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The Crisis of the Sovereign Debt - Interdependencies, Responsibilities and Risks

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Abstract: The increase of government debt continues and maintains the financial crisis as an additional risk factor at national, regional or global level. The causes which lead to the raise of the national debt can be found in the effects of a major crisis but, in turn, this phenomenon feeds imbalances generating economic and financial crisis. The importance of this topic is defined by its magnitude and dynamics, in the long-term effects on the economy, finances, policies and, ultimately, on the completeness of a state. Solutions are available to the national public authorities in the context of regional policy, but they are circumscribed also to the imperatives imposed by the international lenders. Not infrequently, their efficiency was affected by subjective factors, along with the lack of preventive actions or of proper long-term vision. There have been made references to the analysis of international bodies or financial authorities, at authors dedicated to this complex problem. As method of approach we have used the bibliographic study, processing and analysis of data, and previous researches. The results are the analysis and explanation of specific developments of sovereign debt crisis, of interactions, highlighting the effects and solutions. The research is an important basis for specialists, public authorities and academics. As value, the work is a synthesis and a comparative analysis so as to identify trends, responsibilities and solutions.

Keywords: financial crisis; international creditor; budget deficit

JEL Classification: G01; H63

1. Introduction

In the current stage of the world, crises are becoming more complex and virulent, they involve extensive forces, produce upheavals and disorders in the most diverse spheres (economic, monetary, financial, social, moral, political, public and private sector) they propagate with speed in time and space and they have a more extended period.

The 2008 financial crisis was accompanied, in turn, by the exchange rate crashes, banking crises, currency debasements (Reinhart & Rogoff, 2008) and it expanded including in public finances of the developed countries and the effort of public authorities failed to resorb many emerging imbalances.

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Amid these realities, the sovereign debt crisis induces, to an economic and financial process, political risks, of national sovereignty, as the name of the phenomenon indicates. Moreover, over time, many times, the international financing organizations were suspected of interfering too deep and delicate in the state's policy, actions and strategies. If we refer to the absolute value of the external debt at the global level, which rose from about 2000 billion $ in the early 2000s to about 57,000 billion $ currently, the force possible to exert by the main debtors becomes evident.[1]

The official doctrine explains and proposes solutions for the recent financial crisis, unfortunately often overtaken by the new realities, it was built from the experiences of previous crises, motivated by the insolvency of debtors at the level of the sovereign state: deterioration of macroeconomic fundamentals, worsening public deficits and external debt, excessive appreciation of the real exchange rate, excessive inflation or deflation, reducing private savings, official reserves, etc.

2. Experiences, Favoring Factors and Developments of the External Debt Crisis

Recent decades have noted, along with strong financial crisis, an increase in international debt crisis which continues to have "victims" and create global imbalances, under the conditions where the origins, motivations and responsibilities are difficult to sustain. In association with economic crises, many countries needed financial aid, which often took the form of loans from abroad, which led in time to the excessive growth of foreign national debt.

In the second half of the 70s, banks were pressed to grant loans to developing countries without prior thorough analysis and without an exacting control over the final use of funds for various reasons, mainly economic, but also political. A large number of countries took the opportunity and were heavily indebted to fund important projects or to remedy the social, economic problems, especially through excessive subsidies of certain activity sectors.

The beginning of debt crisis in developing countries was considered in 1982, by the Mexico's decision not to repay the debt, which created a major risk in the international financial system as a whole. Resulting in the disruption of trade and financial flows, the consequences would have resulted in driving the world's economy into a crisis similar to that of 1929. (Tinbergen, 1988)

The sovereign debt crisis occurred in August 1982 while the international banking sector was the main financier; even if an important number of international banks attended to the international accreditation (about 750), several large engaged international banks facilitated an agreement between creditor banks and indebted countries. It made such a transfer of financial resources in surplus towards developing countries and a separation of funding sources for capital utilization areas. Basically, the link between funds and certain investment destination is no longer evident, a factor favored also by the magnitude that the operations on the created financial market.

The Public Power from the creditor countries warned late the system changes of financial institutions and the combination of circumstances from the debtor states and it did not impose cautious appropriate measures in due time.

