The role of independent fiscal institutions in managing the European sovereign debt crisis: The case of the United Kingdom, Germany and Poland

Bernadett Kovács Gyöngyi Csuka

Since 2008, several OECD member countries had experienced a debt crisis, or at least were close to it. Three countries, Greece and Ireland in 2010, and Portugal in 2011, needed to receive help from the IMF through rescue packages. The debt ratio is expected to be above 60% of the GDP based on the projections for most of the OECD countries by 2015, (Rogoff, Reinhart, 2010), which means that the number of countries with the debt to GDP ratio of around 80 to 100 percent will increase.

The debt crisis occurs partially as consequences of errors in the economic policy. The government's fiscal discipline institutions can help to maintain the government deficit and manage the public debt.

The reason for the founding of these institutions is mainly to ensure the sustainability of the public debt, to create fiscal discipline, to maintain the budget deficit and to ensure the transparency of the budgetary process. In some EU countries, fiscal councils responsible for preserving fiscal discipline and compliance have existed for years. Ireland, Portugal and Slovakia have also launched initiatives to establish independent fiscal institutions.

The goal of the paper is to examine what the influence is of having approached the critical level of public debt, on changes to the fiscal rules in three countries of the European Union (Germany, Poland and the United Kingdom). The present study aims to compare the institutions that are responsible for fiscal budgetary discipline in the countries that are examined, with special regard to the degree of their independence, the duration of their existence, and areas of activity. The research results will be formulated regarding the lessons learned on the role of the EU fiscal policy institutions in crisis management.

Keywords: fiscal institutions, debt crisis, independence

1. Fiscal Deficit, National Debt

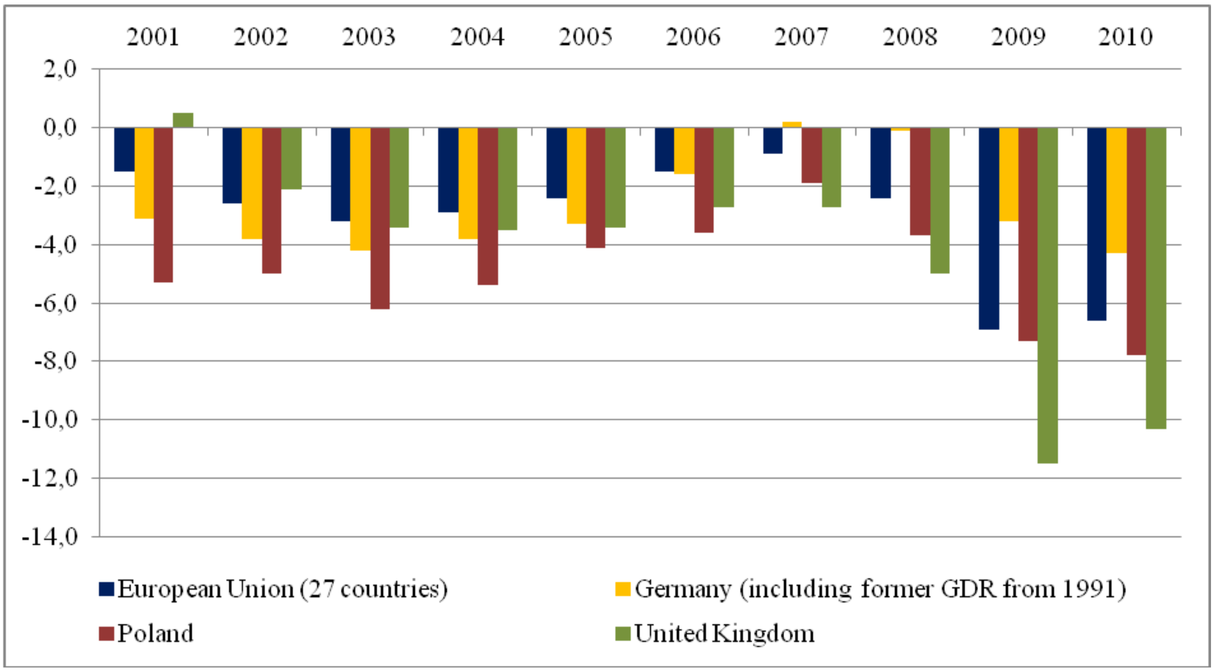
According to the classical point of view fiscal policy possesses three functions: allocation, redistribution and stabilization that realize anti-cyclic policy (Musgrave, 1959). After World War II, until the 70s the main question examined the fact whether fiscal policy was able to fulfil these three criteria efficiently. From the 70s on, most of the developed countries of the world maintained pro-cyclic economic policy[1] which led to a deficit of government budget. When national income does not cover national expenditure, governments have to appeal fund raising. Applying fund raising possibilities (issuing government securities, creditability) may lead to aggregation of national debt which increases default risk. Default risk can be differentiated from economic circumstances. Default risk appears as interest charge owing to the debt and higher discount rates of treasury bills. (Benczes and Kutasi, 2010).

