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ADJUSTMENT PROGRAMMES IN THE EURO AREA: MISSION ACCOMPLISHED?

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This Synthesis is based on the main ideas aired and the conclusions drawn in the course of the debate of the first panel of the expert seminar held on 10 April 2014 by the Notre Europe – Jacques Delors Institute (NE-JDI) and the European Economic and Social Committee (EESC) on "Fiscal adjustment, competitiveness, growth and employment: have the memoranda of understanding achieved their goals?".

Four years after the adoption of the first rescue plan in the euro area, and as some countries have already completed their programmes, the time has come to conduct an initial assessment of the economic adjustment programmes in the euro area. To this end, the Notre Europe – Jacques Delors Institute (NE-IJD) and the European Economic and Social Committee held an **expert seminar** on 10 April 2014 entitled "**Assessing the Memoranda of Understanding of Countries Benefiting from Aid Programmes in the Euro Area**".

The first panel in the seminar, moderated by **Stefano Micossi** (Director General of Assonime and a professor at the College of Europe), was devoted to a debate on "**Fiscal adjustment, competitiveness, growth and employment: have the memoranda of understanding achieved their goals?**" The debate witnessed the participation of **Zsolt Darvas** (Senior Research Fellow with Bruegel), **Anna Diamantopoulou** (founder of Diktio and former European Commissioner) and **Colm McCarthy** (an economist with *University College* Dublin).

This synthesis, which is based on the main ideas aired and the conclusions drawn in the course of the debate, is divided into four parts:

1. An overview of financial aid programmes in the euro area
2. Exit strategies for emerging from the adjustment programmes
3. Forecasts vs. results achieved: an assessment of the programmes
4. What are the future prospects of countries benefiting from an aid programme?

Introduction

Since 2010, the European Union (EU) has been facing the most serious economic crisis in its history. This crisis, whose origin was both international (the global financial crisis) and national (budgetary, macro-economic and/or financial imbalances in certain countries), is a major test for the European integration project because it has highlighted the limitations in the construction of the Economic and Monetary Union (EMU), the first of which is the weakness of the euro area's crisis prevention capacity. In the first decade after the single currency's adoption, member states thought that there were two conditions that were necessary and sufficient for the stability of the euro area: price stability and fiscal stability (even though the rules governing fiscal discipline were not met by all of the member countries). No importance was attributed to the macro-economic and financial imbalances that developed over the past decade. So when the global financial crisis hit the EU, numerous countries found themselves already in a very fragile position.

Furthermore, the EMU was devoid of a crisis management framework, while such a framework did exist for those countries that were not members of the euro area[1]. Thus the countries in the euro area had no European aid instrument, while their national instruments were limited by their membership of the single currency. For example, they could not resort to the exchange rate mecanism to devalue their currency, and their recourse to budgetary policy was hampered by the Stability Pact's fiscal rules.

So it was in an emergency situation, in the wake of Greece's growing difficulty in funding its public debt on the financial markets, that the member states found themselves having to establish a crisis management framework. The European solution was based on "solidarity" – the provision of financial aid (*see Box 1*) – and on "supervision" – the implementation of an adjustment programme tracked by the "Troika" (the European Commission, the European Central Bank [ECB] and the International Monetary Fund [IMF]).

In order to answer the question "Have the memoranda of understanding achieved their goals?", we shall begin by conducting an overview of the aid plans that have been granted in the euro area over the past four years *(§ 1)* and go on to discuss the strategies for exiting the adjustment programmes *(§ 2)*. We shall then assess the adjustment programmes of Greece, Portugal and Ireland (since Cyprus has only been benefiting from an aid programme for a year, it is still too soon to assess the impact of its adjustment programme) by comparing the forecasts made when the programmes were adopted with the results achieved three years later *(§ 3)*. And lastly, we shall analyse the future prospects of those countries in the euro area that have benefited from aid programmes *(§ 4)*.

1. Overview of financial aid programmes in the euro area

Since 2010, four countries in the euro area have had to resort to financial aid from the EU and from the IMF in order to avoid defaulting on payments: Greece, which with its two financial aid programmes (adopted in May 2010 and March 2012 respectively) is due to receive approximately 240 billion euro between now and 2015; Ireland, whose aid programme adopted in December 2010 amounted to 85 billion euro; Portugal, with an aid programme worth 78 billion euro adopted in June 2011; and Cyprus, which was granted a 10 billion euro loan in April 2013. Spain also had to resort to EU financial aid in June 2010 (amounting to 41.3 billion euro), although unlike the other four countries, it did not apply for a complete adjustment programme but rather for an aid plan to recapitalise its banking industry (*see Table 1*).

Box 1. Financial Stability Mechanisms in the Euro Area

Since 2010 the member states have created three financial stability instruments, which it is worth distinguishing:

– The European Financial Stability Facility (EFSF): a temporary instrument, intergovernmental in structure, created in 2010 for duration of three years. Endowed with an effective loan capability of 440 billion euro, the EFSF borrowed on the financial markets on the strength of guarantees provided by the euro area's member countries;

– The European Financial Stabilisation Mechanism (EFSM): an instrument created at the same time as the EFSF in 2010. With an operational capability of 60 billion euro, this instrument allowed the European Commission to borrow on the financial markets using the EU budget as surety;

– The European Stability Mechanism (ESM): a permanent instrument, intergovernmental in structure, with an operational capability of 500 billion euro. It borrows on the financial markets on the strength both of its own capital (made up of funds paid in by the euro area's various member states, to the tune of 80 billion euro) and of a callable capital worth 620 billion euro.

