Effectiveness of International Bailouts in the EU during the Financial Crisis – A Comparative Analysis

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Abstract

The purpose of this study is to examine the effectiveness of economic adjustment programmes during the global financial crisis in the European Union. The analysis is based on two approaches: the presence of recidivism and a comparative analysis of the countries' economic performance before and after the crisis. The macroeconomic performance of the EU Member States is examined and compared in four groups: eurozone countries with and without external funding, and non-euro countries with and without external funding. The analysis concludes, that while the international bailouts were able to prevent sovereign default, the countries which received loans are still showing significantly worse performance and slower recovery in general than their non-funded counterparts. Aside from several exceptions the countries of the euro area show the best results during the crisis as well as in the after-crisis recovery, and the countries with a bailout package are left behind in almost every aspect of the economy both inside and outside the area of the common currency by the self-financed Member States.

Keywords: Euro, Crisis, Bailout, European Union, Imf

JEL F33, F34

Introduction

During the global financial crisis numerous Member States of the European Union (EU) faced so severe financial difficulties that they decided to request support from their European partners and from the International Monetary Fund (IMF). However, international rescue loans and their effectiveness is a disputed area. (See for example Poole 2009; Jeanne et al 2001; Bird 2001; Dreher 2006)

In this paper I try to give an overview of the effectiveness of the bailouts in the European Union during the global financial crisis based on their repetitiveness and a comparative analysis of the macroeconomic performance of the Member States. I examine the economic performance of the EU Member States before and after the crisis, from 2004 to

2014. This timeframe provides a five-year period before as well as after the beginning of the crisis. I divided the countries into four groups to make a comparative analysis of their performance based on whether they are in the euro area and whether they received funding from the EU and/or from the IMF (Table 1.). The loans issued to EU Member States during the financial crisis are collected in Table 2. All countries except Spain received a joint bailout package from EU institutions and the IMF.

Data are drawn from The World Bank's World Data Bank World Development Indicators.

Table 1.
Classification of the EU Member States[1]

Euro-area		Non-euro countries	
Funded countries – Group 1.	Non-funded countries – Group 2.	Funded countries – Group 3.	Non-funded countries – Group 4.
Cyprus (2008-)	Austria	Cyprus (-2007)	Bulgaria
Greece	Belgium	Hungary	Croatia
Ireland	Estonia (2011-)	Latvia (-2013)	Czech Republic
Latvia (2014)	Finland	Romania	Denmark
Portugal	France		Estonia (- 2010)
Spain	Germany		Lithuania
	Italy		Malta (- 2007)
	Luxemburg		Poland
	Malta (2008-)		Slovak Republic (-2008)
	The Netherlands		Slovenia(- 2006)
	Slovak Republic (2009-)		Sweden
	Slovenia (2007-)		United Kingdom

[1] Some countries joined the eurozone during the 2004-2014 period, in these cases they are moved to the applicable group of the euro area from the year of adaption of the common currency (indicated in parenthesis).

Table 2.
International loans received by EU Member States (billion €)[2]

	200	200	200	200	200	200	201	201	201	201	201	201	201
CYP										2.5	2.5	2.5	2.5
GRC							36.4	36.4	41.1	41.1	41.1	41.1	
HU					4.73	4.73	4.73						
IRI							17	17	17	17	17		
LVA					0.9	0.9	0.9	0.9	0.9				
PRT							19.5	19.5	19.5	19.5			
RO						6.66	6.66	6.66					
ESP							13.8	13.8	13.8				

Source of data: International Monetary Fund: IMF Members' Financial Data by Country; European Commission: Financial assistance in EU Member States

Recidivism

A straightforward method to decide whether a bailout what successful or not is to examine whether a country has applied for another programme after or during the initial bailout. The lending instruments of the IMF used during the crisis are the Stand-By Arrangement (SBA) and the Extended Fund Facility (EFF). SBA aims to help countries with short-term balance of payment problems, and its disbursements are conditional on achieving specific targets defined in the Memorandum of Understanding. EFF addresses longer-term balance of payment problems which require more serious adjustments in the requesting country's economic institutions.

Romania and Greece were the only two countries to request another bailout programme during the first one. Romania, despite making two additional agreement on SBAs in 2011 and 2013 (the first one expired in 2011), has not received external funding after 2011. The institution of SBA allows this precautionary approach.

By contrast, Greece faces a much more troubled situation due to more fundamental economic and political difficulties. The First Economic Adjustment Programme was approved in May, 2010 by the Eurogroup and the IMF, then the Second Economic Adjustment Programme was agreed in December 2012. During the summer of 2015 Greece still was not able to meet debt obligations and stabilize its financial system so in July it made a request for a third programme to both the EU and the IMF. After the Greek authorities passed several legislations as prior conditions attached to the third programme, the Third Economic Adjustment Programme for Greece was approved on 19th August 2015. (European Commission, 2015)

With-without comparison

It is difficult to define the role of the international bailout programmes in the recovery of a country's economy in the years after the crisis. There is no way we could find out what exactly would have happened if a funded country would not receive an international loan, and vice versa. The simplest method to point out the differences is the so called With-Without approach described by Khan (1990) and first used by Donovan (1981) which compares countries facing similar external impacts, some of them requesting international financial aid, some of them financing themselves. The approach assumes that if the environment is the same for all countries, than the differences in the performance of the funded and non-funded group will result from the only difference: participating in a programme or not.

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[2] The sum of the disbursed amount is averaged over the years of the program.

Following the approach taken by Bordo and Schwartz (2000) I chose seven macroeconomic indicator to compare: GDP growth, per capita GDP, final consumption, money growth, inflation, unemployment and current account balance. The comparison of the performance of the funded and non-funded countries is carried out for the EU as a whole, and also separately for the eurozone and the rest of the union.

GDP growth (Figure 1)

As for the EU28 the level of the GDP growth is very similar in the two groups of countries. The lowest point is slightly deeper for the funded countries but the difference is not as significant as in case if we examine to euro and non-euro area separately. The growth rate falls to the lowest in the funded countries of the non-euro area, however these countries made the quickest recovery and they even surpassed their non-fund counterparts by 2011. The growth rate of the funded countries remains negative until 2014 in the EU as a whole and also inside the euro area, but it becomes positive outside the euro area as early as 2011, which falls only one year behind the non-funded groups. By 2014, the growth rate for all groups converges toward the same rate. Overall, the recovery of the growth rate is faster in the non-funded countries, and after the initial recovery the funded countries only perform better than the non-funded ones outside the Eurozone.

GDP per capita (Figure 2)

For all the EU Member States, the changes in the level of per capita GDP are quite similar, but the funded countries' level is always $5-10.000 lower. In the euro area the tendency is even more similar in the two groups. In almost every country, the amount of per capita GDP reaches a peak in 2008, then it starts to decline, but for the non-euro countries who participate in an adjustment programme the decline starts one year before the other groups, in 2007. The only group of countries where the value of the per capita GDP after the crisis surpasses its highest level before the crisis is the non-fund countries of the euro area. These are also the only set of countries where the tendency of growing per capita GDP was restored after the first year of the crisis.

Consumption (Figure 3)

The amount of the final consumption in the non-funded countries of the EU overall is higher than in the funded countries. This is also true inside and outside the Eurozone, however there are big differences in the amount of consumption between the euro and non-euro countries. The highest level arises in the non-fund countries of the euro area, however the fastest rate of increase is among the non-fund countries outside the area of the common currency. Moreover, this is the only group of countries where the consumption does not start to decline during the years of the crisis. By contrast, all the other groups exhibit a fall in consumption from 2007/2008. In case of the non-fund countries in the Eurozone this is a sharper downturn, but the decline stops and consumption starts increasing again from 2011. The funded countries show a steady level of consumption throughout the years in the non-euro area, and a slight decline in the euro area.

Money and quasi money growth (Figure 4)

The problem with this indicator is that data of the money growth is highly influenced by the Cypriot banking crisis (Matthews, 2013). Due to this crisis the annual money growth rate in Cyprus increased from around 4% in 2011 to almost 270% in 2012 and then declined to -21% in 2013 while in the other countries the tendency of slow increase continued.

If we eliminate the data for Cyprus we can see that for the EU28 there is a steep increase in the level of money growth for the countries without a bailout before the crisis, but they face an even steeper decline from 2007. However, they don't fall to as low a level as the

funded countries do, the non-funded group is able to stay in the positive range. In 2014, the growth rate converges toward the same rate in both groups. Inside the eurozone (without Cyprus) countries without a bailout do not fall below zero on average, by contrast the countries who took part in an adjustment programme could only climb back to the positive range in 2014. The group of funded countries outside the euro area shows a very strong increase in the growth rate of money supply from 2011, moreover they reach the highest rate among all the other groups by 2014.

