CENTRAL EUROPEAN REVIEW
OF ECONOMICS & FINANCE
Vol. 13, No. 3(2016), pp. 29–40

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THE PROBLEM OF GENERAL GOVERNMENT DEBT IN PIIGS GROUP COUNTRIES WITH THE SPECIAL ATTENTION PAID TO GREECE

Abstract

Commenced by the subprime mortgage crisis in US in August 2007, the global economic crisis led up to the deterioration of public finances in many European countries. The countries which suffered most from it were: Portugal, Ireland, Italy, Greece and Spain, which are jointly referred to as PIIGS group. Despite the fact that it is already 8 years that have passed from the onset of the crisis, the problem is still unresolved and there is the rumour of the critical situation of Greek economy.

The aim of this paper is to present the factors which contributed to the critical situation of PIIGS countries as well as to present the scale of the phenomenon and the attempts made to fight that crisis. The special attention was paid to the problem of public debt in Greece.

JEL Classification Codes: **G010**.

Keywords: public finance crisis, general government debt, Greece, PIIGS.

Introduction

The collapse of the mortgage market caused by the bursting of speculative bubble on the property market in U.S.A in August 2007 initiated the world economic crisis. It is commonly considered as the greatest recession since the times of Great Depression within 1929–1933.

The countries that were exceptionally strongly affected are Portugal, Ireland, Italy, Greece and Spain. Recently and with respect to the world financial crisis, the conventional term PIGS was coined, the term referring to the countries with difficult budget situations and high public debts. The term is an acronym whose

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successive letters are the initial letters of the names of the countries burdened most with the afore-mentioned problems (that is, P standing for Portugal, I for Ireland, G for Greece and S for Spain). A bit later, Italy joined the group and the acronym itself was extended into PIIGS.

The aim of this paper is to present the factors which contributed to the critical situation of PIIGS countries as well as to present the scale of the phenomenon and the attempts made to fight that crisis. The special attention was paid to the problem of public debt in Greece. To attain the presented goals, in this paper the comparative descriptive analysis was used.

1. Essence of public debt

In the professional literature, there are multiple definitions of public debt to be found (public or government or national debt), also known as government or national debt. According to the most succinct student-book definitions, public debt refers to financial liabilities of public authorities related to the loans taken (Owsiak 2005, p. 330). Other sources claim that public debt encompasses all the liabilities incurred by the Treasury, national earmarked funds having legal personality and by municipalities (Misiąg 1996, p. 31).

The definition of public debt sensu largo is to be found in the supplementary documents to the Treatise of Maastricht. According to the afore-mentioned definition, public debt means „the totality of liabilities of the Treasury to national and foreign entities related to loans taken in financial institutions and directly from the governments of member countries of Paris Club or these which were guaranteed or insured by the governments or their agendas as well as remaining-to-be-purchased treasury securities issued onto the foreign and national market and other registered liabilities of the Treasury" (Górniewicz 2012, p. 10).

The economical literature at large, particularly that on public finances, distinguishes a series of kinds of public debt. However, using the term „classifications" does not appear entirely justifiable. Perhaps from the point of view of methodology, at least equally proper is the use at that point the term „debt structures".

Assuming the criterion of the place of origin of creditors, one can distinguish the national and foreign debt. The former, also referred to as internal debt, encompasses the debt in relations to local entities, resulting mainly from treasury bonds still due to be redeemed. On the other hand, foreign debt (external debt) stems from the loans taken from international organizations, governments, banks and from the treasury bonds sold abroad.

Furthermore, professional literature also distinguish the following kinds of debt:
1) gross and net (gross net – receivables),

2) short-term debt also referred to as liquid debt (up to one year) and long-term debt also referred to as funded debt (more than one year),
3) nominal and real (taking inflation into consideration),
4) central (national) and local (local-governmental),
5) voluntary and compulsory debt (Górniewicz 2013, p. 24).

In developed and moderately developed countries with respect to their economies, public debt is a common phenomenon and it has been in effect for dozens of years. Despite the fact that the economic situation of these countries is different, it can be said that public debt has become the constant constituent of their public finances. The accumulation of public debt was the reason for much criticism expressed not only by economists but also by politicians. For these reasons it is worth acquainting oneself with the fundamental causes of indebtedness of particular countries.

