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THE FINANCIAL CRISIS AND THE PUBLIC FINANCES DEFICIT IN POLAND AND THE EUROPEAN UNION MEMBER COUNTRIES[1]

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1. Financial crisis – conceptual digressions

Financial crisis is an occurrence of rapid changes in the financial market, usually associated with insufficient liquidity, insolvency, as well as the fall in production or aggravation of an already present decline. The word comes from the Latin word *crisis* and the Greek word *krisis*, meaning "screening", "settlement", "choice"[2]. Other definitions relating to the crisis include economic downturn, economic weakness, economic turmoil, economic collapse and economic chaos.

Analysing the crises that began to appear at the beginning of the twentieth century, as indicated in the literature of the field, the current crisis is the eleventh

[1] The article is a reprint of the article originally published in System prawnofinansowy: prawo finansowe wobec wyzwań XXI wieku. Law and finance: the financial law towards challenges of the XXI century / J. Gliniecka (red.), CeDeWu, Warszawa 2013

* Katedra Finansów i Bankowości, Wyższa Szkoła Bankowa w Toruniu

[2] Młynarski, F. 1947. *Pieniądz i gospodarstwo pieniężne.* Kraków: Księgarnia Stefana Kamińskiego.

major global financial crisis[3]. Economists are not unanimous as to determining the beginning of the current crisis. Some claim that it has started in August 2007 with the first intervention of central banks to restore liquidity in the banking sector. Others, however, date it from September 15, 2008, when one of the largest investment banks, Lehman Brothers, declared bankruptcy[4].

To avoid excessive disputes in this area, it is safe to describe the current crisis as the first in the twenty-first century. That crisis has significantly affected the public finances of the European Union countries.

2. The public finances deficit as the effect of the financial crisis 2007 – 2010

The public finances deficit is an insufficiency of accumulated income to cover public expenditure. It has become an integral part of the economies of the European Union countries, the Euro-zone countries included. This deficit involves both the government sector, the local government sector, as well as the social security sector, with the first of them, ie: the government sector, mainly responsible for the generation of the deficit.

As a result of the current crisis, the economic indicators of the deficit and public debt in most cases have exacerbated significantly. In fact, in the years 2007 – 2010 none of the 27 EU countries registered a credit balance. In 2011, a budget surplus was reported by three states only. At the same time, many countries, especially of the Euro-zone, began to struggle with the deficit at approximately, or exceeding, 10% of GDP (Greece, Spain, Ireland). These statistics are presented in the following table.

Table 1. Budget balances in the Euro-zone and the European Union in 2007 – 2012

Country	Budget surplus/deficit in relation to GDP						
	2007	2008	2009	2010	2011	2012*	2013*
Belgium	−0,2	−1,2	−6,0	−4,9	−3,7	−4,2	−3,4
Germany	0,2	0,0	−3,3	−3,7	−1,8	−1,2	−0,2
Greece	−5,1	−7,7	−13,6	−9,6	−9,5	−9,3	−5,5
Spain	1,9	−4,1	−11,2	−9,3	−6,3	−8,0	−7,5

[3] Nawrot, W. 2009. *Globalny kryzys finansowy XI wieku. Przyczyny, przebieg, skutki, prognozy.* Warszawa: Wydawnictwo CeDeWu.

[4] Ostaszewski, J. (ed.) 2010. *Finanse*. Warszawa: Wydawnictwo DIFIN.