Inflation (Figure 5)

According to the European Central Bank (ECB) the ideal level of inflation is higher than zero but lower than 2%: the ECB defines price stability as a year-on-year increase of the consumer prices below 2%. This provides a sufficient margin to avoid both deflation and too high inflation levels.

The non-funded countries of the eurozone are able to maintain the level of inflation around this value before the crisis. Inflation drops in these countries after the initial increase in the first year of the crisis, but deflation does not occur. By contrast, in those countries of the eurozone who participate in an adjustment programme, deflation does happen in 2009 and after a recovery in 2014 again. The eurozone today is still on the verge of deflation.

Inflation reaches its highest level in all groups of countries at the start of the crisis in 2008, euro and non-euro as well as funded and non-funded countries show big differences. The highest inflation occurs in the funded countries outside the eurozone with an average of 10%, the non-funded non-euro countries follow them with 6%. However, the difference between funded and non-funded countries in the common currency area is not as significant as outside of it, both groups exhibit an inflation rate between 3,5 and 4%.

Unemployment (Figure 6)

There is no surprise about the unemployment rate during the crisis. When the crisis started in 2008, it meant a loss of lot of jobs around the world. Outside the euro area the rate was initially higher, but the difference between the funded and non-funded countries was not as significant as in the countries using euro. In the non-euro countries the increase stopped after 2010, and by 2014 it reached around the same level in both funded and non-funded countries. Their 10% rate is higher than that of the non-funded countries of the euro area, but much lower than in the funded euro countries. In the latter group, involving the two countries with the highest unemployment rate in the EU (Greece and Spain), the share of unemployed people almost hits 20%.

Current account balance (Figure 7)

Evidence shows a very apparent difference between the countries who requested international bailout and those who did not. The performance of the non-funded countries of the eurozone stays steadily in the positive range throughout the years of crisis and starts a growing tendency from 2012. At the same time their non-funded counterparts show a growing tendency from 2007, but they stay in the negative range until 2013 and start decline again next year.

Outside the area of the common currency, the current account balance starts increasing from 2011 and hits the positive range in 2013 in the funded countries. The funded countries start the increase from a deeper point than their non-funded counterparts and even surpass them for a short time between 2008 and 2010, but after 2009 another steep decline starts and it takes about four years for the bailed out countries to catch up to the other part of the group.
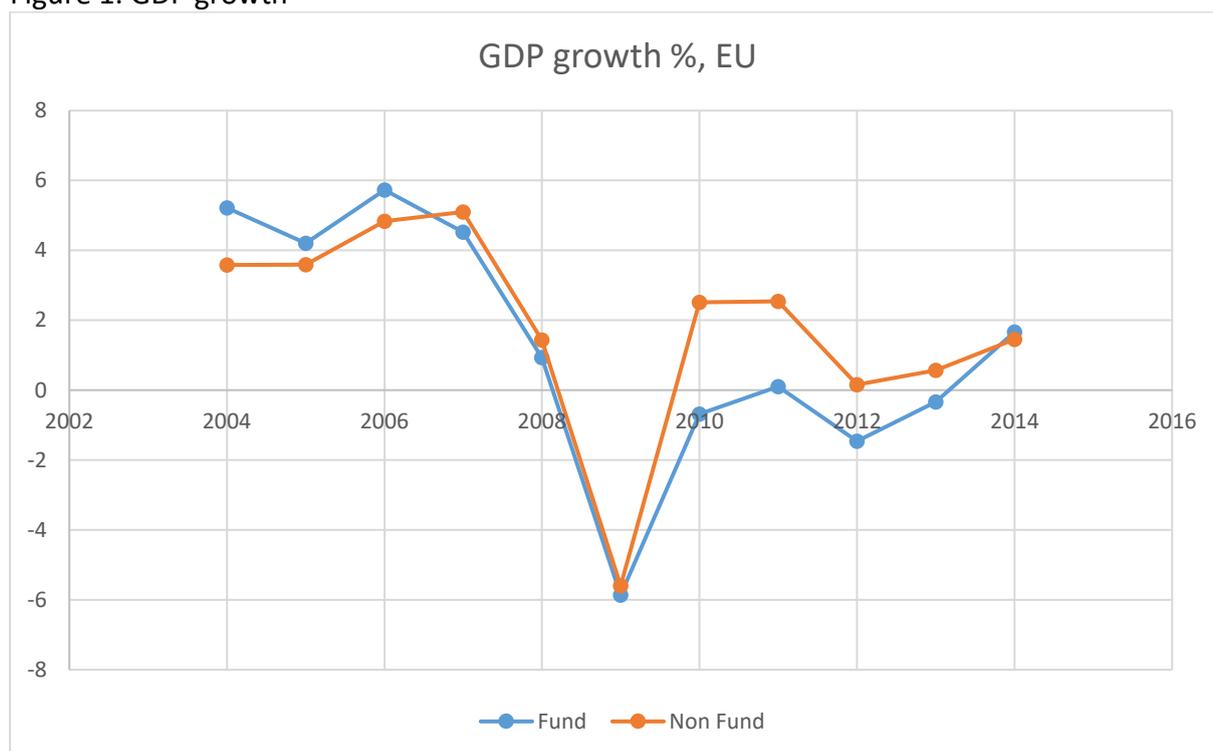
Conclusion

If we only take into account the absence or existence of recidivism, all the bailouts except for the one for Greece can be considered effective, since they fulfilled their initial goal to adjust short-term balance of payment problems with conditions attached to help the requesting country's financial system.

Nevertheless, do the funded countries perform better than their non-funded counterparts? Definitely not. There are some exceptions, where the countries receiving external funding surpassed the self-financing Member States – surprisingly, outside the eurozone non-funded countries showed a relatively strong performance in GDP and money supply growth rates. The overall tendency however is as follows: eurozone outperforms those not using the common currency, and self-financing countries outperform those who take part in an adjustment programme.

Considering the moral hazard posed by international lending, on the long-term it is more effective for the Member States to aim for joining the currency union. As evidence shows, despite international bailouts were able to prevent sovereign default, they were not able to give a boost to these economies to help them catch up with the rest of the Member States, neither regarding the overall performance nor in the speed of the recovery.

