

ON THE SLIDE OF PUBLIC DEFICIENCY AND FINANCIAL SETTLEMENTS

EMILIAN M. DOBRESCU¹, DIANA-MIHAELA POCIOVĂLIȘTEANU²
¹ROMANIAN ACADEMY and “SPIRU HARET” UNIVERSITY, BUCUREȘTI,
²“CONSTANTIN BRÂNCUȘI” UNIVERSITY OF TARGU-JIU
dobrescu@acad.ro, diana@utgjiu.ro

Abstract:

The world of financial – banking specialists should be panicked, observing the modality in which world financial institutions or the exhausted budget of the main states of the Earth are functioning. We get used to easily observe where they appoint us – Greece, in the present case- not wondering profoundly what hides as a matter of fact behind this movement. There are the powerfully industrialised states – of some economies agonising in huge public deficits that have gathered – of 100, 200 and even 300% from their annual GDP- as exposed, as middle states, like Greece, Spain or Portugal, more and more incriminated in the last period. Consumer's conception that is highly applied in the post-war years of the past century and the “state of general well-being” destroyed economy and the environment of the planet or the ones are about to do it?

Key words: public deficiency, financial settlements, Basel III, financial crisis

JEL classification: E6, G3, H6

1. Introduction

Several countries would probably enter in the inability of payment of debts to the state, in the following years, and investors would force the authorities from United States to reduce public expenses, anticipates Kenneth Rogoff, former IMF's chief – economist and professor at Harvard University: "As a result of banking crisis, we often see several sovereign defaults, let's say in several years. I anticipate this would happened again", stated Rogoff, present at a forum of economic themes, in Tokyo. Financial markets would determine at a certain point the increase of interest, and the European states having problems, like Greece and Portugal, would have “more difficulties”. It is very, very difficult to determine the moment, but this would happen. In rich countries, like Germany, United States and maybe Japan, we would see a slow economic increase. These will tighten the belt when confronted with the problem of the interest. These would face off the problems” anticipated Rogoff.

Public debts and budgetary deficits are followed more attentively at world level, after increasing powerfully in volume, during the financial crisis and the recession, based on increase of the expenses and decrease of the budgetary incomes. Fears connected to Greece's capacity to be financed and to respect its liabilities towards creditors severely hit financial markets since January, when the government from Athens announced the increase of the budgetary deficiency at 12,7% in 2009 more than three times than the official forecasts indicated. Rogoff characterized Japan's fiscal politics as “out of control”. Japan has the highest public debt in the world, exceeding almost two times the size of economy.

2. Great Britain's budgetary situation

For several months, all attentions are headed on Greece, but Great Britain's budgetary situation is even worse, and an improvement cannot be seen, on the contrary, writes the edition of Financial Times Deutschland (February 19, 2010).

In the last period, markets focused attention on Greece, Spain and Portugal. Based on the decrease of investor's trust, interests from loans taken by governments of those states increased considerably, which makes more difficult refinancing debts. Analysts draw attention that the Europe's second great economy, Great Britain, risks to reach a similar situation. For the first time in many years, London registered during January of this year more expenses than incomes, in conditions in which, traditionally, this month the Inland Revenue had most of received amounts. Besides a dramatic fall of incomes from taxes (with 19,8 %) also the level of running into debt increased in a fulminatory manner, up to 59,9% from GDP, namely with 10 percentages more than in 2009.

Great Britain's Budget is very bad in comparison with the ones of other states of the world. "The rapport between debts and the gross domestic product deteriorates in a much accelerated rhythm than the ones of Greece, Spain, Portugal and Italy and the deficiency of almost 13% from 2009 was among the greatest in the world...Replacing order in Great Britain's budget is a greater challenge than in Greece's case", explains Bert Jansen, economist at BNP Paribas.

Economists have estimated that Great Britain's budgetary deficiency would reach this year the level of 13,3% and in 2011 would decrease only a little, up to 12,5%. Also, they draw the attention that without serious economy measurements, Great Britain might register a level of gathering public debts up to 200% in GDP.