[1] Artificial growth of inner demand occurs during conjuncture.

From the 70s, indebtedness threw new light upon fiscal policy. The conception of sustainability was also included to evaluate the efficiency of fiscal policy. One defines sustainability in connection with politics, if government is able to finance fiscal deficit without booking the increase of national debt. That debt path is unacceptable, when the process of indebtedness works the budget into a state where – considering the increase of interest charge - outgoings cannot be financed from the rate of earlier revenue tariffs. In some countries the governments are forced to maintain fiscal corrections by permanent and important deficiencies considering the increase of national debt / GDP rate which cannot be regarded as a sustainable state.

The higher the deficiency and the debt rate are the less flexible the fiscal policy reacts to the prevention of different economic shock effects (Benczes and Kutasi, 2010). As long as the financial government keeps maintaining the balance of income and expenditure, without increasing the substance of deficiency, the budget remains sustainable. If the government deficit occurs permanently some countries may get into debt spiral. In the case of persistent or chronic budget deficits, there is a risk the government will need to take out additional loans, which leads to further growing the magnitude of the debt. As a result the budget will suffer from even higher deficit, creating a debt spiral situation. (Auerbach and Gorodnichenko, 2010).

Figure 1: Government deficit/surplus, debt and associated data (percentage of GDP)



Source: author's own construction based on Eurostat (2011) data

The definition of fiscal sustainability highlights that no government can outspend without consequences. Some of the new EU members had already experienced the serious aftermath of debt crisis and reschedule in the pre-90s' political system. According to Kopits (2008), this term can be defined as „fiscal alcoholism". This expression is used for those states that cannot get out of overspending.

Earlier the constantly increasing deficit only had an effect on transforming or developing countries[2], primarily due to the irresponsible economic policy and the inadequate treatment of debt substance. The developed and pronouncedly unbreakable economics used to fear the problem of unsustainability of

[2] These are mainly Latin-America, Africa and politically and geographically changeable Eastern Europe.

the national debt much less[3]. These debt crises and the questions of trustworthiness of fiscal policy did not affect North-America and Western-Europe. The so-called low-keyed era from the 90s stabilized the financial state due to the strict controlling of national capital movement (Jordà et al., 2010; Eichengreen, 2007). Since the Second World War the national debt of developed countries has increased extremely in the years of the crisis which was followed by a huge argument about easing deficit as soon as possible. Decreasing deficit is necessary to stabilize and decrease the national debt according to GDP.

Between 1992 and 2007 the fiscal achievement of a government was qualified as effective if it was able to give a response to three main challenges. These were aging population (and the increase of the national expenditure connected to it), globalization and a bigger competition due to the transforming power relations. The results caused by fiscal stabilization and moderation were immediately swept by the fourth factor which was economic and financial crisis during the low-keyed era (Muraközy, 2011). It is impossible to match all the criteria at the same time.[4]

In spite of getting promises about increasing, in some countries problems with sustainability occur due to the slow economic growth which is accompanied with bigger and bigger deficits. An answer to the sustainability problem of national debt can be the prevention of market reactions which can only be carried out with the help of trustworthy political corrections, not with „stop-gapping" actions. The rule-based fiscal system can be functioned as an "anchor". There are several possible methods: to execute actions with the help of fiscal policy and accompanied with rules, to define directions concerning transparency and to organize an independent controlling committee. A democratic society is based on penetrability especially in those countries where market-trust is weak. Transparency problems are caused by accounting tricks and the difficult to follow complex presentations (incomparable account and financial documents in two years running). The regulation of debt ceiling can decrease penetrability as well. The unpredictable economic policy decreases the political authoritativeness of a country. Since every country is special, social institutions have to adapt to the specialities of the country (Kopits, 2011).

After the crisis in 2008, some developed countries faced up to the trustworthiness of their fiscal policies. A budgetary policy that is trustworthy is believed to be sustainable and remain sustainable. Fiscal untrustworthiness causes harm to the trustworthiness of the monetary policy. However monetary and fiscal policy are closely connected because the trustworthiness of the monetary policy is based on the EU zone (and not on society), but the fiscal policy affects the exchange rate of the euro in the interest of keeping investors from fleeing. The budgetary policy which follows a consistent path in the future can be defined as trustworthy.

