Implications of the financial and economic crisis on the European Statistical System

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Abstract

The economic and financial crisis starting in 2008 had and still has a deep impact on the functioning of the European Union. This paper focusses on the implications of the crisis for the European Statistical System (ESS) and the change initiated since in the ESS. The challenges faced by the ESS are partly of an institutional nature, partly they lie in the requirement for new and/or more readily available data on financial, economic, but also social issues. Quality assurance of statistical data becomes more and more important as European economic policy heavily relies on benchmark indicators produced by the statistical system. In order to best prepare the ESS for the future statistical producers need to enter in a close dialogue with policy makers, operating, however, from a position of strengthened institutional independence.

Key Words: European Statistical System, financial crisis, governance

1 The crisis background

The world economic crisis that had started in 2008 as a financial and banking crisis, originating in sub-prime risk misjudgements of the US banking sector, spread to the real economy, resulting in sharp declines of GDP in 2009 in several countries worldwide, but in particular in the European Union. In the euro area governments increased public spending by more than 5% in both 2008 and 2009 in order to compensate for the shortfall in private demand and to ease the impact of the economic downturn. Public finances, already strained in some EU Member States before the crisis, further deteriorated, leading to 19 Member States falling under the Excessive Deficit Procedure (EDP)[2] with deficit ratios beyond 3% of GDP between 2008 and 2010. Bailouts of financial institutions further weighed on public finances in several countries, driving up debt levels as bad banks had to be accounted for as general government debt under the Maastricht rules. From 2007 to 2010 the average deficit and debt ratios to GDP in the EU-27 increased from 0.9% to 6.5% and 59% to 80%, respectively.

Financial markets stopped considering the euro area as a monolithic risk block and started attributing different categories of sovereign default risk to individual euro area countries. Refinancing costs of countries like Portugal, Ireland and Greece went up substantially, forcing them to request financial assistance from the EU and the IMF. Spreads of government bond yields of those countries over German Bunds reached levels of between 400 and almost 3000 basis points in 2011. But also bigger EU economies like Italy or Spain could only contain their refinancing costs at affordable levels with the determined assistance of the ECB’s bond buying scheme. The economic and financial crisis turned into a sovereign debt crisis in some countries of the European Union.

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[2] The so-called the Stability and Growth Pact (SGP) aims to secure fiscal discipline in the EU. It enforces thresholds on deficit and debt of 3% and 60% of GDP, respectively. When a Member State does not respect these thresholds, it is said to be in "excessive deficit", and an "excessive deficit procedure" (EDP) is triggered against this Member State.

Decisive action by European governments and institutions managed to end talks of a possible break-up of the euro area. However, even in 2013, almost five years after the crisis had started, the euro area and the EU is faced with sluggish economic growth and some southern European countries depending on financial assistance by the Troika (EU/IMF/ECB). The experience made throughout the crisis management has revealed institutional weaknesses in decision making, compliance with existing rules, financial supervisory co-operation and risk assessment in the EU, which need to be addressed in the near future. The uneven distribution of bail out burdens throughout the European Union and the social impact of the crisis have opened the door for anti-European populist movements gaining more power in several national Parliaments of European countries. Selling solidarity spending of taxpayers' money on neighbouring countries is almost as difficult for policy makers of financial net contributor countries as selling austerity measures in countries depending on financial assistance. Some progress has been achieved by creating a European Stability Mechanism (ESM, a sort of European IMF), and by launching the process of forming a banking union, which centralizes an important part of banking supervision and aims for a single bank resolution mechanism. However, on the top of solving its institutional problems the European Union needs to develop a vision of a new Europe in order to regain citizens' support for the common project of a more integrated European Union.

2 The Role of European Statistics in the crisis

European Statistics played a role in the financial, economic and sovereign debt crisis in Europe in two very distinct ways. First, confidence in public finance data was shaken when severe manipulations of Greek deficit and debt figures were revealed in 2010. Second, financial assistance to individual EU countries as well as bailout activities by European governments for financial institutions under stress led to difficult classification decisions, having substantial effects on debt and deficit levels in some EU countries.