The programmes for providing financial aid to the countries in the euro area include extremely large amounts of money; the level of the aid granted to date is without precedent in the history of IMF intervention. While the aid programme for Greece is far and away the largest in absolute terms (amounting to more than all of the other three programmes put together), it is also the largest in terms of percentage of GDP, amounting to more than 100% of the country's national wealth. Also, we should remember that the aid programme for Greece also included the cancellation of 100 billion euro from its overall debt through a private sector involvement (PSI) plan which translated into the voluntary exchange of Greek bonds held by private creditors (amounting to a nominal reduction of 53.5% of those bonds).

While the overall amount of the aid plan for Cyprus is very small compared to those thrashed out with the other countries, the aid granted is still the second highest in proportion to GDP, being worth almost 60% of the country's GDP. The case of Cyprus is different from those of the other three countries because a contribution has been asked of shareholders, bond holders and unsecured deposit holders (with deposits over 100,000 euro) of banks requiring major recapitalisation. That decision was justified, on the one hand, by the major role that the finance industry plays in Cyprus's economy (accounting for eight times the country's GDP, as opposed to an average figure of 3.5 times in the EU as a whole), and on the other hand, by the European authorities' determination to avoid a replay of the Irish "drama" in which government guarantees granted to the banking industry cost over 30% of the country's GDP in 2010.

Table 1: Financial assistance granted to euro area member states (in billions of euro)

	IMF	EFSF/ ESM	EFSM	Bilateral loans – euro area	Bilateral loans – non euro area*	Ireland (contribution to its aid plan)	Total	Aid granted (% of GDP)
Greece	49.8	144.7		45.5			240	103.9
Ireland	22.5	17.7	22.5		4.8	17.5	85	52.5
Portugal	26	26	26				78	45.1
Cyprus	1	9					10	56.5
Spain***	41.3						41.3	3.9
Total	140.6	197.4	48.5	45.5	4.8	17.5	454.3	-

* United Kingdom, Denmark and Sweden
** Nominal GDP in the preceding year to the adoption of the aid plan(Greece and Ireland 2009; Portugal 2010; Spain 2011; Cyprus 2012), Eurostat data.
*** Financial assistance for the recapitalisation of the banking sector
Source: European Commission

While the figures in question are large, we should remember that European solidarity should not be overestimated, for two reasons. First of all, because this financial aid has been granted in the form of loans and guaranties, not of grants. And second, we should remember that the "solidarity" aspect in the management of the crisis in the euro area has been pegged to a "supervisory" aspect. In return for financial aid, those member states that have lost their access to the financial markets have had to agree to commit to the implementation of a memorandum of understanding thrashed out with the members of the "Troika" and endorsed by the national parliaments of the countries in question. Through these memoranda of understanding, the European authorities influence their national budgetary, economic and social choices. So the crisis, and the reform of the European economic governance that it has triggered, have led to the creation of a new status, the status of countries which, in losing their access to the financial markets, have also lost a part of their fiscal sovereignty.

It is important to stress that the major conditionality to which a country benefiting from an aid programme is subjected, is designed to achieve two goals. On the one hand, it aims to ensure the re-establishment of a healthy and sustainable economic and fiscal situation as well as the country's ability to fund its debt wholly on the financial markets. On the other hand, it aims to avoid moral hazard whereby certain countries might be tempted to relax their budgetary efforts by relying on a bail-out from their European partners. Experience over the past few years has shown us that the second of these two goals has been successfully achieved, because those countries having to cope with financial difficulties are doing everything in their power to avoid having to resort to financial aid from the EU.

2. Exit strategies for emerging from the adjustment programmes

Economic adjustment programmes in the euro area last three years. In the case of Greece, as the country has benefited from two programmes, it will last approximately four and half years.

Today, two of the four countries benefiting from an aid programme have successfully completed their adjustment programme (Ireland in December 2013 and Portugal in May 2014). Greece's programme is due to come to an end in December 2014, while Cyprus, which is the last country to have adopted an adjustment programme, will not exit its programme before 2016. When countries reach the end of their programme, they have a choice between: i) committing to a new programme; ii) asking for a precautionary programme allowing them to resort to a European Stability Mechanism (ESM) credit line designed to help member states in the event of any problems they may encounter in funding their debt on the financial markets; and iii) opting for a « clean exit » and return to compete for funding on the financial markets.

Numerous experts[2] recommended that the two countries which completed their programme opt for the second option so as to enable them to return to the markets under a European "umbrella". Yet both Ireland and Portugal opted for the third choice, a "clean exit". There were two reasons for this: on the one hand, to reaffirm the success of the adjustment programme implemented *(§ 2.1.)*, and on the other, to shake off the supervision exercised by the Troika *(§ 2)*.

2.1. The programmes' success assessed on the basis of a country's ability to return to the markets

The ability of a country benefiting from an aid programme to return to the financial markets to fund its debt at the end of its adjustment programme, which translates the investors' renewed confidence, is seen as pointing to the success of the programme implemented.

