

Fiscal Problems and Reforms of EU Member Countries

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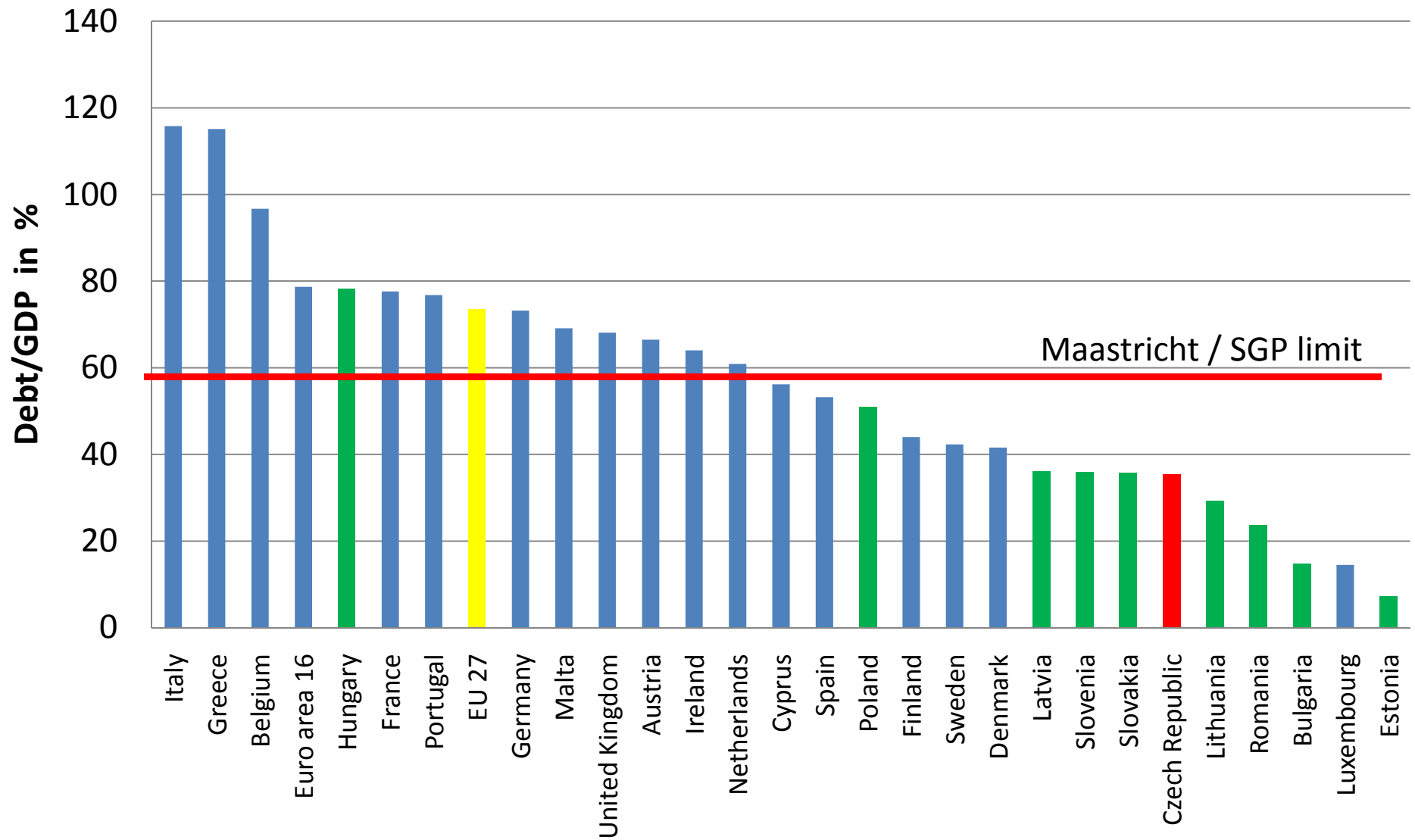


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Outline of the Presentation

- New member countries (EU10) – dynamics of deficits and debts
 - Current situation
 - Is there a real problem?
 - Rating
- What kind of reforms do we need?
- Viability of the reforms