The crisis of Greek statistics became apparent when data notifications of government deficit and debt by Greek authorities in October 2009, covering the data for 2005-2008, and a forecast for 2009 saw substantial revisions within a few weeks' time. The Greek government deficit for 2008 was revised from 5.0% of GDP to 7.7% of GDP. At the same time, the Greek authorities also revised the planned deficit ratio for 2009 from 3.7% of GDP (the figure reported in spring) to 12.5% of GDP, reflecting a number of factors (the impact of the economic crisis, budgetary slippages in an electoral year and accounting decisions). After several further corrections and data checks by Eurostat, we know today that the deficit figures for 2008 and 2009 stood at 9.8% and 15.6%, respectively. At the request of the Council of Economic and Finance Ministers the European Commission prepared a report[3] on the 'renewed problems in the Greek fiscal statistics' and proposed measures to improve the situation.

The report found evidence of severe irregularities in EDP notifications, including submission of incorrect data, and non-respect of accounting rules and of the timing of the notification; poor cooperation between the national services involved in the compilation of EDP figures, as well as lack of independence of the Greek Statistical Institute from the Ministry of Finance; an institutional setting and a public accounting system inappropriate for a correct reporting of EDP statistics, lack of accountability in the individual provision of figures used in EDP notifications, and unclear responsibility and/or lack of responsibility of the national services providing source data.

These devastating conclusions of the European Commission's report on Greek public finance statistics led to important improvement actions, both on the Greek national level and on the European level. A

[3] European Commission (2010)

new Statistics Act was passed by the Greek Parliament in 2010, creating a new independent Greek Statistical Authority (ELSTAT) and an international expert on statistics, previously working for the IMF, was nominated the new Director General of ELSTAT.

On the European level, the main immediate reaction was a strengthening of Eurostat's, the European Union's statistical office's, enforcement and control powers. Already before any regulatory change was introduced Eurostat had been in a position to disapprove incorrect data and change it if needed before publication as European statistics. However, Eurostat was not in a position to investigate 'sur place' whether the information provided by national authorities was accurate or not. The change in European legislation implied that in case of severe doubts about the correctness of fiscal data submitted Eurostat can now launch a procedure including so-called methodological visits. During such visits the production of fiscal data according to European law is checked throughout the entire production chain, including all other compilers of fiscal source data in the respective country. A European regulation was introduced to impose sanctions on any country manipulating fiscal data fed into European statistics and the number of staff working on Government Finance Statistics at Eurostat was increased substantially.

The second important role of European statistics during the European sovereign debt crisis is a more technical one and relates to classification issues. In the European Union, a lot of emphasis is put on fiscal discipline within the boundaries of the Stability and Growth Pact, requiring a "Maastricht" deficit ratio of no more than 3% of GDP and a "Maastricht" debt ratio of no more than 60% of GDP. Those "Maastricht" deficit and debt ratios are calculated on the basis of liabilities attributed to the General Government Sector, including all levels of government, their respective non-market off-budget entities, and Social Security.

Crisis related classification issues came into play in two ways. First, the predecessor of the ESM, a so called European Financial Stability Facility (EFSF) was created in 2010 in order to provide solidarity financing to euro area countries facing difficulties to raise funds on international capital markets. The EFSF was constructed in a way that it remained an intergovernmental facility as it had no own capital and functioned exclusively based on guarantees issued by euro area governments. Thus any financial contribution by the EFSF to a Member State needing financial rescue had, according to the rules of the European System of National Accounts (ESA 95), to be re-routed to the respective general government debt of the guarantor governments.[4] This led to the perverse situation that the more the EFSF lent, the more the debt ratio of guarantor governments rose. This classification issue raised discussions between policy makers and statisticians in Europe. The European Stability Mechanism (ESM) replaced the EFSF two years later. Created as a sort of European IMF with a paid-in capital of 80bn euros, and a callable capital of 500bn euros, the ESM was considered by ESA as a full-fledged international organisation, resolving the re-routing problem.[5]