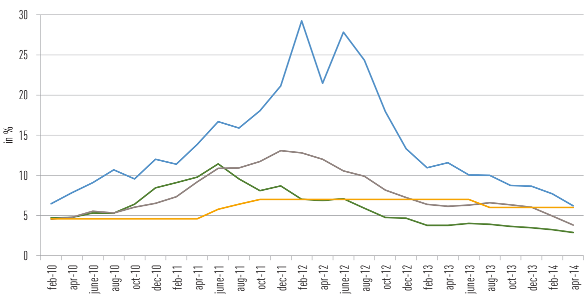
Ireland and Portugal returned to the markets with long-term bond issuances even before the end of their programmes. While Ireland returned to the markets in March 2013 with a 10-year debt issue worth 5 billion euro at 4.15%, five months after exiting its aid plan the country is now funding its debt with 10-year issues at less than 3%[3], the lowest interest rate ever recorded in Ireland for a 10-year issuance. Portugal, for its part, has also seen its interest rates drop sharply over the past year. The country returned to the markets for a 10-year issue in May 2013, issuing bonds worth 3 billion euro at 5.67%, while a year later, in April 2014, it raised 750 billion euro at 3.575%.

Investor confidence can also be detected in the 10-year interest rate trend on the secondary bond market. While interest rates on this kind of bond hit 12.45% for Ireland in July 2011 and 13.85% for Portugal in January 2012, by April 2014 they had fallen to 2.90% and 3.82% respectively. This trend to lower interest rates on the secondary markets can be seen also in Greece, where bonds being traded at 29.24% back in February 2012 had dropped to 6.20% by last month *(see Graph 1)*.

Bringing forward the completion of its aid progamme to December this year, Greece returned to the markets on 10 April with a five-year bond issue (under British rather than Greek law in order to reassure investors) worth approximately 3 billion euro at an interest rate of 4.75%. The most salient aspect of Greece's return to the markets is that the demand for its bonds was almost seven times higher than the supply (over 20 billion euro), which illustrates investors' interest in Greek bonds. Can this operation, hailed as a success, point to Greece's ability to make a « clean exit » at the end of this year? The experts at the seminar had reservations in that respect. This, primarily because, in the light of Greece's indebtment (over 170% of GDP), there is a great deal of uncertainty regarding its ability to pay back the loans granted to it and the need to resort to another restructuring of Greece's debt is currently considered likely *(see § 4.1.)*. So it is by no means a foregone conclusion that Greece will be able to obtain funding at permanently reasonable rates as of the end of the year.

It is also worth stressing that, while it is true that the interest rates sought by investors for funding countries benefiting from an aid programme have dropped sharply since the summer of 2012 this is not due solely to investor perception of an improvement in those countries' national situations. Numerous experts pointed out in this connection that if confidence has been restored, it is because the belief that the euro is going to survive this crisis has won the day, thanks largely to the action taken by the ECB. Indeed, the ECB adopted an unlimited sovereign debt buy-back scheme christened "Outright Monetary Transactions" in late 2012. These purchases are strictly pegged to the condition that countries wishing to benefit from the scheme must submit an application for aid to the ESM. Even though the scheme has never been activated, it has had a clearly positive impact on the financial markets, easing interest rates on the secondary bond market. We should also point out that Mario Draghi, speaking in July 2012, famously said: "We will do whatever it takes to save the euro", a stance which clearly reassured the markets.

Graph 1. Evolution of 10 years interest rates on secondary bond markets for countries benefiting from an aid programme*



Source: Authors based on ECB data
* For Cyprus, the ECB reports the primary market yields.

2.2. Emerging from programmes to recover fiscal sovereignty

If Ireland and Portugal decided to make a clean exit from their programmes, it was not only to display their programmes' success. This, because accepting a precautionary programme as they had been advised to do might have allowed them to enjoy lower interest rates to fund their debt, but it would also have been tantamount to extending the constraints enforced by the European authorities on their national economic and fiscal policies.

Yet it is worth stressing that at the end of their adjustment programme, member states do not automatically resume the same relationship with the European authorities that they enjoyed prior to that programme's adoption. This, because they are in effect subjected to post-programme surveillance until the member state has paid back at least 75% of the aid it has received[4]. Post-programme surveillance is designed to ensure that fiscal consolidation is pursued and that growth potential increases, in order to guarantee that the country's debt is sustainable.

After emerging from their programme, the countries are thus subject to six-monthly assessments by the Commission, and if any problems are identified, the Council can adopt a recommendation urging the member state in question to take corrective measures. While this kind of monitoring is far less binding than that adopted in the case of countries benefiting from an aid programme, it can still last for a very long time. By way of an example, the Commission has forecast that under the current payback timetable, post-programme surveillance in Ireland is going to last until at least 2031[5].

3. Forecasts vs. results achieved: an assessment of the programmes

While the criterion relating to a programme's exit strategy is certainly an indicator that should be taken into consideration when assessing the aid plans, we must resist the temptation to use this criterion as our sole yardstick in gauging those plans's success.

In replying to the question "Have the memoranda of understanding achieved their goals?", it is equally important to compare the forecasts built into the programmes with the results actually recorded in each country's case. To do this, we present a set of economic indicators (GDP and domestic demand variation over the past few years, current account balance and unemployment figures) and of budgetary figures (public debt and deficit) in Table 2. The first conclusion we can draw from this comparison is that in Greece's and Portugal's case, the adjustment programmes' forecasts were excessively optimistic in every one of the indicators presented apart from the trend in the current account balance, which was more favourable than predicted.

We shall now analyse these various indicators under three headings i) public finances; ii) growth and employment; iii) competitiveness.

