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Monetary integration and the competition of fiscal policies

(Budgetary analysis of EU8+2 countries)

Ph.D. thesis

Supervisor:

István Magas CSc, dr. hab
professor

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Department of World Economics

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Content

1. Explanation of choice of the theme

The thesis supposes that the fiscal balance, the introduction of euro and the catch-up policy are mutually inter-dependant. Balancing the governmental budget is of outstanding importance for the EU member states, since it makes possible to create economic stability and serve the monetary integration purposes at the same time.

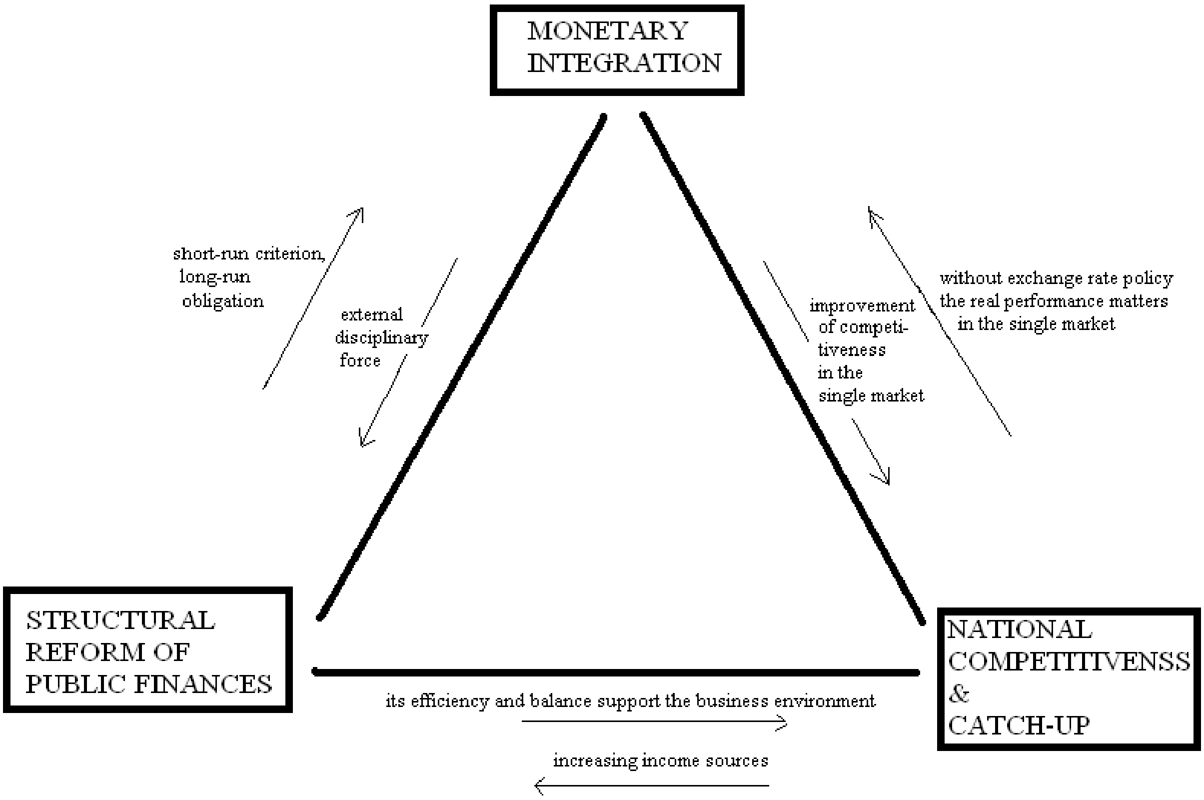
Dedicated efforts to have balanced budgets seem to be the rule rather than the exception across the enlarged European Union. Fiscal stability, more than any other factors, provide favourable macro-environments to increase the competitiveness of the member states and of the single market. These efforts, of course, are being constantly pressed – true, with varying degree – by the Stability and Growth Pact (SGP) that obliges member states to have stable macro-economic environments with deficit caps, or preferably, with balanced budgets. It is argued that optimal ways for budget consolidation must be centered around deep structural reforms of national budgets that are prerequisites for efficient public finance mechanisms.

The monetary integration – that is otherwise internationally obliged by the eastern EU member states through the Accession Treaty and the Treaty of the European Union – cannot be achieved without stable fiscal policy. But the monetary adjustment channel will not be viable any more after the introduction of single currency, so national economic policies can count only on fiscal adjustment. Only balanced budgetary background can ensure possibility to the member state to fiscal intervention, which balance is possible to be realised in long term only if the deficit factors caused by structural reasons are abolished. In parallel, this stability makes national business environment more predictable, by which decreasing country risk can improve national competitiveness.