The second classification issue was related to governments' assistance to the financial sector. During the financial crisis many banks saw parts of their balance sheet turn sour and faced difficulties to cover their refinancing needs in an environment of illiquid money markets. In order to prevent a break-down of the financial sector and possible contagion effects many governments provided financial assistance to struggling banks. This assistance took the form of government guarantees of parts or the entire toxic part of bank assets, of direct capital injections, of institutional solutions like the separation of financial institutes into good and bad banks, or of plain nationalisations of banks. As existing European System of National Accounts (ESA) rules did not include clear instructions of how to deal with heavy

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[4] See European Commission (2011a)
[5] See European Commission (2013a)

government involvement of this kind, Eurostat drew up guidelines for the statistical treatment of these government actions in terms of sector classification.

Rules were set up to decide when a capital injection from government to a bank had to be classified as expenditure, despite being called "equity purchase", thus increasing deficits. Moreover, rules were set up to decide when some government guarantees – normally considered "contingent" thus without immediate impact on a country's debt level – should be re-qualified as debt, given the high risk of being drawn upon. Finally, rules were set up to decide on when to reclassify a bad bank as being part of the government sector (thus adding its liability to government debt). These rules were particularly difficult to set as such an institution might fulfil all criteria of a bad bank, but still be classified in the non-government sector as it is listed on the ECB's list of Monetary and Financial Institutions (MFI). The criteria for being included in the MFI list and the question whether being listed should automatically prevent a bank of being classified in the government sector, was subject to intensive discussions between Eurostat and the ECB.

Overall, during the reference period of 2007-2012, the most significant increase in deficit due to government interventions in financial institutions was recorded in Ireland, amounting to more than 20pp of GDP only in 2010. For several other EU Member States, such as Germany, Spain, Latvia, the Netherlands, Austria, Portugal, Slovenia and the United Kingdom, the deficit increased to a significant, but a more limited, extent. In 2012, the largest impact on the government debt levels is also observed in Ireland (an increase in liabilities by more than 30pp of GDP in 2012). The impacts on deficit and debt levels in 2012 are also large in Belgium, Denmark, Germany, Greece, Latvia, Luxembourg, the Netherlands, Portugal and the United Kingdom, with the highest annual increases exceeding 4pp GDP.[6] These results show the extensive involvement of governments in the rescue of financial institutions in the third phase of the crisis. Eurostat developed a special information system consolidating and quantifying this involvement.

3 A paradigm change for European Statistics

The experience throughout the economic and financial crisis and the consequences drawn by European policy brought about fundamental changes of the environment the European Statistical System operates in. These changes are very much related to the construction of the European Union, where – in the absence of a democratically legitimized central EU government – individual member states are linked together by common rules and procedures. A common feature of the reactions of European policy makers to the experience of the crisis was that discretionary leeway of national policies had to give ground for an even more rules-based system, in which enforcement and control mechanisms were substantially strengthened. Examples are the strengthened fiscal surveillance within the Stability and Growth Pact, deeper and high frequency monitoring of fiscal data and contingent liabilities introduced by the so-called six pack, as well as the introduction of a scoreboard of indicators to identify macroeconomic imbalances of individual member states at an earlier stage.

A system which heavily relies on rules, indicators and thresholds to coordinate national policies in the European Union puts the statistical system which is responsible for the production of policy relevant indicators under strong scrutiny. Not only must the data produced be reliable and internationally comparable, but their prompt availability grows to become more and more important quality criterion as policy decisions need to be taken swiftly and on a sound factual basis at the same time. Policy makers often also require a "stability over time" criterion, especially for policy relevant indicators,

[6] Eurostat supplementary table for the Financial Crisis, Background note (April 2013)

which might trigger automatic reactions – a criterion statisticians have a difficulty to accept, as they are used to revise data, once new information becomes available. Any doubt of data manipulation or political interference in the production of statistical information which gained in importance for European policy making must be excluded. This shift of statistical information to the limelight of political interest represents a paradigm change for the European Statistical System, requiring strengthened National Statistical Institutes (NSIs) with institutional independence of from political interference, enhanced competence in Government Finance Statistics, as well as a quality assurance framework in order to minimize the risk of wrong policy decisions being taken on the basis of erroneous statistical information. At the same time the dialogue between policy makers and statisticians needs to be intensified in order to bring the supply of statistical information provided for by NSIs and Eurostat better in line with information requirements of policy makers.