The professional literature generally distinguishes the causes of the emergence of public debt:
1) long-standing budget deficit;
2) the period of increased public spendings (particularly periods of wars and deep economic crises);
3) the implemented economic doctrine which can consciously assume the long-standing budget deficit and public debt as tools of state interventionism;
4) the implementation of political goals of the ruling elite which does not decide on increasing the taxes and neither does it cut spendings (the theoretical justification of such a policy is public debt-neutrality thesis for both the economy and the society as such. If one assumes that thesis is correct, then it is more advantageous for the government to take new loans than to impose new taxes).
5) public authorities falling for the so-called debt trap (losing the ability of the due repayment of debt) (Owsiak 2005, p. 337).

A particularly important reason for the emergence of public debt seems to be budget deficit, being mentioned at the beginning. The elementary relation between debt and the state of budget is reflected in the following formula:

$$d = d_0 + r \cdot b$$

where:

d – the balance of government budget – conventionally conceived – in relations to national gross product.

d_0 – primary deficit or budget surplus (without the expenses for debt service) in relation to national gross product,

r – average interest rate in the public debt service

b – the level of public debt in relations to national gross product (Gotz-Kozierkiewicz 1994, p. 57).

The analysis of primary balance in the government budget is becoming the issue of utmost importance, the analysis of which sheds some light on its balancing. Primary balance provides an answer to the question how the equilibrium in the government budget would be shaped if there were no public debt and thus there would not be any necessity for its service. It also serves as basis for determining if the amount of debt does not threaten the budget solvency (Wernik 2001, p. 10).

The emergence of negative primary balance means exceeding safety threshold with respect to debt. On the other hand, the increasing primary surplus under the condition of total deficit means approaching balancing budget, which takes place at the moment of the equilibrium between the primary surplus and the expenses for debt service. It is to be emphasized that relatively high public debt does not directly threaten the solvency of the government budget if there is primary surplus in the budget (Ciak, Górniewicz 2002, pp. 97–98).

2. General government debt in PIIGS

The biggest general government debt among the analyzed countries could definitely be attributed to Italy. At the end of 2014, its amount surpassed 2.1 trillion Euros (see table 1). The close second was Spain with its debt amounting to one billion Euros. The third was Greece (over 317 billion Euros), fourth Portugal (225 billion Euros), fifth Ireland (less than 203 billion Euros). It is noteworthy that within 7 years the amount of Ireland general government debt it has grown four times.

Table 1. General government gross debt in billions euro

Years	Portugal	Ireland	Italy	Greece	Spain
2007	120.1	47.1	1605.9	237.5	383.8
2008	128.2	79.6	1671.1	261.6	439.7
2009	146.7	104.6	1769.7	298.7	568.7
2010	173.1	144.2	1851.2	321.6	649.2
2011	195.7	190.1	1907.5	355.9	743.5
2012	211.8	210.2	1988.9	304.7	890.9
2013	219.6	215.3	2068.7	319.2	966.2
2014	225.3	203.3	2134.9	317.1	1033.8

Source: my own work on the basis of the data by Eurostat http://ec.europa.eu/eurostat/tgm/refreshTableAction.do?tab=table&plugin=1&pcode=teina225&language=en (access 08.06.2015)

The debt of a given country is not merely confirmed by its amount, but more importantly by its relation to the worth of gross national product (GNP). In period 2007–2014 what went worse was the ratio between general government gross debt to gross domestic product (for details look table 2). The increase of this ratio in Ireland was almost 5 times (4.6), in 2.7 in Spain and 1.9 in Portugal. The smallest increase was recorded in Italy (1.3) and, interestingly enough, in Greece (1.7). However, the worst index at the end of the 2014 year was recorded in Greece (177.1%). In each country the index definitely exceeded level established in Maastricht Treaty (60% GNP).

Table 2. General government gross debt in % GNP

Years	Portugal	Ireland	Italy	Greece	Spain
2007	68.4	24.0	99.7	105.8	35.5
2008	71.7	42.6	102.3	110.7	39.4
2009	83.6	62.3	112.5	127.1	52.7
2010	96.2	87.4	115.3	142.8	60.1
2011	111.1	111.2	116.4	171.3	69.2
2012	125.8	121.7	123.1	156.9	84.4
2013	129.7	123.2	128.5	175.0	92.1
2014	130.2	109.7	132.1	177.1	97.7

Source: my own work on the basis of the data by Eurostat http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=teina225&plugin=1 (access 08.06.2015).

The primary reason for getting into debt is the occurrence of budget deficit. It is to be emphasized that budget deficits have recently been the constant phenomena in the countries in European Union. Maastricht Treaty stipulated that the relation of budget deficit to the worth of national gross product cannot surpass 3% GNP.