Figure 1. GDP growth

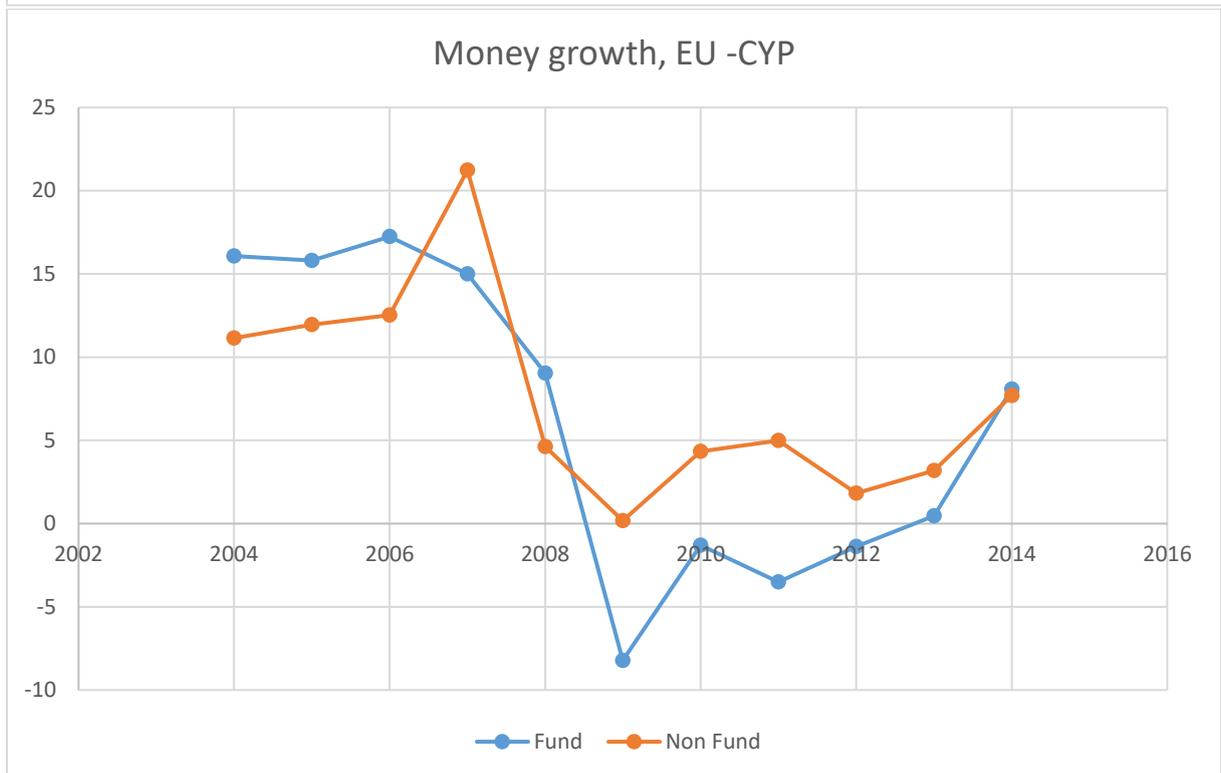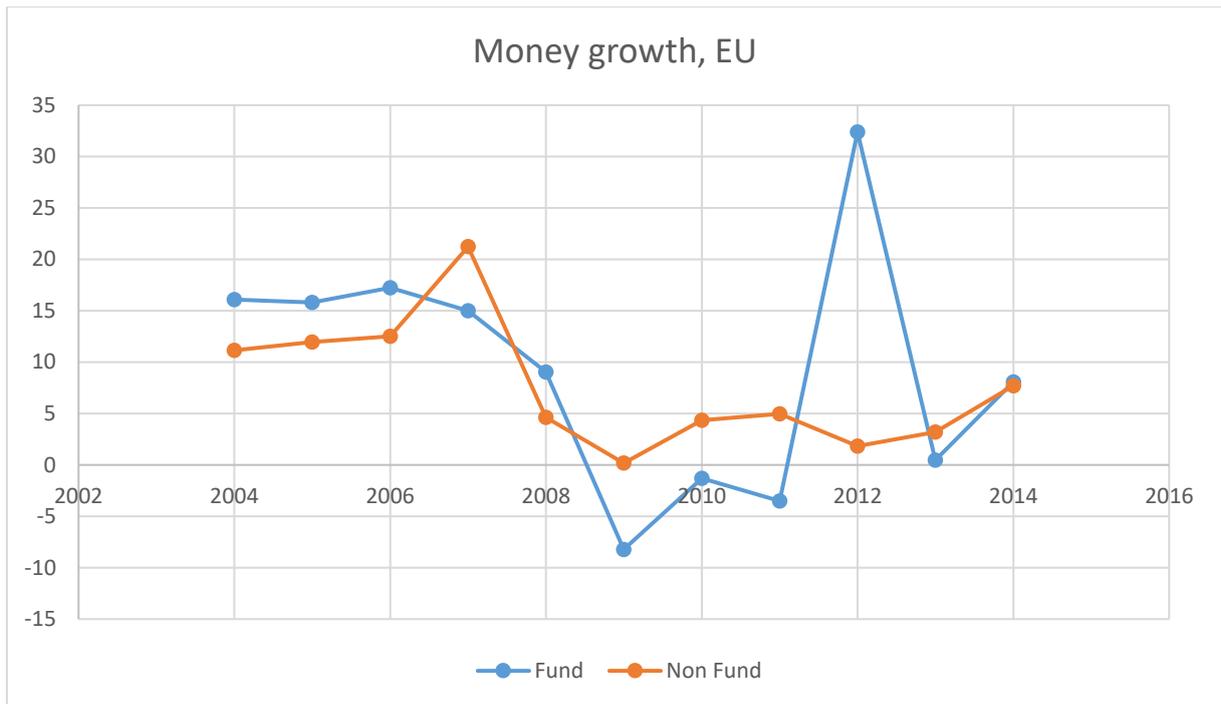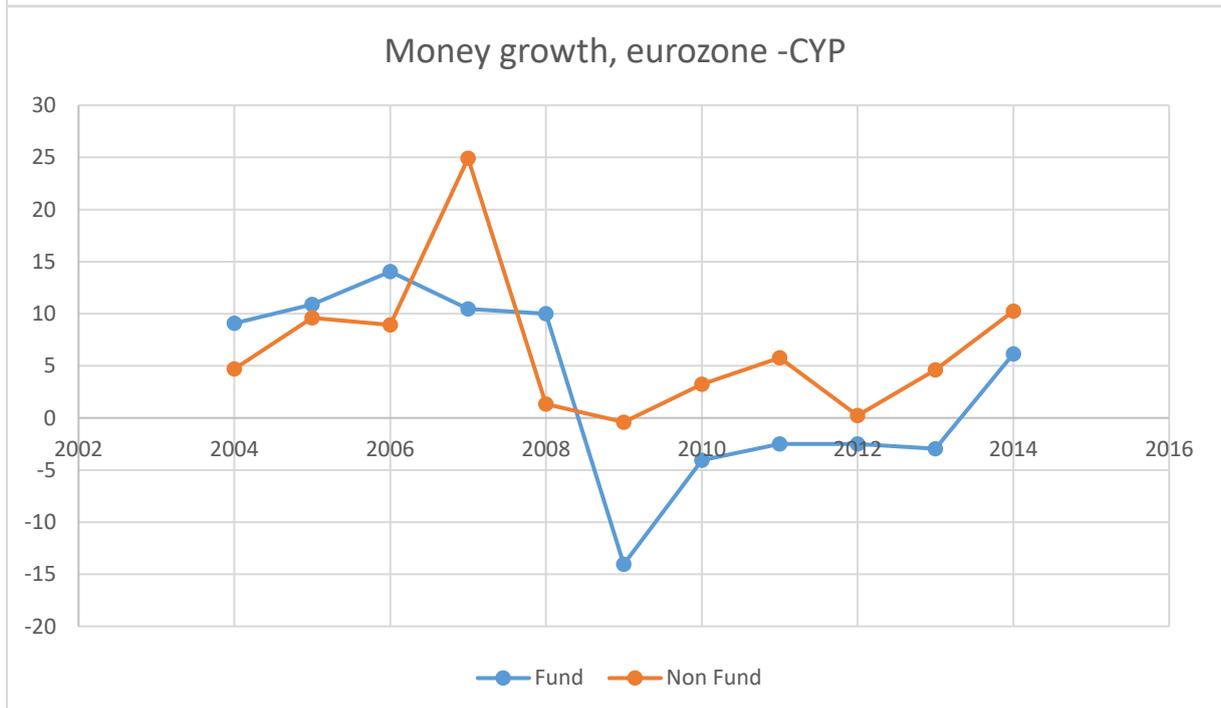Figure 2. GDP per capita

