SUPRANATIONAL ADJUSTMENT OF FISCAL SYSTEMS IN VISEGRÁD COUNTRIES

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This article presents the analysis of fiscal consolidations in Visegrád countries which were anchored by fiscal governance procedures of the EU. As the Visegrád countries have accomplished their consolidation effort, it seems topical to study their experience and assess the efficiency of consolidation measures. Such an analysis could be also crucial for Russia, as the country has faced the necessity to stabilize its fiscal system.

Key words: *budget deficit, fiscal policy, fiscal governance, fiscal adjustments, fiscal consolidation, Visegrad countries.*

Наднациональное регулирование фискальных систем в странах Вишеградской группы

Статья представляет анализ консолидаций бюджета в странах Вишеградской группы, осуществлённых под воздействием наднационального фискального регулирования ЕС. Поскольку консолидация в этих странах завершена, научный интерес представляет изучение их опыта и оценка эффективности политики стабилизации (учитывая, что Россия столкнулась с необходимостью консолидации бюджета).

Ключевые слова: *дефицит бюджета, налогово-бюджетная политика, фискальное регулирование, консолидация бюджета, Вишеградская группа*

The problem of fiscal adjustments seems to appear on the economic agenda quite regularly. Recently, it has become topical again amid debt crisis in the European Union (EU). The need to stabilize national budget looms large for Russia too, as the oil-depending revenues dropped after 2014. Thus, it looks promising to analyze fiscal adjustments in countries that have accomplished budget consolidations. One could highlight the Visegrád economies, namely the Czech Republic, Hungary, Poland and Slovakia. Their experience might be useful to study, because recently they have taken some consolidation efforts and because their economies and fiscal systems have some similarities with Russia’s ones. These are

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level of development, particular elements in structure of government expenditures and revenues, certain problems in common etc. So, such an analysis seems convenient when it comes to measures, which Russia's government could and could not take, while consolidating its budget.

Fiscal adjustments in Visegrád countries (V4) have their own peculiarities. First of all, they were mainly driven by external factors, which include EU fiscal governance. The latter implies the need for a country to comply with certain fiscal rules concerning budget deficit and level of public debt (as percentage of GDP). Since supranational regulation is in place, one should study the efficiency of such regulation, as well as the efficacy of measures taken. It sounds logical to study how fiscal systems of the countries concerned were reacting to fiscal regulation. Then, one should assess a consolidation package in every country. Consequently, an analysis on the efficiency of consolidation effort should be undertaken. After all, applicability of Visegrád experience for Russia should be assessed.

Theoretical assumptions

The problem of fiscal consolidation

The problem of fiscal consolidation is a rather developed field of scientific research. However, there are some theoretical differences about the consequences, which a fiscal contraction may cause. Generally, from a standard Keynesian point of view, a stabilizing fiscal impulse[3] would lead to some losses in output. In this case, the effects of consolidation measures are strongly dependent on the economic conditions in a given country and a number of other factors. Some studies argue that a range of fiscal consolidation, which followed European debt crisis, caused a so-called "double deep recession".[4] An alternative point of view posits that a fiscal contraction could be expansionary or at least would not harm economic development, if necessary conditions are met. Effects of this nature are called non-Keynesian. There are studies, which have found Non-Keynesian effects in Eastern European Countries.[5] Some of the works have concluded that a recent fiscal consolidation didn't harm economic growth in Visegrád countries.

Fiscal Governance

The authors have developed a concept of supranational fiscal governance (regulation)[6], which may imply any form of supranational influence on a given country's fiscal system. Such a notion may be necessary in order to distinguish

[3] It may include reducing expenditures, increasing revenues (taxes) or a combination of these instruments)

[4] Heimberger P. Did Fiscal Consolidation Cause the Double-Dip Recession in the Euro Area? // Wiener Institut für Internationale Wirtschaftsvergleiche Working Paper. – 2016. – Vol. 130. – 22 p.

[5] Rzonсá A. and P. Non-Keynesian Effects of Fiscal Contraction in New Member States / A. Rzoncá, P. Ciżkowicz // European Central Bank Working Paper Series. – 2005. – No. 519. – 34 p.

[6] Сергеев Е.А. Фискальное регулирование в интеграционных объединениях: общая характеристика [Электронный ресурс] // Мировое и национальное хозяйство. – 2017. – №1. – С. 8. – Режим доступа: http://mirec.ru/upload/ckeditor/files/mirec-2017-1-sergeev.pdf

between internal and external factors, enforcing countries to run a fiscal consolidation. It could be useful to analyze national fiscal policy of a country, which is a member of a monetary union or could be subject to any form of supranational impact on its fiscal system. The Treaty on the Functioning of the European Union posits that EU members shall have stabilized budgets. The Growth and Stability Pact of the European Union (amended by the so-called "Six-Pack" and "Two-Pack" regulations) sets the fiscal rules, including the deficit level of 3% GDP and the public debt level of 60% GDP. A country, which infringes those criteria, shall be subject to the so-called Excessive Deficit Procedure (EDP).

