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FROM THE RULES OF STABILITY AND GROWTH PACT AT SIX – PACK: FINANCIAL CERTAINTY

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Abstract

The world economic and financial crisis has shown that, within the European Union as well as the rest of the world, the situation of public finance is not stable even in the presence of a certain level of fiscal and budgetary coordination.

Under these circumstances, even if the Lisbon Strategy would have been adopted at European level and an attempt to reach the established targets would have been put into practice after 2007, the year the crisis began, the necessity for starting new European projects which would lead to a better financial coordination and governing of the 27 EU states was acknowledged. If the Lisbon strategy planned for the EU to become the most competitive and dynamic knowledge-based economy by 2010, the slowdown of the economic growth, the increase in unemployment and public finance and banking issues have determined, after 2008, measures that would result in the economic recovery of European states.

Starting from the actual situation, the present work wishes to highlight the position of public finance in EU countries, in the context of budgetary problems which interfered with the settlement of the stability and growth accord after 2007. In this context, this work will emphasize the causes that led to the improvement and revision of certain key-elements of the PSC, and also the consequences of their implementation.

1. INTRODUCTION

The Lisbon Strategy, adopted in 2000 and renewed in 2005, had the following main strategic objective: to transform the European Area into the world's most competitive area. This was not accomplished, mostly because of the economic crisis that had a major impact on all the states of the world and especially on certain European economies (Greece), which in turn affected the results of all European states.

The instability of financial markets, the alarming increase in unemployment, the instability of prices and implicitly inflation, all lead to the necessity of adopting urgent measures for the economic recovery of the 27 European states. Considering the world situation, the EU Strategy 2020 establishes its central objective: turning the EU economy into a durable economy, favorable for inclusion so that the workforce can register higher levels of occupation, productivity and social cohesion (CE, 2010).

Reaching these objectives is not possible unless the economic activity and position of public finance improve, while subjecting themselves to the limits established by new corresponding European regulations. The European states, although still confronting with major public deficit problems, with a high debt rate, with speculative attacks on the national currencies and financial markets, must improve their budget situation. In this context, budget regulations needed to be reorganized and updated so that, at European level, new regulations appeared, in an attempt to solve the economic and budget crisis of member states.

2. THE NEED FOR EUROPEAN RULES ON PUBLIC FINANCE

Along with the downfall of the Iron Curtain, the liberalization of capital circulation and people and the need for common European finance regulations appears. The Maastricht Treaty and later the Stability and Growth Pact have tried to develop an optimum frame for fiscal, budgetary and monetary politics.

During the first years of the European Monetary Union, the frame for fiscal politics stipulated in the Stability and Growth Pact was the subject of many critics. Although the pact was meant to favorize an environment of discipline, coordination and stability at European level, its constraints became limitations for some countries and represented challenges for the macroeconomical stability (Alesino & al, 2013).

The Stability and Growth Pact was applied in an economically favorable period, marked by economic growth. The divergences began to manifest between countries where the economic growth was consistent but accompanied by deficit growth (Greece, Ireland) and the developed countries that emphasize the increase of competitivity and internal demand (Austria, Germany, Holland).

Generally, the SGP is listed in the general coordination frame for economic politics, as stipulated in the Rome Treaty (art. 99), the actual article 121 from the Treaty on the Functioning of the European Union, the consolidated version of 2012. The SGP logic starts from the premises that if the politics of a EU member state side-slips, the risk that this would affect the European economy is very high.

Initially, the SGP provisions referred to the fact that a European state had to limit its budget deficit to a maximum of 3% of the GDP and its debt rate to 60% of the GDP.

The Stability and Growth Pact offers the possibility to sanction any member state who does not take adequate measures in order to prevent and eliminate excessive deficit. The sanctions could have been applied as a deposit without interest, constituted within the European Union and that can transform into a fine if the respective state does not revise its budget politics.