GDP/capita, EU

GDP/capita, eurozone
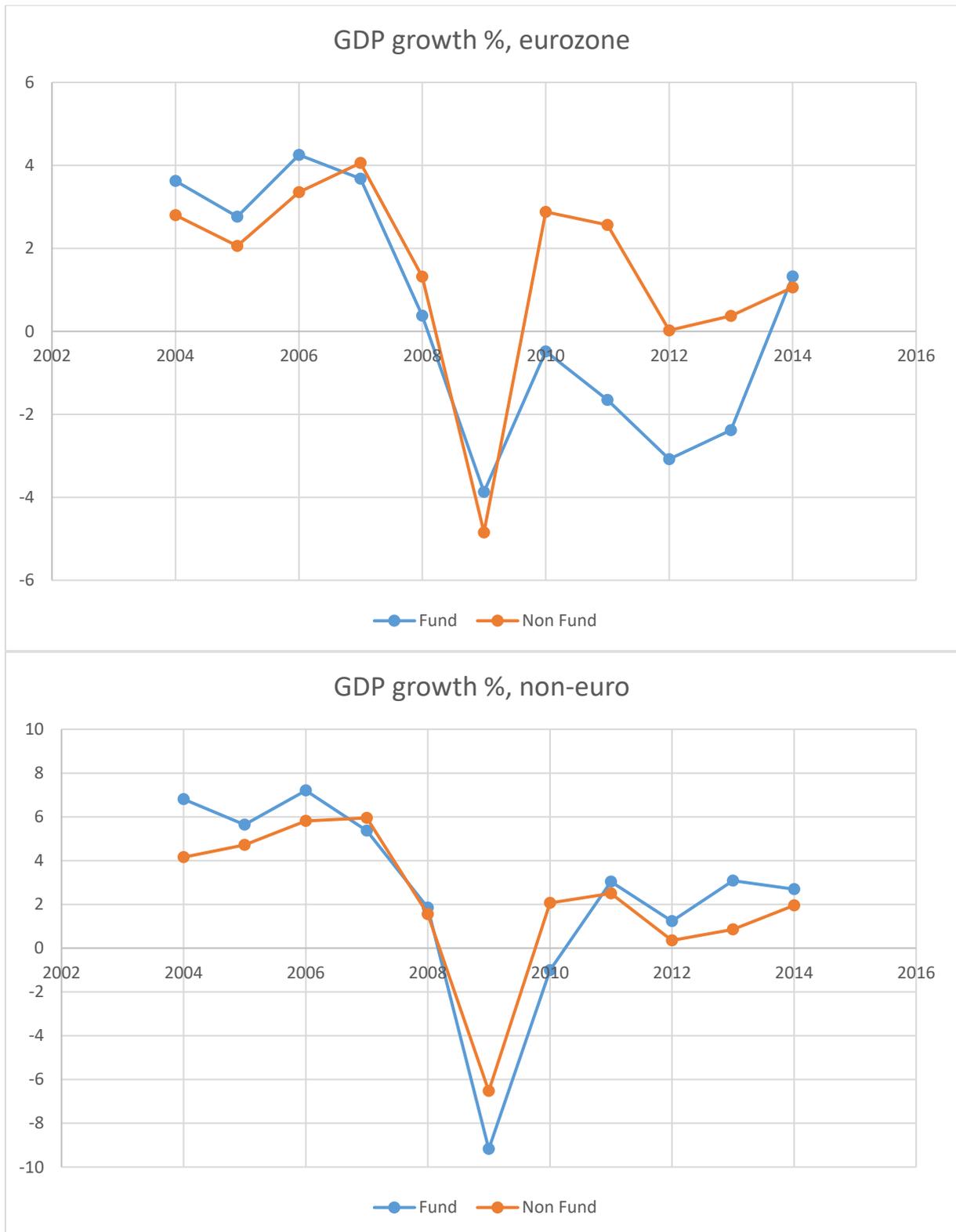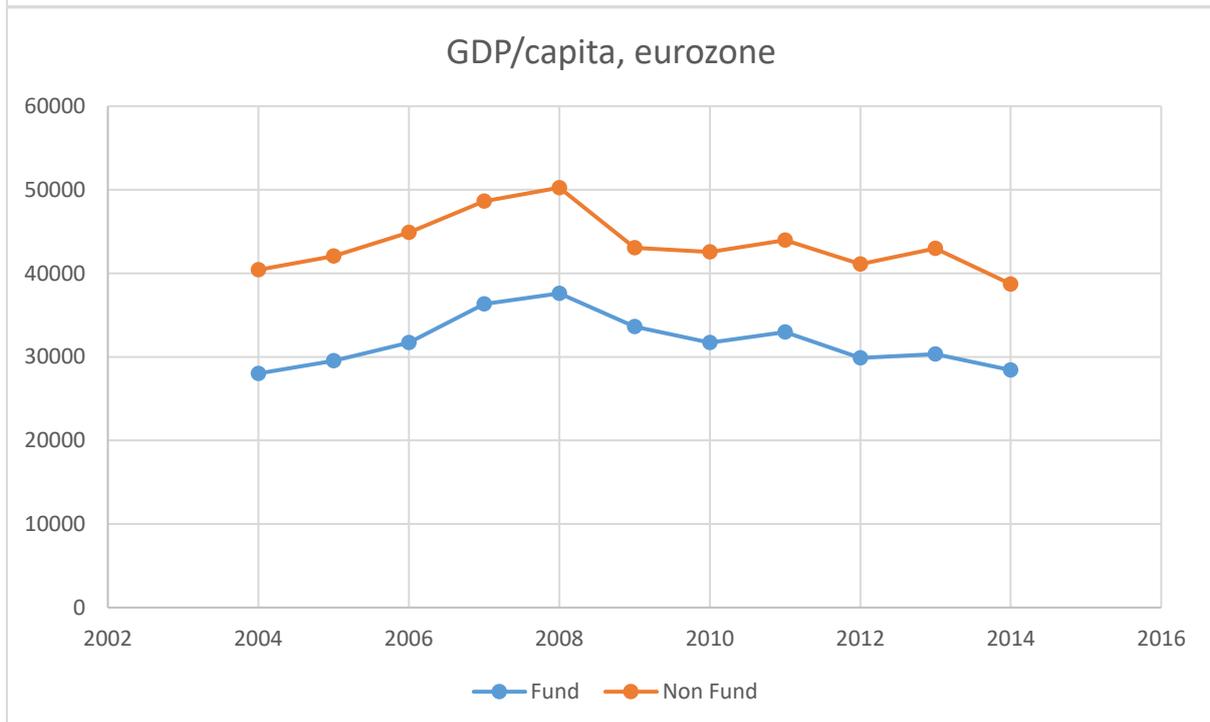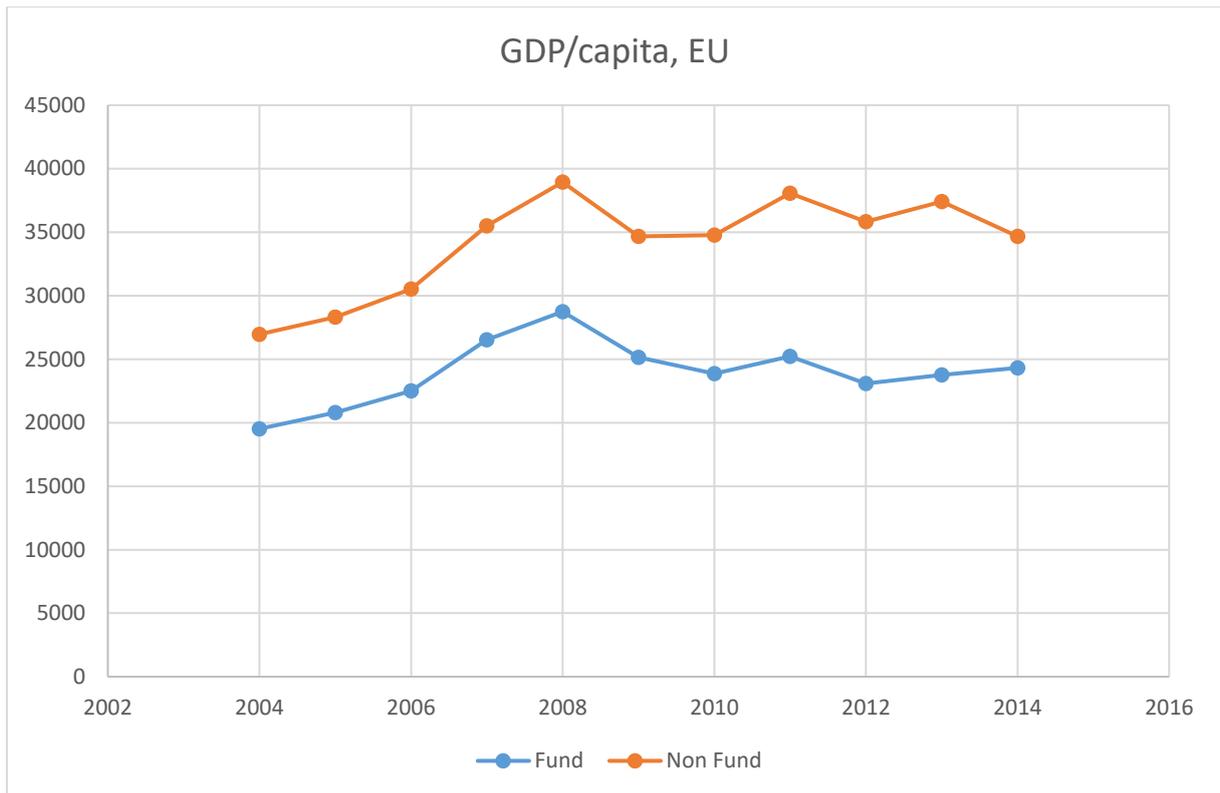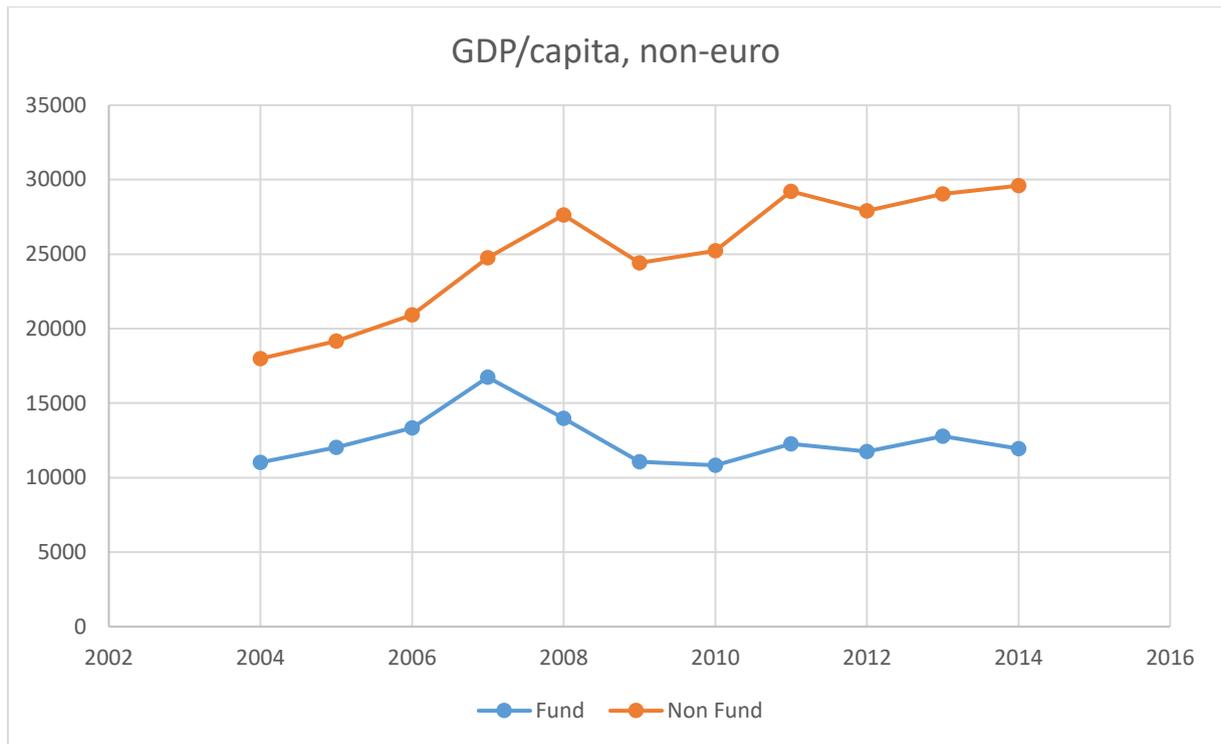