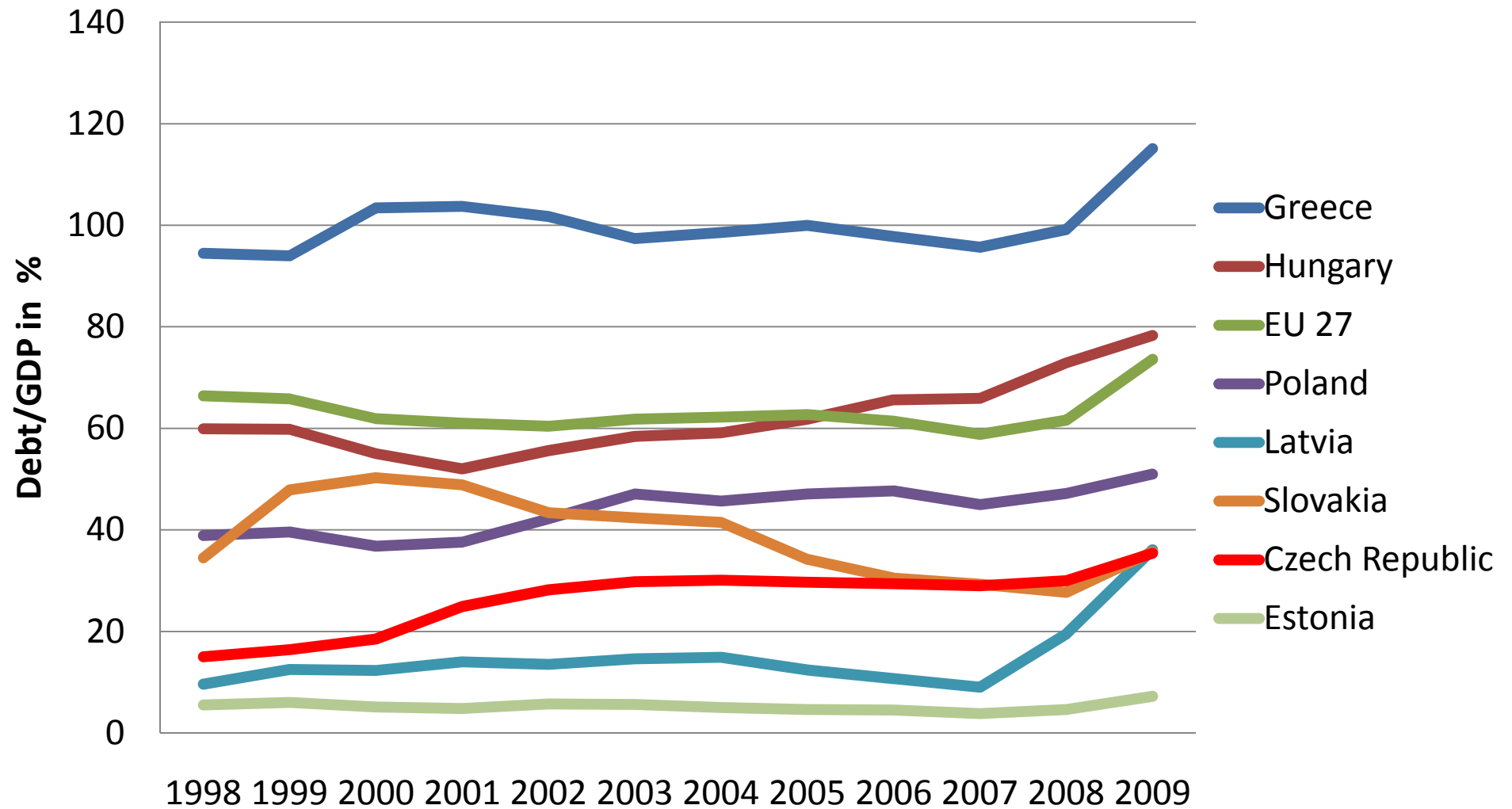
Public Debts of EU Members in 2009



Source of data: Eurostat

Dynamics of Public Debt

General Government Gross Financial Liabilities (% of GDP)

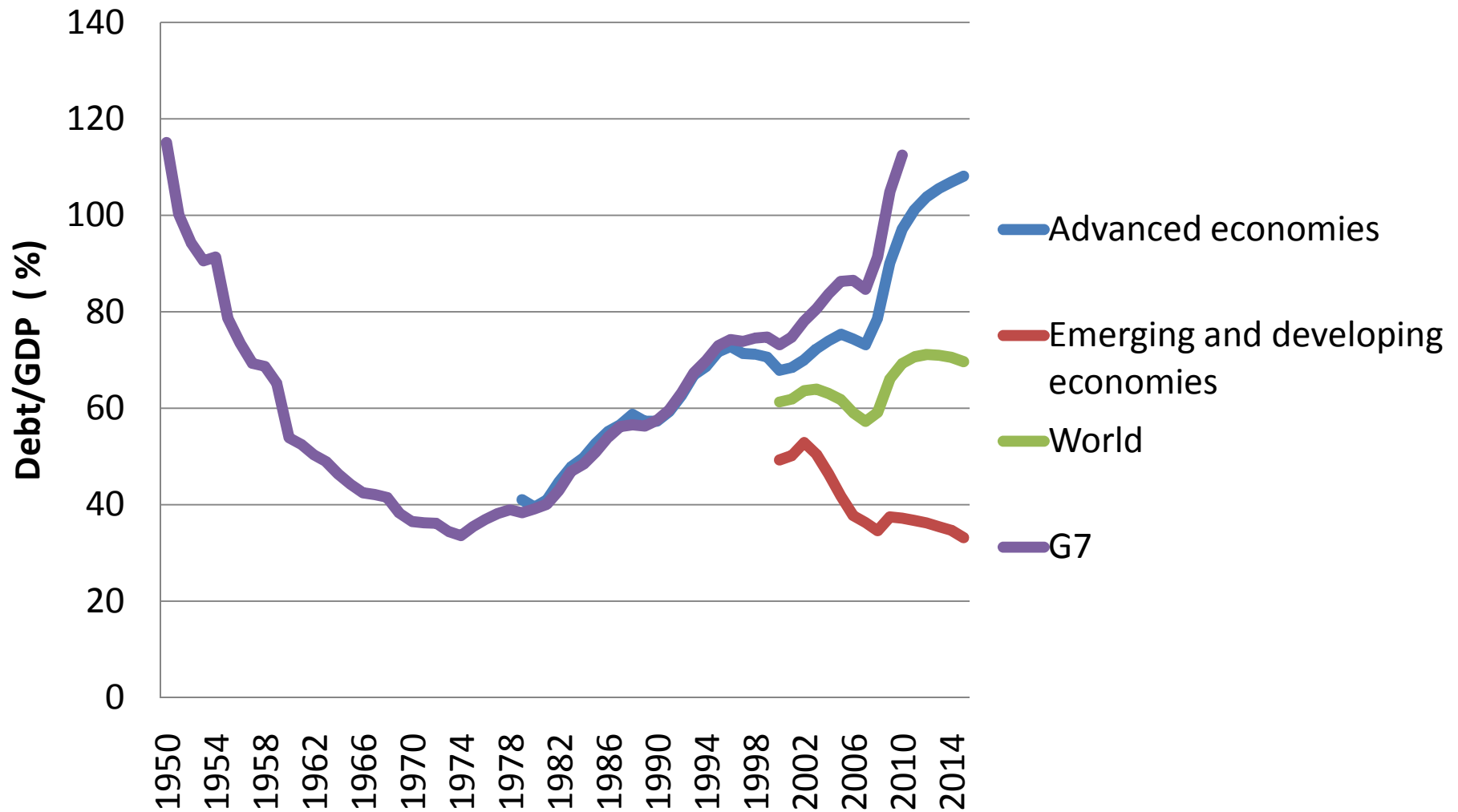


Source of data: Eurostat

Facts about Public Debt of New Member Countries

- New member countries (EU10) were among the least-indebted countries in the EU in 2009
 - Public debt per capita
 - Public debt in % of GDP
- The only exception: Hungary
- In spite of this they were criticized for having imprudent fiscal policies
 - E.g. DB report “Public Debt in 2020” suggest that the Czech Republic, Hungary, Poland, Romania are “subject to tangible consolidation needs”

