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# Impact of the Great Recession and the Role of Assistance Programmes in EMU Countries

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**58th ERSA Congress "Places for People: Innovative, Inclusive and Liveable Regions"**
**28- 31 August 2018, Cork, Ireland**

## Motivation

- **The recent financial crisis** began in 2007 in the US with the subprime mortgage crisis, and quickly spread to the EU. **Underlying causes**: excessive international macroeconomic imbalances, very expansive monetary and fiscal policies, poor financial regulation

- The **economic and sovereign debt crisis** affected the European countries in different degrees depending on their economic structure and vulnerability to shocks

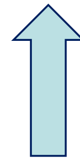
- **Two key factors of macroeconomic imbalances in EMU**: low real financing costs and optimistic assumptions. **These factors led to** a significant cumulative deterioration in competitiveness and, thus, excessive current account deficits and increase of external debt

- The peripheral countries have become the most vulnerable to the vicissitudes of the crisis; in particular, **Greece** (in 2010), **Ireland** (in 2010), **Portugal** (in 2011), **Spain** (in 2012) and **Cyprus** (in 2013) had to **request international financial support**

## Contribution and Objetives

- **Contribution:** providing new evidence on the impact of the Great Recession and the role played by the assistance programmes in the five rescued EMU countries (Cyprus, Greece, Ireland, Portugal and Spain)

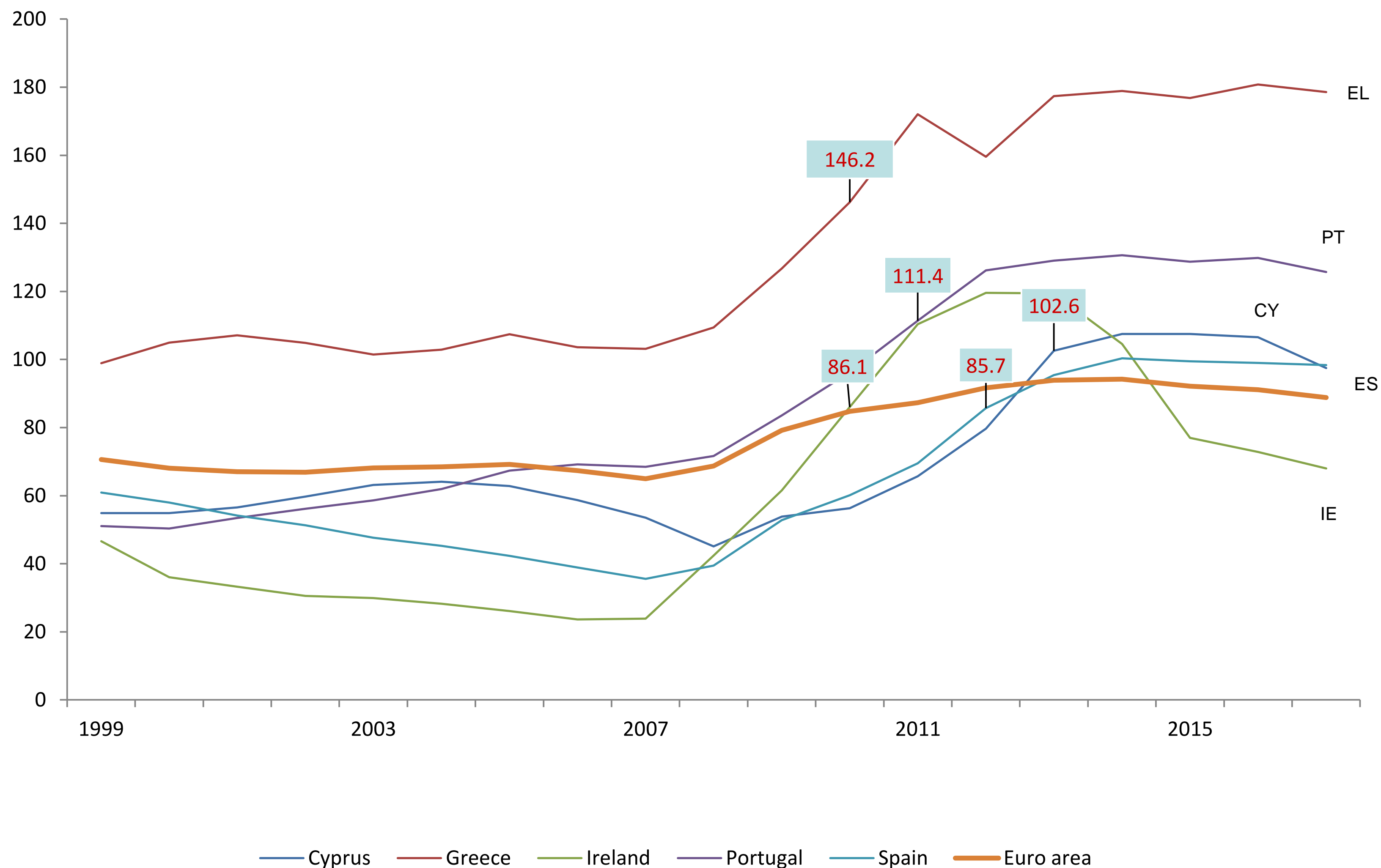
- **Main objectives:**
  - to analyse the effects of the recent crisis and the impact of the assistance programmes in the five EMU rescued countries
  - to examine the evolution of the macroeconomic situation in these countries, exploring the patterns of divergence/convergence relative to the EMU aggregate
  - to identify the main lessons from the crisis for economic policy