The latter implies possible financial sanctions for euro zone countries that have violated the criteria and did not take effective measures to combat the deficit. At the same time, according to TFEU, possible sanctions are applicable for all EU countries. If a country does not take necessary measures to bring the general government deficit below the target level, it may face the suspension of payments from EU structural Funds. Thus, a current form of fiscal governance in the EU implies that a country, which breaks the existing criteria, is forced to consolidate its national budget.

V4 Fiscal Effort

The European Commission launched EDP's against all V4 countries after 2009.[7] Since Slovakia is a member of the euro area, the country had to consolidate its budget in order to evade possible financial sanctions. At the same time, Poland, Hungary and the Czech Republic also had to accomplish fiscal consolidations, because a risk of payments suspension was rather feasible. These countries receive a rather huge amount of funds from the EU budget. Specifically, Slovakia receives 2.53% of its GNI (2.04% for the Czech Republic, 1.75% for Poland and 3.34% for Hungary) in 2016. Thus, the supranational influence in case of V4 countries was quite effective, as these economies were not willing to lose financial support from the EU. It is especially so, given a cumulative size of financial transfers in 6 years following the start of EDP (see table 1).

Table 1. Change in fiscal position of V4

	Δ deficit, % GDP	**Δ public debt, % GDP**	**difference, p.p.**	Δ ***structural deficit***	**cumulative transfers from EU budget 2010-2016, % GNI**
Poland	5,6	-2,5	**3,1**	*5,93*	19,5
Hungary	2,5	-6,6	**-4,1**	*0,25*	25,6
Czech Rep.	5,8	-2,8	**3,0**	*5,09*	14,6
Slovakia	6,5	+9,7	**16,2**	*6,07*	14,4

Source: Eurostat, authors' calculations

Discretionary Measures

[7] A procedure against Hungary was launched in 2004.

OECD assessed the comulative size of consolidation measures declared by national governments for Hungary (5.7% GDP), Poland (3.5% GDP), the Czech Republic (4.9% GDP) and Slovakia (3.4.% GDP). However, their structural balances, which to some extent could be associated with discretionary measures, changed in a slightly different way (see table 1). Overall, Visegrád Four exercised different measures in terms of scales, structure and content consolidation.

Hungary

Hungary has been focused on raising value added tax (VAT), tax burden on business sector and reforming pensions. In 2011, the government totally nationalized the pension system. And it is the pension reform that explains a considerable cyclically–adjusted public deficit leap in 2012, which marks the active stage of budget consolidation in the country. Working citizens had to choose either to fully return, by default, to the state solidarity pension system or to refuse it. The latter option implied that a citizen would have lost the right to get a share of the solidarity pension formed in 2011 (still, solidarity share of pension contribution was kept). As a result, 97% of the working citizens had returned to the state solidarity pension system. By the end of 2011 state budget had been in surplus of 4.3 per cent of GDP and the national debt had been reduced to 81.4 per cent GDP. In 2010, standard and reduced VAT-rates increased by 5 and 3 p.p. respectively. Income tax on corporate profits was raised from 16 to 19% in the same year while income taxation of banks had become 0,5% of bank assets over 50 bln forints by the end of 2009 (the highest rate in the EU). New tax on financial transaction on turnover has been implemented since 2013. There were two more specific levies in Hungary: in 2009-2010 – a tax on utility and energy sector (17% on turnover of suppliers of energy commodities) was introduced, and, from 1.01.2010 to 31.12.2012, an anti-crisis tax on the annual turnover of energy and telecommunications companies and major retail trade chains was implemented.

Poland

Poland decided to raise VAT-rates (in 2011, standard and reduced rates were increased by 1 p.p. with standard rate reaching 23%) and to partly nationalize the Retirement Savings System. The country also privatized the state ownership (during 2012-2013 around 300 enterprises were privatized) and attemted to optimize government spending. In 2014, non-state pension funds were subjected to a ban on investment in government bonds whereas previous investments were nationalized (about a half of retirement savings of the citizens). The funds received were spent on cutting the public debt, which then declined by 7% GDP. In the second phase of the reform the state suggested its citizens either returning to the National Retirement Savings System together with their savings (a default option) or during a three-

month period declaring their wish to choose the previous option with keeping a solidarity pension share. 82 % of working citizens gave preference to the first option.

Czech Republic

The main efforts in the Czech Republic were aimed at radical reduction of the public expenditure and raising budget incomes mainly by indirect taxes and also by taxes on corporate profits, as well as personal income taxes. Almost all items of social expenditures such as defense, agriculture and regional development spending have been cut. The exception was pension spendings that have risen due to pension indexation and increase in pensioners.