Public Debt: Long Run Perspective



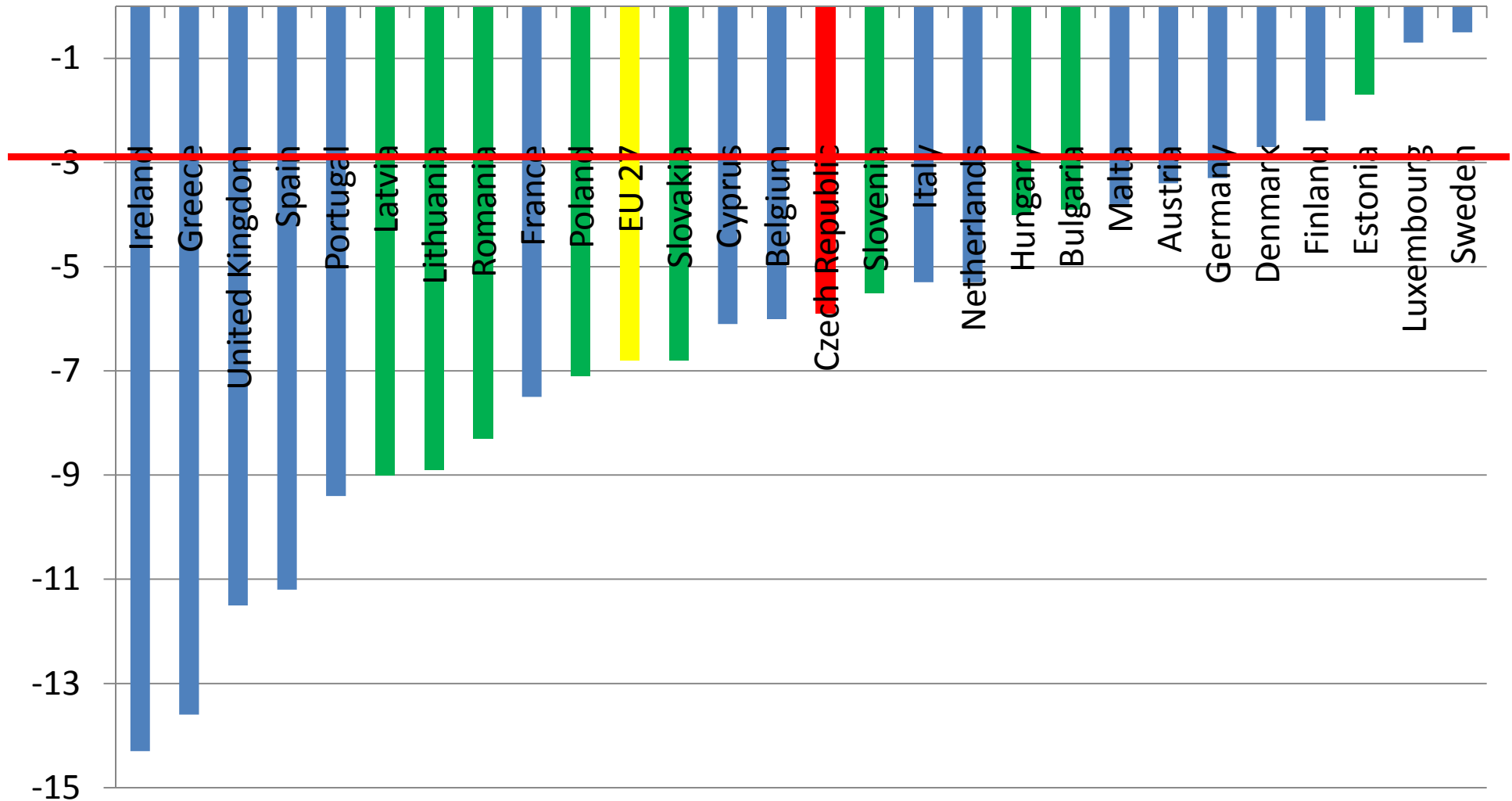
Source: IMF, WEO

Causes for the Criticism

- Dynamics of public debt
 - New member countries were accumulating debts even in years with record economic growth
- Fiscal efficiency
 - Experience with previous inability to improve fiscal policies
 - Many have inflexible structure of liabilities (high share of “mandatory” expenditures)
 - Problems with efficient tax collection (tax arrears), distortive effects of taxation
- Benchmark matters
 - Many analysts continue comparing the EU10 countries not with developed countries but rather with emerging markets (average public debt at 40% of GDP)

Public Balances in 2009

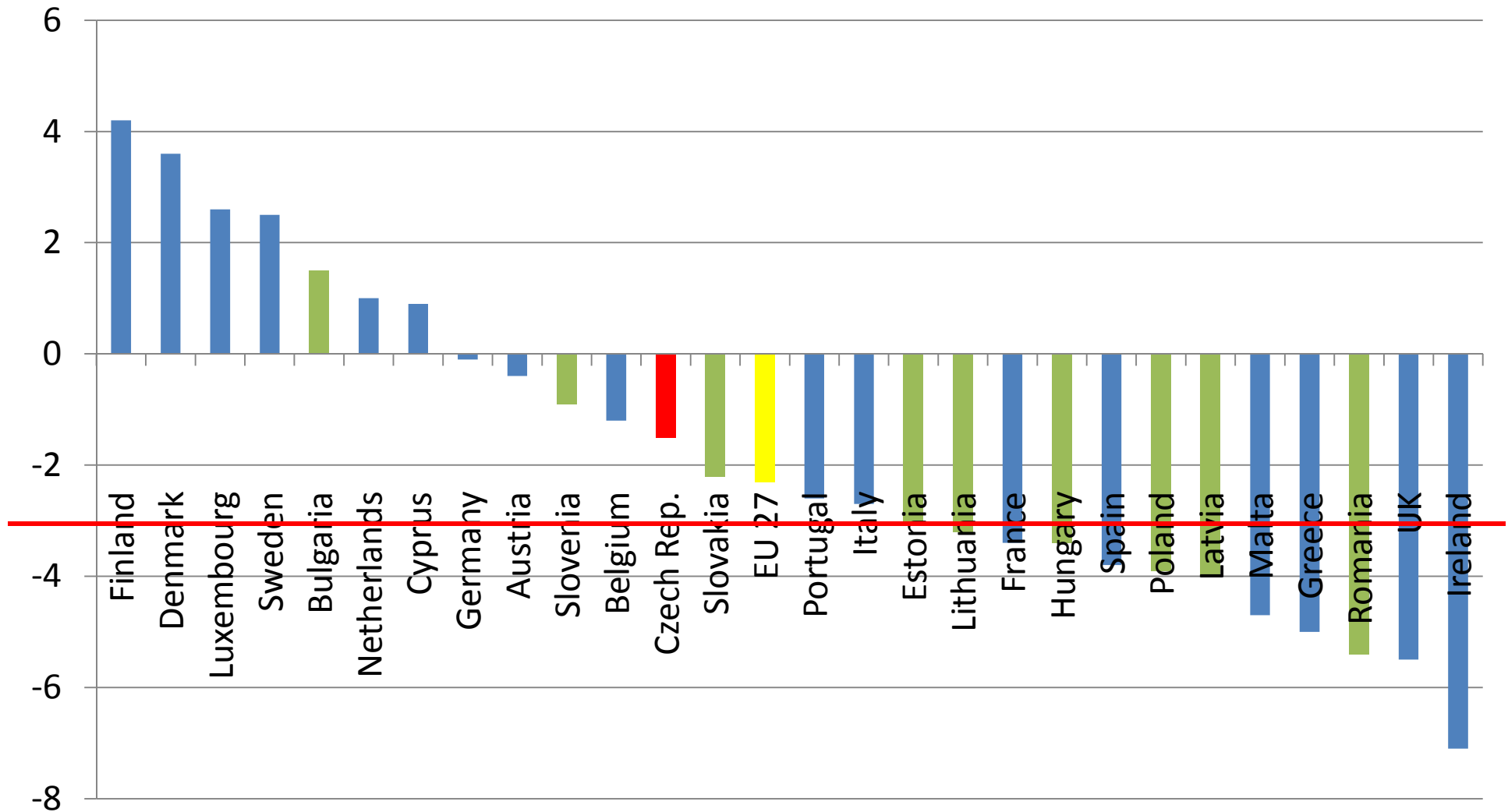
Net borrowing/lending of consolidated general government sector as % of GDP