Using a scoreboard of **14 headline indicators and the respective thresholds from the Macroeconomic Imbalance Procedure (MIP)**

# Assistance Programmes

## Ratio government gross debt /GDP in rescued countries and EMU, 1999-2017 (%)



# Assistance Programmes

## The Assistance Programmes of Greece, Ireland, Portugal, Spain and Cyprus

| Country | | Amount | Agreement Date | Financing | Period |
|---|---|---|---|---|---|
| Greece | 1st bailout | €110 billion | May 2010 | EMU countries: €80 billion<br>IMF: €30 billion | 2010-2013 |
| | 2nd bailout | €130 billion | March 2012 | EFSF: €102 billion<br>IMF: €28 billion | 2012-2014 |
| | 3rd bailout | €86 billion | August 2015 | ESM: €86 billion | 2015-2018 |
| Ireland | | €85 billion | December 2010 | EFSF: €22.5 billion<br>EFSM: €22.5 billion<br>IMF: €22.5 billion<br>Ireland: €17.5 billion | 2010-2013 |
| Portugal | | €78 billion | May 2011 | EFSF: €26 billion<br>EFSM: €26 billion<br>IMF: €26 billion | 2011-2014 |
| Spain | | €100 billion | July 2012 | ESM: €100 billion | 2012-2014 |
| Cyprus | | €10 billion | May 2013 | ESM: €9 billion<br>IMF: €1 billion | 2013-2016 |

**European Financial Mechanisms:**

- EFSF: European Financial Stability Facility
- ESM: European Stability Mechanism
- EFSM : European Financial Stabilization Mechanism

# Macroeconomic Imbalance Procedure



## Scoreboard Indicators and Thresholds

| Main areas | Indicators | Measure | Types of variable | Upper threshold | Lower threshold |
|---|---|---|---|---|---|
| **External imbalances and competitiveness** | Current account balance (% of GDP, 3-year average) | % of GDP, 3-year average | Flow | 6% | -4% |
| | Net international investment position | % of GDP | Stock | | -35% |
| | Real effective exchange rate | 42 trading countries, HICP deflator, 3-year % change | Flow | 5% (EMU) / 11% (Non-EMU) | -5% (EMU) / -11% (Non-EMU) |
| | Export market share | % of world exports, 5-year % change | Flow | | -6% |
| | Nominal unit labour cost index | 2010=100, 3-year % change | Flow | 9% (EMU) / 12% (Non-EMU) | |
| **Internal imbalances** | House price index, deflated | 2015=100, 1-year % change | Stock | 6% | |
| | Private sector credit flow, consolidated | % of GDP | Stock | 14% | |
| | Private sector debt, consolidated | % of GDP | Stock | 133% | |
| | General government gross debt, Excessive deficit procedure concept | % of GDP | Stock | 60% | |
| | Unemployment rate | 3-year average | Flow | 10% | |
| | Total financial sector liabilities, non-consolidated | 1-year % change | Stock | 16.5% | |
| **Employment indicators** | Activity rate | % of total population aged 15-64, 3-year change in p.p. | Flow | | -0.2 p.p. |
| | Long-term unemployment rate | % of active population aged 15-74, 3-year change in p.p. | Flow | 0.5 p.p. | |
| | Youth unemployment rate | % of active population aged 15-24, 3-year change in p.p. | Flow | 2 p.p. | |