2. Debt Crisis

One talk about debt crisis, if the debtor becomes insolvent or the creditor assumes a high risk of this possibility and denies the transfer of further credits (Reinhart and Rogoff, 2010b). In the economic crisis of 2007-2010, the concept of debt crisis has been considerably expanded. When a country is not bankrupt, but the government bonds carry a risk premium over a pre-determined critical level, the country is considered to be in a debt crisis (Török and Veres, 2011). Hierarchical debts can be very

[3] In 2010 Italy, Spain, Ireland, Greece and Portugal got into the endangered countries and partly Belgium and the UK (which does not use the Euro).
[4] Similar to pegged exchange, the independence of central bank and capital movement cannot be carried out at the same time (Mundell, 1968).

important. According to the growth and inflation in the future, debts remaining from a war obviously mean smaller problem than those huge debts that are piled up during peace time. The increase after war will be great because it provides manpower and power equipment to the civil economy. What is more, in wartime, governments spend a lot of money. It is typically the reason for the recruitment of debt. On the other hand, a debt in peace time may show unstable and long-lasting political dynamism. Here the authors do not highlight the formation of debt itself. They only examine the relationship between average and median increase and the results of inflation. This may lead us to understand how to decrease the unfavourable growing effects of debt burden during the crisis.

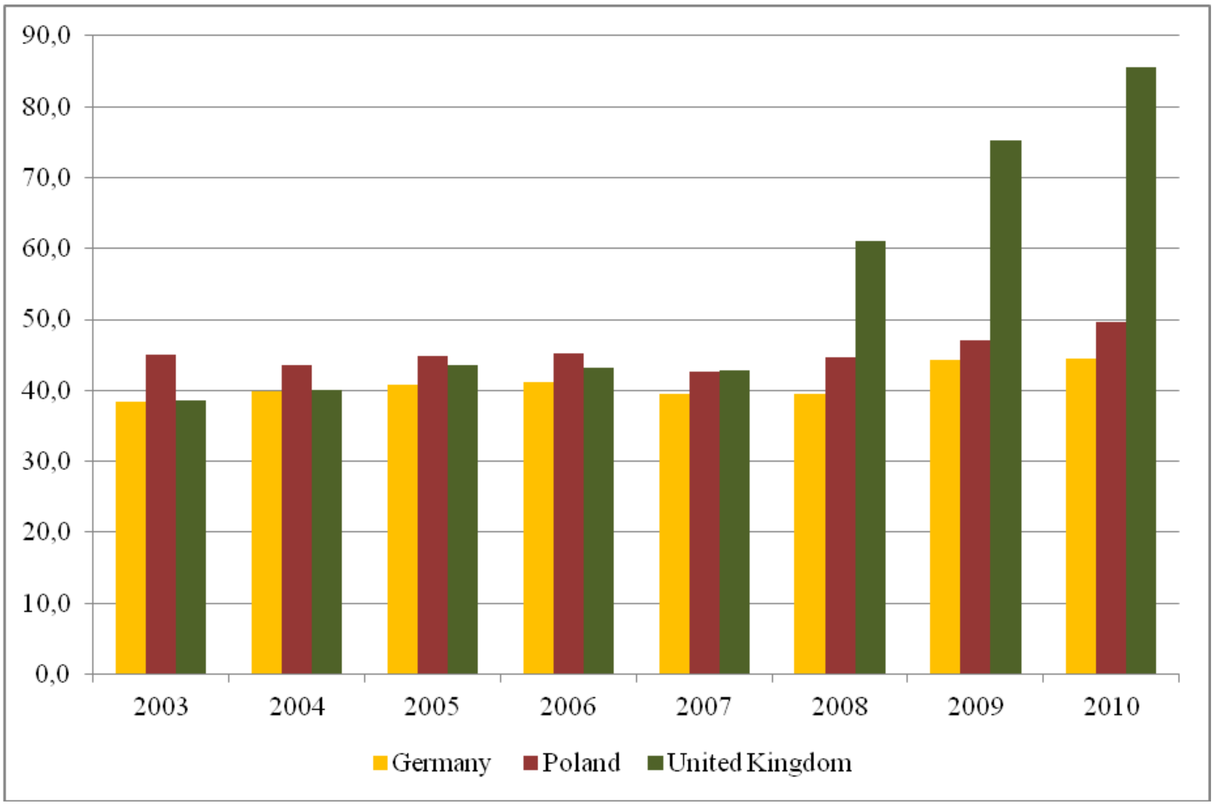
Reinhart and Rogoff (2010a) build their statement upon 200 years of data concerning debt, inflation and economic growth. The year data consist of more than 3700 observations dealing which come from a wide range of political and historical backgrounds, judicial circumstances and monetary systems. In the dissertation the authors made the following conclusions in connection with relationships between inflation and growth of debt:

1. There is little or no obvious relationship between real GDP growth and public debts or liabilities under 90%. Above this percentage the debt burden results one per cent lower median growth to those groups having lower debt. The average increase decreases even more significantly.
2. In the case of emerging economies one can see that – according to external debts (private and national) denominated with foreign currency – this threshold is lower than before: when all external debt reaches the 60% GDP rate, the year increase falls approximately two percent. At higher rates this number gets halved.
3. In developed countries, no obvious connection can be shown between inflation and national debt, not the same as in emerging economies where the growth of inflation adapts to the growth of debt.

Supposing that taxes have to be increased to reach the sustainability of debt, the distortional effect should reduce the possible expenses (Reinhart and Rogoff, 2010b). As a matter of course, governments should be able to carry out austerity measures by decreasing their spending. The government which tries to cover the exact value of its short-term credit may soon have to face up to much higher rate of interest. Financial damages are not the only factor wherefore preventing debt crises is important. The short-term growing effect of debt crisis is the most serious out of the three types of crises. Debt crisis can cause 5% decrease in economic growth. At foreign exchange crisis, this rate is 2,8%, while at bank crisis it is 2%. The three crises altogether can cause 10% decrease (Furceri and Zdzienicka, 2010). If national debt/GDP rate is higher than 90%, further 0,7-0,8% GDP decrease will apply (Reinhard and Rogoff, 2010b). It is important to highlight that deficit itself does not mean a problem if rate of deficit and national debt / GDP rate increase slower than the economy.

Due to the immediate effect of a crisis the differences between the non-payment risks of some economies decreased. In most of the Eastern-Europe countries and in some countries located out of the EU zone a sudden slowing down was observed. In the EU zone the lack of fiscal equilibrium was a surprise which led to distrust. The national debts increased, and most of the countries had to face up to a sustainability problem.

Figure 2: Total central government debt (as a percentage of GDP)



Source: author's own construction based on OECD (2010, 2011) data

3. New Crisis – New Solutions

The solution to the economic crisis not only means that the financial institutions must be reformed. The so-called „This time is different" syndrome comes from the belief that financial crises can only occur in other countries and can affect only other people and in a different time. An economic crisis cannot happen to us. We do things better, we are cleverer, we have already learnt from mistakes made in the past. The traditional rules do not pertain to us. The present boom is based on structural reforms, technological innovation and well-executed policy (Reinhart and Rogoff, 2010a).

During previous crises it was possible to know what tools would be good to use. Typical reactions of fiscal policy contained automatic stabilization, discretionary demand stimulation[5] and direct support of financial sector[6]. The new crisis created a new situation. Some countries have to face up to higher national debt than the earlier, higher risk perception, worse financing situation and lower trend following. In 2010 decision-makers of Europe conceded that a complete review of economic government and development of ruling and controlling social institutions are absolute necessary to stabilize the EU zone.

Fiscal policy had to adapt to crisis as well. One factor is the risk estimation where the adaptation to financial and economical crisis was carried out with the help of measuring risks, carefully planning, storing of money and designing budgetary plans. Budgetary deficit is the main reason but not the only reason of slowing economic growth and financial instability. Constantly high national debt is also a factor. To adapt to the new challenges, the relation of budgetary deficit and national debt is observed

[5] It has to excess demand in some areas of economy (e.g. car scrappage program).
[6] Bank systems to be liquidate to guarantee its work.

when fiscal efficiency has to be defined in a given country[7]. Thus national debt has to decrease consistently to be able to insure sustainability[8]. If it fails to fulfil, the country has to start the risk of deficit procedure.

One of the main points of defeating crises is the amount of initiative debt rate of the given country before the breakout of a crisis. The initiative debt is much more important than the debt rate itself because it will put pressure on amortization. It is also true that the debt rate of a country will increase faster if the external debt rate is higher and/or the debt rate is higher at the moment the crisis breaks out (Furceri and Zdzienicka, 2010). When crises happen, the instalment burdens of the debt will grow due to the increase of risk premiums and the reduced national incomes. That is why it is important for countries to be able to settle their initiative debt rate when the crisis breaks out.

The use of fiscal rules can be a solution to avoid bias towards indebtedness and excessive deficit. Fiscal rules are able to strengthen verifiability of economic policy and are able to prove the independent status of it. Their aim is to establish the trustworthiness of government policy. If the political will is not sufficient to maintain fiscal discipline, it will not be able to fit to the rules. Abiding the laws depends on those politicians who are controlled by these rules. It is vital whether the politicians regard these rules as a must (Benczes and Váradi, 2011).