According to a comparative analyze realized between the greatest 8 states, powerfully industrialized, only Japan would be worse than Great Britain at running into debt chapter, with a proportion estimated to 300%. Countries like Germany, France, Greece, Italy or USA are considerably better than the United Kingdom of Great Britain. "Most recent information show us how urgently is necessary a credible consolidation plan, with reduction of expenses and increase of taxes", says economist Ross Walker from Royal Bank of Scotland.

London understood long ago this necessity. The plan of budgetary consolidation of the present government forecasts the reduction with 1,3% per year of the deficiency from 2010 until 2013. What is not known yet is if the new government, resulted after the elections from the spring of this year, would maintain this plan.

According to the forecasts of the International Monetary Fund, Great Britain should do in the following years, economies of 13% from GDP. In the Greece's case, we speak about only nine percentages. For an improvement of the budget situation not only economies are necessary, but also the increase of the state's incomes. But also here the perspectives are not encouraging enough. Great Britain – "the red lantern" of G8 states – hardly succeeded at the end of past year to exit the recession. Kate Barker, economist at Bank of England notified that the British economy might contract again during the first semester of this year. In these conditions, British inhabitants would have only one solution: "a depreciation of the currency would be the less painful way to change something in the present difficult situation", considers Bert Jansen. At least in this respect, Great Britain has less reserve space than the "problem children" of euro area, induces Financial Times Deutschland.

3. USA has for a long time been preoccupied of the reduction of its record deficiencies

During a year of legislative elections – programmed in November 2010 – it is unlikely that most of the Congress's members to support solutions to diminish the public debt from USA, as well as the increase of retirement age or the extension or increase of taxes and liabilities. Such ideas are much explosive for a party to assume by itself their responsibility, or, exactly from this reason, the President of the USA, Barack

Obama established on 16 February this year the National Commission on Fiscal Responsibility and Reform (CNRRF)¹.

In the conditions in which federal debt should exceed in 2011 14 thousand milliards dollars, or 47.000 dollars for each American citizen, the new Commission of 18 members has the responsibility to realize up to 1st December 2010, a plan of reduction of the annual deficiency up to 3% from GDP up to 2015.

The reduction of the budgetary deficit at 3% from the GDP would lead to an annual deficit of almost 600 milliards dollars, in comparison with the 1.400 billion in 2009 and 1.600 billion forecast for the present year. In the conditions of a 600 billion dollars deficit, being given the size of the American economy, the running into debt of the USA might reach a stable situation, many American economists consider, drawing attention that these should become an important purpose of Administration from White House. The maintenance of the budgetary lacks of balance at the present values, warned recently also Barack Obama, "might concatenate our economy, might darken our future and would put on the back of each child in America an intolerable burden".

The co-presidents of the CNRRF are the republican senator Alan Simpson of Wyoming and the former chief of state from White House, the democrat Erskine Bowles. "No matter the results of our work", said Simpson, "the American nation would know from our activity, much better, where we head, having at hand an honest evaluation of the situation of our country".

The republicans hurried to announce that they do not want to make an exchange between the increase of taxes and the cut of funds for social programs so pleasant for democrats. "The American nation wants to administrate in an efficient manner the problem of public expenses not increasing taxes in a concomitant manner" stated the leader of the minority republicans from the Senate, Mitch McConnell. "The citizens are aware that our problem is not the low taxation, but the fact the Washington spends in excess", he continued.

4. Settlements the lack of settlement

Meanwhile European require imposing some universally valid rules, capable of conditioning bonuses of bankers of long term performances, in the attempt to discourage short term speculations, the Americans consider that such a measure would breach one of the basic principle of economy – who brings profit should be compensated. The introduction of these rules at international level seems an impossible mission, in the conditions in which USA does not seem disposed to block gaining from strict settlements.

