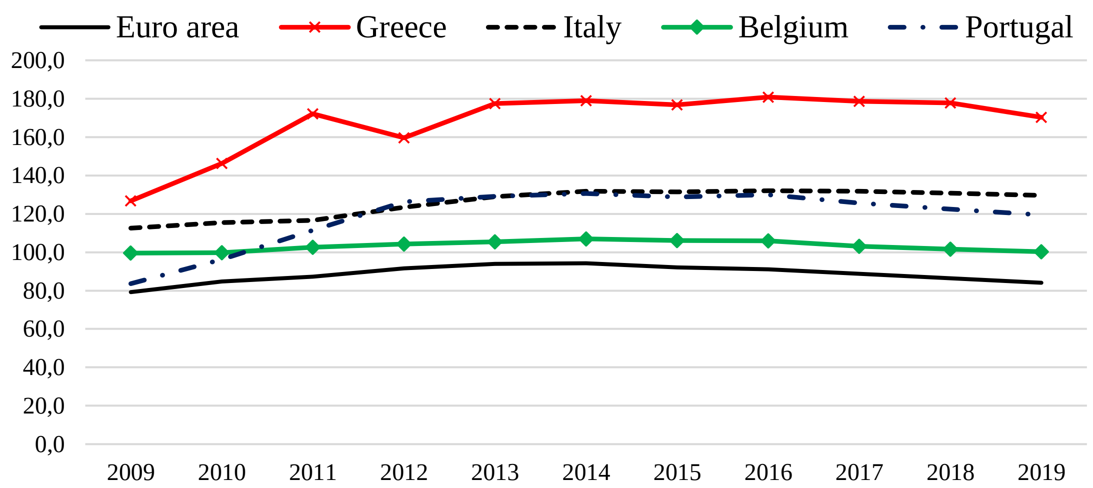

Figure 2. General government consolidated gross debt in 2009 – 2019 (% GDP)

Source: [1]

Table 3. Net lending (+) or net borrowing (-) in 2009 – 2019 (% GDP)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Euro area	-6,3	-6,2	-4,2	-3,7	-3,0	-2,5	-2,0	-1,5	-0,9	-0,7	-0,6
Greece	-15,1	-11,2	-10,3	-8,9	-13,2	-3,6	-5,7	0,6	0,8	0,4	0,2
Italy	-5,2	-4,2	-3,7	-2,9	-2,9	-3,0	-2,6	-2,5	-2,3	-1,7	-1,7
Belgium	-5,4	-4,0	-4,1	-4,2	-3,1	-3,1	-2,5	-2,5	-1,0	-1,1	-1,3
Portugal	-9,8	-11,2	-7,4	-5,7	-4,8	-7,2	-4,4	-2,0	-3,0	-0,9	-0,6

Source: [1]

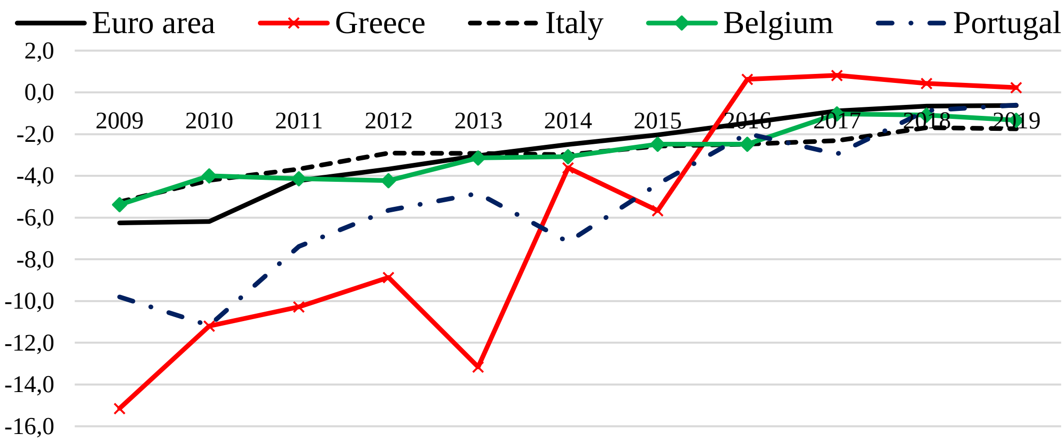

Figure 3. Net lending (+) or net borrowing (-) in 2009 – 2019 (% GDP)