# Macroeconomic Imbalance Procedure

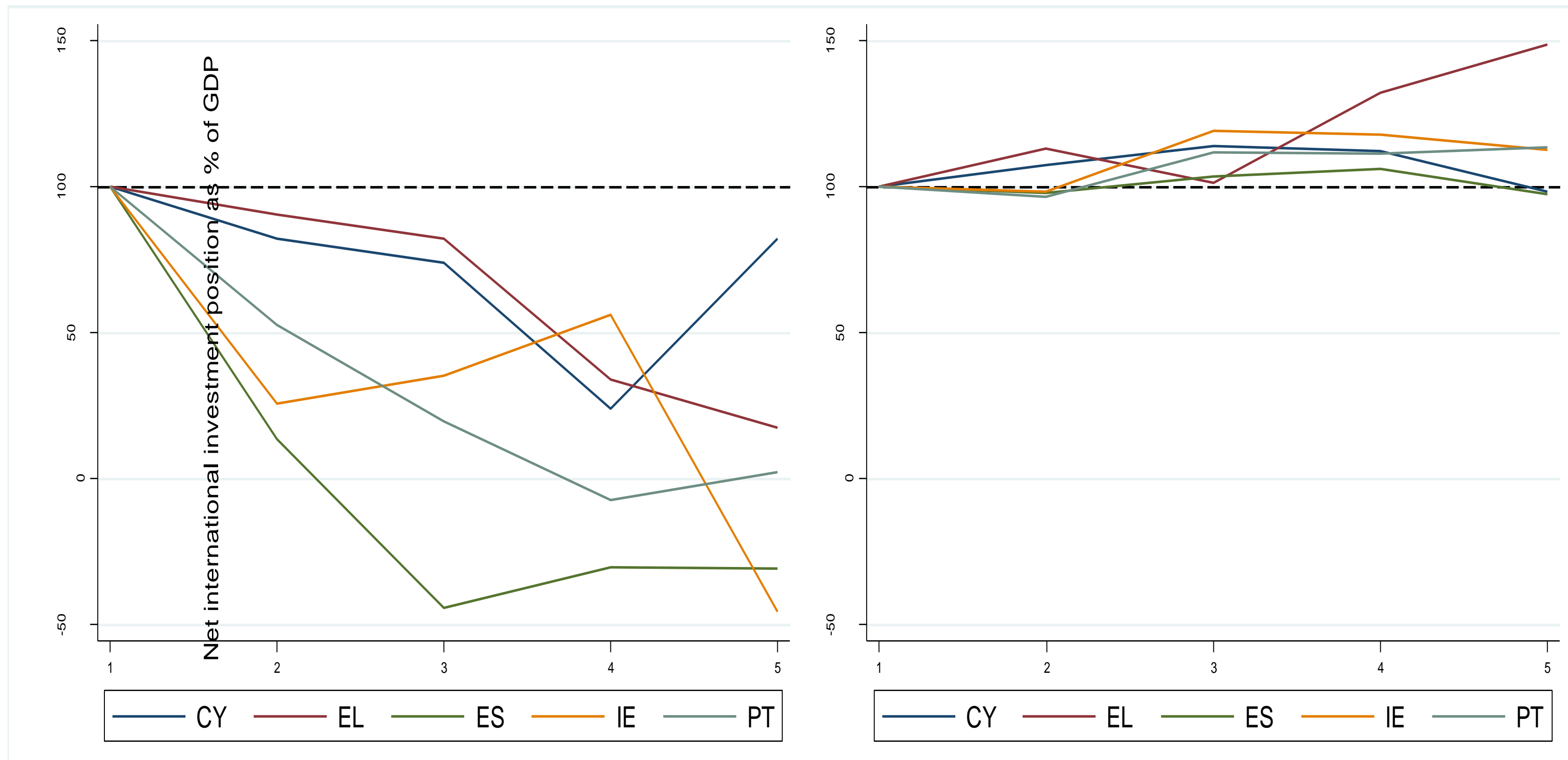
## Main Outcomes of MIP cycles for Rescued countries, 2012-2018

| MIP cycles (year *t*) | AMR | | Conclusion after IDR | | |
|---|---|---|---|---|---|
| | Number of countries elected to IDRs | Number of countries non eligible for AMR assessment | Number of countries with no imbalances | Number of countries with imbalances | Number of countries with excessive imbalances |
| 2012 | 12 | 4 (**EL, IE, PT**) | 0 | 12 (**ES, CY**) | 0 |
| 2013 | 13 | 5 (**EL, IE, PT, CY**) | 0 | 11 | 2 (**ES**) |
| 2014 | 17 | 4 (**EL, CY, PT**) | 3 | 11 (**IE, ES**) | 3 |
| 2015 | 16 | 2 (**EL, CY**) | 0 | 11 (**IE, ES**) | 5 (**PT**) |
| 2016 | 19 | 1 (**EL**) | 6 | 7 (**IE, ES**) | 6 (**PT, CY**) |
| 2017 | 13 | 1 (**EL**) | 1 | 6 (**IE, ES**) | 6 (**PT, CY**) |
| 2018 | 12 | 1 (**EL**) | | | |

- **Countries**: EL - Greece; IE- Ireland; PT - Portugal; ES - Spain; CY - Cyprus
- **MIP**: Macroeconomic Imbalance Procedure
- **AMR**: Alert Mechanism Report
- **IDRs**: In-Depth-Reviews

