The Effects of European Debt Crisis on the Budget Deficits and Debt Stocks of Developing Countries

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The crisis that had started in the US real estate market in 2007 spread to the other countries of the world particularly with the strong financial relations channel and turned into a global fiscal and real sector crisis. The adverse effects of the crisis were significantly experienced in the EU. The preliminary effects of the crisis were experienced in the weakest link, Greece and spread to the other EU countries. The crisis caused budget deficits and debt stocks to reach crucial levels and put risks on the sustainability of public finance in Greece, Italia, Spain, Ireland and Portugal.

Developing countries have strong financial links with European countries and the debt crisis burst in Europe has spread to developing countries. European debt crisis has affected developing countries through three different channels: financial contagion, Europe’s fiscal consolidation effects, and exchange rate effects. In the study, the effects of the crisis on the budget deficit and debt stock of developing countries are examined through chosen country samples. Furthermore the fiscal effects of the crisis on developing countries are compared. The fundamental hypothesis of the study is that developing countries have affected from the crises less than developed countries, developing countries are still the basic determinant of global growth; but the crisis has retarded this growth. On the other hand, it is thought that, the decrease in the public expenditure of developed countries has caused financial resources that are reserved for supporting the development of underdeveloped and developing countries to diminish.

Two basic financial indicators of the Maastricht Criteria are the debt to GDP and fiscal deficit to GDP ratios. These two indicators are for the assurance of fiscal stability. Those countries that experienced the crisis mostly could not meet these two criteria. In order to ensure budget stability, developing countries were more successful in maintaining the rates of debt to GDP and budget deficit to GDP around certain levels. This success is quite crucial for accomplishing significant and sustainable public finance policies. In addition it is observed that the duration of crisis periods in developing European countries is longer than other developing countries. The debt stocks of European countries caused crisis to last longer in the developing countries of the region.

Keywords: Budget Deficit, Debt Stock, Developing Countries, European Debt Crisis, Fiscal Stability.