The British Prime Minister, Gordon Brown a required on 19 February this year, the foundation of a structure at world level to settle the financial system, expressing his hope that agreements in this respect might be concluded at the following reunions of G8 and G20. Speaking at an international conference dedicated to aggressive politics, Brown explained that it is not the moment to be endangered the fragile economic recovery by withdrawal of the financial services: "Common rules for capital and cash, for supervising standards, for bonuses and a common modality to establish the contributions of the banks to the society, to get rid of the disproportional and incorrect settlements and the fiscal paradises penalizing countries with correct behavior".

Reporting to the International Monetary Fund and other states regarding the idea of a global fee (global tax) for banks, Brown expressed hope that such an agreement might be signed at the following reunions of G8 from Canada and of G20

¹ * * *, *The Moment of Truth: report of the National Commission on Fiscal responsibility and Reform*, The White House, December 2010, pe site-ul www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010

from South Korea (G20 is formed of G8, the eight powerfully industrialized countries - Canada, SUA, Japan, France, Great Britain, Germany, Russia and Italy – to which are added the European Union, China, Argentina, Brazil, India, Australia, Mexico, South Korea, Indonesia, Saudi Arabia, South Africa and Turkey).

Regarding the withdrawal of measurements to stimulate the economy to start the reduction of the high budgetary deficit in Great Britain, the British Prime Minister showed his point of view, in a constant manner, stating that it is necessary to post-pone measurement of fiscal authority.

Also France's president, Nicolas Sarkozy, required during January this year more restrictive settlements for banks, including new rules in accountancy and limiting the payments of the financiers. Risks are too high if we wouldn't change the settlements of our banking system and the rules in accountancy to supervise the financial institutions, stated the head of French state. He declared that excessive incomes and huge salary packs would not be any longer tolerated when these are not in connection with creating richness and work places.

IMF inspected, in increase process, the estimations regarding the increase of world economy in 2010 up to 3,9 percentages, in the conditions in which, previously the Fund staked on an increase of 3,1 percentages after a global contraction of 0,8 percentages in 2009. In exchange, Labour International Organization announced that the world unemployment reached a record level of 212 million persons without a place of work, in increase with 34 millions in confronts with the situation existing two years ago and would remain at a high level during 2010².

5. Establishing three committees of financial supervision

During January 2009, the European Commission adopted a series of decision to consolidate the decisional frame of the financial markets from the European Union, to improve the cooperation and convergence in the supervision field between member states and to better guarantee financial stability. The new settlements foreseen that the three committees supervising the sector of shares values – CESR, banking sector – CEBS and insurance sector – CEIOPS, have a specific operational frame and more efficient decision mechanisms. The decisions established by the three supervision committees are, as basis, a continuation of the Communication of the European Commission regarding the revision of the Lamfalussy process since November 2007 and a response to the desire expressed by Ecofin Council during May 2008.

The new decisions have a list of non- exhaustive indebtedness, which are the responsibility of the committees and strengthen their role in the safeguard of the financial stability. To improve the decisional mechanisms of the committees, decision establish the vote with skilled majority when a consensus cannot be reached. Members not respecting measures adopted by the three committees must be prepared to justify this choice. Measures adopted by the committees maintain the non-compulsory character from a legal point of view.

Alongside the three financial supervision committees, the main international and European organisms involved in the elaboration of financial information norms and of accountable control are: International Accounting Standards Committee Foundation

² * * *, *Statistics and Databases*, International Labour Organisation, 2011, pe site-ul <http://www.ilo.org/global/statistics-and-databases/lang--en/index.htm>

(IASCF)³, European Financial Reporting Advisory Group (EFRAG)⁴ and the Public Interest Oversight Body (PIOB)⁵.

A stable, diversified, healthy and adequate financing of these organisms would allow them to fulfill the mission, independently and efficiently. The consolidation of the convergence and cooperation in the supervising field would contribute to establishing financial markets. In the same time, the existence of some high quality norms, harmonized at international level, in the field of financial reporting and accountancy control, as well as of some equitable competitive conditions for European enterprise on world markets is crucial to create a favorable business environment. Resources consolidation and the role of the above mentioned committees and institutions should increase the European contribution at international debates on the margin of applying established accountancy norms. Financial contributions for the above mentioned committees and institutions would rise to 36.2 million Euros for the period 1st January 2010 – 31 December 2013.