Slovakia

In the first phase of the reform in Slovakia (2008-2011), the government focused on shrinking current budget expenses (state machinery was shortened by 20 thousand people and wages of civil servants were reduced by 10%). Revenues rose due to increase in VAT-rates (from 19 to 20%), elimination of a reduced VAT-rate (which stood at 6% before the reform), increase in excise taxes on alcohol, introduction of new taxes (on dividends and on income from sale of real estate) and also due to raising income ceiling for obligatory contributions to medical and social insurance funds. In the second phase (since 2012) one could witness further reduction of expenditures by freezing civil servant's salaries and increase of tax revenues due to rising tobacco tax. Besides, in order to strengthen the distribution segment of the pension system under negative demographic tendencies, the ratio of contribution to state and contributory scheme was changed significantly. Later on, the focus was shifted to increase in tax burden for individuals and legal entities with high income (differentiated rates of those taxes were implemented in 2013) and reforming the authorized bodies of government. The latter included cutting the number of local authorities and budget organizations. Some other taxes were also introduced, including extra 5% income allowances for those individuals who held the elected constitutional public office and a special anti-crisis tax on banks (in order to cover expenditures in case of possible financial crises in the future).

Tax burden

All V4 countries have experienced a slight increase in tax burden (taxes to GDP). Hungary had the shortest increase (from 39.13% GDP in 2009 to 39.41% GDP in 2016). Tax burden increased in the Czech Republic (by 1.75 percentage points from 2009 to 2016), Poland and Slovakia (by 2.35 and 3.86 p.p. correspondingly). The greatest increase in tax burden was observed in Slovakia, which could be explained by country's membership in the euro area (the country has to be more precise in maintaining fiscal stability).

As to the structure of consolidation measures, one should pay attention to the fact that the countries concerned refrained from increasing corporate taxes (but for Hungary), as those taxes could harm economic activity. Only Hungary attempted to raise corporate tax rate, which lead to decreasing collection of taxes. On the side of indirect taxes, all countries tried to raise VAT and excise rates, because those types of taxes do not distort economic activity to a great extent. However, since those taxes are regressive in nature, they could worsen economic disparities in a given country.

Matter of Efficiency

It seems that supranational fiscal governance was quite efficient when applied to V4 countries. They all have made significant consolidation efforts in order to bring their budget deficit to target levels. It could be explained by the fact that those economies are to a great extent dependent on transfers from the EU budget.[8] At the same time, proceeding from von Hagen methodology[9], the public debt was not decreasing at the same rate as was the budget deficit (see table 1). It might mean that not all additional revenues (received from increasing taxes) might have been spent to finance public debt. The only country that witnessed a considerable decline in the level of public debt in comparison with drop in the level of deficit, is Hungary. Indeed, the difference between changes in debt and deficit levels is only negative in Hungary (-4,1 p.p.), while in other V4 countries public debt grew faster than were the rates of deficit reduction. The explanation of this phenomenon might be as follows: the overwhelming amount of Hungary's public debt is nominated in national currency (about 74% comparing to 54% in the Czech Republic), which is called monetization of public debt. So, the efficiency of supranational regulation is not universal, since countries continued to accumulate debt. Moreover, some measures taken were of a formal nature (such as nationalizing pension system in order to raise government revenues with a view to meeting EDP's criteria).

However, one might witness that following the period of fiscal constraint, V4 countries experienced a rather rapid economic growth (see table 2). According to a number of studies, fiscal consolidation measures in V4 did not harm economic growth to a great extent. As to the study[10], a Pearson correlation between stricter fiscal rules (which could be associated with stricter fiscal policy) and 10-year government bonds interest rate was positive and statistically significant. That means that fiscal consolidation measures could possibly lead to lesser interest rate (through

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[8] Комиссарова Ж.Н., Сергеев Е.А. Процедура чрезмерного дефицита бюджета в странах Вишеградской группы // Вестник РУДН. Серия: Экономика. – 2018. – Т. 26. – № 2. – С. 246-257.

[9] von Hagen J. What Do Deficits Tell Us About Debt? Empirical Evidence on Creative Accounting with Fiscal Rules in the EU / J. von Hagen, G. Wolff // Deutsche Bundesbank Discussion Paper. Series 1: Studies of the Economic Research Centre. – 2004. – No. 38. – 30p.

[10] Hölscher J. The impact of fiscal rules on sustainable development of the Visegrád Group countries / J. Hölscher, M. Postula, A. Alińska, J. Klepacki // BAFES –Bournemouth Accounting, Finance & Economic Series. – 2018. – No. 17. – 29p.

the channel of restored investors' confidence in a given economy). Consequently, that could potentially lead to the emergence of non-Keynesian effects. We found strong negative and statistically significant Pearson correlation between 10-year interest rate and exports from all V4 countries. This fact is important because export is one of the main factors, which determine GDP growth in V4 countries. These findings indirectly indicate possible presence of non-Keynesian effects in the field of exports as well.