With the onset of the unfavorable economic social or political environment, in the '80s there was a general detachment of financial institutions towards most developing countries. The Net capital outflows from these countries, as a result of the very oppressive external debt service, "the capital

[1] http://databank.worldbank.org/data/views/variableSelection/selectvariables.aspx?source=world-development-indicators#.

flight", given their situation extremely difficult, and the brutal interruption of foreign capital inflows have imposed severe constraints on their ability to develop.

Adjusting liquidity crises is difficult to achieve in the new context of international finance. (Eichengreen & Portes, 1996, pp. 26-45)

During the 90s, the international financing arrangements involved a very large dispersion of creditors and a multitude of lenders support only a small part of a country's debt crisis. In the absence of coordination procedures between creditors on the one hand and between lenders and borrowers on the other hand, each creditor has a tendency to withdraw first from the market, in order to limit the capital losses induced by the "escape/flee" of other investors.

The difficulties were compounded by the deterioration of trade relations with developed countries, with protectionist measures to cease funding. Developing countries not only that they do not receive loans in high risk situations, but they are isolated in international trade, with negative consequences for other states with which they have commercial or financial relations.

The real cost of debt service of developing countries increased with the accumulation of variable interests established to the contracting credits.

The current global financial crisis started from a subprime loan problem in the United States (2007), continued with the US mortgage market crisis, the growth rate of mortgage debtors insolvency, surplus of liquidity, toxicity extension of credit, resounding bank failures, not only in the US (about 150 banks), unemployment, economic recession. The crisis of confidence had spread including by the decrease of confidence in the euro area economy and in the European single currency; the effects were found also in the financial policies background.

Since the pre-crisis period, there has been registered an ever-increasing growth of public debt, which affects most countries, regardless of their development. Increasing budget deficit since 2008, caused also an increase in public debt balance, one of the reasons being the loans engaged for restoring macroeconomic balance and fiscal consolidation, see Table 1. Real GDP growth rate – volume and General government deficit follows the same trend.

Table 1. Evolution of economic growth, the budget deficit and public debt - meaningful comparisons

Indicator	State / year	2005	2006	2007	2008	2009	2010	2011	2012	2013
Real GDP growth rate - volume Percentage change on previous year (%)	***EU****	2.0	3.4	3.1	0.5	-4.4	2.1	1.7	-0.4	0.0
	of which *Romania*	4.2	8.1	6.9	8.5	-7.1	-0.8	1.1	0.6	3.4
	Euro area	1.7	3.2	3.0	0.5	-4.5	2.0	1.6	-0.7	-0.5
	United States	3.3	2.7	1.8	-0.3	-2.8	2.5	1.6	2.3	2.2
General government deficit/surplus % of GDP and million EUR	***EU****						-6.4	-4.5	-4.2	-3.2
	of which: *Romania*	-1.2	-2.2	-2.9	-5.6	-8.9	-6.6	-5.5	-3.0	-2.2
	Euro area						-6.1	-4.1	-3.6	-2.9
	United States	-4.16	-2.98	-3.56	-7.03	-12.69	-12.02	-10.59	-9.15	

General government gross debt % of GDP and million EUR	***EU****						78.2	80.8	83.5	85.4
	of which: *Romania*	15.7	12.3	12.7	13.2	23.2	29.9	34.2	37.3	37.9
	Euro area						83.7	85.8	89.0	90.9
	United States	78.1	75.6	75.8	91.9	105.0	115.3	120.6	122.5	71.8

Note: *28 Countries

Sources: Eurostat, http://ec.europa.eu/eurostat/web/government-finance-statistics/data/main-tables; http://ec.europa.eu/eurostat/web/national-accounts/data/main-tables http://data.oecd.org/gga/general-government-deficit.htm; http://data.oecd.org/gga/general-government-debt.htm#indicator-chart

In 2013, United States public debt-to-GDP ratio was 71.8%, according to the CIA World Factbook[1] or 104.5%, according to the IMF including external debt[2]. The level of public debt in Japan 2013 was 243.2% of GDP, in China 22.4% and in India 66.7%, according to the IMF[3].