Against this background the European Commission (Eurostat) proposed changes in the existing basic legal framework with the aim to achieve four major objectives:

First, the independence of NSIs should be strengthened by insulating methodological decisions of the respective national Chief Statistician from any political interference, by making nomination and dismissal procedures of Chief Statisticians more transparent and by clarifying internal management powers in terms of staff recruitment and budget administration.

Second, the coordinating role of NSIs within their respective national statistical system vis-à-vis other national authorities producing European statistics or in charge of compiling the primary data used to produce these statistics should be strengthened in order to better provide for a harmonized way of producing European statistics according to European rules.

Third, so called “Commitments on Confidence” should be signed between the respective government of a member state and the European Commission, including a clear commitment of national policy makers to adhere to the Principles of the Code of Practice of European Statistics, as well as possible improvement actions.

Fourth, the NSIs’ access to and their involvement in the design process of administrative data for the purpose of the production of European statistics should also be strengthened.

This proposal by the European Commission was followed by an intensive debate in which some of the member states obviously struggled with this new more important and more independent role NSIs should play in their national institutional setup.

On the quality assurance front, Eurostat contributed to improve the governance of the national statistical production systems of government finance data by organising the so-called Upstream Dialogue Visits (UDV). During such UDVs all key players contributing to the production and control of government finance data, including the National Statistical Institute, representatives of all layers of government, Social Security Fund representatives as well as representatives of Central Banks and Court of Auditors were invited to describe and explain their particular role and contribution throughout the entire production chain of government finance statistics. The focus of the concluding recommendations of Eurostat’s UDV report was on the governance of the entire process and the institutional role of the NSI in particular. All these measures led to a substantial improvement of the quality of government finance data in the European Union.

Other measures taken to ensure a high quality standard of European statistics were stepping up the frequency of ordinary bilateral country visits by Eurostat to discuss issues of quality and adherence to European rules. The possibility of a financial sanction was introduced in the case of manipulation (either by intent or by serious negligence) of European statistics by a member state of the euro area. Furthermore, Eurostat has taken the lead of an ambitious project to create European Public Sector Accounting Standards (EPSAS). These will be "micro" harmonised accounting standards applicable to all public entities of the EU. This illustrates the fact that, in the EU and in particular in fiscal data, statisticians are going way beyond traditional responsibilities. In addition, beyond fiscal data, a European regulation was proposed by the European Commission to provide quality assurance for the scoreboard of indicators under the Macroeconomic Imbalances Procedure. This set of eleven indicators is meant essentially to cover the measurement of competiveness and the monitoring of (housing) bubbles.

4 Conclusions

The area of European Statistics was and still is affected by the economic and financial crisis starting in 2008. A paradigm shift has taken place for the ESS in the sense that the production of European statistics has become much more essential to policy making in the EU. Rules based systems of policy making in the European Union which increasingly rely on the monitoring of selected indicators require the highest quality of statistical information possible. Governance systems of the ESS and national statistical systems need to be set up in a way that the production of statistical information can be insulated from any interference from policy makers or interest groups. Stronger institutional independence of NSIs, however, must go together with increased capability of the statistical system, a sound system of accountability and an intensification of the dialogue between policy makers and statisticians. New challenges, however, go beyond issues of governance and institutional independence and comprise the coverage of new information needs and the development of new indicators and statistical products. A lot of progress has been achieved in the European Union in all of the fields mentioned in recent years, but a lot still lies ahead.

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