Table 2. Economic indicators for 2013: projections of adjustment programmes vs. outcomes

	GREECE		IRELAND		PORTUGAL	
	Projection 2009-2013	AMECO Jan. 14	Projection 2010-2013	AMECO Jan. 14	Projection 2010-2013	AMECO Jan. 14
Real GDP (cumulative change in %)	-3.5	-20.6	5.4	1.5	-2.8	-6.1
Domestic demand (cumulative change in %)	-11.8	-27.8	-3.4	-7.7	-10.5	-13.1
	Projection	2013	Projection	2013	Projection	2013
Public deficit (% of GDP)	-4.9	-12.7	-7.5	-7.2	-3	-4.9
Public debt (% of GDP)	149.7	175.1	120.5	123.7	108.6	129
Current account balance (% of GDP)	-5.6	-2.3	2.6	7.0	-3.9	-0.4
Unemployment rate (%)	14.8	27.3	11.6	13.1	12.4	16.5

Source : Study of Bruegel: "The Troika and financial assistance in the euro area : successes and failures". Study on the request of the Economic and Monetary Affairs Committee",19th February 2014 , Eurostat data for public deficit, public debt, the unemployment rate for 2013 and data from the Winter forecast 2014 for the current account balance.

3.1. Public finances

While this crisis is in effect a sovereign debt crisis, one of the programmes' primary aims is to ensure member states' fiscal consolidation. Yet the result of the financial aid granted to countries benefiting from aid programmes has been to trigger a serious increase in national public debts (approximately 30 percentage points between 2010 and 2013[6]). While the major debt increase is a feature shared by all three countries, there is a difference in the dynamic between Ireland on the one hand, and Greece and Portugal on the other. While the public debt trend in Ireland has reflected the forecasts made by the European authorities when the adjustment programme was first adopted back in 2010, in the case of Portugal and of Greece the public debt has increased by far more than expected *(see Table 2)*. This is due primarily to a sharper drop in the national GDP than expected, as we shall see under the next heading.

Despite the fact that Greece had the highest public deficit of the three countries in 2013, it is still the country which has achieved the best results in terms of reducing its excessive deficit. This, because if Greece's public deficit was so high in 2013 (12.7%), it was due to exceptional spending in support of the banking industry. Eurostat has calculated that, aside from this exceptional spending, Greece's budget deficit stands at 2.1% of GDP. Moreover, Greece posted the largest structural budget surplus in the euro area last year (1.7% of GDP), as well as a primary budget surplus (net of debt servicing) for the first time in ten years, worth 0.8% of GDP. These figures reveal the Greek Government's huge effort in the field of fiscal adjustment. While the public deficit trend is less impressive in Ireland and in Portugal, we have no choice but to recognise that the adjustment programmes have achieved their goal of reducing nominal public deficits and of improving structural balances, as we can see from Table 4.

3.2. Growth and employment

The experts pointed out that the adjustment programmes adopted in the euro area were based on an economic doctrine whereby the economic recovery would be the natural corollary of fiscal consolidation. There has been a heated debate over the past few years regarding this doctrine's validity and today even the IMF has begun to question it, highlighting instead the negative impact on growth and employment of the adjustment programmes adopted in the euro area.

Fiscal adjustment has indeed had more of a negative impact on growth than was hoped when the programmes were first adopted. The most dramatic situation is in Greece: its programme provided for GDP to shrink by 3.5% between 2009 and 2013, whereas in fact Greece has lost over 20% of its national wealth in five years (*see Table 2*). Greece was expected to return to growth in 2012, whereas in fact it will not be returning to growth before 2014.

The shrinkage in Portugal's GDP, while considerable, is still below the level of Greece's loss of wealth, amounting to approximately 6% in four years rather than the figure of 3% forecast in 2010. The situation is less dramatic in Ireland's case because GDP rose by 1.5% over the period, although in fact growth of more than 5% had originally been forecast.

This sharper drop in GDP than expected (or weaker increase, in Ireland's case) is due in part to a far stronger contraction than predicted in domestic demand. Domestic demand shrank by more than twice the expected figure in Greece and in Ireland (-27.8% and -7.7% respectively; -13.1% for Portugal).

This major contraction in domestic demand can be explained primarily by domestic factors. The negative impact of fiscal adjustment had been underestimated and the difficulty in accessing credit turned out to be tougher than predicted despite the ECB's massive injection of liquidity.

Above and beyond the major drop in domestic demand and other explanations relating to the economy of each individual country, it was pointed out that poor national performances in the sphere of growth are also justified by the fear that the euro area would break up, a fear fuelled by a heated debate on the "Grexit" (Greece's exiting the euro area) which prompted a capital drain and held investors back. And finally, the weak growth rates recorded in most of these countries' trading partners, including those in the EU itself, also had a negative impact on the countries' economic performances.

It comes as no surprise to discover that the far stronger than forecast shrinkage in GDP in Greece and in Portugal has had a very negative impact on employment: the unemployment rate has reached alarming levels in Greece, with over 27% of the active population out of work (as opposed to the figure of 15% in 2013 forecast in the adjustment programme) and almost 60% among young people under the age of 25.

Ireland is the country that has suffered least in terms of the negative impact of adjustment on employment, with an unemployment rate of approximately 13% in 2013, a level close to the average for the euro area as a whole (12%). Moreover, the unemployment trend started to curve downward in 2013 and forecasts suggest that the drop in the number of unemployed is likely to continue over the next few years.

Aside from the adjustment programmes' strongly negative impact on employment, it is also worth pointing out that these programmes have had major social consequences, cutting into purchasing power and triggering rising inequality and poverty[7]. It was stressed during the seminar that the middle classes and lower income brackets have the feeling that they have borne the brunt of the adjustment effort and that that effort has not been fairly shared by all.