Demand-stimulating governmental policy does not fit into this strategic system of purposes, as in an open economy of the single market excessive demand can be satisfied by external supply. Instead, this policy can be substituted with stimulating savings and motivating investments. In EU economies highly open (at least toward each other), the classical assumption is not valid that supply creates its demand through state intervention. Considering economic growth – strongly linked to direct investments –, foreign direct investors will disprefer countries where there is relatively high investment risk compared to similarly developed and performing ones, as the latter can easily replace the preceding. Fiscal consolidation can thus save national positions, as it results in a decline of risk premium. (Magas 2002)

Comprehending the importance of balance in economic growth positions, it becomes clear that the catching-up process of the less developed EU member states (namely quickened growth), and sustainable fiscal policy (namely fiscal balance) are mutually supporting objectives. Thus, it can be established that the fiscal sustainability purpose of SGP and the catching-up purpose of less developed Community members overlap each other.

Figure 1 National economic policy triangle in the single European market



Source: Author’s construction

It is a special policy challenge for eastern (transition) EU members that they accepted the purpose of monetary integration together with the budgetary discipline supporting price stability, while they had to operate and in parallel reorganise their peculiar post-communist social model. This social model shows much similarity to other European social service systems, but because of its certain characteristics, extreme efforts are needed to adjust it to the changing world-economic and social environment. Although these countries had almost two decades to restructure the public service system, mostly political “rationality” and social adaptation capacity slowed down the process. None of the post-communist EU members can avoid, after all, the adjustment to the new economic environment embodied in single European market. As illustrated in the *figure 1*, economic policy in an eastern member state is bound in three basic things. If it wants to be beneficiary of EU accession, it must keep its competitiveness in the single market. Since it means internal market cooperation, the introduction of the single currency is an unavoidable step, if the real regional rival countries had already achieved the level of monetary integration and got rid of the exchange-rate risk in single market trade. In this case, the country staying out will have disadvantage.

The only chance for EU8+2 to catch up is the participation European Economic Community, where the number of economic policy instruments – to shape the real performance – is reduced. Thus, it is worth to survey the state of balance creation in the EU8+2 countries (Bulgaria, Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Rumania, Slovakia and Slovenia).

The theme rose up in the author's mind during the researches of Szentes Tamás Doctorate School, in the debate about relative competitiveness. If there are competitiveness scoreboard about capital attraction, labour cost or economic performance, one should be composed also about fiscal state of effective rivals. (Szentes et al. 2005)

The objective of the thesis was to explain and prove the mutual interdependence and interaction among EU8+2 countries' catch-up purpose, the monetary integration and the balanced budget policy, in theoretical sense. Besides, such public finances analytical framework was composed that can evaluate the relative fiscal success of EU member states. Thus, the applied fiscal policy can be ranked and qualified in the aspect of balance and sustainability. Empirically, the EU8+2 countries got subjected to qualification.

2. Method of research

2.1. Steps of the research

The survey was supported by the instruments of political economy. On one hand, the instruments of macroeconomics and statistics and the results of econometric studies were used, on the other hand, the decision-making and political institutional factors and variables are also taken into account.

To get to the EU8+2 fiscal scoreboard, plenty of factors must have been examined during the construction of analytical framework. First of all, the expression of 'fiscal competition' must have been explained. The definition was set on the precisely described national competitiveness and the well identified task of the state in the 21st century. Thus, the task of fiscal policy is to create stable business environment for the economic growth, especially capital investments. Latter ones can create spillover impacts as work places, income, solvency, economic effectiveness, technological development. So, the Economic competitiveness, or the rivalry of fiscal policies means the fiscal policy, which can create stable and supportive business environment for economic catch-up sooner or more effectively.

Second, it was necessary to examine the interactions between the budget and the other segments of the economy and the basic procedures of fiscal policy.