Source of data: Eurostat

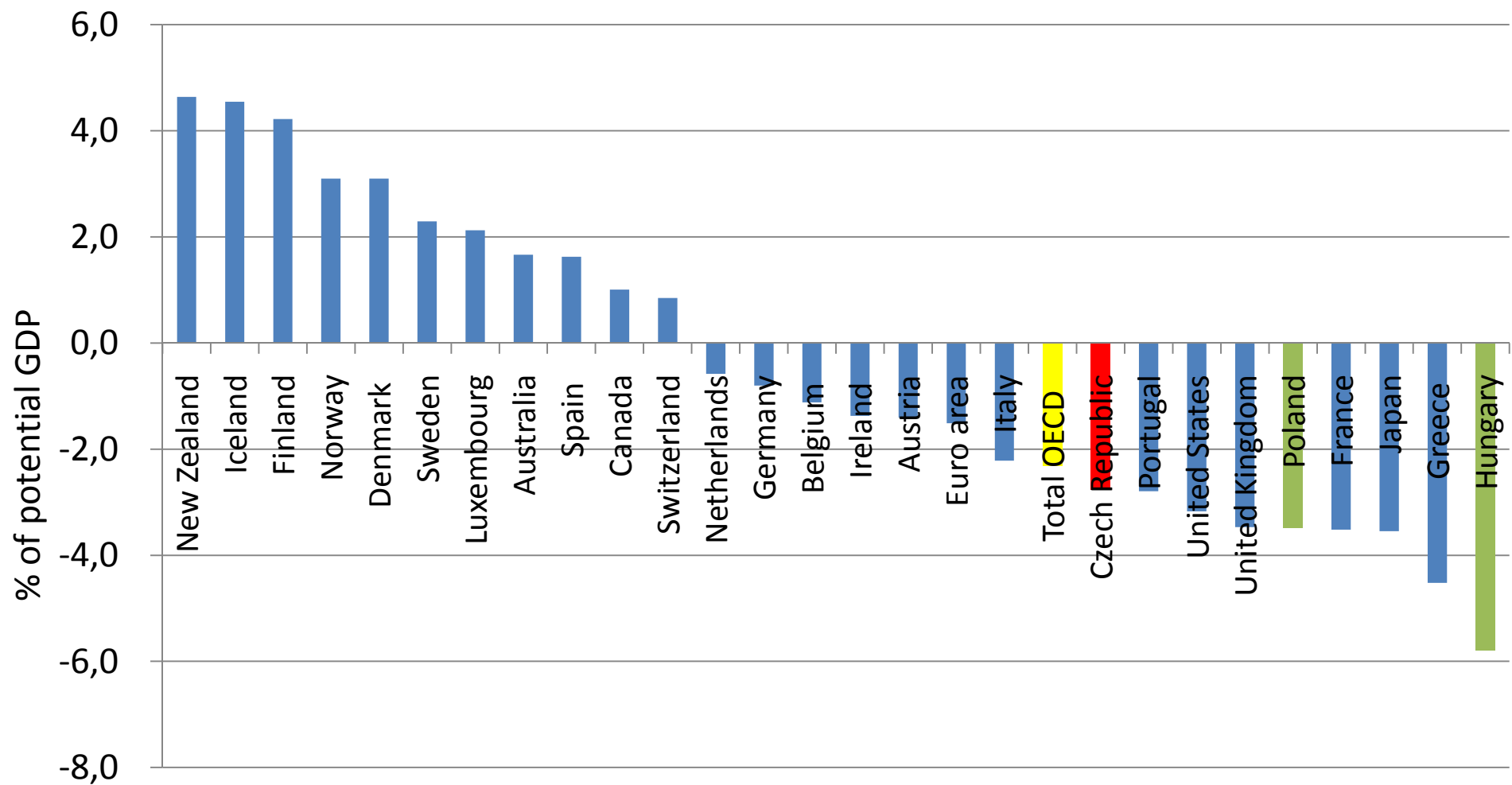
Public Balances in 2008

Net borrowing/lending of consolidated general government sector as % of GDP



Source of data: Eurostat

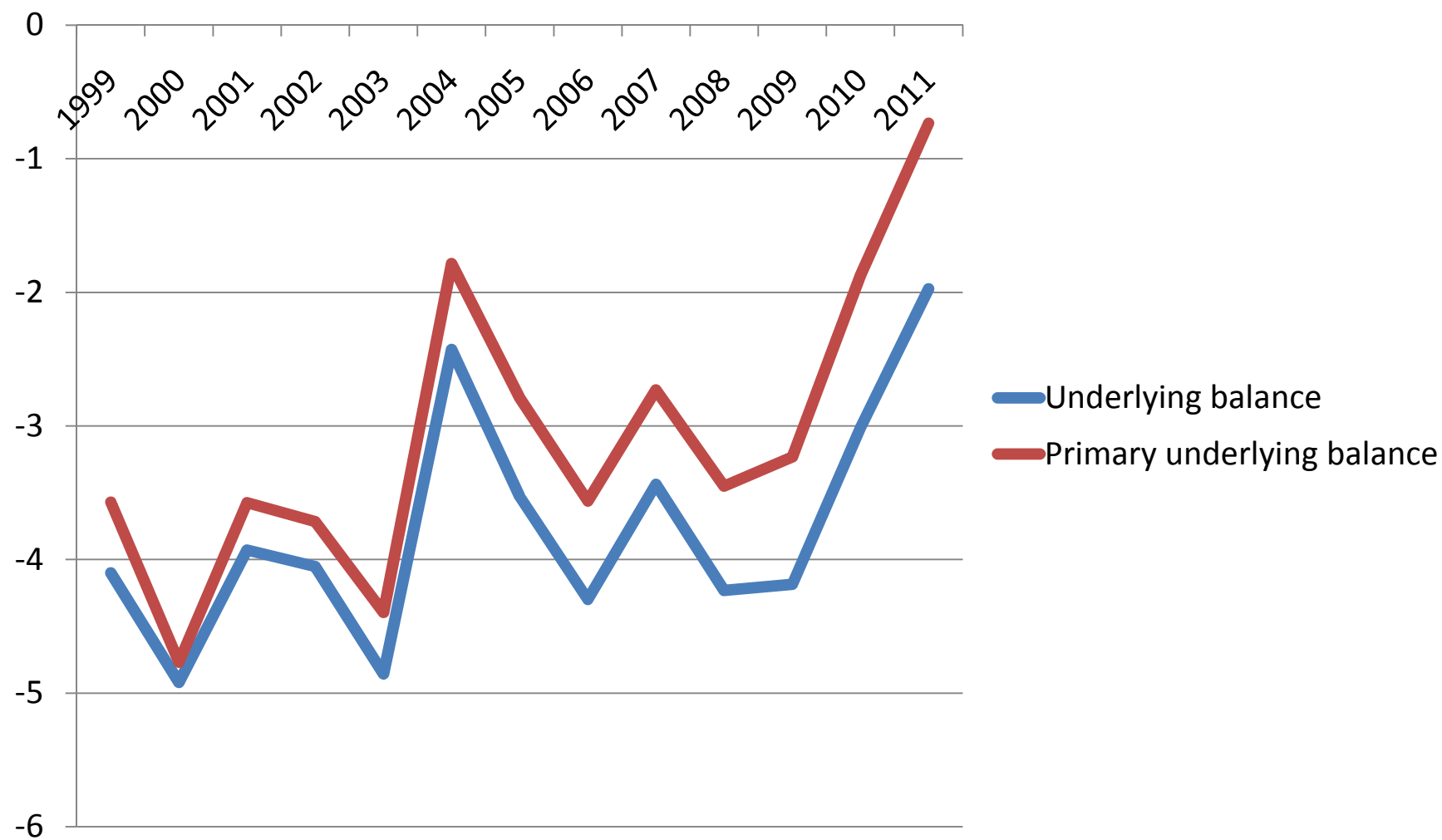