3.3. Competitiveness

The only indicator in Table 2 in which the trend recorded over the past four years has been more favourable than forecast for the three countries involved is the current account balance indicator. While shrinking domestic demand has led to a drop in imports, a higher rise than forecast in the sphere of exports has caused the current account balances has post this positive trend.

Yet despite this more favourable tend, Greece's current account balance still shows a deficit (-2,3% of GDP). But having said that, if we consider that Greece showed a deficit of almost 15% in its current account balance between 2005 and 2009, it is obvious that this indicator has vastly improved all the same.

Portugal, for its part, posted a current account surplus in 2013 (0.8% of GDP) for the first time in ten years. Like Greece, so Portugal too has had to come a long way, having shown an average current account balance deficit of approximately 11% between 2005 and 2009.

And finally, Ireland posted one of the largest current account surpluses in the EU in 2013, coming in at roughly 7% of GDP; this is even higher than the threshold for current account surpluses set by the indicator scoreboard for macroeconomic surveillance in the EU (which stands at 6%).

Given that the countries in the euro area have not been able to resort to currency devaluation to strengthen their competitiveness, they have had to undertake a domestic devaluation, lowering prices and wages. Very grievous measures have therefore had to be implemented: a drop in the minimum salary (Greece and Ireland; a freeze in Portugal's case); a freeze on public-sector salaries and enforced cuts above a certain threshold (in all three countries), and the abolition of the "fourteenth month" bonus (in Greece and Portugal), among other measures. So while in the years preceding the crisis unit labour costs had risen in all three countries at a higher rate than the euro area average (2.3% in the euro area and 0.8% in Germany), the labour cost has dropped in all three countries since 2010. The slightest drop of all has been in Portugal, the adjustment being far more painful in Greece and in Ireland. Ireland adjusted its wages right from the start of the programme (2010/2011) while Greece made its most substantial adjustment in 2012/2013 (*see Table 5*).

It was pointed out on numerous occasions in the course of the seminar that the drive to boost competitiveness cannot rest solely on this pillar – lower labour costs – but also rest, in particular, on an increase in factors' productivity, which means in particular investing in education, training and innovation policies. Yet austerity policy leaves little room for manoeuvre for such priorities, which gives serious cause for reflection.

4. What are the future prospects of countries benefiting from an aid programme?

While, on the one hand, the interest rates demanded from the three countries benefiting from an aid programme to fund their debt have dropped sharply since 2012 (which appears to confirm the success of the adjustment programmes), the assessment of the programmes through a comparison of results forecast and results effectively achieved is more nuanced, with a number of positive factors (public deficit and current account balance trends) but with numerous negative factors (trends in GDP, in domestic demand, in the public debt, in unemployment, in inequality and in poverty).

Thus we shall conclude this analysis by taking a look at the future prospects of the four countries benefiting from an aid programme. After four very difficult years (for Greece, Ireland and Portugal) with numerous sacrifices and much belt-tightening being enforced on the citizens, is it possible to argue today that the worst is behind them and that these countries have now come to the end of the tunnel? Is a new leaf turned over when countries reach the end of their programme? To attempt to sketch out a reply to those questions, we shall take a look at the forecasts built into the quarterly assessments for each country, starting with growth and employment prospects and with the three priorities in the adjustment programmes: ensuring debt sustainability; implementing structural reforms in order to boost competitiveness; and consolidating the finance industry.

4.1. Strengthening growth, reducing employment

Despite the adjustment programmes' negative impact on growth in those countries benefiting from an aid programme over the past four years, growth forecasts for 2014 and 2015 are encouraging, inasmuch as the GDP growth rate rises every year over the previous year. After six and three years of shrinking GDP respectively, Greece and Portugal will be returning to growth in 2014 (in annual data).

While forecasts suggest that Greece and Ireland will enjoy growth rates higher than the European average, of 2.9%, growth in Portugal will be weaker, hovering around the 1.5% mark. These growth prospects reflect what has happened over the past decade (prior to the crisis): while Greece and Ireland were already among those countries where GDP growth was the highest in Europe, Portugal was already showing weak growth, well below the European average. Thus Portugal is facing a major medium/long-term economic challenge involving resolving its structural weaknesses and promoting the transition towards a new growth model.

Table 3. GDP growth rate and unemployment rate (2012-2015)

		2012	2013	2014	2015
GREECE	GDP growth rate (%)	-6.4	-3.7	0.6	2.9
	Unemployment rate (%)	24.3	27.3	26	24
IRELAND	GDP growth rate (%)	0.2	0.3	1.8	2.9
	Unemployment rate (%)	14.7	13.1	11.9	11.2
PORTUGAL	GDP growth rate (%)	-3.2	-1.6	0.8	1.5
	Unemployment rate (%)	15.9	16.5	16.8	16.5
CYPRUS	GDP growth rate (%)	-2.4	-6.0	-4.8	0.9
	Unemployment rate (%)	11.9	16.0	19.2	18.4

Source: Winter forecast 2014

Where the unemployment rate is concerned, Ireland reversed its unemployment curve in 2013 and the trend is expected to continue into 2014 and 2015. In Portugal's case, the unemployment rate stabilised at around 17% in 2013 and the curve is expected to turn down in 2015 (Greek unemployment curve is expected to be reversed in 2014). Several experts stressed, however, that the stabilisation or reduction of the number of unemployed is not necessarily linked to a return to jobs for the unemployed because it may also conceal the reality of workers emigrating to try their luck in another country[8].