6. G20 summit from London

On 2nd April 2009, at the end of G20 summit from London, USA president Barack Obama stated that the obtained agreement represents “a turning point in our effort to realize a recovery of global economy”. Obama made these commentaries after the G20’s leaders announced an important plan for the stimulation of the world economy, including the fortification of the legislation regarding investment funds and fiscal paradise, as well as the more strict settlement of the financial global system.

Among the most important ideas of the leader from the White House have been: the G20 agreement representing a turning point in the effort of member countries to realize a recovery of the global economy; to prevent producing a new crisis, it was decided the increase the transparency and protection of the capital of financial institutions from member countries; in life there are no warranties and nor in economy are, there are always risks. And the measures taken are capable to prevent an economic depression. If are sufficient, we should wait and see. In 2-3 years we will look back and we will see if these decisions are fruitful. It is very important to be aware of the crisis. Generally, it was a constructive approach from all the leaders...Without strategies conceived together, these problems might return in the future. We owe to all our citizens to act in an urgent manner. We decided to take some measures to retake the economic increase and to prevent repeating such crisis. We have rejected the protectionism which might lead to crisis aggravation. This cooperation between main economies in the world indicates the American support for free markets. USA is decided to realize a complete reform of the actual unsuccessful settlement system. SUA would grant 448 million dollars to vulnerable state, representing future engines of world economic increase.

G20 leader reached an agreement to settle the global financial system. The financing package of 1.1 trillion dollars, to support commercial global fluxes was voted by leaders of the world that are present in the capital town of Great Britain, at G20 summit. The British Prime Minister Gordon Brown announced that G20 leaders reached an agreement to enforce legislation connected to investment funds, fiscal paradises and to strictly settle the global financial system.

³ * * *, *About the IFRS Foundtaion and the IASB*, pe site-ul <http://www.ifrs.org/The+organisation/IASCF+and+IASB.htm>

⁴ * * *, *European Financial Reporting Advisory Group (EFRAG)*, pe site-ul <http://www.efrag.org/content/default.asp?id=4103>

⁵ * * *, *First Public Report of the Public Interest Oversight Board (PIOB)*, 16 May 2006, pe site-ul http://www.financialstabilityboard.org/publications/r_0605.htm

The most important requirements of British Prime Minister Gordon Brown, approved by G20 leaders have been: drag out of the law the fiscal paradises that are not according to international fiscal settlements; establishing new rules to pay salaries and bonuses to the managers of great corporation, including from financial and bank sector; spending about 3 trillion dollars to enforce world economy up to the end of 2010, from which 250 billion dollars for the advancement of commerce at world level; supplementation of IMF funds and of other financial institutions with one trillion dollars, from which one trillion dollars would be granted to the international financial institutions; and from these, 750 billion dollars are for the IMF; the IMF will sell gold reserves of several milliards dollars to help countries in budgetary difficulties and poor countries; developing some rapid actions to end Doha round.

“People need a change of the world financial system, with new rules, preventing any kind of abuses. To bring back prosperity, we need trans-borders actions, investments to create new work places. We must reach a hand to markets in development, but also to poor persons, suffering most from the crisis”, was the message of American leader Barack Obama. World leaders managed, despite some previous disputes, to agree on “depth reforming of the international organizations” and to define “a strategy to exit the crisis” for the first time from the Bretton Woods agreement, in 1945, settling the basis of the present financial system.

The four major orientations, established as part of the summit, refer to money, adopting new rules, consolidation of the international institutions and receiving emergent states at the table of rich countries. According to final communicate, the participants decided to triple financial resources of IMF at 750 milliards dollars, appointing some special drawing rights of 250 milliards dollars, supplementing financing grants to development banks with at least 100 milliards dollars, as well as ensuring a support of 250 milliards dollars for world commerce. This program sums up 1.100 milliards dollars and will support crediting retake, economic increase and increase of the work places number, at world level.