Third, the question was the factors that can create risk in the budget and make the financing mechanisms to be vulnerable. The fiscal vulnerability got very important element in the construction of indices about fiscal sustainability, flexibility, structure and institutional effectiveness. (Hemming & Petrie 2000)

As the thesis aimed the survey of EU8+2 countries, the European Social Model (ESM) as social environment can not be overlooked. ESM is usually mentioned as a trend-setting economic policy model in case of employment policy and public welfare services, these policies has remained in national competence in the EU. Thus significant member state budgetary expenditures relate to these policy fields. Moreover, in fiscal sense, no unique European Social Model could be described, for the expenditure and revenue structure is far not the same in European countries. Of course there are many similarities among the different social models regarding high welfare expenditures and, accordingly, high level of taxes, in global comparison. A distinction should be made among 4–5 different social models in Europe: the continental, the (English) liberal, the Mediterranean, the Nordic, and (maybe) the eastern European post-communist. Central European countries are more similar to the German/French continental model, while the Baltic states and in certain sense the Bulgarian, Rumanian and Slovakian economic policies are closer to the liberal model. Sapir (2005) supposes to follow the Nordic model, but it shall be rejected in case of eastern EU members, and the liberal model shall be the base of European restructuring of public finances. The Scandinavian statistics hide the reality, when it comes to the employment ratio. Beside, the EU8+2 societies are not rich and disciplined enough for a welfare tax and benefit system. The liberal model means higher market rationality plus stronger implementation of risk and cost pricing. Meanwhile, the liberal model can keep the flexibility in the labour market just as the Nordic model, but beside lower level of social expenditures and public debt. (Sapir 2005)

The macroeconomic framework explained above got political economic support by institutional theories about budgeting. The literature about the correlation between the appearance of budget deficit and political decision making supposed to survey the political business cycles and the EU8+2 budgeting with the following expectations: (1) The more centralized the process of budgeting and the stronger the financial minister's power in budgeting, the more disciplined the execution of the budget plan will be. (2) The political business cycles have significant impact on the fiscal balance. (3) It is worth to examine, which organs have influence in budgeting that can soften the original budget draft. Empirically, the Governmental Centralization Index was used for the EU8+2 survey. (von Hagen & Harden 1996, Strauch & von Hagen 2000, Alesina & Perotti 1998, Benczes 2004)

After the theoretical premises mentioned above, the analytical framework specialized for EU8+2 was constructed. This system contains 5+1 main elements. The fiscal policy is examined from five aspects: budget structure, institutional effectiveness, fiscal sustainability, fiscal flexibility, financial effectiveness. The complementary element – in line with the other five – is EU8+2 economic development. The fiscal ranking of EU8+2 constructed from the five fiscal elements.

But before cross-country survey, the importance and relation of two more topics should have been understood. It must have been defined, first, how the introduction of euro related to the fiscal policy (Gáspár & Várhegyi 1999, Brunila et al. 2001, Neményi 2003), and, second, if the creation of stable business environment was expected by the fiscal consolidation and reform, the ideal consolidation policy for short and medium term must have been determined. (Kornai et al. 2001, Erdős 2003)

Following the EU8+2 fiscal policy, it can be established that from a similar starting structure of budgeting system and fiscal weaknesses, through the economic transition, the EU8+2 countries got to very various position till 2007. Certain governments foreran the structural problems, others trusted in delaying just to avoid the unpopular fiscal consolidation.

The importance of consolidation in the second half of 1990s was the possibility to use it as a surmounting period for fiscal restructuring of financial mechanisms. Not every EU8+2 fiscal government used the accumulated "reserves" to adjust public finances to the narrowed economic policy room for maneuver in the single market, before the boundaries of the accession treaty and the Stability and Growth Pact would have gotten into force.

2.2. Construction of fiscal scoreboard indices by the author

The fiscal competition of EU8+2 countries were surveyed form five aspects (structure, institutional effectiveness, sustainability, flexibility, financial effectiveness) what are summarized in weighted average to assess national fiscal policies.

Budgetary structure is composed from three scoreboard sub-indices (S_i), that are also detailed to more indices:

S_1 = expenditure scoreboard sub-index = [$s_{1;1}$ (expenditure volume rank) + $s_{1;2}$ (Social Insurance net balance rank) + $s_{1;3}$ (interest payment rank)]/3;

S_2 = revenue scoreboard sub-index = [$s_{2;1}$ ('revenue demand' rank) + $s_{2;2}$ ('weight of indirect tax' rank) + $s_{2;3}$ ('weight of wealth tax' rank) + $s_{2;4}$ ('reciprocate of weight of corporate tax' rank)]/4;
S_3 = deficit structure scoreboard sub-index = [$s_{3;1}$ ('primary balance' rank) + $s_{3;2}$ ('structural balance' rank)]/2.

Institutional effectiveness scoreboard is composed from three scoreboard sub-indices (I_i):

I_1 = Governmental Centralization Index scoreboard sub-index; (Gleich 2003)

I_2 = Corruption Perception Index scoreboard sub-index; (Transparency International, www.transparency.com)

I_3 = 'Deviation from balance target' scoreboard sub-index.