4. Independent Fiscal Institutions

Fiscal policy is much more than defining the balance of next year. Fiscal deficit is regular in most of the countries in the world thus debt financing has to be carried out constantly. During governmental interference the state can pressurize two opposite effects on the market. It may reduce the consumer demands with the help of taxes and in the same time it increases the demand by buying goods. However the governmental expenditures also have a so-called crowding-out effect. Due to the taxes, the government reduces the demand namely it displaces private expenditures and with the process of buying goods it also displaces private demand from the economy (Auerbach and Gorodnichenko, 2010). This crowding out effect means that interests increase due to the growth of the national debt. Investments will move towards the safer form, which is why the interest rate also increases thus it will be more difficult to obtain capital.

The state sector ought not to displace the source of growth, for instance with public investments just because the price of increase effect is high compared to the growth of deficit and it is hard to maintain the costs between limits. Instead of this the sector has to establish the conditions to be able to expand later.

In the case of Hungary the adaptation of fiscal policy is more difficult because it had to face up to high initial debt ratio, low trend increase, high risk premium and trustworthiness problems from 2000 to 2006. Thus the situation of Hungary before the crisis was exactly the same as some countries will have had after the crisis. Hungary gave a pro-cycle response to the economic fallback. To accelerate the increase is not enough, the high growth pace cannot be sustained for a long time. Some countries can show high growth value but have to face up to serious problems. For example the Baltic countries

[7] The various indicators of fiscal performance such as the primary gap, government bond yields and credit default swaps (CDS) see in detail: Török, 2011a; Török 2011b.
[8] The long-term sustainability of government debt seems quite critical in the United States and in most PIIGS (Portugal, Italy, Greece, and Spain) with partial exception of Italy (Török, 2011a).

have great tolerance due to the „Russian heritage”. To maintain their national independence is the most important.

The fiscal rule system is based on four pillars (i.e. fiscal policy challenge): the debt control or debt management as a limiting factor, the budgetary target as a tool, balance the expenditures and finally the fiscal council as the supporter of the whole rule system (Ódor and Kiss, 2011). An independent organization such as a fiscal council can guarantee a transparent fiscal policy. This has to be an organization in which the participants in the economy can believe and therefore trust as well. At the same time fiscal rule system means the self-restriction of fiscal policy. Fiscal rule system contains complex and serious sanctions that require great transparency. The credibility of fiscal policy can be realized only if sufficient transparency can be achieved. A task of fiscal council is to increase transparency. The fiscal council's main function is to support the whole system.

These independent fiscal institutions may be able to restrict the growth of public debt increase of national debt by means of their legal authorization. In order to avoid the debt crisis, the "institutional anchor" of fiscal policy needed in any country where investors may doubt the government's full commitment towards fiscal sustainability and transparency (Török, 2011a).

The duties of these councils can be different and depend on the fiscal rule system of the given country and the members involved in the operation. Its functions may be manifested by carrying out fiscal analyses without legal consequences as well as by veto. The transparency should be at a higher level if the power of the council is greater (Ódor and Kiss, 2011). Those institutes which assure fiscal responsibility and transparency can take part in arranging political decision-making. According to Kornai there are three main areas where fiscal policy has the right and obligation to form a strong opinion (Kornai, 2010):

1. Analysing the effects: the independent fiscal institution should require the analysis of the decision that have an effect on fiscal policy. It has to criticize the decision and publish its opinions and to make controlling investigation.
2. Monitoring consistency: Examination for consistency of economic rules by the government, without fighting for or against it. It is not possible to decrease the income of the nation, while increasing the expenditures at the same time. The duty of fiscal council is to examine whether the increase in fiscal expenditures are accompanied in parallel by plans to increase revenue as well expenditures.
3. Transparency of fiscal policy: commitment to transparency of decisions and steps regarding fiscal policy. Information regarding decisions and their consequences has to be clearly stated, unambiguous and made available for everyone, not only for decision-makers and experts. Check whether the budget is correct and avoid tricking and creative booking. Fiscal council must function as a bridge between government and fiscal policy.

Only the fully independent analysis is accepted by the markets. The economic populism may be bought by the electorate. A suitable fiscal policy is an important tool to solve a financial crisis. Proper fiscal policy can act as an automatic stabiliser of the economy (Török and Veres, 2011). The insistence on the transparency of fiscal policy decisions and actions may mean a lower likelihood of sustainability. The independent fiscal councils may increase the degree of domestic and international credibility of the national fiscal policy.