4.2. Is the debt of countries benefiting from an aid programme sustainable?

One of the adjustment programmes' primary goals has been to prevent the countries from defaulting. Four years on, are we able to state that the debt in those countries benefiting from an aid programme is now sustainable? The debate on this issue took its cue from the debt sustainability analyses put together by Bruegel[9].

Table 4. Fiscal indicators of countries benefiting from an aid programme (2012-2013) and forecasts (2014-2015)

		Fiscal balance		Public debt
		Solde nominal	Solde structurel	
GREECE	2012	-8.9	-0.1	157.2
	2013	-12.7	1.7	175.1
	2014	-2.2	0.7	177.0
	2015	-1.0	-0.1	171.9
IRELAND	2012	-8.2	-7.7	117.4
	2013	-7.2	-6.4	123.7
	2014	-4.8	-4.9	120.3
	2015	-4.3	-4.6	119.7
PORTUGAL	2012	-6.4	-4.0	124.1
	2013	-4.9	-3.6	129.0
	2014	-4.0	-2.6	126.6
	2015	-2.5	-1.8	125.8
CYPRUS	2012	-6.4	-6.4	86.6
	2013	-5.4	-3.8	111.7
	2014	-5.8	-4.5	121.5
	2015	-6.1	-5.2	125.8

Source: Eurostat data for the years 2012 and 2013 for nominal balance and public debt. Winter forecast 2014 for other results and forecasts.

Ireland's situation is the most optimistic, even though the forecasts suggest that it is the country which will be showing the highest public deficits of the three between 2012 and 2015. The fact that Ireland has a much lower public debt than Greece and that it benefits from more solid economic foundations and better growth prospects than Portugal work in its favour. Yet it was pointed out in the course of the seminar that Ireland faces a significant challenge if it is to pursue its deleveraging. In order to achieve this goal, Ireland needs to post a balance of payments surplus for many years, which means low consumption, low investment and low public spending.

Where Portugal is concerned, there is a danger that its debt may not be sustainable, in view both of the level of the country's indebtment and of its poor growth prospects. Thus the sustainability of its debt depends on an improvement in its growth prospects, failing which it is highly likely that it will prove necessary, initially, to extend the maturity of the EU loan in order to reduce the burden of the debt over the next few decades (the EFSF and ESM loans to Portugal – and indeed to Ireland – have an average twenty-year maturity, as things stand today).

And lastly, where Greece is concerned, in view of the country's extremely high level of indebtment (despite the cancellation of part of its debt in 2012), it is probably going to be necessary to envisage a new debt restructuring. This initiative should entail an extension of the maturity of the "Greek Loan Facility" (euro area countries' bilateral loans to Greece) to fifty years (as opposed to approximately thirty today) as well as a cut in the interest rates and an extension of the EFSF loans' maturity (even though they already have a longer deadline than that of other countries benefiting from an aid programme, which stand at approximately thirty years).

The countries in the euro area had set a precondition to this proposal, demanding that Greece post a primary surplus in 2013, and sure enough it did. Thus negotiations on restructuring the Greek debt will probably take place in the coming months. Several experts also argued that Greece can be expected to benefit from a new programme worth about 40 million euro (based on Bruegel's figures) at the end of its current adjustment programme, in order to keep the country off the markets until 2030.

4.3. Pursuing structural reforms

Forecasts for the trend in current account balances show that the positive trend recorded over the past few years may well continue on into 2014 and 2015, inasmuch as the balance is continuing to improve in the three countries (and in Cyprus) thanks to the ongoing upward trend in exports (*see Table 5*). The adjustment of labour costs is also going to continue, with a drop in the unit labour cost in the four programmes benefiting from aid programmes.

We need to make an initial distinction, in the four countries benefiting from aid programmes, between the situations in Greece and Portugal on the one hand, and those in Ireland and Cyprus on the other. As has already been pointed out, the two former countries were having to face more substantial structural difficulties than the other two even before the crisis began. In order to address those difficulties, an ambitious agenda of structural reforms was built into the adjustment programmes, ranging from labour market and pension reforms to the reform of the taxation system, of the civil service and of the service industry, among other things. Thus the adjustment programmes are the tools that have allowed the countries to enforce reform discipline even though the Portuguese and Greek national administrations had been having management problems for years.

What people often question where the reforms enforced on countries benefiting from an aid programme are concerned, is not the need for them – Greece and Portugal, in particular, were suffering from major structural shortcomings – so much as the pace at which they are being enforced. The structural adjustment being demanded of the peripheral countries today is often compared with the adjustment implemented by Germany in the 2000s – a move which allowed it to boost its competitiveness. Yet it is worth pointing out that Germany implemented its adjustment at a time when the European and international economies were doing fairly well, while the peripheral countries are implementing theirs in the wake of the most serious economic crisis since the 1930s, while also having to address serious problems in the finance industry and while subject to major budgetary constraints. Thus they have three challenges to face: consolidating their public finances, consolidating their finance industries and reforming their economies. The rapid pace of the reforms has meant that there is no time for debate or for negotiation. The structural reform challenge today is a dual challenge.

On the one hand, there are still several major reforms that have yet to be adopted. In Greece's case, for instance, two reforms are still wanting: the reform of the country's taxation system, which is crucial to increase tax revenue; and the reform of its legal system, which is important in particular to attract foreign investment. So the reform agenda does not come to an end with the completion of the adjustment programmes.

On the other hand, there is the issue of member states' ability to successfully implement the reforms adopted. The public administrations' ability to successfully implement reforms is being called into question, particularly in Greece and in Portugal in view of the important reforms adopted.