Fiscal Sustainability scoreboard is composed from three scoreboard sub-indices (F_i):

F_1 = primary gap scoreboard sub-index; Blanchard (1990)

F_2 = tax gap scoreboard sub-index; Blanchard (1990)

F_3 = IFS(60;0) in 2005 scoreboard sub-index;. Croce & Juan-Ramon (2003)

Fiscal Flexibility scoreboard equals with the Standard and Poor's (2007) FFI (*fiscal flexibility index*) scoreboard.

Financial effectiveness scoreboard equals with the tax wedge scoreboard in 2006.

Evaluation of sub-indices:

- The lower the better: GDP-ratio level of expenditures, interest payment, revenue demand, tax wedge;
- The higher deficit the worse, but the higher surplus the better: Social Insurance net balance, primary balance, structural balance (GDP-ratio);
- The higher the better: indirect tax weight, weight of wealth tax rank, reciprocate of weight of corporate tax rank among tax revenues,
- |IFS| the higher the better;
- Deviation from balance target: the higher the deviation is toward negative value the worse the score is, but the higher the deviation is toward positive value the best the score is.

3. Conclusion of the thesis

3.1. Results of research

1. The survey resulted Estonia to have the best and most competitive state budget among the EU8+2 countries and she is followed in order by Latvia, Rumania, Lithuania, Slovakia, Czech Republic, Bulgaria, Slovenia. The worst positions were achieved by Poland and Hungary. The last two were the worst almost from every aspect. The order of countries covers the deviation from the ideal budget structure, the level of tax encouraging the capital investments, the institutional effectiveness of the fiscal government and the budgeting procedures, the sustainable solvency, the fiscal reacting capacity for world economic shocks and the financial effectiveness.

The composition of order of EU8+2 countries:

Table 1 EU8+2 fiscal competitiveness scoreboard

	Budgetary structure**				Institutional effectiveness				Fiscal sustainability				Fiscal Flexibility	Budgetary Financial Effectiveness	**Summarized score**	
	S_1	S_2	S_3	$\frac{\Sigma S_i}{3}$	I_1	I_2	I_3	$\frac{\Sigma I_i}{3}$	F_1	F_2	F_3	$\frac{\Sigma F_i}{3}$	FFI rank	Tax wedge rank	**average**	**rank**
Bulgaria	5,67	5,75	2	4,47	8	8	3	6,33	1	2	9	4	6*	8	**5,76**	**7**
Chech Rep.	5,33	9,25	7,5	7,36	5	4	4	4,33	7	7	1	5	10	2	**5,738**	**6**
Estonia	1,33	5	1	2,44	1	1	1	1	2	1	6	3	4	6	**3,288**	**1**
Poland	9	5	8	7,33	3	9	9	7	9	9	4	7,33	5	7	**6,732**	**9**
Latvia	3,33	3,25	3	3,19	2	6	2	3,33	3	5	3	3,67	7	3	**3,904**	**2**
Lithuania	2,33	5,25	4,5	4,03	7	4	6	5,67	4	3	7	4,67	2	4	**4,074**	**4**
Hungary	9,67	5	10	8,22	9	3	10	7,33	10	10	10	10	9	10	**8,91**	**10**
Rumania	3,33	4,5	6	4,61	10	10	5	8,33	5	4	5	4,67	1*	1	**3,922**	**3**
Slovenia	8,33	6,5	4	6,28	4	1	8	4,33	6	6	8	6,67	7	9	**6,656**	**8**
Slovakia	6,33	5,5	8	6,61	6	6	7	6,33	7	8	2	5,67	3	5	**5,322**	**5**

Author's calculation

* No FFI score, author's ranking about expenditures and revenues

** details in table 2

Table 2 Detailed composition of budgetary structure sub-index

	s11	s12	s13	S1	s21	s22	s23	s24	S2	s31	s32	S3	(S1+S2+S3)/3
BG	4	7	6	5,67	7	1	8	7	5,75	2	2	2	4,47
CZ	7	4	5	5,33	8	10	9	10	9,25	8	7	7,5	7,36
EE	2	1	1	1,33	5	4	10	1	5	1	1	1	2,44
PL	8	10	9	9,00	6	8	1	5	5	7	9	8	7,33
LA	5	2	3	3,33	3	3	4	3	3,25	3	3	3	3,19
LI	3	2	2	2,33	2	6	7	6	5,25	4	5	4,5	4,03
HU	10	9	10	9,67	9	7	2	2	5	10	10	10	8,22
RO	1	5	4	3,33	1	2	6	9	4,5	6	6	6	4,61
SI	9	8	8	8,33	10	9	3	4	6,5	4	4	4	6,28
SK	6	6	7	6,33	4	5	5	8	5,5	9	7	8	6,61