5. The Case of the United Kingdom

An independent fiscal institution is able to function properly if it is owned by its mother country. Governments suffering from fiscal alcoholism depend most on markets. Coherent self-discipline anchors expectations and insures fiscal independence. Credibility cannot be imported thus a domestic owned fiscal framework is needed. The rule-based fiscal system (including fiscal rules and supervisory bodies) is successful if the applied measures are able to improve the structural balance and the sustainability of national debt (Kopits, 2011). Normally, the jurisdiction of an independent budgetary committee should cover the following: observing budgetary laws, supervising transparency, rating the sustainability of national debt and fiscal directives, making macro-fiscal prognoses, defining planned measures and differentiating normative and decision-making functions. Finally, it has to communicate with public opinion (Kopits, 2011).

After 2000, more and more countries (like Sweden and Hungary) have established such fiscal institutions. Budgetary rule systems were reinforced in Germany, Romania and Poland. Independent controlling institutions were founded in the UK, in Slovenia and Romania. Furthermore, initiatives were started to establish independent budgetary institutions in Ireland, Portugal, Slovakia, Finland, Cyprus and in the Czech Republic. The purpose of establishing institutions is to assure the sustainability of national debt, to maintain budgetary discipline, to keep government budget deficit on level and to ensure the transparency of budgetary process (Simon Wren-Lewis).

In the UK, the conservative party lodged to establish Office of Budget Responsibility (OBR) in 2008. Several studies were written about the operating principles of council such as by Kirsanova et al. (2007) and Besley and Scott (2010). The first measure of new conservative / liberal party (which has been in power since May 2010) was to establish a temporary institution (OBR) led temporarily by Sir Alan Budd. During their operation, a preparatory report for the first budget and a crisis calculation were made. In July 2010, thanks to the recommendations of Sir Alain Budd and those of the Treasury Select Committee (TSC's) and also the commentaries of Lars Calmfors, the head of Swedish budgetary committee, a debate was initiated about the temporary structure of the OBR.

The budgetary committee in England was founded during the era of Great Depression using fiscal policy with narrow jurisdiction. The OBR works as complementary to fiscal rules. The macroeconomic prognosis of the English institution can influence the budget. At the same time, the close relationship with ministry of finance means a danger factor to transparency, thus it decreases the trustworthiness of analyses (Calmfors and Wren-Lewis, 2011).

The OBR has three full members. Two out of these are academic experts. The third member functions as a governmental expert. Members are elected for five years. TSC has a right of veto when choosing members. The committee responds to the government, but it is also under parliamentary supervision. The institution responding for budgetary discipline is only half-independent in England. The ministry of finance can ask the OBR to prepare analysis about different areas of economic policy, but the committee can decide, after considering its jurisdiction and financial resources, whether to make these reports or not. Although it is not obligatory, the OBR has the possibility to consult the ministry of finance while preparing the reports. The English committee on member level is independent of politics, because the members can be recalled and their mandates are prolong able. These options reduce political independence.

„Hard" institutional form can be found in Sweden, Belgium, in the Netherlands and in the UK. These „hard" controlling institutions of budgetary policy are able to increase the trustworthiness of fiscal policy both from domestic and foreign points of view. The advantages of these methods are that they decrease the costs of sovereign debt-financing (Debrun, 2011). In USA the Congressional Budget Office (CBO) responds to the Congress. In all the other countries the fiscal institution responds to the government or to the Parliament. Reporting commitment itself does not affect the political independence. On the other hand, the way members of fiscal institutions are nominated or recalled and their jurisdictions changed do affect it.

6. The Case of Germany

In Germany the so-called Golden Rule (which limited current expenditure and was tied to the level of gross investment) was initiated in 1969. This was the first independent budgetary rule. Golden Rule forbids financing current expenditure from credit and it only allows deficit financing in the case of national capital investment (Benczes and Váradi, 2011[9]). The main advantage of this rule is the fact that it ignores the depreciation of investments. The rule does not count the net growth of capital stock contrary to the fiscal rule applied in UK, which refers to traditional net investments.