Structurally Adjusted Balances Before the Crisis (2007, % of Potential GDP)



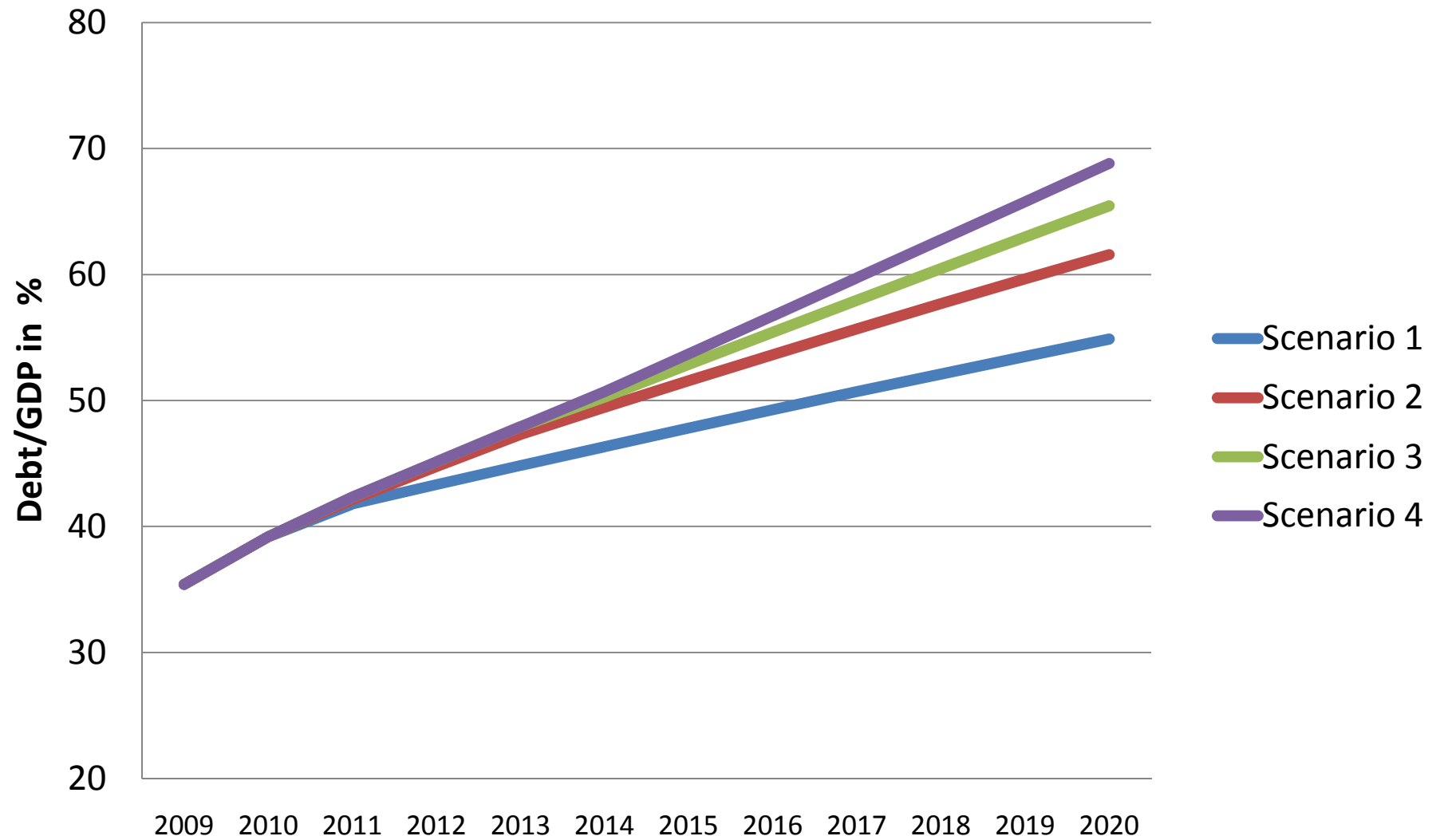
Source: OECD

CR: Underlying and Underlying Primary Balances

% of GDP



Public Debt: Scenarios for the Czech Republic (IDEA)