Even with all these provisions, the shortcomings of the SGP have been considered important, some economists stating that the 3% deficit limit does not make sense it a time of economic decline because, in this case, the state will try to compensate the decreasing demand by increasing the deficit (Mathieu & Sterdyniak, 2003). Also, they considered that other data concerning competitivity, private debt and even evolution of the real estate market were being discarded.

Practically, these SGP provisions created tension between EU member states, because some refused to use restrictive politics in order to respect the specified limits for debt and deficit, which would affect economic

development, unemployment and internal demand.

The SGP reform of 2005 did not succeed in solving budget problems, but did increase the flexibility of regulations (the excessive deficit procedure will not be launched against a member state confronted with a negative economic growth, or a prolonged period of reduced growth, the member states can have a temporary deficit of over 3% of the GDP if they can justify, the excess deficit with relevant arguments, in order to correct excessive deficits the member states have 2 years, at their disposition etc.) as an ex-post response to France and Germany breaking the SGP, and reinforcing the arguments of these two countries for breaking the pact. In figure 1, we present the evolution of the modifications of European provisions concerning public finance.

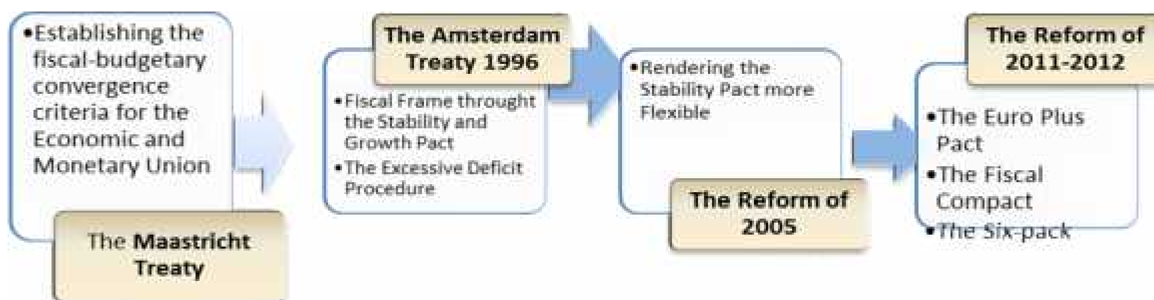

Figure 1 European modifications concerning finances between1992-2012
Source: (European Commission)

Because of the fragile banking system, great budget deficits and increasing public debt (figure 2), the SGP is once again reformed. The period of 2005-2009 lead to an increase in public debt of aprox. 25% in the euro zone, while the EU experienced a global increase of 12.7%.

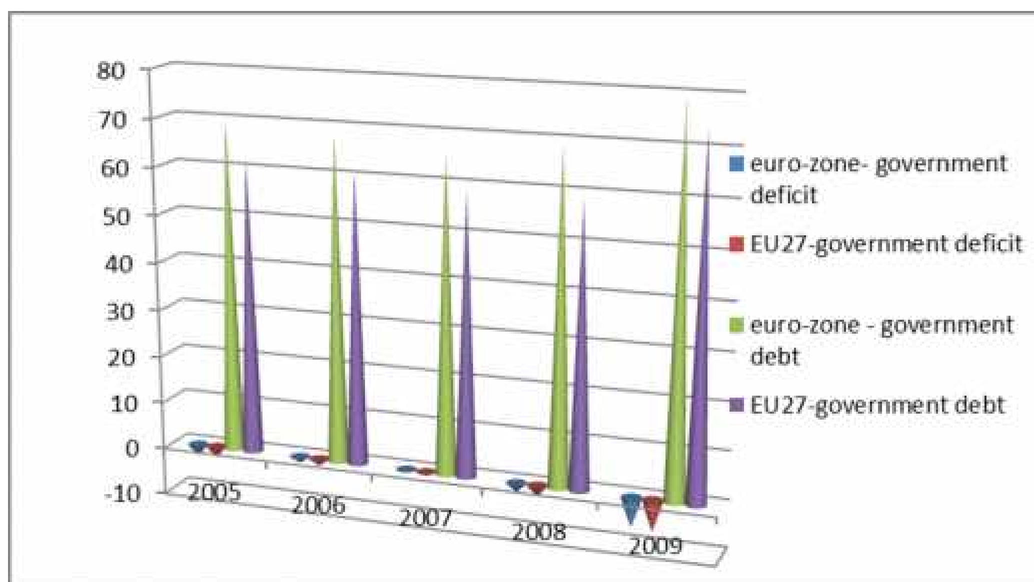

Figure 2 Evolution of the public debt/GDP and deficit/GDP percentage in the euro zone and UE 27 between 2005-2009(Source: Eurostat data processing)