# Impact on Rescued Countries

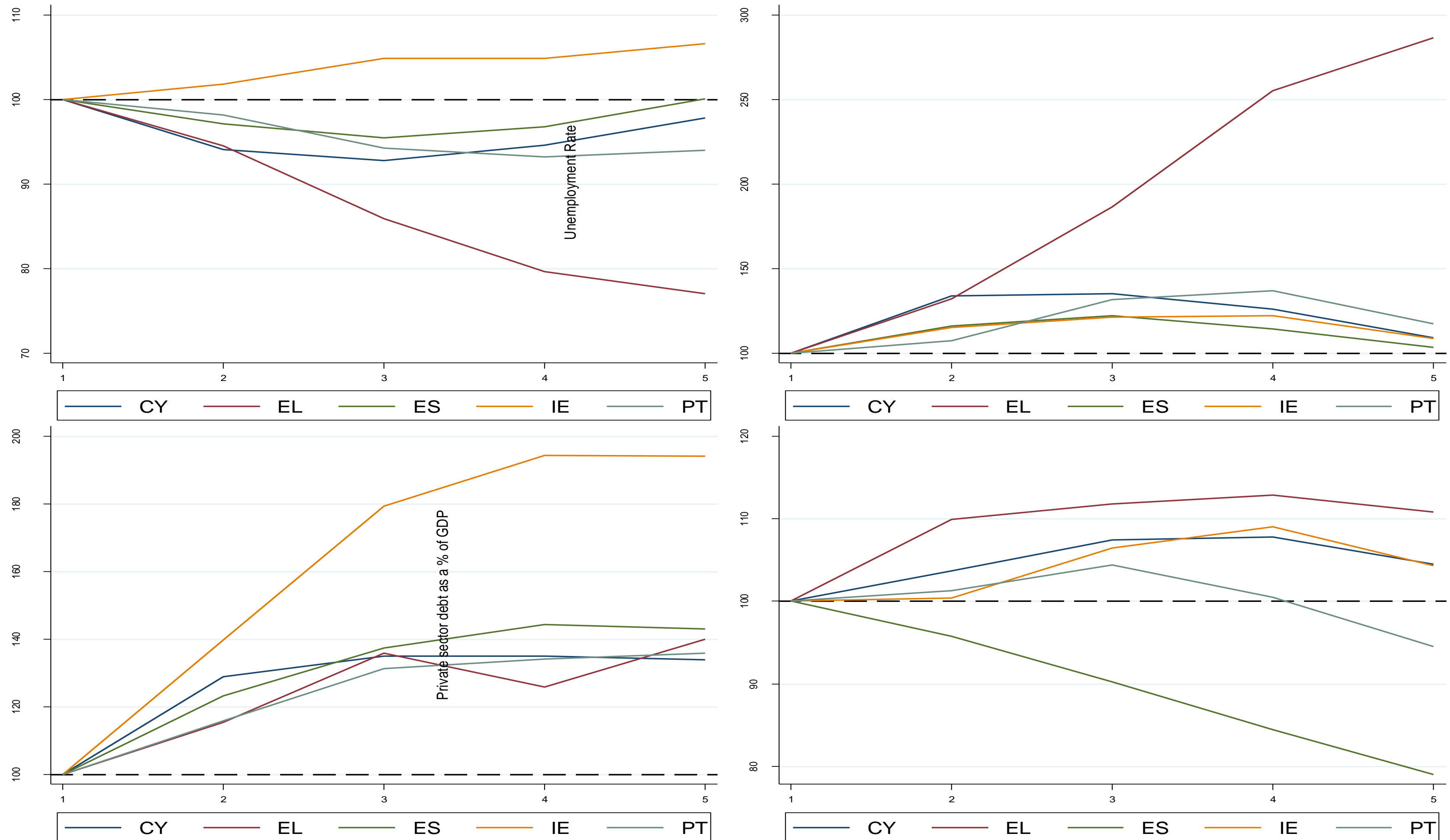
## Impact of Programmes: External Imbalances




- **Current account deficits:** All assistance programmes contributed to some improvement of the current account deficits, but the trajectory was different among countries. In year 5, only Ireland and Spain have a current account surplus
- **Net international investment position:** There was a worsening in the case of Greece, Portugal and Ireland; Spain and Cyprus were able to reduce their large stocks of net external liabilities