In a series of complex studies that focused on data analysis over a period of about 200 years, representing all areas of the world, Carmen M. Reinhart and Kenneth S. Rogoff (2008) showed that public debt increased on average by 86% during the three years following a banking crisis. And the realities of the 2008 financial crisis reached to these conclusions.

One of the Euro convergence criteria was that government debt GDP to be below 60%. The financial crisis has left its mark on respecting this requirement. Data analysis indicates that most EU countries recorded an increase in public debt under the crisis impact, so the European average, more pronounced in the euro area exceeds the required level, which means that the European economic space remains as a whole it is one of the chronic deficits and indebtedness (Table 1). Long-term sustainable public finances can be an imperative for being out of the crisis, especially for Eurozone Member States, the currency being strongly put to test by the sovereign debt crisis. A total of 16 EU Member States reported a debt level of over 60% of GDP in 2013 and more than 6 countries had levels above 100% of GDP.[4] Greece is the leader in the ranking (174.9%), followed by Portugal (128%) and Italy (127.9%) - values of over 100% for this indicator, they appear in the first year of crisis, not only for the European countries, being considered historical levels which had not been much reached in peacetime.

Moreover, there is a risk of self-supplying the crisis (crise autoréalisatrice) for all states that had a public debt of over 100% of GDP, unable to obtain new funding markets, regardless of interest rates. (Marini, 2011) This is an additional risk to EU leaders, who bear the full burden of covering these serious shortcomings. The figures show that the EU remains an economic area in which the state plays an important economic and social role, many of the major infrastructure projects to modernize Europe being built also by the public authorities through debt. There is a policy space and a social welfare, at great expense in order to ensure a minimum welfare for a large part of the population. The main threat is related to the accumulation of deficits that will lead to an increase of public debt by borrowings that the states contracted from the economic resident agents or financial institutions abroad. The solutions lead, at the same time to inflation, special taxes or unjustified cuts of government spending. The data

[1] https://www.cia.gov/library/publications/the-world-factbook/rankorder/2186rank.html.
[2] International Monetary Fund: All countries Government finance, General government gross debt (Percent of GDP).
[3] Idem.
[4] http://ec.europa.eu/eurostat/web/government-finance-statistics/data/main-tables.

lead to adverse developments, growth will remain weak because of still-high public and private debt, tight credit conditions and high unemployment.

Studies show that the high levels of public debt limit the effect of economic policy, in the event of future shocks, i.e. too indebted economy will be more volatile (Villieu, 2011)

It appears that Romania is not subject to alarming developments in the sense that the analyzed indicators remain within the limits more favorable than the European average. However, the accelerated pace of growth of public debt remains worrying and it is yet another reason to adopt proactive budgetary fiscal policies of fiscal consolidation. The public debt, since 2009, has increased continuously and with a very high rate, i.e. tripled in only six years, it increased from 12.7% of GDP in 2007 to 37.9% of GDP in 2013. This public debt was created for consumption and not for investment. The long-term attenuation rate of the economy by these consumed amounts is zero or close to zero.

3. Interactions and Responsibilities

If we analyze the problem of responsibilities in the external debt crisis, the debtor states are primarily responsible, given that they must provide reasons of trust of citizens in their national economy and to lead them to repatriate the capitals that they have sent abroad. Foreign creditors will not provide funds to countries whose investors have not, themselves, trust in the national economy. The countries that have difficulties must find the paths which lead towards economic efficiency. For this to happen there are required efforts towards creating a trusting climate for domestic and foreign investors.

In parallel, the industrialized countries should ensure open markets, stable interest rates, sustainable economic growth and to provide necessary assistance and public support under the conditions of not finding the solutions for a viable market economy.

The banks also have their share of responsibility. In periods of optimism on the economic development of the medium and small banks, the major banks had spontaneously granted loans to borrowers without having, objectively and thoroughly, their own analysis, being about the action of a gregarious instinct or mimetic behavior which would characterize the fund managers. (Aglietta, 1998) It can be exemplified by the financial crisis developments in the recent years or more precisely, the situation recorded in the US in 1982 when about 1,500 banks have granted loans to enterprises and governments in Latin America. (Slighton, 1983, p. 3) Similarly, third world countries have benefited from a large volume of loans relative to productive investment opportunities.