Country	Budget surplus/deficit in relation to GDP						
	2007	2008	2009	2010	2011	2012*	2013*
France	–2,7	–3,3	–7,5	–7,7	–5,8	–4,5	–3,5
Ireland	0,1	–7,3	–14,3	–32,3	–13,1	–8,4	–7,5
Italy	–1,5	–2,7	–5,3	–5,0	–4,0	–2,9	–2,1
Luxembourg	3,6	2,9	–0,7	–1,8	–0,6	–1,9	–1,7
Netherlands	0,2	0,7	–5,3	–5,8	–3,7	–3,7	–2,9
Austria	–0,4	–0,4	–3,4	–4,3	–3,7	–3,2	–2,7
Portugal	–2,6	–2,8	–9,4	–7,3	–5,9	–5,0	–4,5
Finland	5,2	4,2	–2,2	–3,1	–0,5	–1,8	–1,2
Cyprus	3,4	0,9	–6,1	–5,9	–5,1	–5,3	–5,7
Malta	–2,2	–4,5	–3,8	–4,2	–3,0	–2,6	–2,9
Slovenia	0,0	–1,7	–5,5	–5,8	–6,4	–4,4	–3,9
Slovakia	–1,9	–2,3	–6,8	–8,2	–5,1	–4,9	–3,2
Bulgaria	0,1	1,8	–3,9	–3,8	–2,7	–1,5	–1,5
Czech Rep.	–0,7	–2,7	–5,9	–5,2	–4,4	–3,5	–3,4
Denmark	4,8	3,4	–2,7	–5,1	–4,1	–3,9	–2,0
Estonia**	2,6	–2,7	–1,7	–1,0	1,0	–1,1	–0,5
Latvia	–0,3	–4,1	–9,0	–7,7	–4,5	–1,7	–1,5
Lithuania	–1,0	–3,3	–8,9	–8,4	–5,5	–3,2	2,8
Poland	–1,9	–2,3	–6,8	–7,9	–5,8	–3,4	–3,1
Romania	–2,5	–5,1	–8,3	–7,3	–4,7	–2,8	–2,4
Sweden	3,8	2,5	–0,5	–0,9	0,4	0,0	–0,3
Hungary	–5,0	–3,8	–4,0	–3,8	4,4	–2,5	–2,9
United Kingdom	–2,8	–4,9	–11,5	–10,5	–7,8	–6,2	–7,2

* European Commission's forecasts.

** Estonia joined the Euro-zone in 2011.

Source: own study based on: *European economic statistics*, Eurostat, European Commission 2010 and 2011.

As shown in Table 1, in 2011, positive balances occurred in only three European Union countries, i.e. Hungary, Estonia and Sweden. In other countries, despite

the efforts related to the implementation of austerity packages, the balances remained negative. According to the forecasts of the European Commission, the situation of the budgets of EU countries is not to improve significantly. Although certain improvements are expected in the state of the budgets of some of the European countries (Germany, Luxembourg and Latvia), in many cases the budgets are to deteriorate even further.

In terms of public finances, the situation seems to be most favourable for Hungary. A surplus of 4.3% of GDP was by far the largest surplus in the past four years[5]. This surplus resulted from the introduction of bank and crisis taxes and the nationalization of pension funds. At the same time cuts were made in government spending (e.g. in public administration, higher education and the pension schemes of uniformed services) [6]. However, according to European Commission forecasts of November 2012, in spite of these efforts, the Hungarian public finances are to close at a deficit of 2.5 % of GDP in the current year and in the following year that imbalance is to deepen[7].

In the case of Sweden, significant changes were introduced to the existing tax system, namely rates were reduced for applicable taxes and some of the tax burden eliminated. This included the liquidation of compensatory grant levied on incomes of more than 1.5 million crowns, the reduction on personal income tax rates, as well as further plans to lower corporate tax.[8] On the other hand, a conservative fiscal policy was introduced in Estonia, allowing for a surplus and the lowest in the EU public debt.[9] The indicators of public debt-to-GDP ratio are shown in Table 2

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[5] It is worth mentioning Norway which, although not a country of the European Union, have maintained a surplus at 7% of GDP (or higher) for over 11 years (since the available data on the country). This is obviously no incident. The Republic draws large revenues from the profits of oil and natural gas and it is estimated that it will maintain the rate at 14% of GDP until 2014. Further reading: http://www.prognostic.pl/-/deficyt-i-nadwyzka-budzetowa-w-krajach-europy, DOA November 16, 2012.

[6] Further reading: *Wprowadzenie podatków kryzysowych oraz nacjonalizacja OFE uratowały Węgry przed bankructwem*, www. forsal.pl, DOA November 16, 2012.