# Impact on Rescued Countries

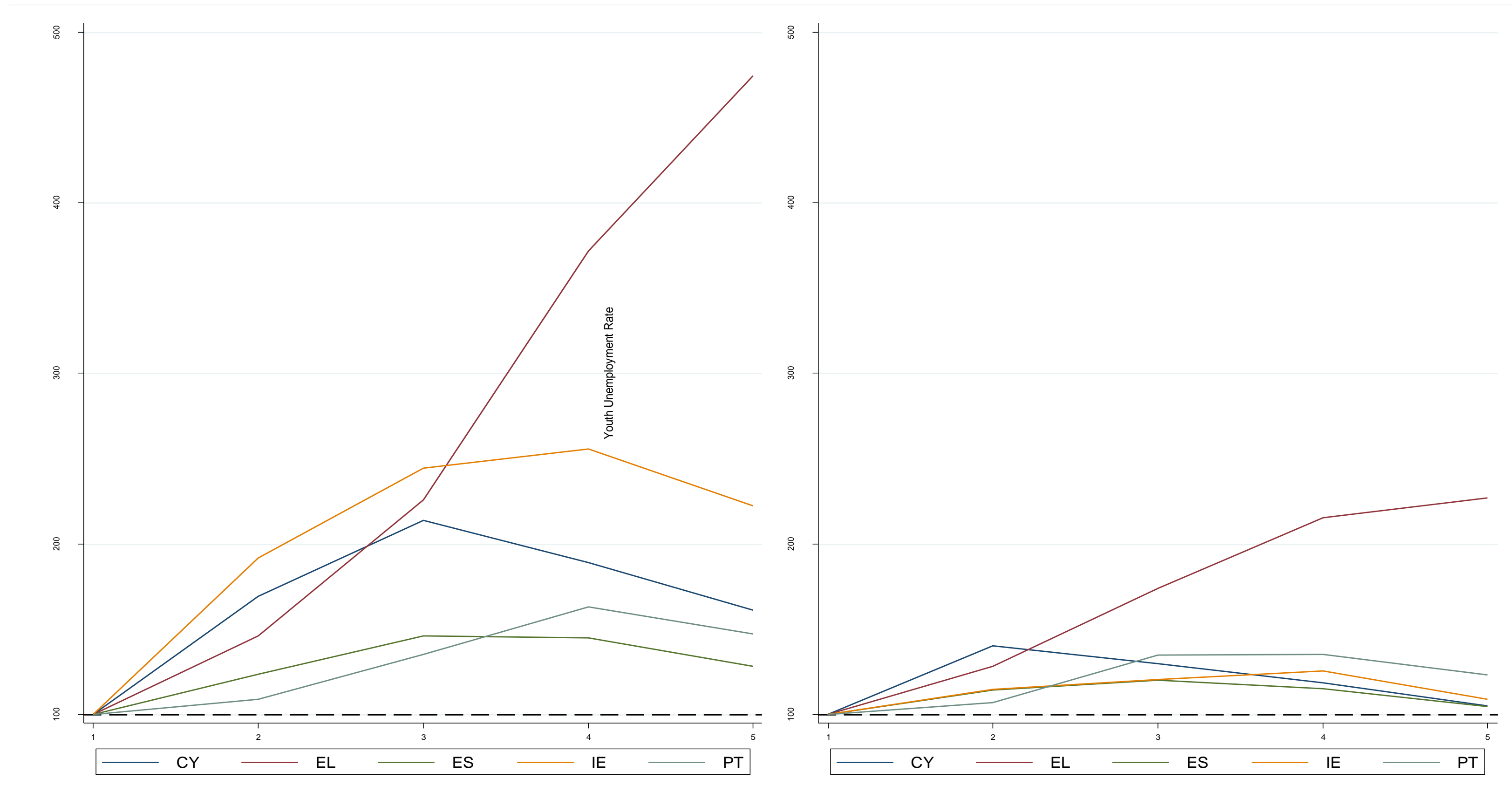
## Impact of Programmes: Internal Imbalances




- **Real GDP:** Economic contraction in all countries except in Ireland that experienced a moderate economic growth
- **Unemployment rate:** Increased in the first years and declined in the last year; the exception was Greece
- **Public and private debts:** The policies increased mainly public debt but also private debt in all countries, except in Spain

# Impact on Rescued Countries

## Impact of Programmes: Employment Indicators




- **Long-term unemployment rates:** Very high growth rates in all rescued countries, mainly in Greece and Ireland
- **Youth unemployment rate:** Young people have also been significantly affected by unemployment, mainly in Greece and Portugal