Figure 3. Final consumption
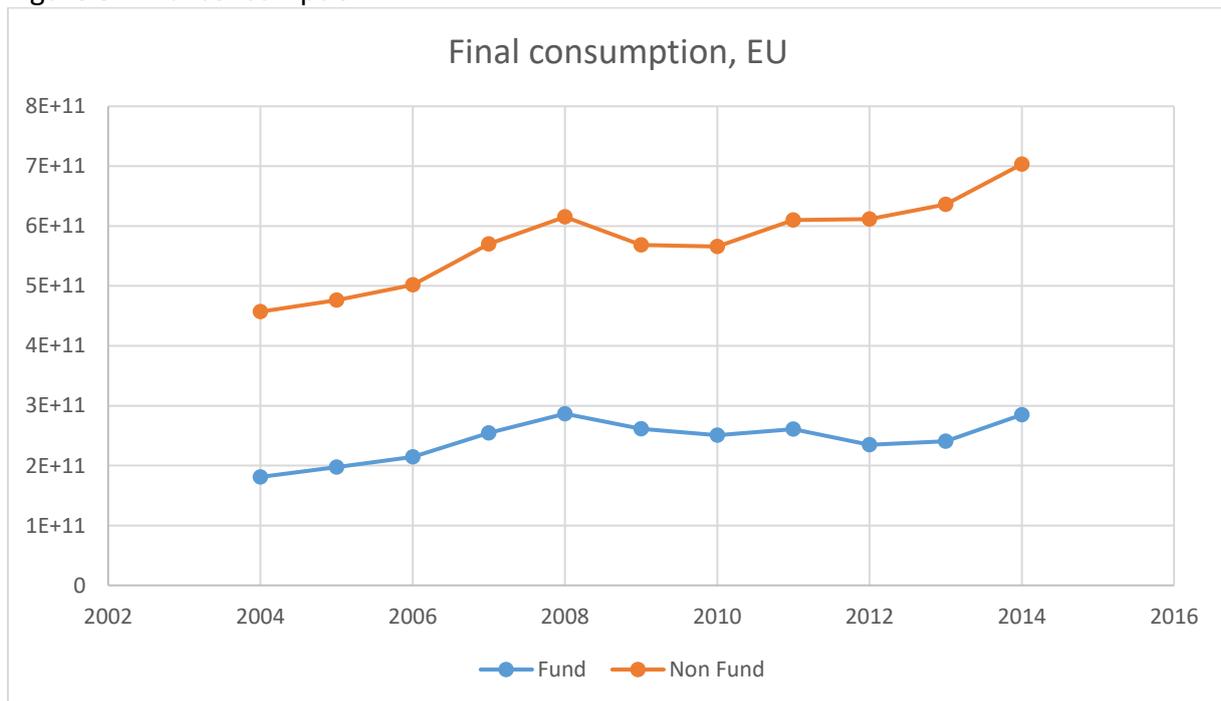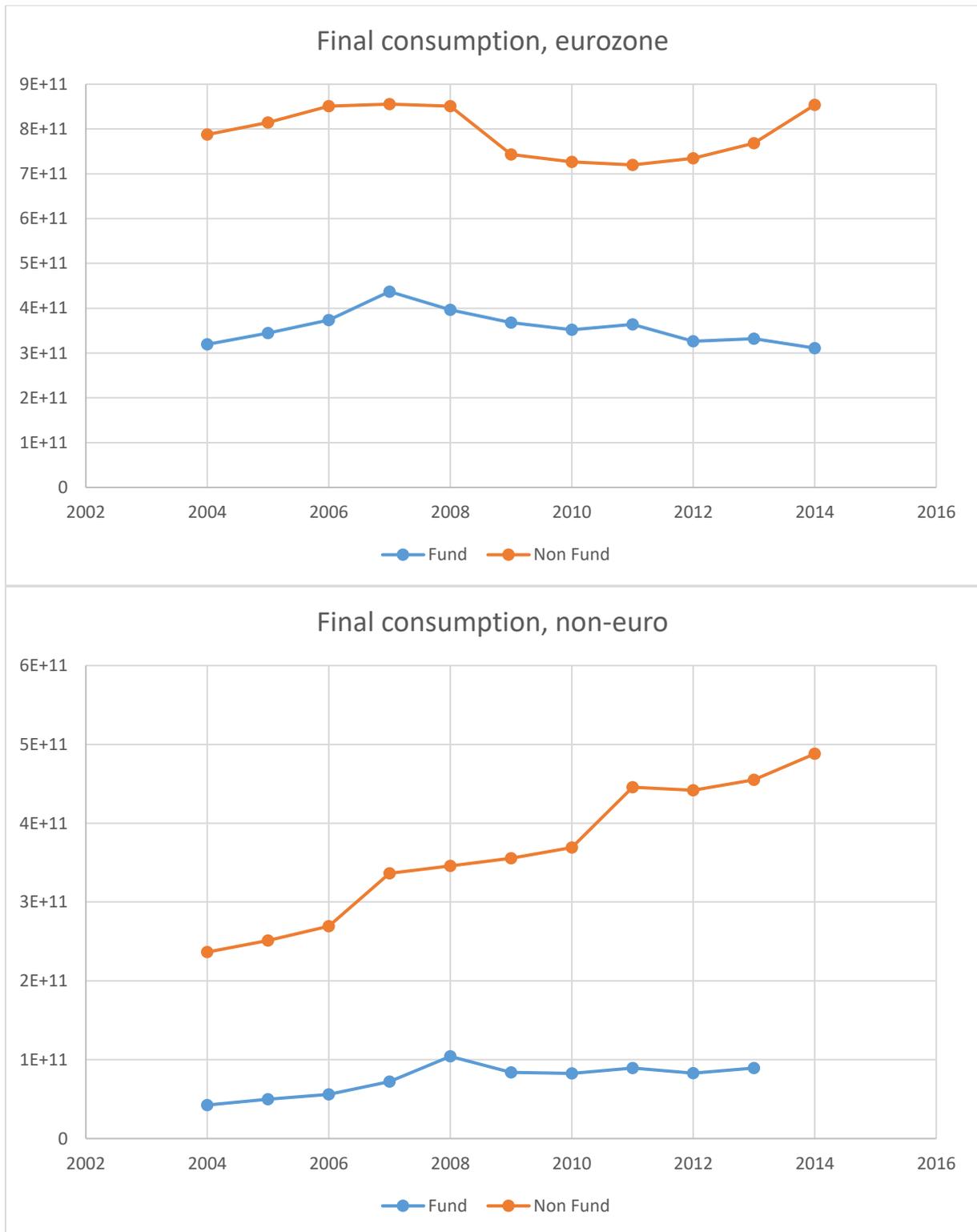
Figure 4. Money and quasi money growth