More details on: <http://idea.cerge-ei.cz>

For Comparison: Baseline Scenario of the Deutsche Bank

	Pre-crisis Debt 2007	Current Debt 2009	Baseline Scenario for 2020
Czech Republic	38*	53*	69
Slovakia	32	43	74
Poland	52	63	77
Hungary	72	90	97

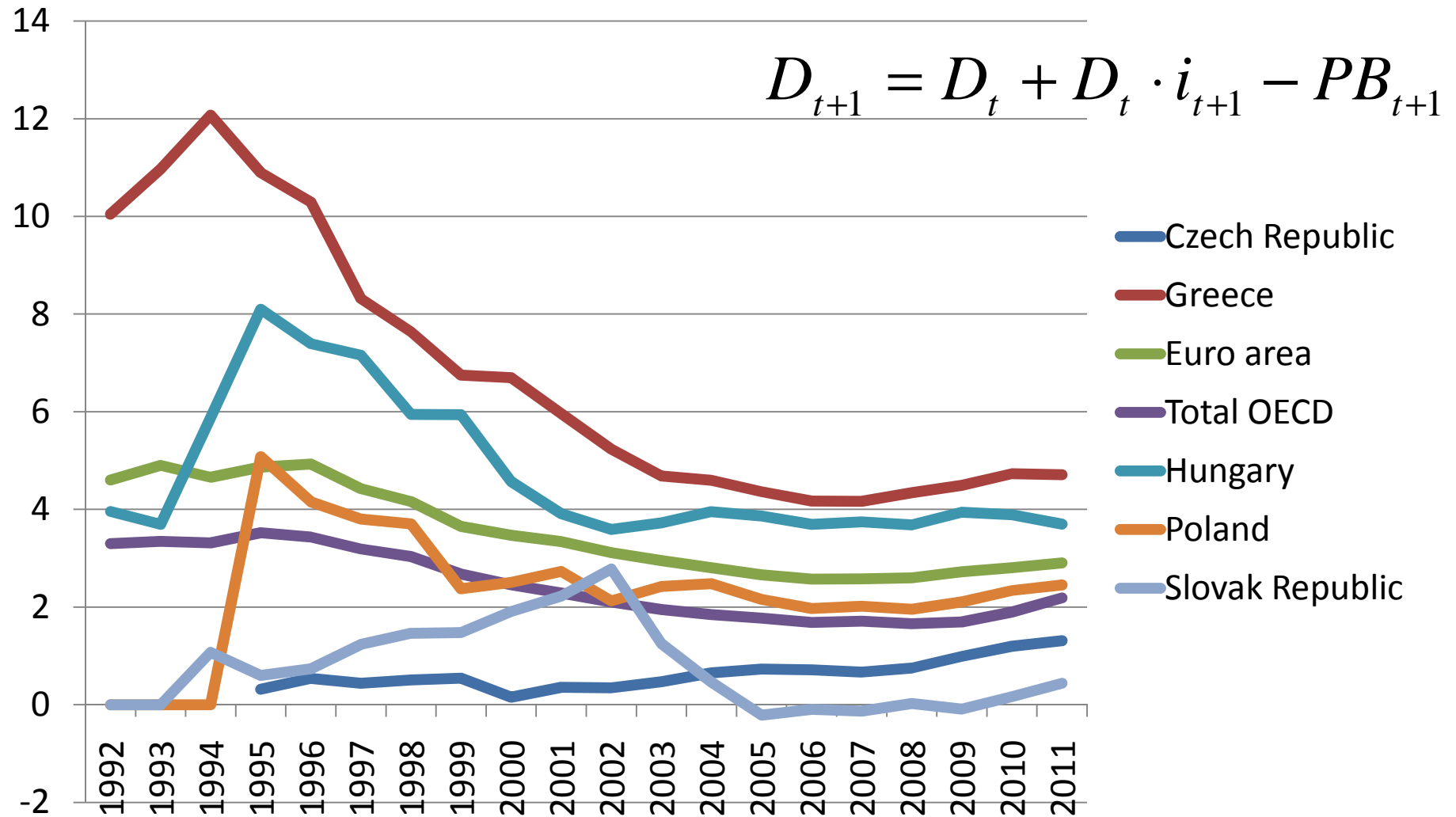
* As reported by the DB, higher than IDEA numbers

Source: DB Research - **Public debt in 2020**, March 2010

Possible Dangers

- High levels of debt make achieving balanced budget even more difficult
 - Primary surplus is necessary to achieve balanced budget
- The higher the debt, the bigger risk of negative change in rating and of adverse response of lenders
 - High interest rates on newly issued government bonds
- Specific risk: EU10 countries may face future troubles with meeting the Maastricht criteria (EMU membership)
 - Non-membership can be costly in terms of higher interest rates (once markets fully stabilize)

General Government Net Debt Interest Payments (% of GDP)