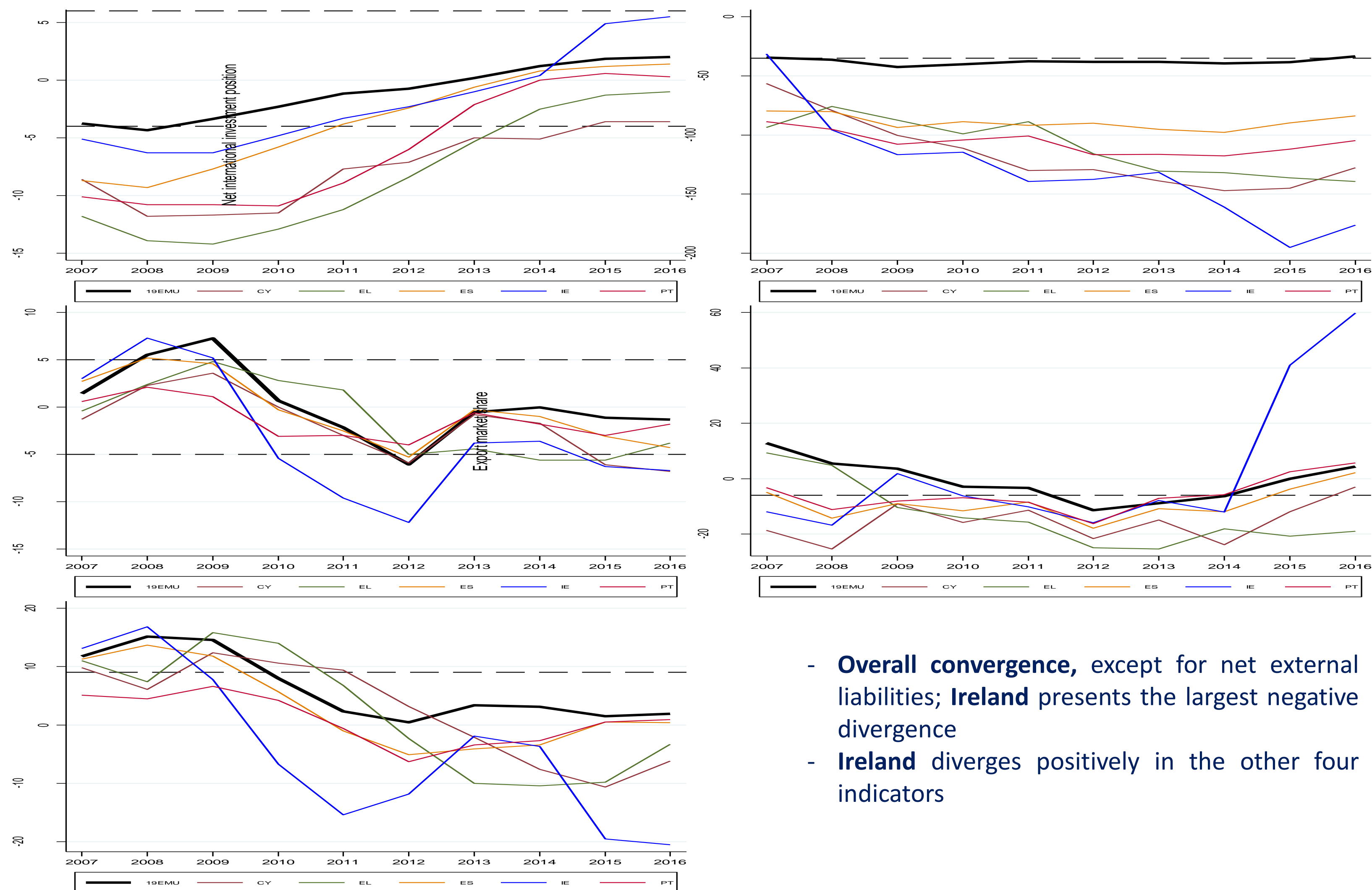
## Impact of Programmes: Global Growth Rates (%)

| Countries | External imbalances | | Internal imbalances | | | | Employment indicators | |
|---|---|---|---|---|---|---|---|---|
| | Current account deficit | Net international investment position | Gross domestic product | Unemployment rate | Public debt | Private sector debt | Long-term unemployment rate | Youth unemployment rate |
| CY | -17.7 | -1.5 | -2.2 | 9.2 | 33.8 | 4.5 | 61.1 | 5.1 |
| EL | -82.4 | 49.0 | -23.0 | 186.5 | 40.0 | 10.8 | 374.4 | 126.8 |
| ES | -130.8 | -2.4 | 0.1 | 3.3 | 43.0 | -21.0 | 28.1 | 4.5 |
| IE | -145.6 | 13.0 | 6.6 | 8.7 | 94.1 | 4.3 | 122.2 | 8.9 |
| PT | -97.5 | 13.7 | -6.0 | 17.5 | 35.8 | -5.5 | 47.4 | 23.0 |

- **Greece:** Was the country where the programmes most aggravated the respective external and internal imbalances
- **Spain:** Improved its external imbalances, reduced private debt with the lowest loss in terms of employment
- **Ireland:** Had a moderate growth, but the unemployment increased (mainly in the long-term) and had the great growth in the public debt
- **Portugal:** Reduced external and private debts, but experienced a strong economic contraction and a great increase in unemployment
- **Cyprus:** reduced external debt, but with considerable economic repercussions, particularly in terms of long-term unemployment rate