2. Following the EU8+2 fiscal policies in dynamic view during the preparation for (single market and single currency zone) integration (1999-2006), the order above can not be considered to be fix, but the positions keep on varying together with change of fiscal discipline. The supplementary element of the analytical framework about the general national economic performance proved, too, that the economic growth and the national competitiveness moves together with the stability of business environment in the small, open EU8+2 economies. The low level of fiscal risk means for the investors and the households, that they can spare the tax increase, the raising interest rate or the robust devaluation in the future, since there is no increasing public debt service, worsening credit rating or capital flight away from fundamental risk.

3. The task of the economic policy is to create and strengthen the favourable expectations. The euro-zone membership – because of the low risk by its scale – strengthens the feeling of stable business environment for market participants. The EU8+2 group contains ten similarly developed, competing countries in rivalry for catch-up to the EU average level, from the periphery to the centre. In this hard competition for FDI, work places, technological advantage, income source and tax revenue possibilities, no lag-behind can be afforded by the rivals in comparison to each other. In figure 1, it can be clearly view that any eastern EU member states need sustainable fiscal balance for stable business environment and the euro-zone integration to avoid competitive disadvantages if they want to catch-up. At once, the introduction of euro can not be realized without permanent fiscal balance, beside, the membership promises stability by enforcing fiscal discipline among others. Moreover, the economic catch-up will create the basis for further fiscal revenues and real price competitiveness without any monetary loosening. The EU8+2 economic policy decision-makers should understand that the three elements (introduction of euro / sustainable fiscal

balance / economic catch-up) can be realized only together, otherwise on weakness will pull back the other two.

4. The EU8+2 countries are good examples for the conclusion mentioned above. Who show weak fiscal performance (Hungary, Poland and less Czech Republic), those are getting more and more lagged behind in the monetary integration and loosing there growth advantage. While in the 1990, together with Slovenia, these three mentioned countries had leader position in the region in growth, development level and fiscal balancing, in the next decade only Slovenia could keep it, since the decision-makers in the other countries can not stand the temptation of easier and more popular way of fiscal loosening. That can be also observed that the spoiling fiscal positions will not cause irreversible lag-behind in a five year-long period. The fiscal scoreboard can change.

5. In case of long-term sustainability of public finances, it was established, that the ideal state is a positive present value for the difference of all future surpluses and the sum of future deficits plus the present net debt. Otherwise, the long-term budget balance can not be realized. (Brunila 2001)

6. In case of the eastern EU member states, the recommendation of the English liberal model is strengthened by the eastern European labour market and business environment formed during the transition that is similarly uncertain as the British one. The Eastern-European societies must have got used to the flexibility of employment. What typical both in the British and the Eastern EU environment are the not guaranteed work place and the lack of strict labour law about notice. Thus, the individuals are compelled to accept and adjust to the variability of the labour market. This social adjustment pressure and the compulsion to take individually the risk of income procurement might have made the Eastern-European societies to be more flexible for the restructuring of the risk burdened on the state toward a more and more individual burden in health care, education and pension services.

7. After the introduction of euro, the fiscal policy must take the whole burden of the adjustment having been carried by the monetary policy to treat the impact of asymmetric world economic shocks through the exchange rate and interest rate. But there is need room of maneuver to the fiscal adjustment that means necessity of reserves in the national budget to raise the expenditures or cut the tax revenues without endangering the structural balance and

the sustainability of fiscal policy. If an EU member state have structural deficit, she will not be able to treat the asymmetric shocks with fiscal items neither in the monetary union, nor in the looser co-operation of single market. (Gáspár & Várhegyi 1999, Brunila et al. 2001)

8. Among the direct impacts of euro zone accession, the additional financial discipline expected from the Stability and Growth Pact must be emphasized, as a support to the creation of stable business environment through balanced budget. (Neményi 2003)

9. The purpose of short and long term fiscal consolidation is the balanced budget. To realize it in the best way, the restructuring of public finance systems must ensure that the reproduction of annual deficit will be avoided, or else the temporary financial deprivation must be repeated regularly. If the long-term structural balance can be ensured, only the cyclical items will volatile what will happen automatically, and their medium-term impact on balance will neutralize each other. (Csillag & Mihályi 2006, Kornai et al. 2001)