Thus, one might note that the consolidation efforts in V4 were quite efficient as to their influence on economic growth. However, some of the measures did not change the structure of government revenues and expenditures, and were of a formal nature.

Table 2. Budget Deficit and Economic Growth in V4

	Budget deficit, % GDP		**GDP Growth, %**						
	2009	2015	2011	2012	2013	2014	2015	2016	2017
Czech Rep.	5,5	0,6	1,8	-0,8	-0,5	2,7	5,3	2,6	4,4
Hungary	4,5	2,0	1,7	-1,6	2,1	4,2	3,4	2,2	4
Poland	7,3	2,6	5	1,6	1,4	3,3	3,8	2,9	4,6
Slovakia	7,8	2,7	0,6	-2,7	-1,1	3	2,3	3,1	5

Source: Eurostat

Applicability for Russia

One may consider stabilization of public finances in Russia to be a necessity, same as in Visegrád Four. In many aspects it has been caused by external factors, in particular, by oil revenues drop. From the one hand, a necessity to stabilize budget in Russia is not extremely obvious. Firstly, Visegrád Four risked to lose a significant part of net transfers from EU budget and there is no such risk for Russia. Secondly, the level of public debt in Russia is not so excessive compared to Visegrád Four. At the same time, a necessity of budget consolidation in Russia is caused by a number of serious risks connected both to world oil prices rate fluctuations (looming unexpected budget unbalancing) and with other factors down to geopolitical.

The Visegrád Four experience regarding the structure of consolidation measures may be seen as the most suitable for Russia. Mainly, it concerns a matter of income component of the budget, as expenditure rates are more vulnerable to non-economic factors. Corporate and income taxes have distorted effects, and their increase may negatively affect business activity and tax collection. Indirect taxes have the least distorted effect. Their share in the structure of budget revenues in Russia is big enough. And therefore, the implementation of such instrument may cause some positive effects. However, increase of indirect taxes can deepen the social and economic inequality.

Considering potential dangers for Russia, one should note increase in tax burden and other risks connected to having or not having political will to carry out

full structural measures of budget consolidation (as the example of Hungary's reforms shows). Fiscal adjustment may benefit the restoration of a general trust for the financial system. However, there are other fundamental factors that influence investors' credit and export performance in Russia making effects of consolidation less significant.

Results and Concluding Remarks

Under the pressure of external factors (the Excessive Deficit Procedure of the EU), the V4 countries implemented consolidations of national budgets. It shows a rather high effectiveness of supranational fiscal regulation in the EU, regarding the following countries. This fact can be explained by the importance of transfers from the EU budget for these countries, which they could theoretically lose if they had not fulfilled supranational recommendations. However, the overall efficiency of supranational regulation can be considered limited, because volumes of the budget deficit reduction turned out to be greater than the decline in gross public debt (as % GDP). In addition, several countries (for example Hungary and Poland) took measures, which were of a quite formal nature (target levels were achieved not by improving the efficiency of the system, but due to formal measures such as the nationalization of pension systems).

It should be noted that all V4 countries implemented different consolidations in terms of scale and sets of measures. At the same time, a number of similar features can be noticed. All countries involved the mechanism of indirect taxation, which can be rather effective, as indirect taxes form a significant part of budget revenues. A number of countries did not make a significant change in the structure of income and expenditure. First of all, these are Hungary and Poland, as they went to the full (Hungary) or partial (Poland) nationalization of the pension system) in order to formally comply with statistical consolidation criteria. This fact shows that they were not really into carrying out large-scale structural reforms. Some concomitant conditions, which helped consolidation efforts, could also be noticed. Economies considered (except Slovakia) are not members of the euro area. So, therefore, the fixed exchange rate was not a deterrent to the consolidation. Moreover, the consolidation of the budget in countries like V4 usually leads to a restoration of investors' confidence and to an increase in exports. And that has exactly happened in these countries. It can be said, that the consolidation of the budget in the V4 countries proved to be quite successful largely because of the effect of such conditions.

In general, the analysis of fiscal consolidations in the countries of the Visegrád Group shows limited applicability of their experience in Russia, though several implementations (for example, a significant reliance on changing indirect taxation or carrying out formal measures aimed at stabilizing budget) could be used.

However, one should note that Russia does not have some external conditions in relation to fiscal policy, which would be able to support economic activity in the course of consolidation. Mainly, this refers to a strict credit policy of the Central Bank of Russia, volatility of the exchange rate and some other factors.