# Impact on Rescued Countries

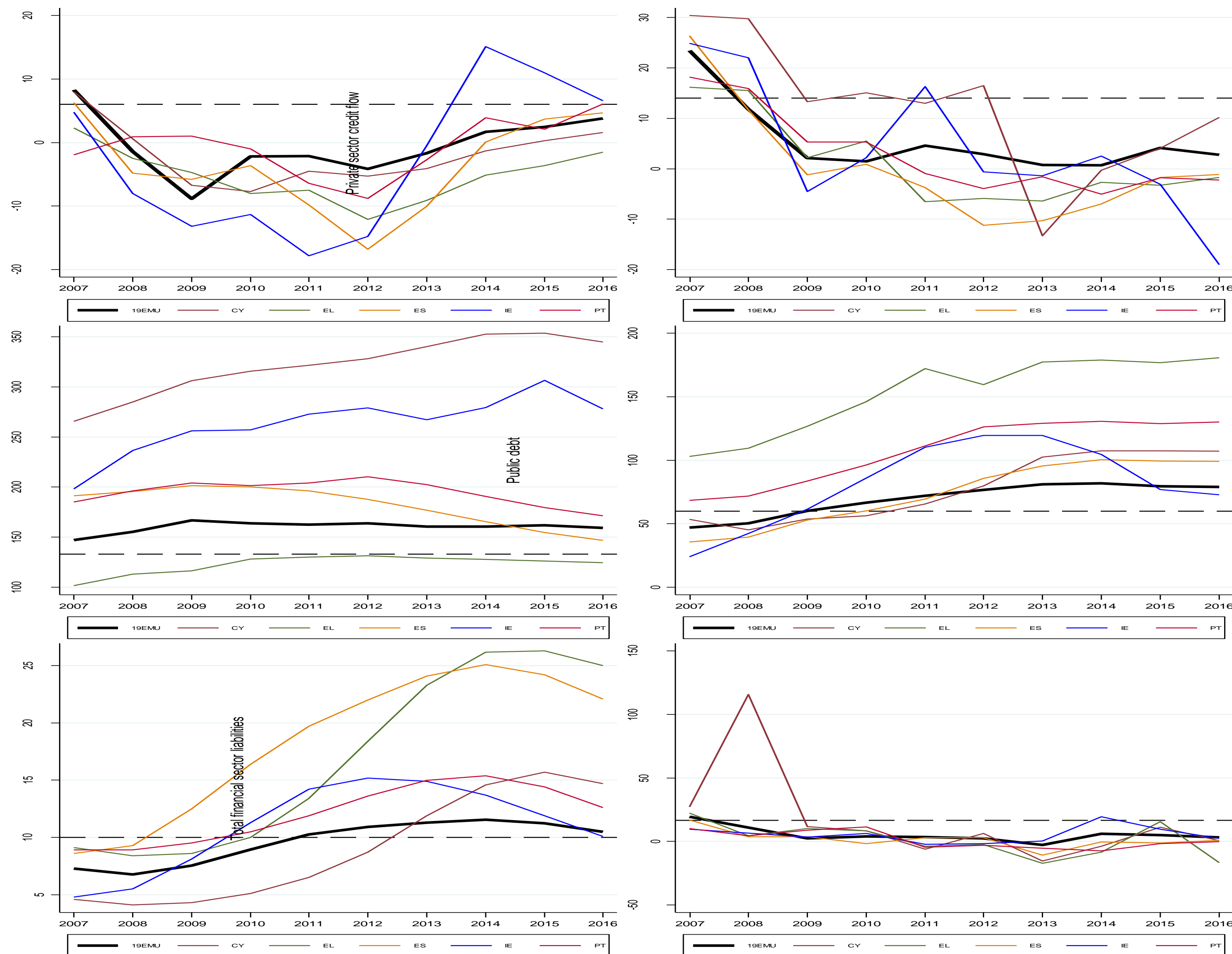
## Economic Evolution and Convergence: External Imbalances and Competitiveness, 2007-2016




- **Overall convergence,** except for net external liabilities; **Ireland** presents the largest negative divergence
- **Ireland** diverges positively in the other four indicators