[7] Comp. Gadomski, W. „Niełatwo uwolnić się od procedury nadmiernego deficytu", http://www.obserwatorfinansowy.pl/forma/analizy/nielatwo-uwolnic-sie-od-procedury-nadmiernego-deficytu/?k=analizy, DOA November 16, 2012.

[8] CIT in Sweden is 26.3%. The stimulus package aimed at reducing the corporate tax rate is due to come into force in 2013., This should result in further improvement in the public finances of the country. Further Reading: Lomas, U. „Sweden Eyes Corporate Tax Cut In Growth Package", www.tax-news.com, DOA November 16, 2012.

[9] According to government forecasts, the Estonian target budget deficit in 2013 is to equal 0.8% of GDP. Comp. http://obserwatorfinansowy.pl/forma/analizy/estonia-i-lotwa-z-nadwyzkami-w-budzetach/ , DOA November 16, 2012.

Table 2. Public debt in the Euro-zone and the European Union in 2007 – 2012

Country	Public debt-to-GDP ratio					
	2007	2008	2009	2010	2011	2012*
Belgium	84,2	89,8	96,7	96,8	98,0	97,5
Germany	65,0	66,0	73,2	83,2	81,2	81,1
Greece	95,7	99,2	115,1	142,8	165,3	172,7
Spain	36,2	39,7	53,2	60,1	68,5	71,0
France	63,8	67,5	77,5	81,7	85,5	86,8
Ireland	25,0	43,9	64,0	96,2	108,2	117,9
Italy	103,5	106,1	115,8	119,0	120,1	119,8
Luxembourg	6,7	13,7	14,5	18,4	18,2	19,0
Netherlands	45,5	58,2	60,9	62,7	65,2	64,0
Austria	59,5	62,6	66,5	72,3	72,2	75,4
Portugal	63,6	66,3	76,8	93,0	107,8	107,4
Finland	35,2	34,2	44,0	48,4	48,6	52,2
Cyprus	58,3	48,4	56,2	60,8	71,6	64,3
Malta	61,9	63,7	69,1	68,0	72,0	67,9
Slovenia	23,4	22,6	35,9	38,00	47,6	46,0
Slovakia	29,3	27,7	35,7	41,0	43,3	46,8
Bulgaria	84,2	89,8	96,7	16,2	16,3	18,6
Czech Rep.	29,0	30,0	35,4	38,5	41,2	42,9
Denmark	27,4	34,2	41,5	43,6	46,5	47,1
Estonia**	3,8	4,6	7,2	6,6	6,0	6,9
Latvia	9,0	19,5	36,1	38,2	42,6	49,4
Lithuania	16,9	15,6	29,3	44,7	38,5	43,6
Poland	45,0	47,2	51,0	55,0	56,3	55,1
Romania	12,6	13,3	23,7	30,8	33,3	34,8
Sweden	40,8	39,3	42,3	39,8	38,4	33,4
Hungary	65,9	72,9	78,3	80,2	80,6	72,7
United Kingdom	44,7	52,0	68,1	80,0	85,7	87,9

* European Commission's forecasts.

** Estonia joined the Euro-zone in 2011.

Source: own study based on: *European economic statistics*, Eurostat, European Commission 2010 and 2011.

Table 2 shows that the financial crisis contributes to the exponential growth of public debt in many EU countries. Special attention should be paid to Greece with its public debt-to-GDP ratio of 165.3%. According to European Commission forecasts in 2012 that rate is expected to reach 172.7% of GDP. The country is still on the verge of bankruptcy, despite the assistance of the "big three", i.e. the European Commission, the IMF and the ECB. Although the next tranche of financial aid depends on the introduced austerity packages, the country's borrowing needs are much greater.

The indicators of public debt are similarly alarming for other countries, especially the so-called PIIGS, i.e. Portugal, Ireland, Italy, already mentioned Greece, and Spain. In 2011, these indicators have deteriorated significantly in comparison to the previous years. Ireland in particular is in a specific situation, with a debt of 25% of GDP in 2007, and a more than fourfold increase, to the level of 108.2%, in 2011.