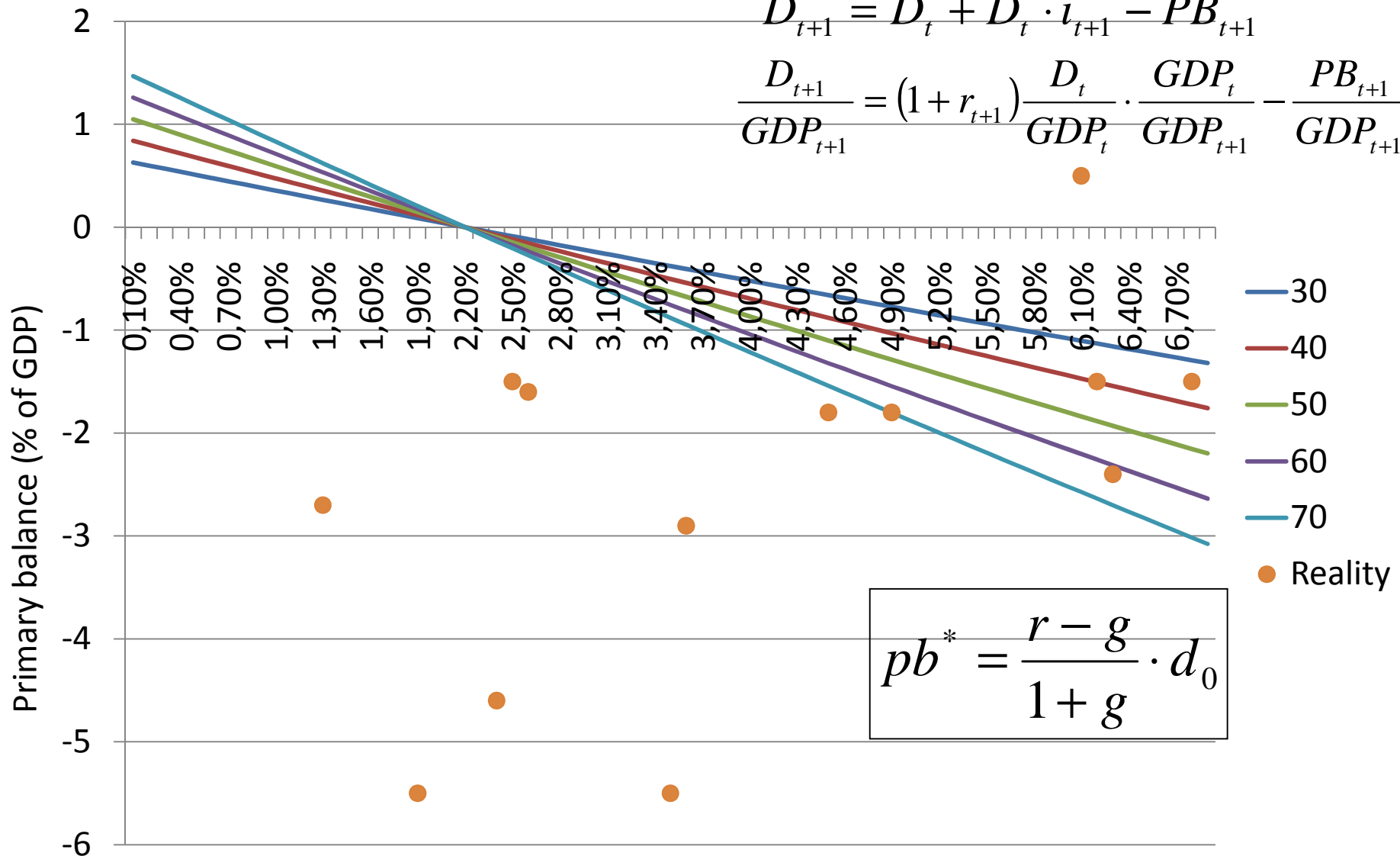


Source of data: OECD

Debt-Stabilizing Deficits: Czech Case

$$D_{t+1} = D_t + D_t \cdot i_{t+1} - PB_{t+1}$$

$$\frac{D_{t+1}}{GDP_{t+1}} = (1 + r_{t+1}) \frac{D_t}{GDP_t} \cdot \frac{GDP_t}{GDP_{t+1}} - \frac{PB_{t+1}}{GDP_{t+1}}$$



$$pb^* = \frac{r - g}{1 + g} \cdot d_0$$

Source of calculations: IDEA

Sovereign Rating: Standard & Poor's

Entity	Domestic Rating	Foreign Rating
Belgium	AA+	AA+
China	A+	A+
USA	AAA	AAA
Slovenia	AA	AA
Czech Republic	A+	A
Slovakia	A+	A+
Hungary	BBB-	BBB-
Poland	A	A-
Estonia	A	A
Latvia	BB	BB
Lithuania	BBB	BBB
Bulgaria	BBB	BBB
Romania	BBB-	BB+

Source: S&P's website, September 2010

Chinese View: 大公国际资信评估有限公司

No.	Sovereign	Local Currency		Foreign Currency	
		Rating	Outlook	Rating	Outlook
1	Norway	AAA	stable	AAA	stable
10	China	AA+	stable	AA+	stable
11	Germany	AA+	stable	AA+	stable
13	USA	AA	negative	AA	negative
18	Belgium	A+	stable	A+	stable
22	Estonia	A	stable	A	stable
24	Poland	A	stable	A-	stable
35	Hungary	BBB	negative	BBB-	negative
40	Romania	BB+	negative	BB	negative