Money growth, EU

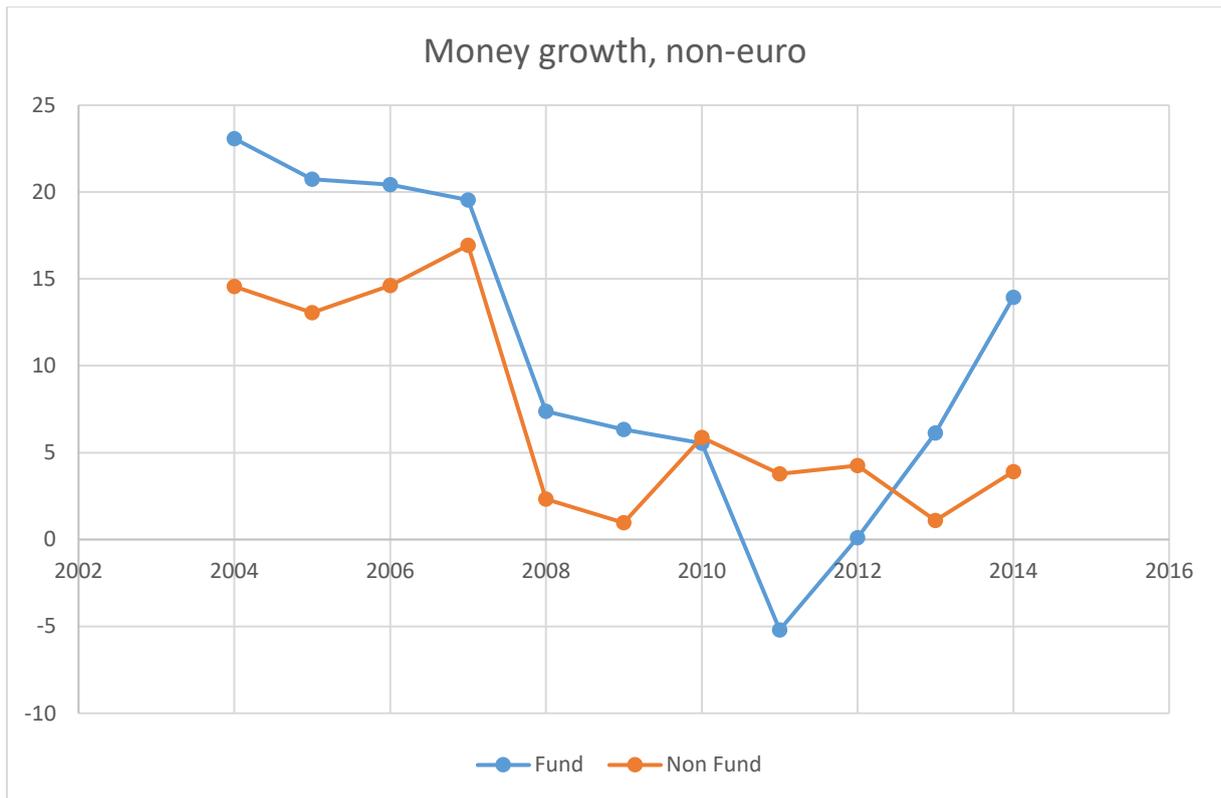Money growth, EU -CYP

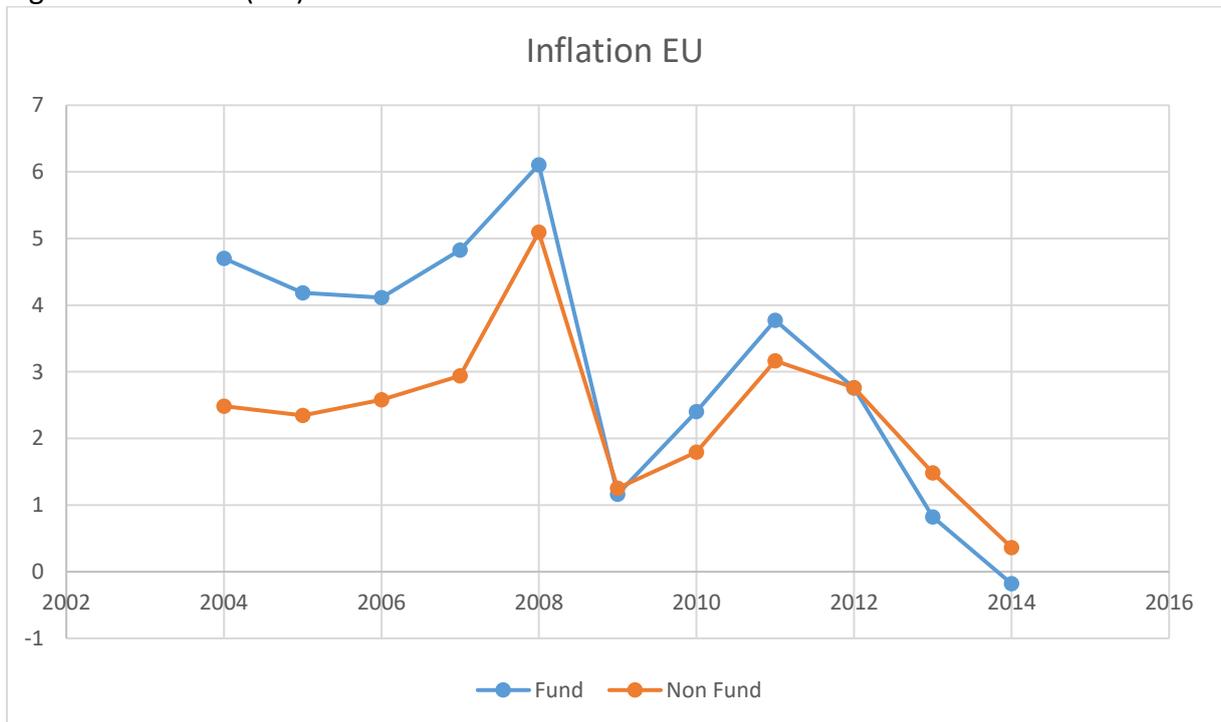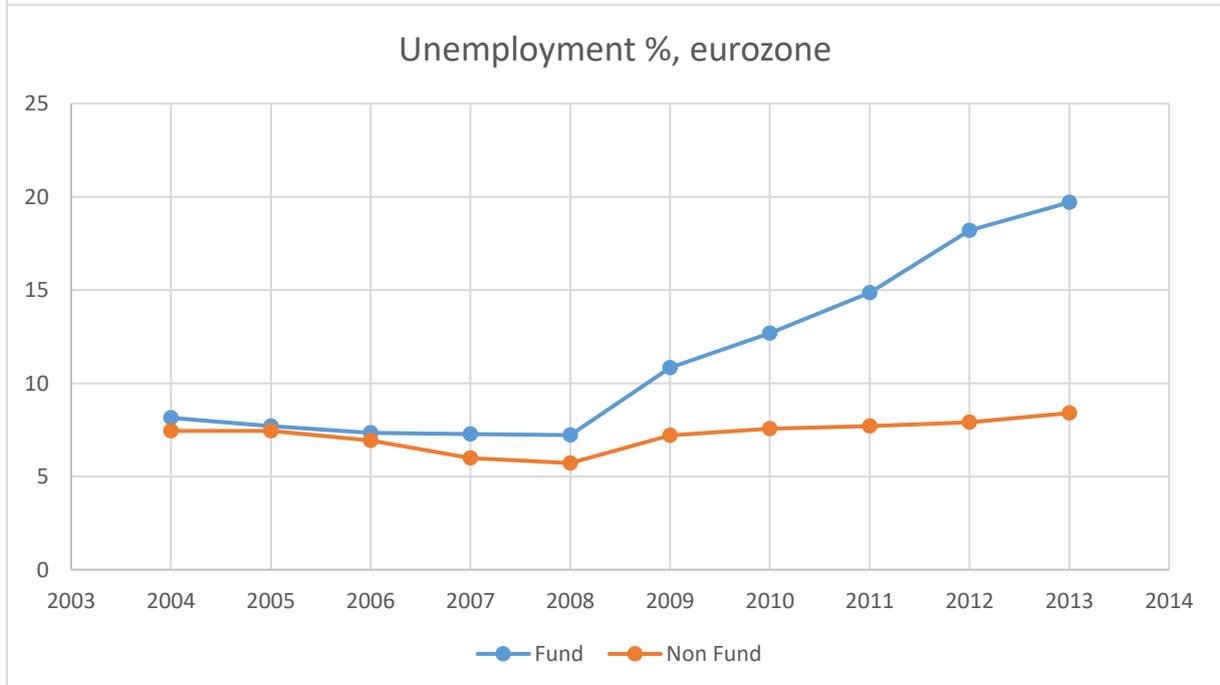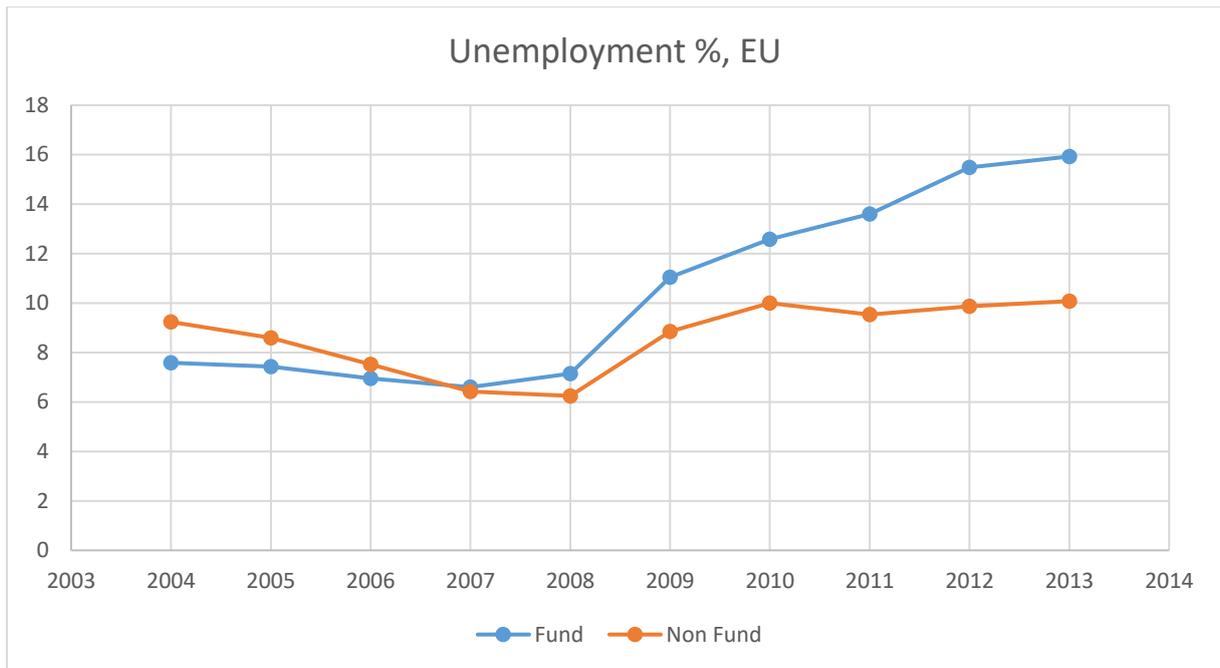Money growth, eurozone