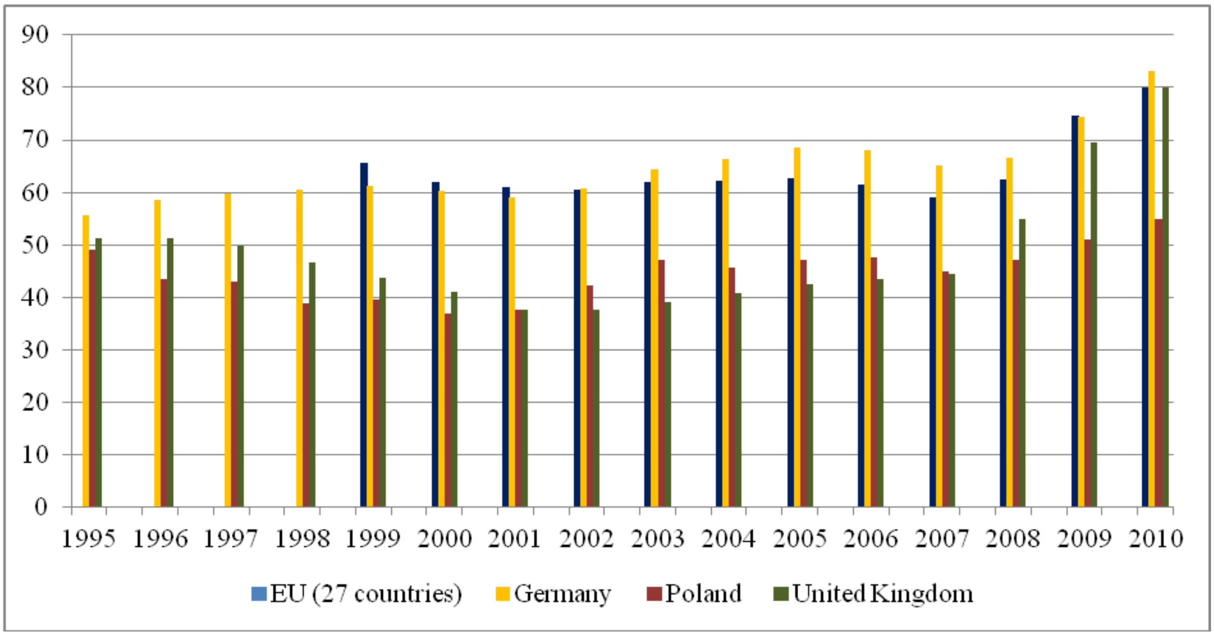
In 1990 Germany has already applied rules for fiscal sustainability well before switching to the Euro. As the greatest investor, Germany's role in crisis management is undisputable. Unlike the discretionary economic policy used earlier, the rule-based economic policy seems to be more acceptable in answering the new challenges of crises. It turned out that discretionary economic policy is able to carry out structural reforms but it inspires some governments to overspend. In the past two years Germany has been carrying out pro-cyclical budgetary policy. In 2002 the country reached the 60 % debt limit, In 2010, as a result of the crisis, the gross debt was at 83,2% of GDP.

As a reaction to the crisis, debt-brake functions as a great example for the members of the EU. Initiating debt rule could have been another alternative (such as in Poland), but in the summer of 2009 Germany was off the beaten track and the country enforced a law about controlling the deficit (structural deficit) of finances[10]. Debt-brake is supervised by the Stability Council (which can be divided into Federal Ministers of Finance and Economy and Finance Ministers of the Länder). This Council contains sixteen provincial ministries of finance and the economic minister of the Federal State. His responsibilities include constantly monitoring and, if necessary, preparing consolidation programs. The Council has no right to punish. The disadvantage of debt-brake is that it can go against the criteria of simplicity and transparency, because it is complex to work with. Whenever the Council considers that a federal or state government risks falling into financial distress, that government has to propose corrective measures. The Council is expected to monitor the implementation of the consolidation plan. Evidently, it is not an independent Fiscal Council, but peer pressure can also be effective (Franco, 2011). The control bill assigned to the German debt-brake constantly forces the government to work out the necessary corrections, hence, forcing politicians to follow the rules (Benczes and Váradi, 2011).

[9] Benczes and Váradi (2011): „Debt-brake instead of Golden Rule: the German case" – These examples are highlighted with using timeline data and shows how Germany changed from Golden Rule to debt-brake.