Table 3. Budget deficit in % GNP

Years	Portugal	Ireland	Italy	Greece	Spain
2007	–3	0.3	–1.5	–6.5	2
2008	–3.8	–7	–2.7	–9.8	–4.4
2009	–9.8	–13.9	–5.3	–15.7	–11
2010	–11.2	–32.5	–4.2	–11.1	–9.4
2011	–7.4	–12.7	–3.5	–10.2	–9.4
2012	–5.6	–8.1	–3	–8.7	–10.3
2013	–4.8	–5.8	–2.9	–12.3	–6.8
2014	–4.5	–4.1	–3.5	–3.5	–5.8

Source: my own work on the basis of the data by Eurostat http://ec.europa.eu/eurostat/tgm/table.do?tab=table&plugin=1&language=en&pcode=teina200 (access 15.07.2015).

In 2007 year budgetary surpluses were recorded in Ireland and Spain. Permanent deficits in next years – were recorded in all PIIGS countries. The highest one has taken place in Ireland in 2010 year (32.5% GNP). In the last analyzed year (2014) all countries had higher budget deficits than they agreed to in Maastricht Treaty (see table 3). However, one can possibly see that the situation is somehow improving.

Until recently, Spain has been regarded as a dynamically developing country. It owed its favourable conjuncture mainly to then boom on the real estate market, which had a positive influence not only on developers but on civil engineering companies and the banks financing those investments (Sadecki 2010, pp. 57–58). The crash occurred already in October, 2008. The mortgage sales decreased then by 44%. Additionally, high unemployment rate (particularly in the civil engineering branch) limited the tax incomes and simultaneously increased the governmental spendings on allowances, which amounted to the serious budget problem. According to the predictions by Eurostat, Spanish civil engineering market is bound to shrink till 2012. The cabinet of Jose Luis Rodriguez Zapatero implemented radical budget cuts amounting to about 15 billion Euros, that is 1.1% GNP. Such actions added to the credibility of Spain in the eyes of financial investors. On the other hand, direct investors – to a considerable extent – left Spain – as well as the other member countries of PIIGS group. Foreign direct investment outflow additionally strengthened the descending trend and additionally solidified the economic recession. Spain is fourth country of Euro Zone, which has received international support (Górniewicz 2013, pp. 29–30).

From the end of the 80s, Ireland developed most among European Union member countries. At the beginning of XXI century, Irish economic growth was mostly based on civil engineering. For Irishmen, it was a period of genuine prosperity. However, when the demand for real estate collapsed (prices decreased by about 50%) the government in Dublin had to save the banking sector, burdened with the misfired loans for the real estate investors, from bankruptcy (Górniewicz 2011, p. 58).

Financial status of Ireland deteriorated in consecutive months. Ireland has received the loan from European Union and the loan from International Monetary Fund amounting to 85 billion Euros. The Prime Minister Brian Cowen's plan was presented 24 November 2010, which assumed the reduction of public spendings by about 10 billion Euros and the increase of tax income amounting to about 5 billion Euros. Recently in comparison with PIIGS countries situation of Ireland has improved.

In Portugal, the cabinet of the Prime Minister Jose Socrates started saving by reducing salaries of clerks and members of the parliament (MPs) by 5% and froze them for 3 years. Salaries of employees from the public sector earning over 1.5 thousand Euros a month were also decreased by the same percentage. Furthermore, the spendings on social benefits were drastically cut. Apart from the reduction of expenses, Portuguese government introduced additional income tax amounting to 1.5%. From 2011, VAT increased by 1% (21%) and big companies paid a new tax amounting to 2% of their income. These measures can potentially bring the savings and the income of 5.7 billion Euros – annually. Moreover, 17 national companies are about to be privatized for about 8 billion Euros (Walewska 2010, p. B7).

At the beginning of April 2011 Portugal asked European Union for a financial aid. In return, Portugal was obliged to privatize public sector amouting to 5 billion Euros. It sold in 2012 the part of Portuguese energy infrastructure (600 million euro), 21% equities in Energias de Portugal (national supplier of energy) valued for 2.7 bilion Euro and Aeroportos de Portugal (about 3 billion Euros) (The Guardian 2012).

Italian economy, being third best in Eurozone with respect to the value of national gross product, developed more slowly than expected. At the end of the first decade of XXI century, industrial production fell down whereas unemployment rate rose. In 2010, Italian public debt surpassed 1.7 billion euros, which amounted to 115% of national gross product. According to the president of the Central Bank, Mario Draghi, Italy was not competitive because of the misguided labour law, making its economy and small enterprises unable to compete on the global market, which eventually caused the inefficiency of financial sector (Werner 2010, p. A8). However, in comparison with PIIGS countries, Italian situation seemed relatively positive.