Table 5. Competitiveness indicators for countries benefiting from an aid programme (2005-2015)

		5 year average (2005-2009)	2010	2011	2012	2013	2014	2015
GREECE	Current account balance (% of GDP)	-14.9	-12.8	-11.7	-5.3	-2.3	-1.8	-1.6
	Exports of goods and services (% of change)	-1.3	5.2	0.3	-2.4	2.5	4.6	5.5
	Import of goods and services (% of change)	0.2	-6.2	-7.3	-13.8	-6.8	-1.3	2.7
	Unit labor costs (% of change)	3.2	-0.1	-1.8	-6.2	-7.8	-1.5	-0.3
IRELAND	Current account balance (% of GDP)	-4.0	1.1	1.2	4.4	7.0	6.8	7.2
	Exports of goods and services (% of change)	2.5	6.4	5.4	1.6	0.3	2.8	3.7
	Import of goods and services (% of change)	1.8	3.6	-0.4	0.0	0.1	2.8	2.6
	Unit labor costs (% of change)	3.4	-6.7	-4.0	0.0	1.6	-0.8	-0.8
PORTUGAL	Current account balance (% of GDP)	-10.9	-10.4	-7.2	-2.2	0.4	0.8	1.1
	Exports of goods and services (% of change)	1.4	10.2	6.9	3.2	5.8	5.0	5.3
	Import of goods and services (% of change)	1.3	8.0	-5.3	-6.6	2.6	3.0	3.8
	Unit labor costs (% of change)	2.4	-1.4	-0.9	-3.0	1.0	-1.9	-0.1
CYPRUS	Current account balance (% of GDP)	-9.6	-9.2	-3.5	-6.8	-1.7	0.0	0.4
	Exports of goods and services (% of change)	0.5	3.8	4.4	-2.7	-4.8	-2.7	1.9
	Import of goods and services (% of change)	2.1	4.8	-0.2	-6.4	-14.7	-7.2	0.2
	Unit labor costs (% of change)	1.9	1.1	2.5	-2.7	-4.7	-2.6	0.8

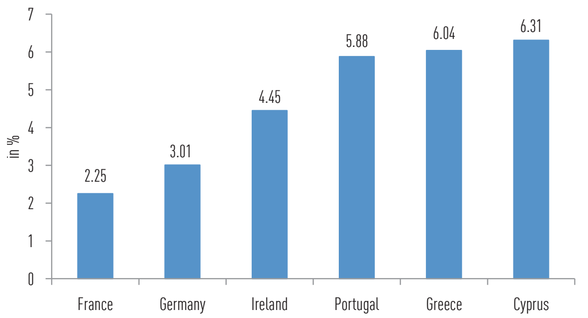
Source: Winter Forecast 2014

4.4. Consolidating the financial sector

The crisis in the euro area debt has highlighted a vulnerability in the countries sharing the same currency, and that is the close link between banking crises and sovereign crises. In an effort to remedy this vulnerability, the euro area countries have adopted a reform designed to transfer powers from the national level to the European level in the field of bank supervision and of banking crises resolution. This "banking union" aims to achieve two goals in the medium term: avoiding banking crises through better bank supervision, and limiting the budgetary consequences for the European taxpayer in the event a bank crisis does occur. The new European directive on banking crises resolution provides, in this connection, for shareholders and creditors to chip in before public money is used, if and when it becomes necessary to rescue a bank (bail-in).

In addition to these medium-term benefits, the banking union should have a major impact in the short term on rebuilding investor confidence in the euro area. This is crucial if we are to resolve the problem of the European finance industry's fragmentation, which does so much damage to the peripheral countries' economy. One of the most important problems for banking systems in countries benefiting from an aid programme is the difficulty encountered by households and businesses in accessing credit. This is due to a problem with credit supply (which has dropped considerably) but also with demand, because the households and businesses in those countries are often heavily indebted. As we can see from Graph 2, Greek, Cypriot and Portuguese businesses are borrowing money at interest rates which are two or three times higher than those asked of French or German businesses. Funding SMEs is crucial to kick start growth, to save jobs and to create new jobs, as well as to strengthen the competitiveness of those countries currently benefiting from an aid programme. In this light, the banking union, with the establishment in 2014/15 of single supervision and resolution mechanisms, marks important progress in the search for a solution to this problem.

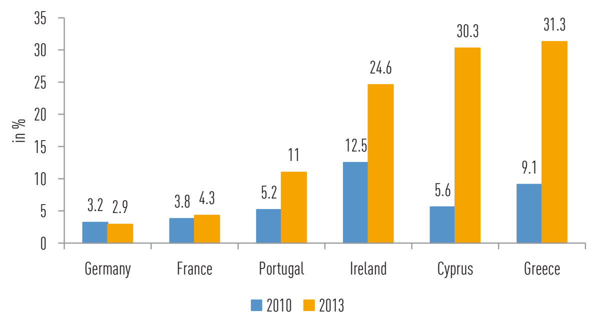
Graph 2. MFI interest rate* for loans to non-financial corporations- March 2014 (in %)**



*MFI = Monetary financial institutions
**Loans up to 1 million euro at floating rate and up to 1 year initial rate fixation
Source : European Central Bank

Above and beyond these responses at the European level, there are also efforts to be made at the national level in terms of consolidating the banking industry. The financial system in countries benefiting from an aid programme still has major weaknesses that need to be addressed. While Ireland and Cyprus are in a better situation in structural terms than either Greece or Portugal, consolidating the banking industry is nevertheless a major challenge for these two European countries, which need to reduce the weight of the financial system in their economy and to restructure their banking system. Graph 3 highlights the high percentage of doubtful accounts in banks in countries benefiting from aid programmes compared to their overall loans, as well as the major increase in those doubtful accounts since 2010, the problem being of lesser importance in Portugal than in the three other countries benefiting from an aid programme.