In the Euro Zone, the highest debt rates were registered in Greece and Italy (between 2005-2009). In 2009 Greece registered a debt rate exceeding twice the limit imposed by the

SGP, respectively 126.8%, while Italy was at 116%. Overall, out of the 27 EU countries, 12 had a debt higher than 60% in 2009.

Regarding the deficit from the same period, no country registered surpluses, but 11 countries went over the 3% limit (largest values were registered in Greece 15.4%, Ireland 14,4%, Great Britain 11,4%, Spain 11,1%, Latvia 10,2%). Overall, in 2009 25 european states registered a degradation of public finance and two an improvement, compared to 2008.

In this context, European Comission presents an ensemble of 6 directives known as SIX-PACK, with the purpose of improving the coordination of economic and budgetary politics in the european space, by introducing a surveillance mechanism for the macroeconomical imbalances, so that if major macroeconomical imbalances arise, sanctions can be applied as fines between 0,1% and 0,3% of the GDP.

The Euro Plus Pact is a political document, having the following objectives: to stimulate competitivity and the job market, to sustain public finance and impose fiscal stability, while member states establish their own measures for reaching these objectives.

The Treaty on Stability, Coordination and Governance brings new rules regarding discipline in the EU, establishing that national budgets need to be balanced or overflowing, a criterium that will be respected if the structural budget deficit does not exceed 0,5% of the nominal GDP. This rule, considered golden, needs to be included in the state legislation one year before the treaty becomes effective.

3. THE EVOLUTION OF PUBLIC FINANCE IN EU STATES BEFORE AND AFTER THE CHANGE EUROPEAN RULES

The period between 2008-2011 was marked by numerous european legistation modifications, the government's attempts to stabilize economies, an increase in unemployment and economic recession. Concerning EU countries, the indicators tracked by the SGP and the new fiscal compact, namely the public debt/GDP and public deficit/GDP percentages had the following evolution (figures 3 and 4):