Still in connection with IMF it was established that, from now on, managers from the International Monetary Fund and the World Bank to be named on virtue criteria, thus ending the agreement reserving the management of the IMF to the Europeans and the one of WB to the Americans. More so, central banks of the G20 member states compelled to maintain support politics of economy and to use all instruments at hand in this sense.

G20 leaders decided to realize credible strategies of renouncing at necessary measurement, to support the financial sector and reconstruction of the request at world level, to reduce the amplitude of budget's consolidation, necessary on long term. It was decided the establishment of a Financial Stability Board, with a more powerful mandate, as successor of the Financial Stability Forum (FSF), to include all G20 member states as members of FSF, as well as European Commission.

The Swedish finances minister, Anders Borg, proposed in the second decade of month January, this year, in a letter addressed to the European Finance ministers, to propose the imposition upon European banks of a tax for the “impact that saving measurements had on public finances. There is a crisis risk coming from banks and these should pay a part from payment bill. We cannot accept a situation in which bankers refuse to pay”. Anders Borg required starting a debate regarding advantages of a tax at European level, which might be applied for the liabilities of the banks, rather than on the transactions of the banks, showing that, starting from 2009, the Swedish government taxes with 0,036 per cent per year, final accountable balances sheets of the banks. Incomes from this tax are canalized towards a special stability fund, which already reached the level of 1% from GDP, and in the following 15 years would reach 2,5% from GDP.

Taxation of the bank's liabilities is a more efficient method than transaction's taxation, "imposing a tax on transactions might penalize consumers as well as non-financial companies, attempting to make payment and reduce risks" declared Borg. Thursday, 14th January this year, USA's president, Barack Obama announced a plan regarding the application of the „Tax for the responsibility of the financial crisis”, which is realize to recover a part of fund allocated to support financial institutions and reduce risks assumed by banks in the period of this crisis; it is estimated that the tax will collect 90 milliards dollars in the following 10 years and about 60per cent of these one would come from the first 10 great financial companied of USA. President Obama also requested the limitation of the bank commercial assets, including the complexity of great international financial groups. Referring to these proposals, the British Chancellor of Exchequer, Alistair Darling expressed its skepticism, stating that this couldn't have prevented the financial crisis and risks to undermine the fragile international consensus in the field.

7. The European Commission and Parliament propose

After the bank system was about to collapse during October 2008, the president of the European Commission, Jose Manolo Durao Barroso formed a group of bank experts, moderated by the former chief of International Monetary Fund, Jacques de Larosičre. This group had the responsibility to find modalities of improving financial supervising, and its recommendations are at the basis of the proposals of the Commission. At the end of May 2009, the European Commission presented intentions connected to a better financial supervision in Europe, proposing to establish a new European institution: European Systemic Risk Council (CERS), organism responsible for identification and elimination of the risks that appeared at this system.

The financial – banking crisis of 2008, the most serious of the past decades, showed that risks assumed regarding investments can destabilize the world financial system and even the entire economy. As part of different reunions at high level, organized at the beginning of 2008, EU leaders and the ones of Group of 20 compelled to consolidate the surveillance of the financial system to prevent excessive risks. "A better surveillance of the trans-border financial markets are crucial from ethical and economic point of view", stated the president of European Commission, José Manuel Durao Barroso. CERS will contribute to re-establish faith and greet crises, to protect work places and economic increase".

Before the foundation of CERS, the European bank system was supervised, mainly, at national level. CERS is an organism of European range, which might respond of the identification and elimination of the risks appeared at system level. The European Council for system risks will be conducted by the president of the European Central Bank, and will be composed of financial inspectors and representatives of the central bank in every country. Its mission will be the one to warn regarding the risks endangering the market's stability and to recommend remediation actions. The European Commission proposed also the realization of a European system of the financial inspectors, capable to supervise financial institutions acting in two or several countries of the EU. According to this system, European authorities from banking system, of the insurances and personal values might supervise and coordinate the activity of inspectors acting at national level.