Table 4. Ratings for PIIGS countries in July 2015

	Standard & Poors		**Fitch**		**Moody's**	
Country	**Rating**	**Perspective**	**Rating**	**Perspective**	**Rating**	**Perspective**
Portugal	BB	Positive	BB+	Watch Negative	Ba2	Stable
Ireland	A+	Stable	A–	Stable	Baa1	Stable
Italy	BBB–	Stable	BBB+	Stable	Baa2	Stable
Greece	CCC–	Negative	CC	Negative	Caa3	Negative
Spain	BBB	Stable	BBB+	Stable	Baa2	Positive

Source: my own work on the basis of the data by Standard & Poors, Fitch and Moody's.

Financial status of country ratings in Portugal, Ireland, Italy and Spain was stable. In July 2015 Standard & Poors, Fitch and Moody's evaluated negatively Greek public finance (for details see table 4). It was completely understandable from the point of view of the crisis in this country.

Table 5. Long-terms interest rates in PIIGS group

Country	July 2014	June 2015
Portugal	3.69	2.93
Ireland	2.28	1.65
Italy	2.79	2.2
Greece	6.1	11.43
Spain	2.68	2.22

Source: my own work on the basis of the data by European Central Bank.

The credibility of individual countries is reflected by their respective long-terms interest rates. A country is more credible, when its interest rates are low because then the risk is the smallest. Recently all PIIGS countries (with the exception of Greece) have decreased long-terms interest rates (see table 5). It should be considered a good result. The result of Greece is tragic in comparison with the remaining PIIGS countries. In June 2015 year long-term interest rate has reached the level of over 11%. No other country in European Union recorded a half of that percentage. It resulted in the real threat of insolvency of Greece. Situation of this country will be presented in detail in the next section of this article.

3. The Case of Greece

In winter (2009–2010), there was a sudden increase of financial problems in Greece. The revelation of hoaxes and statistical manipulations – often euphemistically referred to as „creative accounting" – delivered the final blow to this heavily indebted and a highly corrupted country. Goldman Sachs helped Greece with their operations – or actually frauds. This investment bank was accused by the American Securities and Exchange Commission (SEC) of the frauds and unethical practices. The Greek government tried to improve the situation by initiating spending cuts. Despite the fact that these were inadequate, they infuriated Greek citizens being accustomed to high social welfare services (Nelson, Belkin, Jackson 2015, p. 1). The riots made people appreciate the real essence of debt crisis. People became aware of the fact that the threat to the stability of Eurozone is not only Greece but also the other ineptly governed and highly indebted countries such as Spain, Ireland, Portugal and Italy. The revelation of the scale of the problem forced the European politicians to design a plan of saving not only Greece but also the whole Euro Zone (Górniewicz 2011, pp. 55–56).

At the beginning of May, 2010, Eurozone heads of state gathered at 2010 Brussels and International Monetary Fund summit eventually ratified the assistance packet for Greece amounting to 110 mld Euros until 2012. The price incurred on

Greece for the support by International Monetary Fund was drastic budget reforms. The plan assumed decreasing the budget deficit from 13.6% of the national gross product in 2009 to 2.6% in 2014 (Górniewicz 2012, p. 102).

The reduction of budget spending included: the reduction by 30% of Christmas bonuses, the 12% reduction of the severance pay for the former employees of the public sector, the reduction of incentives, freezing the pensions in public sector and all government-controlled pensions as well as 5% reduction of public investments and some cuts in educational sector. On the other hand, budget revenues increased: VAT from 19% to 21% and excise tax for fuels, cigarettes, alcohol; also, luxury duty increased (relating to such commodities as cars worth more than 17 000 euro, boats, helicopters, gemstones and noble metals (Górniewicz 2011, pp. 56–57).

In 12 February 2012 Greek member of Parliament have voted for savings programme and also asking for next aid. The programme included:
- decrease of employment in public sector about 150 thousand persons,
- freezing salaries in public sector,
- decrease of minimal wage about 20%,
- limitations of pay rises, pension services and of benefits for the unemployed.

This program had to bring savings amounting to 14 billion Euros.

In 21 February 2012 ministers of finance of Euro Zone countries have agreed upon conceding of second aid package for Greece to equal euro 130 billion Euros. Private creditors (mainly banks) will additionally cut down about 53.5% the value of Greek bonds. Greece was obliged to decrease public debt in 2020 year for 121% GNP (Górniewicz 2014, p. 49).