10. The start of reforms demands "investment" from the budget. To restructure the financing systems, it is necessary to pull down old mechanisms mentioned above and motivate the deviation, omission of them, or to penalise their insistence. Namely, when balancing becomes urgent, right that time there is no possibility to spend on starting costs of reforms, for unless restriction includes both the costs of deficit balancing and reforms, it burdens much certain public sectors and/or interest groups. In case of such consolidation that got forced directly by economic/financial crises or their perceptible signs, no reserves remained either for effective short-term consolidation. But in the end of consolidation free indebting procedure, the participants in credit and investment markets will enforce the drastic change in economic policy with devaluation of credit rating and capital outflow. (Erdős 2003, Kornai et al. 2001)

11. The political decision makers do not like the reforms demanding short-term "investment" but offering only long-term "profit", that is why the execution keeps on postponing. The economic crisis can induce changes so quickly, just because the crisis affects strongly so much on household and company sector that the demand of the society may increase to the adequate level for fundamental restructuring. But one more difficulty could emerge in the dynamics. The crisis can keep the social demand for the reforms, but usually it is not as long lasting as much time is necessary to the execution of reforms. Thus, the crisis is

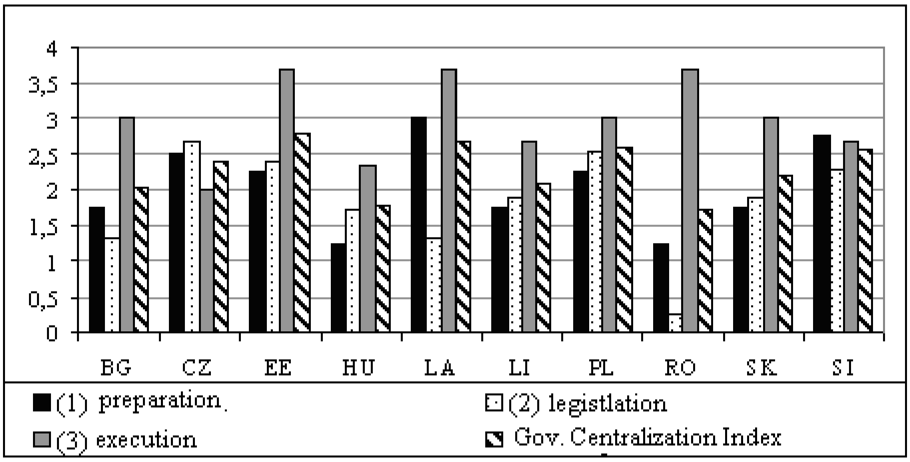
enough merely to enforce social pressure for restructuring, but can not be taken into account as a supportive driving force during the whole fiscal process. (Strauch & von Hagen 2000)

12. Comparing Slovenia to Hungary, Poland and Czech Republic, the experience is that every mentioned ones' public expenditure structure and public debt stock, or the fiscal flexibility do not differ significantly from each other. Meanwhile, Slovenia has significantly better results in the fiscal – and also monetary – convergence then any other EU8+2 countries, since she fulfilled the convergence criteria in 2005, sooner then any other eastern members. The success factors can be found mostly in the institutional effectiveness, especially in the budget execution phase, just like in Slovakia, Bulgaria and the Baltic states. In the mentioned successfully balancing countries, there is less chance to deviate from the budget plan because of the execution rules, beside the financial minister's influence is stronger in the expenditure procedures. In case of Slovenia, the unique type of multi-year budgeting has significant role in disciplined budgeting because of strong legal background. It set medium-term targets that can be changed only by broad parliamentary support. The good timing of launching of structural reform had important role, too, namely Slovenian governments started the restructuring of public financing systems, so they had possibility for gradual strategy. The gradualism got possible, because the medium-term purposes and structural reforms have broad political and social support. (Mrak et al. 2004, Festič & Bekő 2006)

13. In the aspect of fiscal discipline and effectiveness, the Baltic countries lead the fiscal competition, although they had to postpone the introduction of euro. The weak point was the inflation. However, the inflation is just an output variable, and its root is the excessive import consumption that resulted 9-16% deficit in the balance of payments in GDP-ratio. The Economic policy has no other choice, just to continue the tightening the budget in surplus. Thus, expenditures could be decreased, taxes could be raised, or, at least it occurred in the Baltic region, the tax cutting can be postponed after the EMU-accession. (IBRD 2007)