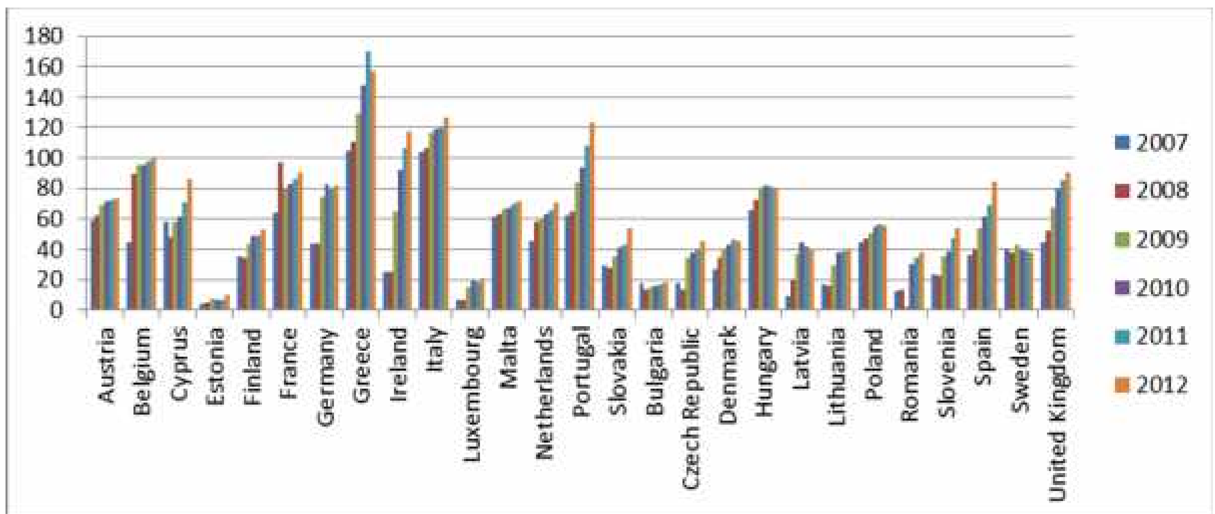

Figure 3 Public debt as percentage of the Gross Domestic Product (GPD) in the European Union,2007-2012
(Source: Eurostat data processing)

We see that, in the European Union, the public debt/ GDP ratio increased from 62,3% in 2008 to 82.3% in 2012, and in the euro zone from 70% to 87,9% in 2011. Therefore, although the SGP provisions for 2005 relaxed, they did not reach the desidered result, since an attempt was made to stabilize public debt, not decrease it.

Public debt increased between 2008-2011, the greatest values having been registered in Greece, Italy, Portugal and Belgium.

According to the European comission, public debt is expected to reach 88,7% of the

GPD in the euro zone at the end of 2012, unlike in the EU, where the same percentage is expected to reach 83,3% . On a short term there is still a risk of increase of public debt in the case of public interventions in the financial sector (CE, 2011).

Although together with 2011 come new european rules concerning public finance, we cannot say that they had the expected result. We say this because Greece's debt continues to increase (170.3% in 2011, respectively 156.9% in 2012), since 2008. Italy's debt also increases drastically, from 106.3% in 2008 to 127% in 2012. Concerning the deficit, the highest value was recorded in 2010 in Ireland (31.2 % of the GDP).

According to the data in figure 4, public debt has exceeded 3% of the GDP in 22 EU member states in 2012, and in 18 in 2011. Exceeding the 3% threshold has been considered when activating the Excessive Deficit Procedure.

Between 2007-2009, the mean budget deficit increased from 0.7% to 6.3% of the GDP in the euro zone and from 0.9% to 6.8% of the GDP withing the European Union, caused half by automatic stabilizeres and also by temporary measures for sustaining automatic stabilizers, and politics applied during the crisis.