In January 2015 in Greece there were parliamentary elections, which was won by leftist, populistic SYRIZA. This party was opposite to savings and foreshadowed renegotiations agreements with European Union. In 5 July 2015 the referendum proceeded. Greeks have rejected international assistance in it. A bit sooner (that is a few days before the referendum), Greeks did not pay the installment to the International Monetary Fund. Despite it, next negotiations have proceeded. In 13 July leaders of Euro Zone member states agreed upon third assistance packet for Greece (about 86 billion Euros, first installment equal to 26 billion Euros). In return for loans, Greeks were obliged to introduce reforms: increasing VAT and retirement age, liberalization of labor market, abolishing price controls, reform of medicine market and privatization of energy system. Besides, Greeks had to establish trust system, which would administer Greek assets of the value 50 billion Euros, harbours, energy companies, water-supply and banks. Besides Greek government agreed on selling 14 regional airports for 1.23 billion Euros. The buyer will be a German company Fraport (Słojewska 2015, p. B1).

20 August 2015, Greek Prime Minister Aleksis Cipras was dismissed and he appealed to the President to call the earlier-than-scheduled Parliamentary elections. In the forthcoming days, there was a conspicuous slow-down of the reforms in in the country (Walewska 2015, p. B6).

In 2015 among Greek creditors the biggest share had Euro Zone (above 193 billion Euros). In this group the biggest amounts belong to: Germany (56.6 billion Euros), France (42.4 billion euro), Italy (37,3 billion Euros) and Spain (24.8 billion Euros). It should be noticed, that all countries of PIIGS Groups, except for Ireland, are creditors of Greece. Besides, important part of debt was possessed by International Monetary Fund (32.3 billion Euros) and the European Central Bank (20 billion Euros). Table 6 presents the details.

Table 6. Greek creditors

Specification	Debt in billions of Euros
EURO ZONE	193.8
Germany	56.6
France	42.4
Italy	37.3
Spain	24.8
Netherlands	11.9
Belgium	7.2
Austria	5.8
Finland	3.7
Slovakia	1.5
Portugal	1.1
International Monetary Fund	32.3
European Central Bank	20.0
Greek banks	10.9
Bank of Greece	4.3
external banks	2.4

Source: my own work on the basis of the data by Euronews www.euronews.com (access 05.06.2015).

Greek ministry of finance dealing with the structure of government debt has differentiated three areas. The first area was fixed and floating rate. In 2010 it was fixed rate that prevailed. The situation has been changed in next years. It must be judged negatively. Second area concerned the tradability of debt. In 2010 year what prevailed was the tradable, but later the non-tradable one. Third area concerned currencies in which Greece was in debt. Within whole analyzed period Euro predominated (see table 7).

Scientific research demonstrates that high level of debt negatively affects economic growth (Reinhard, Rogoff, 2010). In reality, in Greece big debt accompanied economic recession. In order to implement reforms, the drastic budget spendings cuts were implemented. From the onset of the crisis gross domestic product has fallen by about 1/4. Only high economic growth could cause solvency of Greece. According to forecasts of European Commissions in 2015 year GNP will grow about 0.5%. It is undoubtedly not enough.

Table 7. Composition of general government debt in %

Specification	2010	2012	2014	2015*
A. Fixet rate	70.7	32.7	33.2	33.9
Floating rate	29.3	67.3	68.8	66.1
B. Tradable	84.0	34.3	25	26.1
Non-tradable	16.0	65.7	75	73.9
C. Euro	98.2	96.7	95.7	95.7
Non-euro zone currencies	1.8	3.3	4.3	4.3

* Data finally march 2015

Source: my own work on the basis of the data by Hellenic Republic Public Debt Bulletin, no 61, March 2011; Hellenic Republic Public Debt Bulletin, no 69, March 2013; Hellenic Republic Public Debt Bulletin, no 76, December 2014 and Hellenic Republic Public Debt Bulletin, no 77, March 2015.

Conclusions

At the beginning of the second half 2015 it was not possible to ascertain that crisis of public finance has taken place in PIIGS countries. Situation of Greece seemed particularly critical still. Its public debt surpassed 170% GDP. Economy of this country was in recession for 6 year and it has shrunk by about 1/4. Many weeks lasted next negotiations as to how to escape uncontrolled insolvency. There was a real threat for Greece to be expelled from Euro Zone (Grexit) and to return to old currency of this country (drachma).

The Process of exiting Euro Zone sparked off bank panic, disturbances, riots and breakdown of economy. However, to remain in the Zone, Greece will probably have to increase taxes and decrease public spendings. It means economic stagnation and high unemployment. It concerns not only Greece but also other countries of PIIGS group.

The economic crisis in Greece has also evolved into a broader political crisis in Europe. Analysts argue that the acrimonious debates among European leaders about the appropriate crisis response have heightened political tensions to a degree that could negatively impact the EU over the longer term.

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