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PROBLEMS WITH FULFILMENT OF STABILIZATION PACT IN THE FACE OF THE FINANCIAL CRISIS OF THE EUROZONE

Abstract

The main aim of the rules of fiscal policy of European Union is to identify and limit the negative impact of wrong policies of some of the member states on the functioning of the remaining countries of the Eurozone. In order to limit possible threats institutional and legal regulations were put in place in form of Stability and Growth Pact. Its main aim was to discipline the fiscal policies led by the countries of the Eurozone. The debt crisis in the Eurozone proved, that the convergence criteria of the Maastricht Treaty and the Stability and Growth Pact were not sufficient to provide stability of public finances in the countries of the Eurozone. It is thus justified to launch an analysis concerning the debt situation of the Eurozone and its further existence. What is also to be analyzed are the problems resulting from the non-adherence of the countries of Eurozone to the Stability and Growth Pact. The analysis was conducted on the basis of literature study and analysis of statistical data.

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Keywords: Stability and Growth Pact, fiscal union, debt crisis, excessive deficit procedure.

Introduction

The creation of EMU in 1999 was accompanied by very high risk of instability of the common currency of the member states in the result of lack of uniform political power that would supervise and monitor the common currency. The stability of Euro can be safeguarded not only through monetary policy, but most of all by fiscal policies led independently by the respective member states of the

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Eurozone. Stable and strong currency must find support in stronger fiscal discipline accomplished by the member states (Giżyński 2012). The member states can't be left fully autonomous. That is why some limits were imposed, and applied to the whole Union, on the member states for keeping and safeguarding the aforesaid assumptions.

1. The fiscal policy of the economic and monetary union

Within the EMU there is currently the complete monetary union in force and the incomplete economic one, as a result of, among others, lack of fiscal federalism. The criterion connected with fiscal policy of the monetary union leads to the following implications: 1/ it is desirable for the large proportion of the state budgets to be passed on to the centralized budget within the whole union, 2/ the national fiscal policy of the member states shall be applied in a flexible way, that is in set situations the member states shall be entitled to increase budget deficits (Burawski, 2005). The Eurozone is a unique structure that is far from being an optimal currency area, understood as a group of countries adopting a common currency and creating a monetary union (Księżyk, 2012). It is thus evident, that the member states, pursuant to the Stability and Growth Pact (hereinafter the SGP) have to avoid budget deficits.

The aforesaid Stability and Growth Pact concerns all member states of the European Union, but its repressive part, that imposes sanctions on countries with excessive deficits only applies to the states of the Eurozone. The SGP is thus to secure that the fiscal policy of the member states will not cause tensions between the countries participating in the EMU. Decentralization of the fiscal policy may lead to appearance of excessive budget deficits (Burawski, 2005, p. 41). This means that the negative effects in form of budget deficit on the part of one of the member states may cause adverse effects in another member state.

Analyzing the above the difficulties of the European countries that appeared after the outbreak of the global financial crisis do clearly point to the fact, that lack of common fiscal policy bears negative consequences for the stability of the Eurozone. That is why the precondition for further budget integration is the stronger political intervention, that is the abandonment of some of sovereignty of the member states (Skiba, 2011). The member states should no longer wait with the necessary institutional reforms and national rules, aiming at the enhancement of the positive influence of their fiscal policies on economic growth.

On the other hand the full coordination of economic policy on the union scale of the Eurozone would require major changes in form of larger budget, common responsibility for the public debt and more coordinated tax system. The larger coordination of the fiscal policy in the Eurozone is required for prevention of future situations similar to those current ones (Skrzypczyńska, 2012).

As the EMU was introduced, together with a single currency, there are recurrent opinions saying that a uniform fiscal policy should also be introduced – at least in the Eurozone. The EU budget is very small, which makes the EU's efforts aimed at fiscal federalism justified, as in reality they would mean that the central budget would be substantial in relation to the GDP of the respective country, with a level of 20 to 30% (Oręziak, 2007; Szeląg, 2003). After the introduction of Euro the differences in taxation levels of businesses in the respective countries became even more visible. This means there is the need for more stricter economic coordination and political integration, with the concurrent harmonization of the tax rates within the EU. Due to that the need emerges for further, wholesome harmonization of regulations and tax rates for indirect taxes (VAT) to a degree that harmonization is required for proper functioning of the internal market. In this context we also see the question of reforming the commercial taxes, through the introduction of uniform, consolidated taxation base and/or establishment of the European commercial income tax (Szeląg, 2003). The harmonizing directed at increase or decrease of tax rates remains debatable. Some of the states wish not to lower the taxes due to the fact that it lowers the income of their budgets. As long taxation issues remain at the discretion of the respective countries, EU initiatives can be effectively blocked.