As for Poland the moderate debt-to-GDP ratio achieved in 2011 is still below 60%. It is worth mentioning that Estonia remains the only EU member state with a debt not exceeding 10% GDP. In 2011 this indicator amounted to 6% of GDP. The expected increase in this ratio, according to the European Commission forecast, is 6.9% of GDP.

3. The excessive deficit procedure in the European Union

The excessive deficit procedure was established in the Stability and Growth Pact of 1997 (amended in 2005) and is also enclosed in Article 126 of the Treaty on the Functioning of the European Union. This procedure is initiated if the general government deficit exceeds 3% of GDP and public debt in the sector is higher than 60%. It is worth noting that the second criterion was not taken into account until 2008. When the Stability and Growth Pact was entering into force, only a few EU countries had the debt lower than 60% of GDP.

If the European Commission finds the occurrence of an excessive deficit, it communicates the review and the recommendations to the Council of the European Union to decide, whether to initiate the excessive deficit procedure. If the procedure is deemed necessary, the Council recommends the steps to be undertaken by that country to reduce the deficit. The Council also defines the deadline for the correction of the excessive deficit. In the recommendations, the Council requests the Member State to achieve a minimum annual improvement of at least 0.5% of GDP.

The European Commission and the Council of the European Union may decide against the excessive deficit procedure, if they recognize the deficit as a result of an unusual event irrespective of the Member State, or of a severe economic downturn (e.g. a recession or a cumulative decline in output in a situation of a very low growth).

On the assessment of the fiscal situation, the economic policy of the country in the context of the Lisbon agenda is also taken into account. In particular, the promotion of research and innovation, changes in the medium-term budget, with an emphasis on fiscal consolidation in times of prosperity and the reform of pension systems, consisting of the pillar pension capital formation.

The decision to initiate the procedure is therefore not automatic, as it is not the decision to terminate the procedure. If the Member State fails to comply with the recommendations, the Council may decide to proceed to the next step of the procedure, with the final step being the imposition of financial penalties in the form of an interest-free deposit, eventually converted to a non-refundable fee.

The deposit includes a fixed component equal to 0.2% of GDP and a variable – equal to one tenth of the difference between the deficit (as a percentage of GDP in the year in which the deficit was considered excessive) and the reference value (3%). In subsequent years, if the country is still not following the recommendations, the Council may decide to intensify sanctions, requiring an additional deposit. The annual amount of the deposit may not exceed the limit of 0.5% GDP[10].

Table 3 The excessive deficit procedure in the European Union (as of 3 March 2011)

Country	Group	Status	Correction date
Austria	EA	EDP	2013
Belgium	EA	EDP	2012
Bulgaria	D	EDP	2011
Cyprus	EA	EDP	2012
Czech Rep.	D	EDP	2013
Denmark	ERMII/O	EDP	2013

[10] Comp. Ciak, J. 2011. *Kryzys finansowy a deficyt sektora finansów w Polsce i krajach Unii Europejskiej*, [in] *Ekonomiczne i prawne uwarunkowania i bariery redukcji deficytu i długu publicznego.* Warszawa: LEX a Wolters Kluwer business.

Country	Group	Status	Correction date
Estonia	EA	-	-
Finland	EA	EDP	2011
France	EA	EDP	2013
Greece	EA	EDP	2014
Spain	EA	EDP	2013
Netherlands	EA	EDP	2013
Ireland	EA	EDP	2014
Lithuania	ERMII/D	EDP	2012
Luxembourg	EA	–	–
Latvia	ERMII/D	EDP	2012
Malta	EA	EDP	2011
Germany	EA	EDP	2013
Poland	D	EDP	2012
Portugal	EA	EDP	2013
Romania	D	EDP	2012
Slovakia	EA	EDP	2013
Slovenia	EA	EDP	2013
Sweden	D	–	–
Hungary	D	EDP	2011
United Kingdom	O	EDP	2014/2015
Italy	EA	EDP	2012

*EA – the Euro-zone member , ERM II – ERM II participant, D – country embraced by a derogation, O – country having an *opt-out*.
**EDP – ECOFIN recommendation on the date of the excessive deficit reduction
Source: own study based on: Ministerstwo Finansów 2011, *Monitor konwergencji nominalnej w UE.* Warszawa, p. 4.