# Impact on Rescued Countries

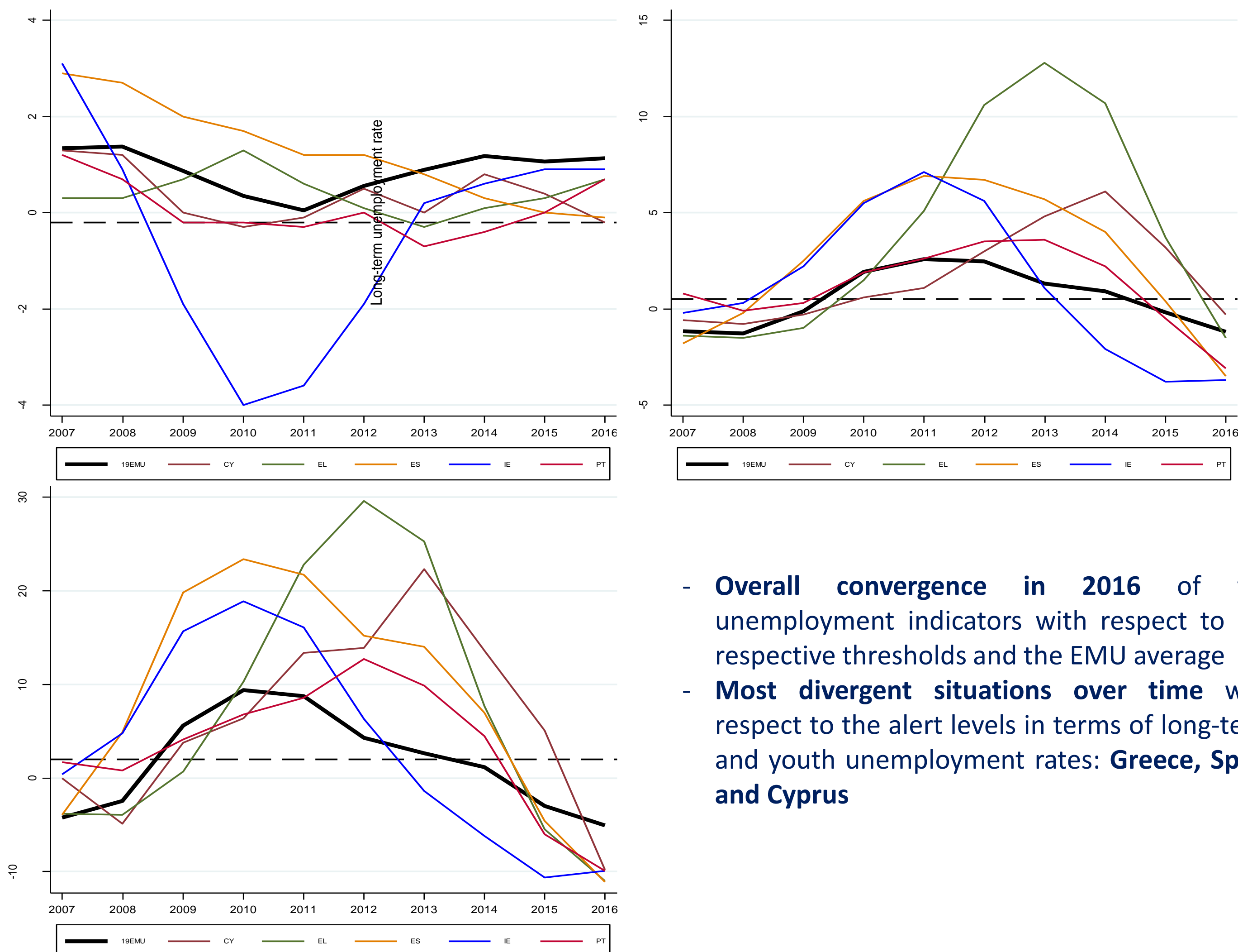
## Economic Evolution and Convergence: Internal Imbalances, 2007-2016




- **Overall divergence** with respect to **private and public debts**
- Marked **divergence** in the **unemployment rates until 2013**
- **Correction** of the non-compliance situations with the alert levels for the **other three indicators**

# Impact on Rescued Countries

## Economic Evolution and Convergence: Employment Indicators, 2007-2016




- **Overall convergence in 2016** of the unemployment indicators with respect to the respective thresholds and the EMU average
- **Most divergent situations over time** with respect to the alert levels in terms of long-term and youth unemployment rates: **Greece, Spain and Cyprus**

# Lessons for Economic Policy

## Three Main Lessons

- The **first lesson** is related to the **resolution of the sovereign debt crisis.** The economic and social repercussions of the European dcrisis have shown that **the implementation of austerity measures should be gradual** in order to limit the negative effects on economic growth. It is necessary to delay some of the budgetary adjustments until an economic recovery occurs and the fiscal multipliers become smaller (Cottarelli et al., 2014)

- The **second lesson** is that "**financial crises often lead to fiscal crises**" (Mishkin, 2017: 256), mainly due to a sharp increase in government indebtedness. So, **it is essential to preserve financial stability.** Monetary policy is different from financial stability policy and, thus, using monetary policy to achieve financial stability is ineffective and leads to poorer outcomes for monetary policy (Svensson, 2011)

- The **third lesson** is that a **more active role of fiscal policy is necessary** in negative economic situations, since monetary policy is not enough to achieve economic stabilization (Blinder, 2016). The SGP was designed to enforce fiscal discipline in the Member States of the EU "while allowing them to respond, within certain bounds, flexibly and effectively to the cycle" (van den Noord, 2007: 36). Nevertheless, the European crisis proved that the SGP was unable to accomplish these objectives

# Conclusion

- **The Great Recession** has exposed important **structural and institutional weaknesses** in the European Project; based on the principles of "no default, no bailout and no exit", **the EU failed doubly in crisis prevention and its resolution**

- The assistance programmes and the option of austerity, adopted to deal with the crisis, have led to economic recession in the rescued countries, with **more external and public debts, more unemployment and, in general, worsening social conditions**

- For the rescued countries, the values of the **net international investment position, the private and public debts and the unemployment rates** have **diverged** from the thresholds and the EMU average in the 2007-2016 period

- **As a result**, **ten years after** the beginning of the European crisis, although the economic situation has improved, **the effects of the crisis and of the austerity policies continue to be alive** in some rescued countries and the macroeconomic imbalances persist after the end of the assistance programmes, being classified as excessive imbalances in Portugal and Cyprus in 2017

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