Graph 3. Bank nonperforming loans to total gross loans (%) in 2010 and 2013



Source: World Bank

Conclusion

So what assessment can we make of the past four years for those countries benefiting from an aid programme? As several participants pointed out in the course of the seminar, it is necessary to emphasise that any analysis of the aid programmes in the euro area needs to take into consideration a number of cogent factors: i) the aid plans amount to extremely high sums worth between 45% and more than 100% of national GDPs (the operation implemented in Greece is unprecedented in the history of IMF intervention); ii) the magnitude of the adjustments that these countries have had to make is equally unprecedented – Greece is pursuing the most important fiscal adjustment ever implemented by any OECD member country – and those adjustments require action on several fronts (budget consolidation, a boost to national competitiveness and the reconstruction of the banking industry); iii) all of this has taken place at a time of extremely weak growth at the European level and against a backdrop of fear regarding the possible breakup of the euro area.

If we take an initial look today at the situation of the countries benefiting from an aid programme, we cannot help but be critical regarding the success of their adjustment programmes. This, because GDP and domestic demand have shrunk more than expected, and the public debt and unemployment rate have doubled compared to the figures for before the crisis. The crisis has also spawned a rise in inequality and in the number of people in danger of falling below the poverty threshold. These social repercussions of the crisis, which were originally underestimated, are having an impact on the countries' economic performance as well as on their social cohesion and on their political stability.

Yet the picture is not all black, and there are positive trends to be detected in the countries benefiting from an aid programme. Budget and current account deficits have been considerably reduced and the forecasts for 2014/15 are encouraging (in particular, the improvement in growth prospects and the downward turn both in the unemployment curve and in the indebtment curve). Two countries have come to the end of their adjustment programmes and have exited them without any precautionary programme (Ireland and Portugal). Also, interest rates on bonds issues by countries benefiting from an aid programme have dropped enormously since 2012, in particular for Greece which, after seeing its 10-year interest rates on the secondary bond markets climb to almost 30%, now enjoys rates on the same bonds in the region of 6%. These positive trends are due to the results achieved by each individual country, but they also rest on the initiatives adopted at the European level (in particular, the ECB's adoption of an unlimited debt buy-back scheme, which has boosted investor confidence).

In order to ensure the sustainability of their debt and to strengthen their growth potential, the countries benefiting from an aid programme (and those that have completed such programmes) are going to have to pursue their fiscal adjustment efforts (at a pace which needs to be revised in order to curb their negative impact on growth) and their efforts in the fields of structural reform and of the reconstruction of their banking industry. Yet the success of their adjustment does not depend solely on the efforts made by each individual country but also on what can and must be done at the European level and by the other euro area member states.

At the European level, it is going to be necessary to build a better balance between fiscal consolidation and growth. This may entail restructuring the debts of certain countries (by extending the maturities and/or lowering interest rates) and increasing support for imparting a fresh boost to growth, in particular by strengthening the European Investment Bank's lending capability (in addition to the extra 60 billion euro granted in 2012 in the context of the Growth and Jobs Compact). Also, in order to strengthen member states' growth potential, it is necessary to allow those member states a little more budgetary leeway so that they can earmark investment spending designed to boost their growth potential while avoiding having to continue cutting social expenditure (in particular, in the fields of education, training and health).

Concerning the other euro area member states, it is worth pointing out that adjustment in the euro area over the past few years has been asymmetrical, the burden of adjustment falling solely on the shoulders of countries showing deficits rather than also on the shoulders of those posting a surplus. All of the member states must make their contribution to this adjustment, and countries with a certain budgetary margin for doing so must stimulate domestic demand in order to strengthen their own growth which, in turn, will have a positive impact on the economies of those countries benefiting from an aid programme.

In conclusion, it was argued that the euro area today is not a "common monetary area" but a "common currency area". So in order to guarantee the stability and the prosperity of the countries in the euro area, it is crucial to continue to pursue the reform of the EMU in the fiscal, economic, banking and political spheres.

1. The European treaties provide for a balance of payments support mechanism (Article 143 in the TFEU) which makes it possible to provide financial aid in the medium term in order to allay difficulties encountered by countries that are not members of the euro area in seeking external funding (Hungary, Latvia and Rumania have all benefited from this facility).
2. Darvas Zsolt, Sapir André and Wolff Guntram B., "The long haul: managing exit from financial assistance", *Policy contribution*, Bruegel, February 2014.
3. On 10 April 2014 Ireland raised 1 billion euro over 10 years at an interest rate of 2.92%.
4. According to Article 14 in the Regulation n° 472-2013.
5. European Commission, "Economic Adjustment Programme for Ireland", Autumn 2013 Review, European Economy, December 2013.
6. Variation in the three countries' public debts between 2010 and 2013: from 148.3% to 175% for Greece; from 91.2% to 123.7% for Ireland; from 94% to 129% for Portugal.
7. See Marcin Szczepanski, "Social dimension of austerity measures", *European Parliamentary Research Service*, 10 December 2013.
8. Cécile Remeur, "Welfare benefits and intra-EU mobility", *Library of the European Parliament*, 24 September 2013.
9. Darvas Zsolt , Sapir André and Wolff Guntram B., "The long haul managing exit from financial assistance", *Policy contribution*, Bruegel, February 2014.

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