2. Stability and Growth Pact

Due to the lack of uniform fiscal policy and thus the threat of instability of Eurozone, practically from the very beginning of the monetary union the discussions indicated the need of creation and implementation of mechanisms for prevention of excessive budget deficits or excessive public debt.

The decentralized fiscal policy, left at the national level is currently the main source of problems of the Eurozone.

The annual European Union budget accounts for just 1% of its GDP: EUR 145 bn. in 2015 (http://europa.eu/pol/financ/index_pl.htm) in relation to the government budgets of the member states that account for 30 to 50% of their GDPs or even more. The EU budget should be balanced and the disciplining function in this area is to be held by the provisions of the treaty.

The Stability and Growth Pact (hereinafter: the SGP) was intended as the main tool for coordination and active stabilization of fiscal policy.

This Pact, forming the continuation and solidification of the resolutions of the Maastricht Treaty which formed the basis for introduction of common currency and a warranty of financial stability of the Eurozone in the conditions of independence of fiscal policy of the member states of the monetary union (Lubiński, 2011). The SGP was in the first place intended as a safety measure for balancing the public finances and leveling excessive budget deficits and public debts.

In 1997 the European Council issued three acts that constitute the Stability and Growth Pact, which in turn consists of the preventive and repressive parts.

In the preventive part of the Pact the regulation no. 1467/97 (Council Regulation (EC) no. 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies) imposed the duty of annual preparation of stability and convergence programs on countries from outside the Eurozone (See also: Skiba, 2011). These programs include the analysis of the situation of the public finances for the current and previous period and the project of medium-term budget plans. In case of large differences between the accomplished and planned targets the European Council has the competences to issue recommendations for the member state, through which it obliges the state, pursuant to the Resolution of the European Council of 17 June 1997 (Resolution of the European Council on the Stability and Growth Pact Amsterdam, 17 June 1997) a member state is obliged to „undertake corrective budgetary actions necessary for achievement of its stability and convergence goals” (Resolution of the European Council on the Stability and Growth Pact Amsterdam, 17 June 1997).

Within the repressive part of the Pact the regulation no. 1467/97 (Council Regulation (EC) no. 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure) foresees sanctions against countries that fail to adhere to the budget criteria, allowing for excessive budget deficit or public debt, in excess of 3 and 60% respectively.

Penalties may be imposed on countries that fail to adhere to preventive regulations, as set in the SGP.

Table 1. Public debt in the Eurozone in the years 1999–2014 (% GDP)

Years	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Public debt	72.4	69.9	68.6	68	69.2	69.6	70.5	68.6	66.3	70.1	79.9	83.8	86	89.3	91.1	92.1

Source: Own summary on the basis of Eurostat statistical data, <http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tsdde410&plugin=1> (accessed: 24.11.2015).

Table 2. Budget deficit in the Eurozone in the years 1999–2014 (% GDP)

Years	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Budget deficit	-1.3	-1.0	-1.9	-2.6	-3.2	-3.0	-2.6	-1.5	-0.6	-2.2	-6.3	-6.2	-4.2	-3.7	-3.0	-2.6

Source: Own summary on the basis of Eurostat statistical data, <http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tsdde410&plugin=1> (accessed: 24.11.2015).

In case of Eurozone states these penalties may take the form of a warning or, finally, the form of financial penalties of:

- 0.2% of GDP if the preventive or corrective regulations are breached;
- 0.5% of GDP in case of numerous breaches of corrective regulations (http://ec.europa.eu/economy_finance/economic_governance/sgp/index_pl.htm).

The Stability and Growth Pact came in force in relatively beneficial economic conditions (of 1999-2001) and due to that there were no problems connected with adherence to it in that period. The circumstances changed in the beginning of 2001, when an economic slowdown occurred, with consequence in form of excessive budget deficits in Eurozone (Lubiński, 2011), (see: tables 1 and 2).

3. Problems with completion of Stability and Growth Pact

The debt crisis that started in Greece and then spread on to other Eurozone countries revealed the shortcomings of the process of stabilization of economic situation with means of fiscal policy.

The inefficiency of SGP was first manifested in 2003 when the Council of the European Union decided to reject recommendations of the European Commission to initiate the excessive deficit procedure after threat of financial sanctions being imposed on Germany and France, as both countries failed to introduce the ordered corrective actions for their excessive budget deficits (Pszczółka, 2012). It was then assumed that the excessive deficit procedure should not be introduced in situation of a deep recession of a country.

In consequence of the actions of the Council the credibility of the Stability and Growth Pact suffered significantly.

In the result the Pact was revised in 2005. Changes were introduced regarding procedure. Mid-term budget obligations were added to the preventive part, in order to take the situation of the country in question into account, and the repressive part saw revision of excessive deficit procedures, that in case of substantial deterioration of economic situation do excuse the state from application of the aforesaid procedure (Bukowski, 2007). Thus the rules of the Stability and Growth Pact were largely weakened and made much more flexible.