According to the data presented in Table 3, 24 EU Member States are obliged to take measures in order to reduce their budget deficit below 3% of GDP. It is required by the excessive deficit procedure initiated against them[11]. In 2011, the budget deficit ratios in relation to GDP had to be adapted to the requirements of the Treaty

[11] Ibid. 75–76.

of Maastricht by four countries, namely Bulgaria, Finland, Malta and Hungary. All of the countries were able to introduce corrective measures and achieve the required deficit level. In 2012, seven more countries are obliged to comply, including Latvia and Lithuania, members of ERM II. Ten countries must achieve a proper deficit to GDP ratio in 2013. The countries allowed the longest period of adjustment (to 2014 and 2015) are Greece, Ireland and the United Kingdom.

4. Conclusion

The economic indicators of EU Member States presented in the tables show a significant deterioration in their public finances resulting from the economic crisis. In 2007 – 2010, all of the countries slipped into deficit of various ratios to GDP, with the worst indicators concerning Ireland, Greece, Spain and Portugal. The lowest rates (below the reference value of 3% of GDP) are maintained by Sweden, Luxembourg, Estonia and Finland. In 2011, only three countries achieved a budget surplus, i.e. Hungary, Sweden and Estonia. Unfortunately, the European Commission forecasts show that in the coming years the balance of these countries is to deteriorate. The countries from outside the Euro-zone present a better financial situation, with the highest rate of GDP reached by United Kingdom (6.2% of GDP). In other countries, the rate hovered around 2.7 – 5.5% of GDP. The forecasts of the European Commission in this area, however, are more optimistic.

At the same time a significant deterioration occurred in the public debt-to-GDP ratio in excess of 60%. Among the most indebted countries are: Greece, Italy, Ireland, Belgium and Portugal. In fact, in the group of Euro-zone countries, the public debt below 60% of GDP was maintained only by a few countries, among which are: Luxembourg, Slovenia, Slovakia and Finland. Regarding the non-Euro-zone countries, only the United Kingdom and Hungary exceed the rate of 60% of GDP (85.7% of GDP and 80.6% of GDP respectively). The public debt in other countries does not exceed 60% of GDP.

The exceeding of the deficit value over the 3% of GDP and public debt over 60% results in the initiation of the excessive deficit procedure. In practice, the decision to apply the conditions of the Pact for Stability and Growth was made only on the basis of the deficit ratio to GDP. It has been proposed recently, however, that the excessive deficit procedure be initiated against the country with the debt in excess of 60% of GDP even if the deficit is equal to, or lower than the preferred value.

It is worth noting that the Treaty on Stability, Coordination and Management of Economic and Monetary Union, commonly known as the fiscal pact (to be ratified soon), requires EU countries to pursue a policy of a balanced budget, i.e. the annual structural balance of the general government sector is not to exceed 0.5% of GDP. A higher ratio, at the level of 1% of GDP, is to be granted to countries with the public debt-to-GDP ratio significantly lower than 60% of GDP.

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Summary

As a result of the current economic crisis, the indicators of the deficit and public debt in most European Union countries have exacerbated significantly. In fact, in the years 2007 – 2010 none of the 27 EU countries registered a credit balance. In 2011, a budget surplus was reported by three states only. At the same time, many countries, especially of the Euro-zone, began to struggle with the deficit at approximately, or exceeding, 10% of GDP. The indicators of public debt are similarly alarming for the EU countries, especially the so-called PIIGS, i.e. Portugal, Ireland, Italy, Greece, and Spain. In 2011, these indicators have deteriorated significantly in comparison to the previous years. The aim of this article is to present and analyse basic economic indicators of EU Member States.