In the fiscal sense, successfully balancing Slovakia's, Bulgaria's and Rumania's strategy was to copy the current spearhead. Slovakia copied the developed reform plans and launched reform from the other three Visegrad countries in 1998, e.g. Thus, she could left behind their delaying fiscal policy, and it seems, that it will happen with the GDP/capita, too, in the second half of 2010s. Rumania follows the same way with a time lag, while Bulgaria tries to copy successfully the Baltic currency board that actually determines strictly the fiscal room of maneuver. This copy strategy seems to be enough to speed up the catch-up process, too. (Mathernová & Renčko 2006)

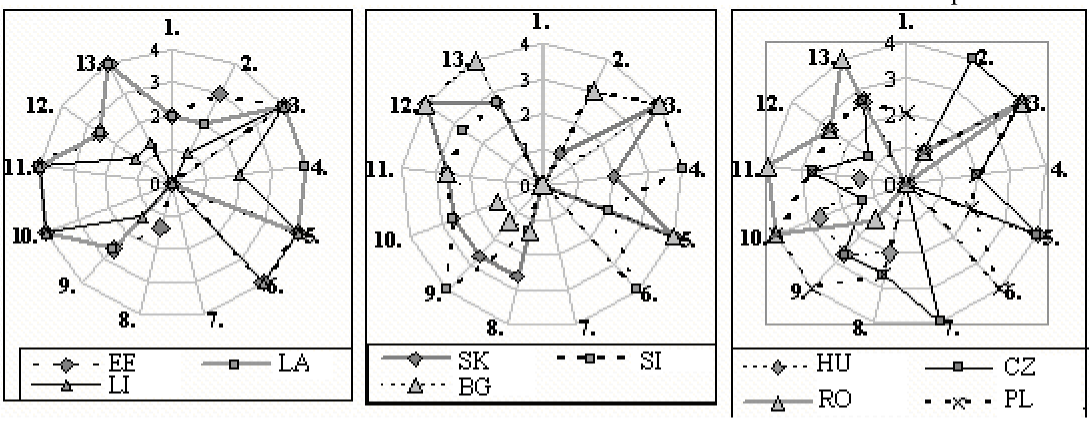
Figure 2 Governmental Centralization Index and sub-indices in EU8+2



Author's construction

Figure 3 Composition of Governmental Centralization Index in EU8+2

Baltic Ambitious Central Europeans less disciplined Central Europeans



1 to 13 are the sub-indices: 1. existence of obligatory fiscal rules; 2. schedule of budgeting; 3. constructing process of budget draft; 4. responsible persons for consiliating the budget gaps; 5. relative influence of the two houses of parliament; 6. barriers of parliament in amendment of budget draft; 7. schedule of voting; 10. flexibility in execution; 11. reallocation among budget chapters; 12. transferring possibility of unused funds to the next fiscal year; 13. Deficit procedure in case of deviation from the deficit plan

Author's construction

14. In case of cross-country survey of the institutional system of budgeting, the author concluded that the fiscally disciplined countries – Slovenia, Slovakia, Estonia, Latvia, Lithuania, Bulgaria – differ from the less disciplined countries – Hungary, Poland, Czech Republic, Romania – in the efficiency of plan execution. So the preceding ones has less possibility to deviate from the annual budget law, or if they would change it, there must be strong legal mandate, i.e. consensus. Besides, the financial minister's power is stronger in case of determining the fiscal targets in the disciplined countries, except Lithuania.

3.2. Economic policy recommendation

The followings are recommended for EU8+2 decision-makers:

a) The decision-makers in the eastern member states can achieve the national catch-up to the most developed countries level, if they support this procedure with the introduction of the single currency through the exchange rate risk free market representation and with the fiscal balance through the investment attractive aspect of stable business environment.

Then again, the monetary integration can not be achieved without stable fiscal policy. Only the balanced budgetary background can ensure play to the member state fiscal intervention, which balance is possible to be realized in long-term if the deficit factors caused by structural reasons are abolished. By the way, this stability makes the national business environment more predictable, thus the decreasing country risk will improve the national competitiveness.

b) Those EU8+2 countries could achieve good rank in the fiscal competitiveness scoreboard, which make fiscal policy similar to the English liberal model. (Relatively low level of redistribution around the 30-40% of GDP, indebtedness below 30% of GDP, low level of social transfers, social transfers are mostly related to labour market activity, Social Insurance system base on economic rationality and insurance principle. So, after balancing the budget, it is worth to reduce the level of governmental redistribution, increase the employment and enforce the market principles in social insurance.

c) The balance of public finances must be kept for the long-term sustainability. Actually, the zero deficit is considered to be necessary in long-term. The so called cyclically adjusted deficit can be balanced, if the deficit in bad years in economic sense is counter-balanced with the surplus of good years of GDP growth.