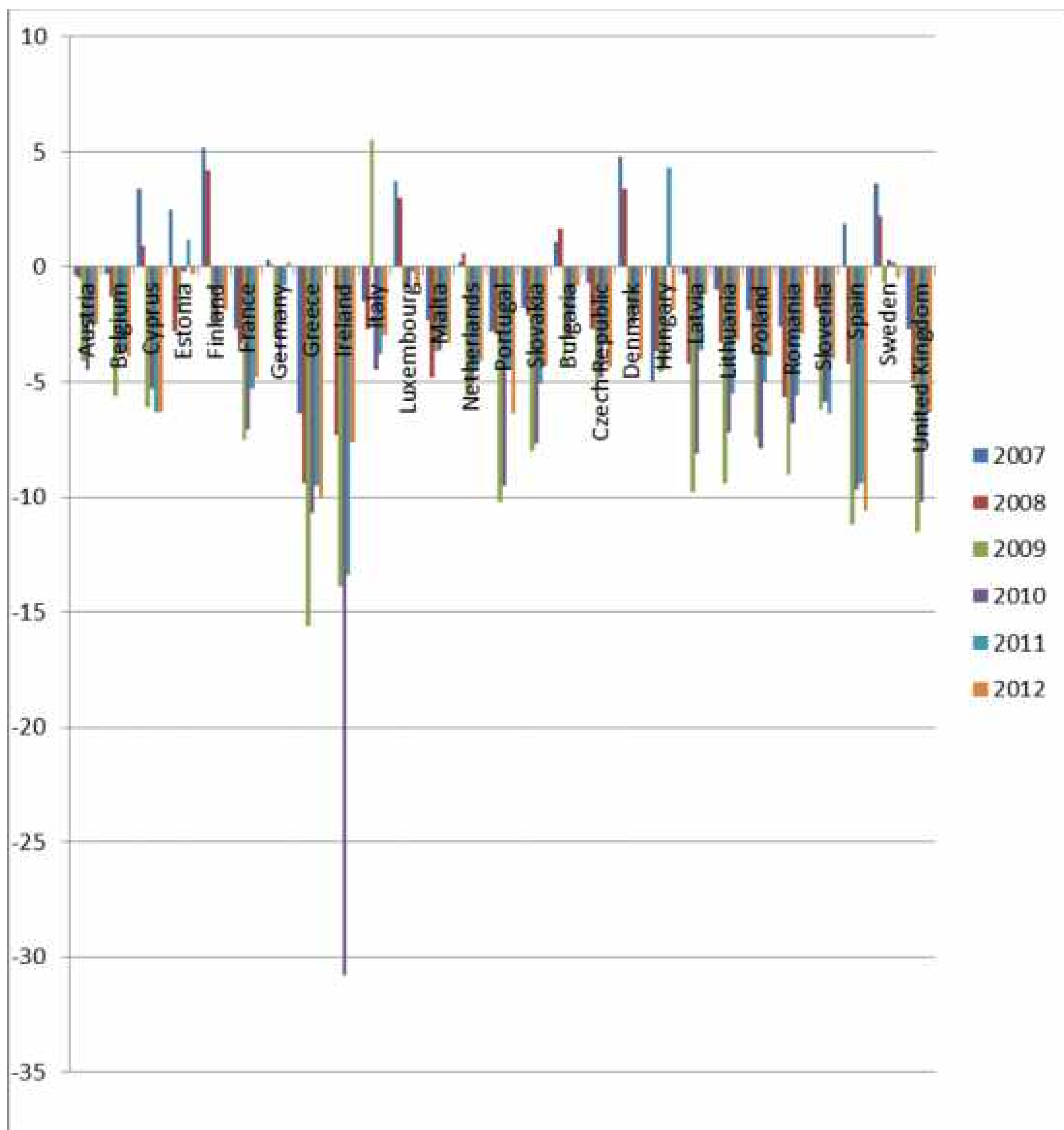

Figure 4 Evolution of the deficit/surplus percentage in the EU, between 2008-2011 (Source: eurostat data processing)

2012 brought no major changes compared to 2011, since Germany alone has registered a surplus (0.2% of the GDP) while 17 states go over the 3% limit (Spain : 10.65%, Estonia : -0.3%). Compared to 2011, in 2012 13 european states have improved their deficit, 12 have increased it, while 2 remained stable.

CONCLUSIONS

The European states reached an unmatched degree of development in the 55 years since signing the Treaty of Rome, by creating a model of economic, social and politic collaboration.

Together with the benefits came also problems and challenges, especially after 2007, when the need for a more strict European frame that would ensure the European space's financial sustainability was at its strongest.

Although, at European level, the Pact for Growth and Stability imposed specific criteria for the evaluation of the fiscal-budget health of member states, but also sanctions for severe imbalances, they did not yield the expected results out of numerous reasons among which: the bureaucratic process, the lack of political will of member states and the inefficient fiscal measures.

The corrective component materialized by the Excessive Deficit Procedure has become a simple formality in the first few years of the Euro currency. The influent states could not be sanctioned, thus bringing great disservice to the fiscal frame for the entire European Union, with major influences in the year of economic recession.

The Flexibilization of the Pact in 2005 has satisfied the European economic powers, like Germany, France and Italy, for the moment, but has also encouraged excessive budget deficits in many of the Euro Zone countries (Ireland, Greece, Spain). The long periods of surveillance and applying sanctions have diminished the legal and economic effects of the Excessive Deficit Procedure to such an extent that some countries maintained such a procedure active for 4, 5 or even 6 years.

In conclusion, the present regulations for sustainability in public finance are necessary for a sustainable development of the European Union, but must adapt better and faster to the macroeconomical conditions specific to each of the member states, through new evaluation instruments, analysis and proposed sanctions.

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