The reform did not induce the improvement of fiscal discipline in the individual countries of the Eurozone. There were still breaches of the rules of the SGP and all too frequent crossing of the reference values. This led to systematic growing of public debt in the Eurozone to such an extent, that some of the states, e.g.: Greece, Portugal, Italy were on the verge of bankruptcy already in 2009 (Rosati, 2013).

The difficulties with enforcement of the SGP rules led to a situation in which practically the majority of Eurozone countries exceeded the 3% GDP threshold in the years 2009-2011 (see table 3).

Table 3. Budget deficit in the Eurozone countries in the years 2009–2011 (%GDP).

State	2009	2010	2011
Austria	-5.3	-4.4	-2.6
Belgium	-5.4	-4	-4.1
Cyprus	-5.5	-4.8	-5.7
Estonia			1.2
Finland	-2.5	-2.6	-1
France	-7.2	-6.8	-5.1
Greece	-15.2	-11.2	-10.2
Spain	-11	-9.4	-9.5
Holland	-5.4	-5	-4.3
Ireland	-13.8	-32.3	-12.5
Luxemburg	-0.5	-0.5	0.5
Malta	-3.3	-3.2	-2.6
Germany	-3.2	-4.2	-1
Portugal	-9.8	-11.2	-7.4
Slovakia	-7.9	-7.5	-4.1
Slovenia	-5.9	-5.6	-6.6
Italy	-5.3	-4.2	-3.5

* Grey color marks the areas in excess of the allowed reference values.

Source: Own summary on the basis of Eurostat statistical data, <http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tsdde410&plugin=1> (accessed: 24.11.2015).

In the aspect of deepening debt of the Eurozone countries the second reform of the Stability and Growth Pact was conducted in 2010-2011, that introduced changes in the field of so called economic management. Two new rules were introduced: 1/ expenditure and 2/ defining the pace of debt reduction in case of exceeding the allowed limits (Marchewka-Bartkowiak, 2012). The reform aimed at stricter financial discipline in the Eurozone.

Another step in reply to the debt crisis of the Eurozone was the strengthening of GSP in its fiscal area, through the 2012 adoption of the so called „six pack”, which was rooted in the „fiscal pact” that is the Treaty on stability, coordination and governance in the Economic and Monetary Union (Skrzypczyńska, 2012), which came in force in 2013 forming a separate modification to the GSP.

The above setting has the main aim of increasing the budget discipline, coordination of economic policies and improvement of debt situation in Eurozone.

As newest data suggest, according to Commission forecast the deficit in Eurozone is to fall to 1.7% of GDP in 2016 from 1.9% of GDP in 2015. At the same time the public debt should also fall to a level slightly below 90% of GDP in 2016,

compared to 91.1% of GDP in 2015. The forecasted data presents an improvement of debt situation of the Eurozone.

Conclusion

What contributed to the financial crisis of the Eurozone was the way the fiscal policy was managed, remaining on the national level, in some of the member states of the Eurozone. Lack of proper and appropriately early disciplining of individual countries for their breaches of the reference values, and the poor macroeconomic policies of countries contributed to the fact that the majority of the Eurozone countries failed to fulfill the convergence criteria at the very introduction of Euro.

It is also worth stressing that the growing financial unbalances in individual member states were also the result of wrong institutional system. The main point was to be the Stability and Growth Pact, with its imperfections revealed as early as in 2003 by the controversial situation of Germany and France and the overthrowing of the recommendations of European Commission that wanted to impose financial penalties on both countries. This event marked the definite undermining not just of the importance of the Pact, but also European institutions as such.

The safeguards introduced in SGP and its later amended revisions were insufficient. This finds confirmation in the budget deficit or public debt levels of some of the member states of the Eurozone.

In current situation the financial crisis has shaken the very existence of the monetary union. And in analyzing the above situation one must find that the lack of coordination of fiscal policies, which may become a chance for effective actions fighting the second wave of the economic crisis, has undermined the stability of the Eurozone and its common currency.

If the debt of the Eurozone will continue to grow it is worth to consider one of the two following scenarios: either the individual countries will start to leave the monetary union or full fiscal coordination in form of a fiscal union will occur.

The current crisis has decisively shown the instability of a balance in form of a monetary union devoid of its fiscal element. According to the B. Ballasay scheme during the integration process the economies drop successive privileges and close cooperation, passing subsequent stages from the customs union, through free trade zone, common market, monetary union up to political union. Euro proved to be a currency for good economic situation only. In face of turmoil of world economy the weaknesses of the optimal currency zone of the Eurozone were exposed (Gotz, Budnikowski 2012).

In sum- deeper coordination of fiscal and monetary policies is required most of all in the era of growing budget deficits and in order to avoid situations similar to that faced by the Eurozone now.

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