Money growth, eurozone -CYP

Money growth, non-euro
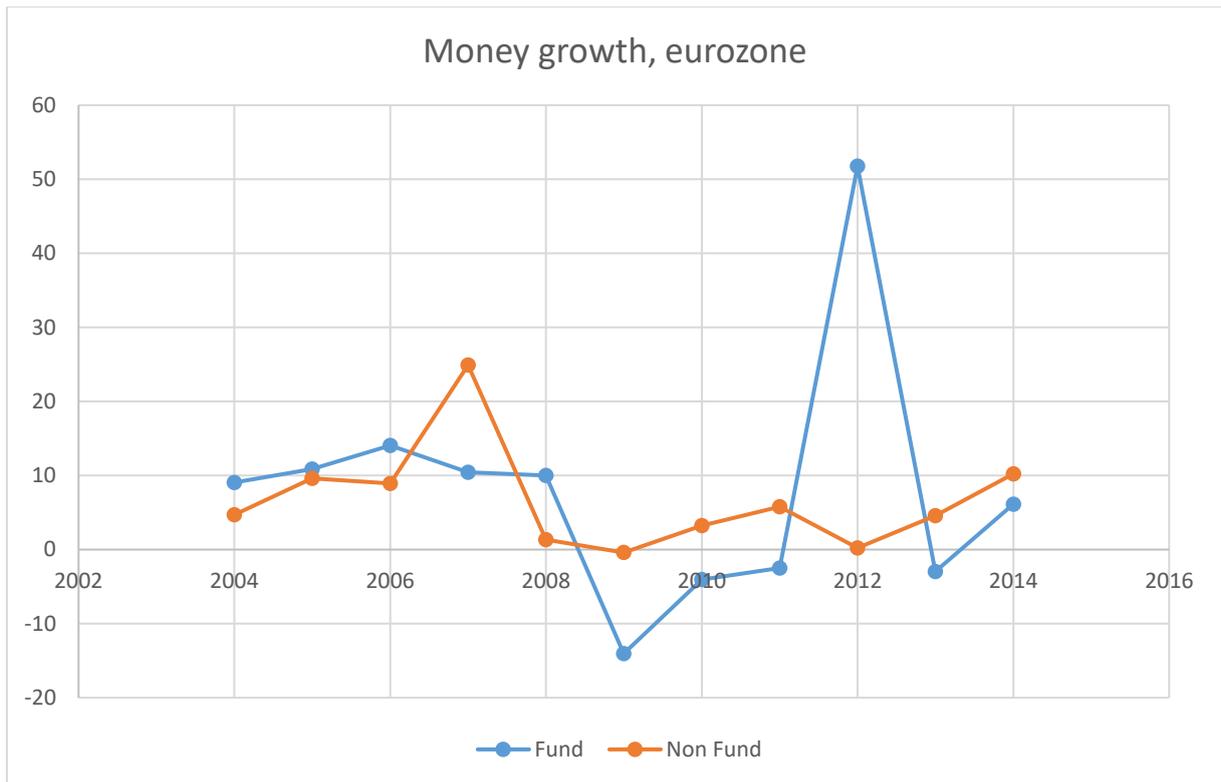
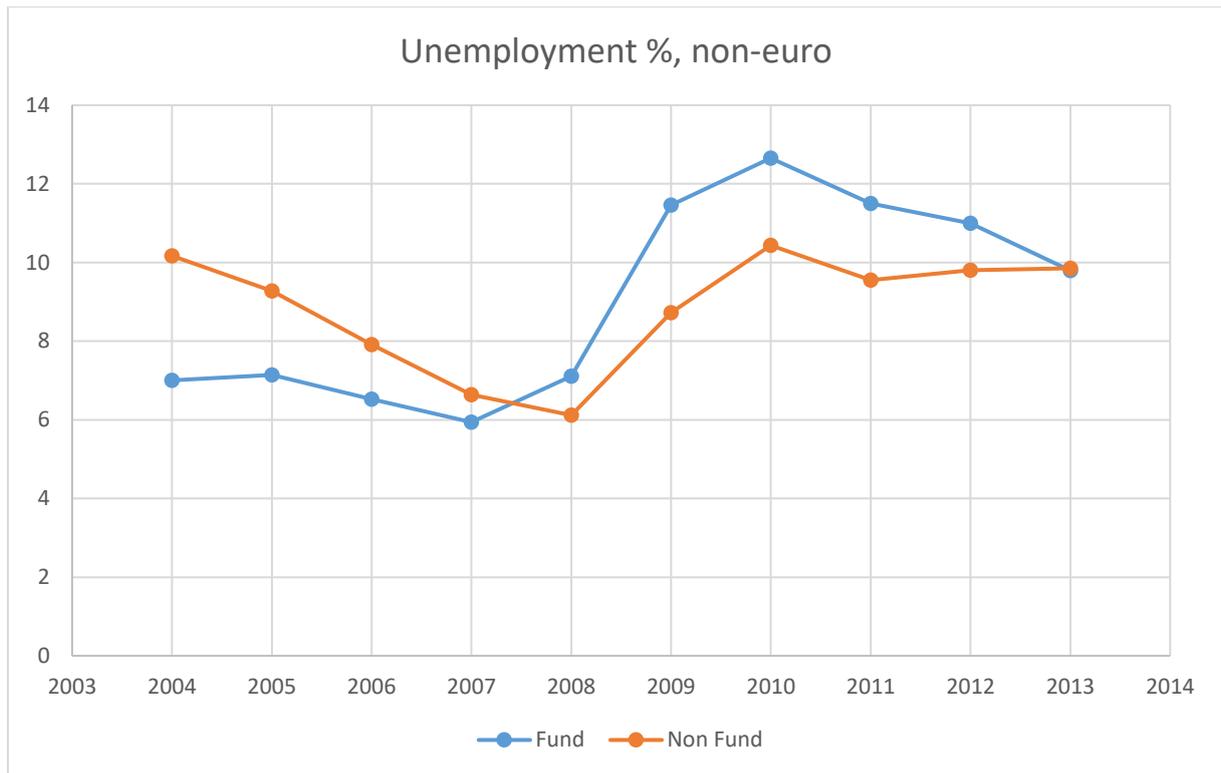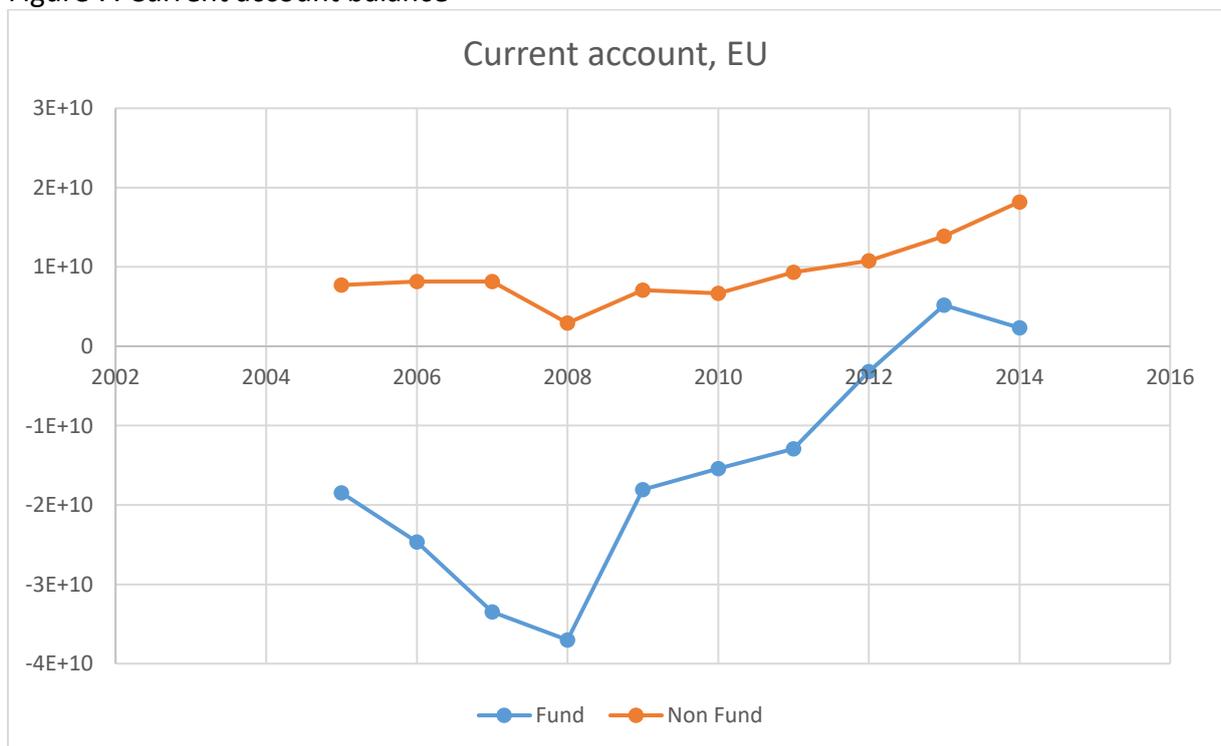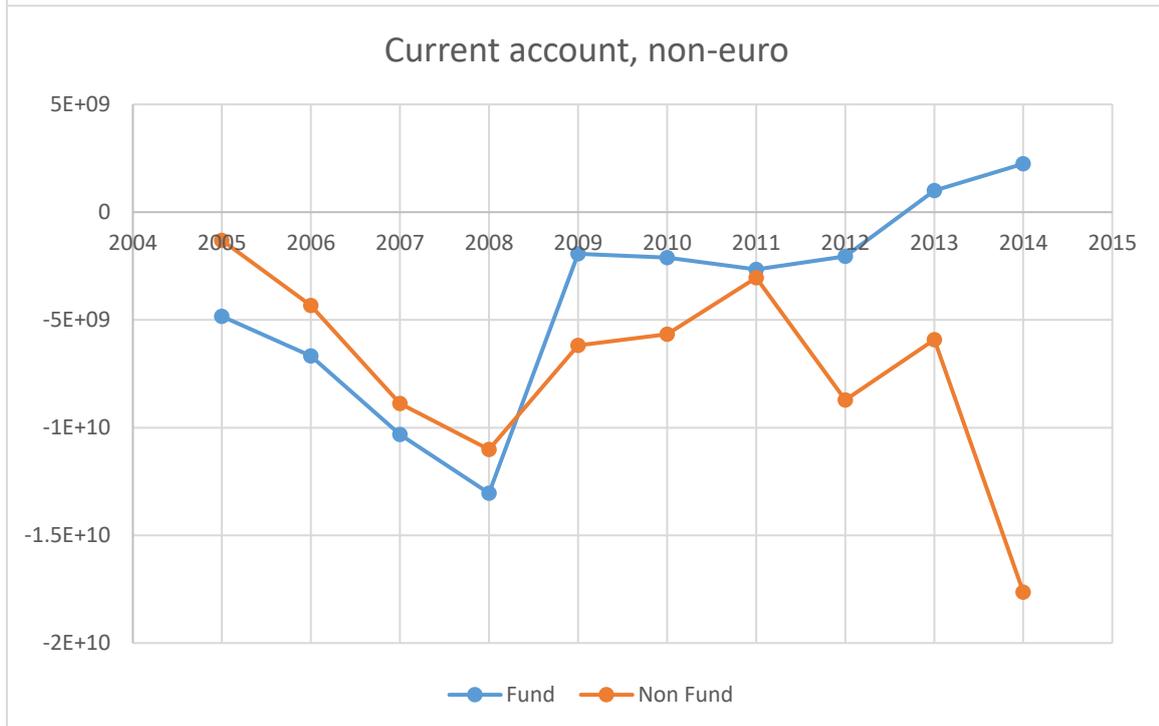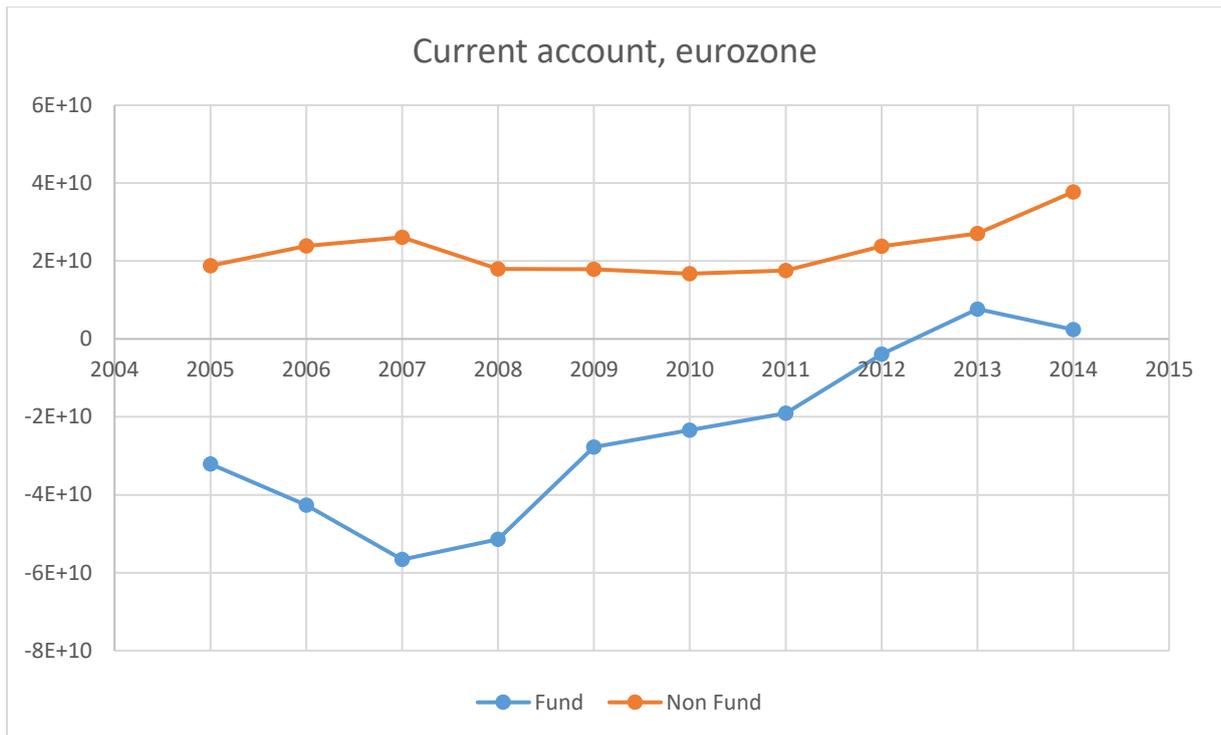Figure 5. Inflation (CPI)

Inflation EU

Figure 6. Unemployment

Unemployment %, EU

Unemployment %, eurozone

Figure 7. Current account balance

Current account, eurozone

Current account, non-euro

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