Source: [1]

Evaluation of the post-crisis consolidation of public finances in the euro area reveals fairly satisfactory results. An average budget deficit in the euro area since 2013 has not exceeded 3% of GDP and public debt has been declining since 2015. From 2016 all four analyzed countries fulfill the treaty criterion of budget deficit. Figure 2 illustrates the size of Greece's debt compared to Belgium, Italy and Portugal. The second most indebted country was Italy and in 2014-2017 the debt to GDP ratio has not declined, in addition forecasts for 2018-2019 do not predict a marked debt reduction.

The basic condition for the improvement of the budgetary situation and the condition of public finances is economic growth. In Belgium it was GDP growth that contributed to the reduction of the deficit and public debt. In 2009-2013 an average GDP growth rate was 0,54% and in 2014-2017 it climbed to 1,49%. On the other hand, in 2009-2013 Greece, Italy and Portugal suffered from a declining GDP with average rates of -5,89% for Greece, Portugal -1,61% and Italy -1,55%. In 2014-2017 economic revival occurred in the European Union following two waves of recession. Average GDP growth rate for the EU-28 surpassed 2%, and for the analyzed countries the rates were as follows: Portugal 1,72%, Belgium 1,49%, Italy 0,88% and Greece 0,46% [7]. All the Southern countries (including the analyzed ones) suffered the biggest losses in GDP, but Greece and Italy registered the slowest economic growth then most of the EU countries during the period of economic recovery (2014-2017).

As a result of comparing the consolidation paths of selected countries with scenarios of diminishing public debt constructed by Ad van Riet in 2010 the following results were obtained: : 1) the path in Belgium was close to the moderate scenario (blue), 2) the path of Greece was partly similar to the pessimistic scenario (red) since the highest debt ratio occurred in 2016 and since then it started to decline and the scenario foresaw an increase of debt until 2030, 3) the path of Italy was also close to the pessimistic scenario, except since 2016 their debt ceased to grow and even slightly declined and the scenario foresaw an increase of debt until 2030, 4) the Portuguese path does not fit any of the three scenarios, the peak of the debt was in 2014 and since than it has been declining, but slower than foreseen in the blue scenario.

CONCLUSION

The analysis carried out in the paper revealed that joining of the monetary union by the countries characterized by a large economic gap towards hard-core countries and what's more countries suffering from many years of problems with maintaining budget balance and public debt exceeding 100% of GDP resulted in a severe structural shock and a collapse of public finances during the financial and economic crisis. Stabilization of public finances required financial support from the European Union and the International Monetary Fund, but foremost restraint in public expenditure and the cuts in social benefits. The case of Belgium shows that extensive public debt in a highly developed and competitive economy does not constitute such a threat as in the case of less developed economies with an extensive sector of public services supplemented by a growing employment and wages in that sector. Greece and Portugal can be considered classic examples of the second type of economies. They did not bear responsibility for the lack of budget discipline and the sanctions envisioned in the Maastricht Treaty were not imposed on them. Italian economy has both the attributes of the highly developed country as well as less developed, however it does not match the hard-core countries in terms of technology, labour productivity and economic growth rates, but it is mostly perceived as permanently indebted. Since the second wave of the crisis in the euro area (2012) public debt has increased remaining thereafter at a high level. Due to the deep recession and lack of considerable economic revival until 2014 the largest losses in terms of GDP - also due to the most extensive debt crisis - were suffered by Greece, Portugal and Italy.

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