The best solution is the lowest room for discretional interventions and the highest weight for automatic stabilizers in the budget structure. So the economic policy decision-makers should have as few chances as possible to enforce their short-term popularity interest during the budgeting.

If, contrary to the automatic stabilizers, there is permanently negative primary balance, the problem is in the structure of financing mechanisms that is why these systems should be restructured not to produce deficit in any circumstances.

d) To execute fiscal reforms effectively and to achieve such medium-term targets like introduction of euro, there is need for political consensus just like in Slovenia, otherwise such withdrawals can happen as started in Slovakia in the fiscal positions, or such crisis signs could emerged because of delaying as occurred in Hungary. Thus, it remains worth considering the application of the fiscal council, the two/three-year budgeting with legal force according to the Slovenian example, and the regular, independent public finance audit.

e) The economic strategy recommendation about the structural reform of public finances can be summarised in three main elements: (1) programme budgeting, (2) multi-year budgeting, (3) implementation of rules about limited expenditures.

f) The consolidation procedures should be irreversible, so it is necessary to restructure the tax and transfer systems.

g) It is necessary to increase the labour market activity that will have positive impact on the budget balance, too. This increase demands such a social transfer system that can strongly motivate individuals for labour market activity. The health care fund must be sustainable. The retirement age must be raised.

h) It is necessary to improve the transparency and the control in the local governmental public finances.

i) The transparency of the central budget is also indispensable. Especially the off-budget items should be reintegrated in the public accounting. Instead of cash basis, the public accounting should follow the accrual basis view.

j) Those countries have the largest fiscal play in the fiscal reform, which are not yet accessed to the ERM-2 system, as they are the less under the pressure to set a short-term deficit decline target because of monetary integration. This is the situation in the EU, when the community sanction is the weakest against excessive deficit and, at once, there is no artificially generated extra exchange rate policy risk because of lack of ERM-2 obligations

For the EMU-members, to avoid the excessive deficit penalty, the necessary structural reforms can be executed together with temporally more significant rearrangement of use of tax revenues, in comparison to ERM-2 participants.

k) In case of a dual fiscal purpose – creating short-term balance and taking on the cost of reforms – than the annual deficit target should content play both for the long-term structural deficit target, for the volatility of revenues and incomes because of business cycles and for the fiscal shock caused by the reforms.

l) The non-Keynesian approach emphasises the long-term favourable impacts of public expenditure cuts and tax increases on the output. The argument is built on agents' rational expectations. Thus, market participants will build into their expectations that successful consolidation clears the way for a possible tax reduction in the future. So, private wealth is expected to grow in the future, which future assets can serve as bail for expansion of consumption in the households in the short run – that is called “Ricardian behaviour”. The process of more and more encouraged private consumption will be strengthened by the decline of default risk in state debt repayment. Besides, the non-Keynesian approach draws attention also to favourable impacts on the supply side where, since the cuts of public spending will mitigate risk premium, crowding-out effects will lessen in the investment market. Furthermore, future tax reduction possibilities created by successful consolidation can initiate positive expectations about the decline of taxation on labour. However, if fiscal consolidation was not successful, the opposite impacts can be expected. One thing is not avoidable in case of expansionary consolidation: credibility of the consolidation, whether it is considered to be feasible by the market participants. (Afonso 2006)

m) The market participants need time to be sure in the political devotion to the irreversibility of the reforms. The impact of debt decrease will appear in 8-10 year-long period. (Schuknecht & Tanzi 2005)

n) According to the most developed European countries’ fiscal experience, the ambitious reformers could sustain the results in a six year-long period, while the timid consolidators suffered from a turn-back of expenditure trend. (Schuknecht & Tanzi 2005, Hughes-Hallett et al. 2003)

o) There is possibility to create funds to finance the restructuring of public finances from special revenues, like oil income, mining rent, excise tax revenue etc. (Posner & Gordon 2001)

3.3. Future research possibilities

The research can be continued to the broadening of the index analysis framework and the number of surveyed countries. More sub-indices can be included to have more exact country evaluation. As the fiscal competitiveness scoreboard focused, first of all, on countries in transition and integration, the number of surveyed countries should be broaden with Eastern and South-Eastern European countries whose fiscal room for maneuver is similar to the EU8+2 states’. The thesis is also a good base for research of reform in the public health care, education, administration and pension systems.

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