The package of measures realized on two axes, represents an essential segment of EU's reaction at the economic crisis, being assigned to grant investor a greater safety of financial markets and to re-establish faith in the system. Also, proposals will contribute to consolidation of European market of financial services.

In the last plenary session, from May 2009, the European deputies of the Parliament before the elections from 7th June 2009 approved a proposal regarding

minimal funds that banks should have to ensure the solvability of the financial system. In the present legislature, 2010-2014, they have to decide if these capital requirements will be applied also to other types of financial institutions, as well as speculative funds and investment funds in the private system. The euro parliamentarians must settle the frame of the Union for managers of the alternative investments funds. It would be the first attempt to create a jurisdiction in this field.

In this context, the famous billionaire George Soros stated that after going too far in the lack of settlements, what contributed to the present crisis, we have to resist to the temptation to go further in the opposite direction. Even if markets are imperfect, the authorities are far from being perfect. Not only are human, but also bureaucratic and submitted to political influences and, that is why, settlements should be maintained at a minimal level. First, since markets are inclined towards bubbles, the authorities should accept the responsibility to pre-encounter the apparition of some great dimensions bubbles.

Alan Greenspan, former Fed president and others rejected this responsibility. Still, authorities should accept this mission even knowing they might be wrong...there should be an internal protection to separate transactions in their own name from commercial operations.

8. Conclusions

The main measure established in the meetings of the G20 member states, reconfirmed at London during September 2009, was that banks should collect more money to increase the capital basis, a measure that is necessary to equilibrate their accountant balance sheets. It was also decided that only best quality capital – as well as the actions of the institutions should be taken into consideration. This measure affects in a powerful manner one of the greatest European banks, which should collect money, fact involving possible new state aids.

Diminishing banker's bonuses seems to be a secondary measure to be applied, in comparison with bank's recapitalization. The summit from the fall of year 2009 of G20 insisted clearly in increasing capital basis of the banks, fact which might lead to the modification of the Basel Rules regarding settlements of the bank system. The decision of reshaping the bank system has as basis past evolution, showing that some banks are based more on the complex financial instruments provoking important losses of the financial system.

The new banking rules do not allow obtaining, in the future, some level of gain as high as before the burst of the financial crisis. As USA did not yet adopted the system of Banking Rules Basel II, it was easy for them to propose designing a new system of rules, Basel III, which should be adopted until 2012.

As host country of G20 summit⁶, from May and November 2010, taking important decisions on the theme of reform of the financial system, Germany announced that is necessary that G20 countries should not work on their own in projects of settlements and supervising of their financial and bank system.

REFERENCES

- * * *, *About the IFRS Foundtaion and the IASB*, pe site-ul <http://www.ifrs.org/The+organisation/IASCF+and+IASB.htm>
- - * * *, *European Financial Reporting Advisory Group (EFRAG)*, pe site-ul <http://www.efrag.org/content/default.asp?id=4103>

⁶ * * *, *Joint statement of European Commission President Barroso and European Council President Van Rompuy at the end of the G20 summit in Seoul*, pe site-ul <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/574>

- * * *, *First Public Report of the Public Interest Oversight Board (PIOB)*, 16 May 2006, pe site-ul http://www.financialstabilityboard.org/publications/r_0605.htm
- * * *, *Joint statement of European Commission President Barroso and European Council President Van Rompuy at the end of the G20 summit in Seoul*, pe site-ul <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/574>
- * * *, *National Commission on Fiscal Responsibility and Reform*, Wikipedia, pe site-ul http://en.wikipedia.org/wiki/National_Commission_on_Fiscal_Responsibility_and_Reform
- * * *, *Statistics and Databases*, International Labour Organisation, 2011, pe site-ul <http://www.ilo.org/global/statistics-and-databases/lang--en/index.htm>
- * * *, *The Moment of Truth: report of the National Commission on Fiscal responsibility and Reform*, The White House, December 2010, pe site-ul www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth121_2010