Source: Dagong International Credit Rating Company

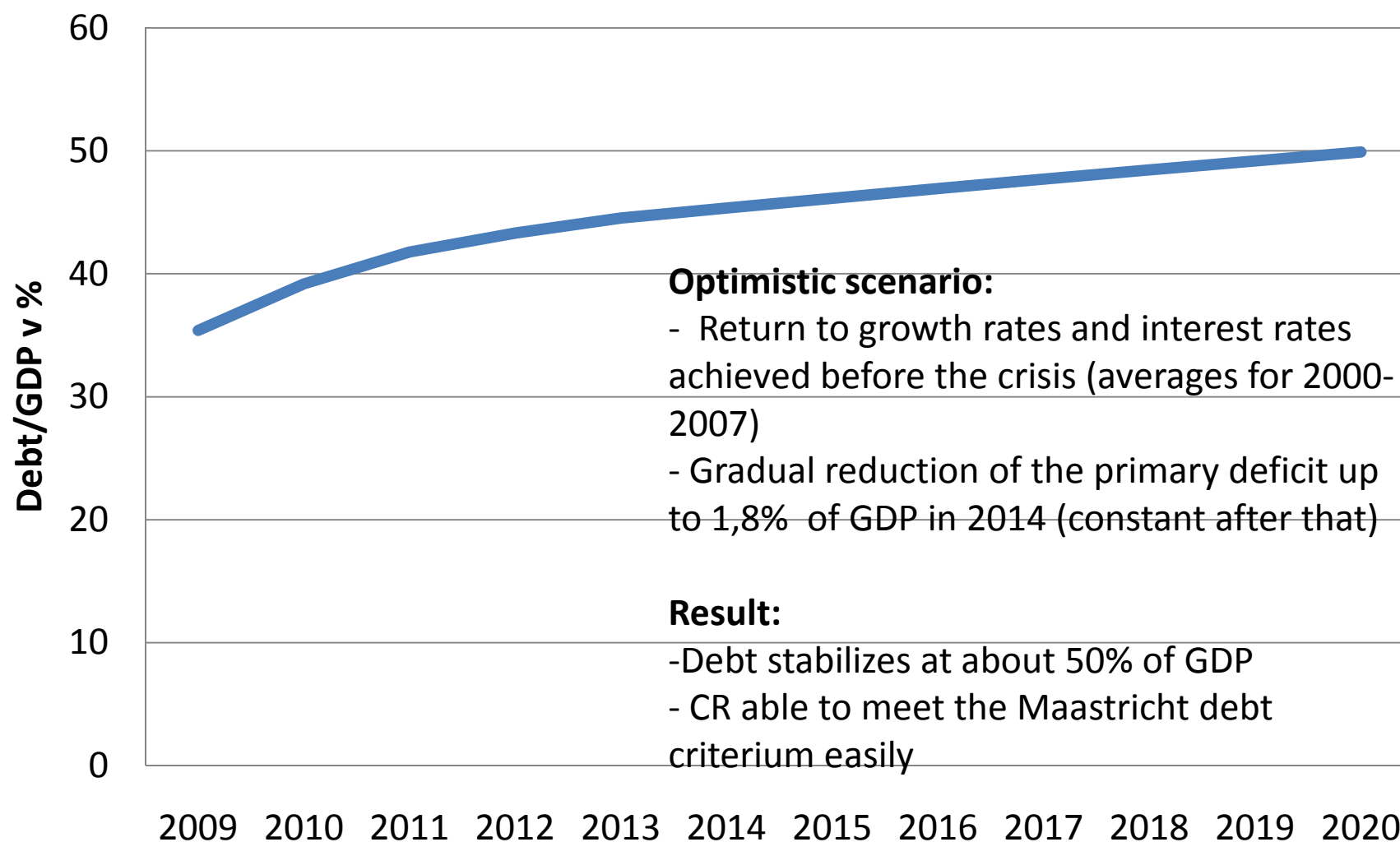
Types of Possible Response

- Emphasis on immediate fiscal consolidation
 - Higher taxes (especially VAT, consumption taxes)
 - Limited options
 - Tax competition
 - Increased mobility to tax evasion
 - Reduced expenditures
 - **Increased efficiency of both tax collection and spending**
 - In the ideal case it should include anti-corruption effort
- Emphasis on credible path towards debt stabilization
 - Analysis of sustainability of the path of primary deficits
 - Not all tax and expenditure change are sustainable and credible
 - Should include analysis of growth-related effects
 - Preferable for countries that can afford it!

Fiscal Reforms: What Do we Need?

- Change necessary!
- We should try to keep the public debt below 60% of GDP
 - It is easier than to subsequently reduce the debt quota
- Credibility and prudence instead of speed
 - Situation is not critical in most of the countries
 - Rapid decrease of current expenditures can have detrimental effects
 - Recoveries remain fragile
 - Danger of creation of hidden debts (e.g. in the quality of infrastructure)
- It is wiser to use the current situation for as an argument for change and optimization of tax systems and structure of expenditures rather than for simple mindless cost-cutting
 - For example: for the Czech Republic it can be better to set a credible target (stabilization of public debt at 50% of GDP) and achieve this goal while reforming tax and expenditures without excessive public protests rather than decrease current expenditures regardless of the consequences

Debt Stabilization Achieved by Reduction of the Primary Deficits



More details on: <http://idea.cerge-ei.cz>

Ideal Reform? General Features

- Provide reliable and transparent data and outlook
 - Necessary for both policy-makers and to keep financial markets calm (and interest rates lower)
 - Create independent institution in charge of fiscal forecasts
- Deficits during the financial crisis are not the main problem, we must prevent policymakers from running deficits during the “good years”
 - We need optimization of fiscal institutions
 - IDEA estimate for the Czech Republic – inefficient fiscal institutions increase the primary deficit by about 9 billion CZK (9% of the deficit)
- Options:
 - EU oversight over fiscal stability – unlikely at this stage and probably inefficient (precedent of the SGP)
 - Binding rules for budgeting procedure at national level
 - **Multiyear targets/frameworks for budgeting** – change the balance of power in haggling over budgets, reduce the compulsion to abuse the situation
 - **Fiscal policy rules**
 - Common problem – how to make the rules really binding...

Czechia: Budget Frameworks and Reality

	2006	2007	2008	2009	2010
Framework T-1	988.6	987.6	1088.7	1100.9	1126.5
Framework T	1038.9	1131.5	1215.1	1241.9	1295.2
Change	50.3	143.9	126.4	141.0	168.7
Allowed adjustment	26.0	87.3	141.0	141.0	169.5
Change exceeding the allowed adjustment	24.3	56.6	-14.6	0.0	-0.8
Expenditures in billions of CZK					

Officially exists since 2004, but never really enforced!

Gist: the main problem is to make policymakers to respect their own rules...

Data by Libor Dušek, IDEA

Viability of the Rules?

- Problem: fiscal policy rules exist but they are often ignored
- Besides changing the rules or introducing new ones, we must also make them binding
- How to do it?
 - Make aggregate fiscal policy position more independent on governments?
 - Fiscal constitution?
 - Punishments for governments that break the rules?
 - Independent budget supervisor with status similar to central banks?
- One big problem – there will always be loopholes
 - Every such rule in a sovereign country will have to include provisions for special cases (wars, crises, natural disasters)

References

- IMF: World Economic Outlook, April 2010 and July 2010 (WEO Update)
- MFČR: Makroekonomická predikce
- Eurostat
 - National accounts
- Worldbank: World development indicators
- WIIW: Handbook of Statistics
- OECD
- IMF: International Financial Statistics

Basic Data: Visegrad Countries

	捷克	波兰	匈牙利	斯洛伐克
人口 (2009)	10.5 mil.	38.1 mil.	10.0 mil.	5.4 mil.
国内生产总值 (2009, 欧元)	137,245.3 mil.	310,075.1 mil.	93,086.1 mil.	63,331.6 mil.
人均国内生产总值 (2009, 欧元)	13,100	8,124	9,300	11,700
人均国内生产总值, 购买力平价 (2009, 欧盟 27 = 100)	80	61	63	72
人均国内生产总值, 实际增长率, 2009 (%)	-4.1	1.7	-6.3	-4.7
最低工资, 2010 (总的, 欧元, 每月)	302.2	320.9	271.8	307.7
失业率 (harmonised, 6/2010)	7.4	9.6	10.4	15.0
Member of the EU since	2004	2004	2004	2004
Member of the EMU	No	No	No	Since 2009

Source of statistics: Eurostat