In addition, the availability of banks to grant loans led to the postponement of economic austerity programs promoted by governments in difficulty.

After acknowledging the risks they pose and the losses they entail, including during the times of economic uncertainty, the creditor banks are no longer willing to accept risk taking, and the debtor countries would be deprived of external funding indefinitely, being isolated of the international trade.

Excessive or inconsistent reaction of creditors was an additional source of economic instability at a global scale. Even borrowers who have honored the commitments had difficulties in financing, interruptions of credit lines due to the negative consequences generated by the insolvent debtors. Also, the collapse of banks will induce losses also to other banks of sound management, business associated (e.g. interbank loans, mutual customers, etc.) or cause withdrawal of customers that lose confidence in banks operating in the same market.

Thus, it appears that problems arise from both debtors and creditors: information asymmetry, mimetic behavior of financial intermediaries, liquidity crisis on critical segments of the money market are only a few factors that "infect" the fast international financial system and it presents symptoms of *systemic risk* at global level.

It is estimated that the ideal forum to address the external debt problem is the International Monetary Fund (or partially the World Bank), where all countries involved (developed or developing, debtors and creditors) are members. (Aglietta, 1998) Promoted by the IMF, the *conditional financial support* can be an effective tool to ensure the implementation of appropriate and realistic adjustment policies, in order to protect the developing countries, export promotion and thereby ensuring the fulfillment of their financial obligations. But lasting solutions cannot be applied without structural adaptations in the indebted countries, which promotes competitiveness, productive spending, stopping the exodus of capitals, corruption.

4. Specific Risks of State Creditors and Possible Solutions

Giving the customer a loan from a foreign country involves additional risks compared to the normal national credit, included in the country's risk and which involve:

- The risk of losses caused by government actions in the detriment of the bank or its customers (administrative, trade, monetary restrictions, exaggerated taxation);
- Transfer risks arising from difficulties on debtor's currency non-convertibility and the establishment of an exchange rate control;
- The risk of social, political or military conflict;
- Some governments may deny the predecessors' commitments or attempt to evade the obligations (often as a result of changes in regime or serious crises);
- Most governments, mainly in developing countries or with economies strongly nationalized, provide incomplete and distorted information;
- Risks derived from the failure of economic reforms.

For risk prevention and protection of foreign creditors, the debtor countries were subject to the legislation of the creditor country, but the procedures are difficult and the protection is modest against in relation to the loan value.

The international debt problem *solutions* are structured around a number of possible different directions, depending on the specific situation of each country and the global context:

- Restructuring debt portfolios by extending the date of payment; there are proposed different rescheduling solutions, including swaps "debt-own funds", which involves converting debts into own capital, therefore of bank loans in investments or direct equity - this tool allows the country to repay a part of the foreign debt in local currency.
- Conversion of debt in real assets or securities, sold on secondary markets;
- Facilitate imports of products from Member debtors by market liberalization;
- Policies to reduce financial obligations;
- For very poor countries that do not provide real prospects for debt repayment, it is preferable to convert part or all of the debt in financial support.

5. Conclusions

In their development, the financial crises affect sovereign states, the regional stability, the relations between nations in many areas, forming attitudes and reactions, constituting a major risk associating with huge risks network that maintain each other and connect the crises in a chain harder to loose. Increasing government debt turns into a new crisis, which continues to maintain financial crisis, with the same destructive power at national, regional and global level.

Deciphering crisis poses problems both for the national responsible executive and for those with international prerogatives and the crisis' inventiveness is hard to beat with the proposed actions or solutions. Not infrequently, their efficiency was affected by subjective factors, of unexpected developments, which are the unique aspects of each crisis, along with preventive actions or lack of proper long-term vision.

A way forward for debt reduction may be stimulating the economy, above the level of the interest rate of the public debt, so that the level of budget revenues would increase along with the turnover and GDP, and the state debt would diminish. The results are highly dependent on many factors, but the same effect proves correct that "it is unlikely that an appropriate macroeconomic policy is sufficient to keep the economy in balance, much less if it is not supported by sane micro-economic conditions". (Lindgren, 1996) This is a true statement both in budgetary and financial-monetary policy – related to the external debt, monetary stability and the banking system.

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