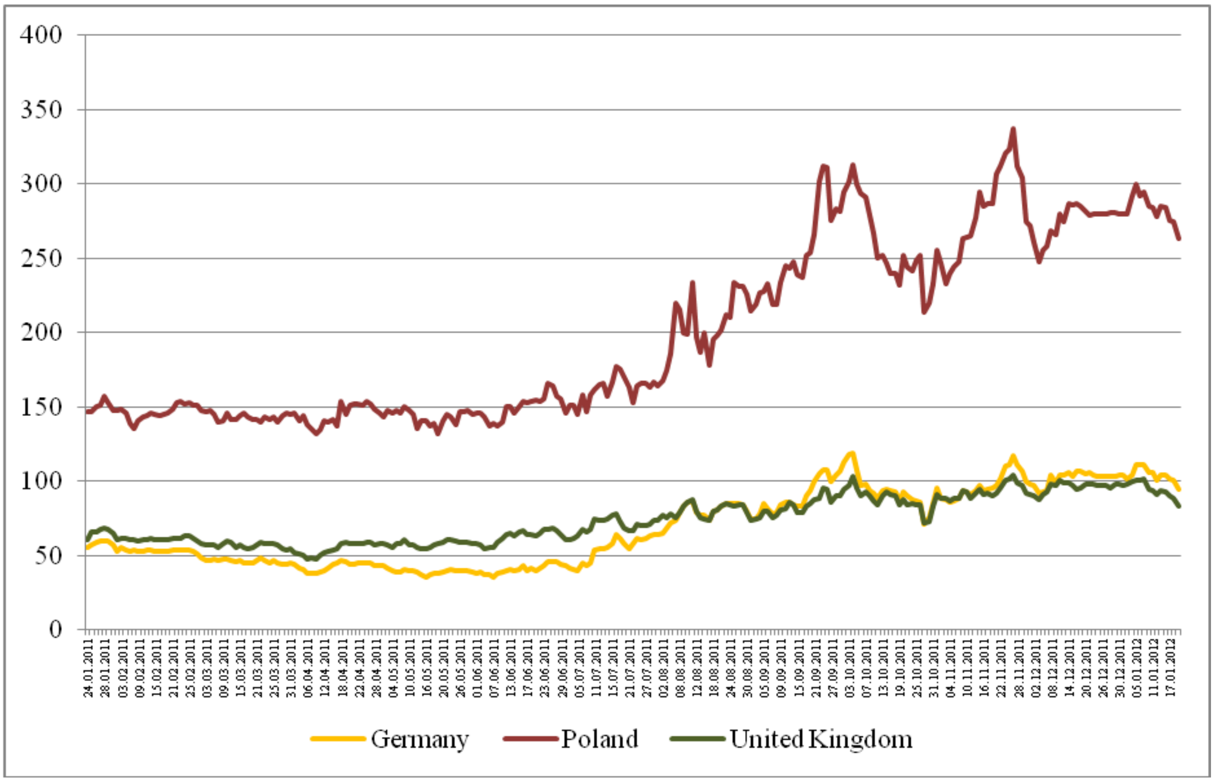
[10] The deficit rate of structural balance can be 0.35% of GDP on federal level. If this deficit is different from the 0,35% rate, the positive or negative difference is transferred to a nominal account. If the deficit on the control account is above 1,5% of GDP, the government has to appeal correction. This correction must be initiated at the deficit equal to 1% of GDP.

Figure 3: General government gross debt (percentage of GDP)



Source: author's own construction based on Eurostat (2011) data

Figure 4: CDS spreads in Germany, in Poland and in United Kingdom



Source: author's own construction based on Deutsche Bank Research (2010)

The German Council of Economic Experts, CEE (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung) has five members and a crew of thirty members, who possess specialised knowledge of economic theory and experience in the field of economic policy. The Council selects one of its members as chairperson for three years. CEE was established in 1963 with a wide range of functions including macro-fiscal policy. The German Federal Government has to publish his remarks about the yearly report of the council. The CEE is an academic body advising

German policy makers on questions of economic policy. The Council assesses the macroeconomic development in Germany, with the objective of informed judgements in all of the economically relevant institutions and in the public opinion. The Council of Economic Experts is supported by the Scientific Staff chaired by the secretary general. The Council resorts to the Laision Office at the Federal Statistic Office in matters of organisation and statistics. The Council has two main roles[11]: to analyze the economic situation, to produce forecasts for the economy and public finances. CEE assesses and evaluates the fiscal transparency (ex-post and ex-ante) and the fiscal sustainability. The Council scrutinises the ways and means of ensuring sustainable growth.

In support of these activities, CEE undertakes a variety of research projects through a year. The Council publishes an Annual Economic Report which is released in mid-November and also prepares ad-hoc Special Reports. Since 2005, the Council has also been compiling Occasional Reports on selected topics upon the Federal Government's request.

In Germany the law does not provide the possibility to fire a council member likewise in the UK, where the consent of the Treasury Select Committee in the Parliament is required. Germany is an in-between case (between the Dutch CPB and OBR in the UK). The German Council is instructed not to give recommendations on specific policies, but recommendations are given nevertheless in contrary to OBR in the UK, which is explicitly forbidden to undertake any analysis of policy options (Calmfors, 2011). In Germany the composition of Councils is made up of only academics. The period of office is five years in Germany and also in the UK. The fiscal councils in Germany and in the United Kingdom make their macroeconomic forecasts. The German council evaluates the quality of the government forecasts in the budget bill.

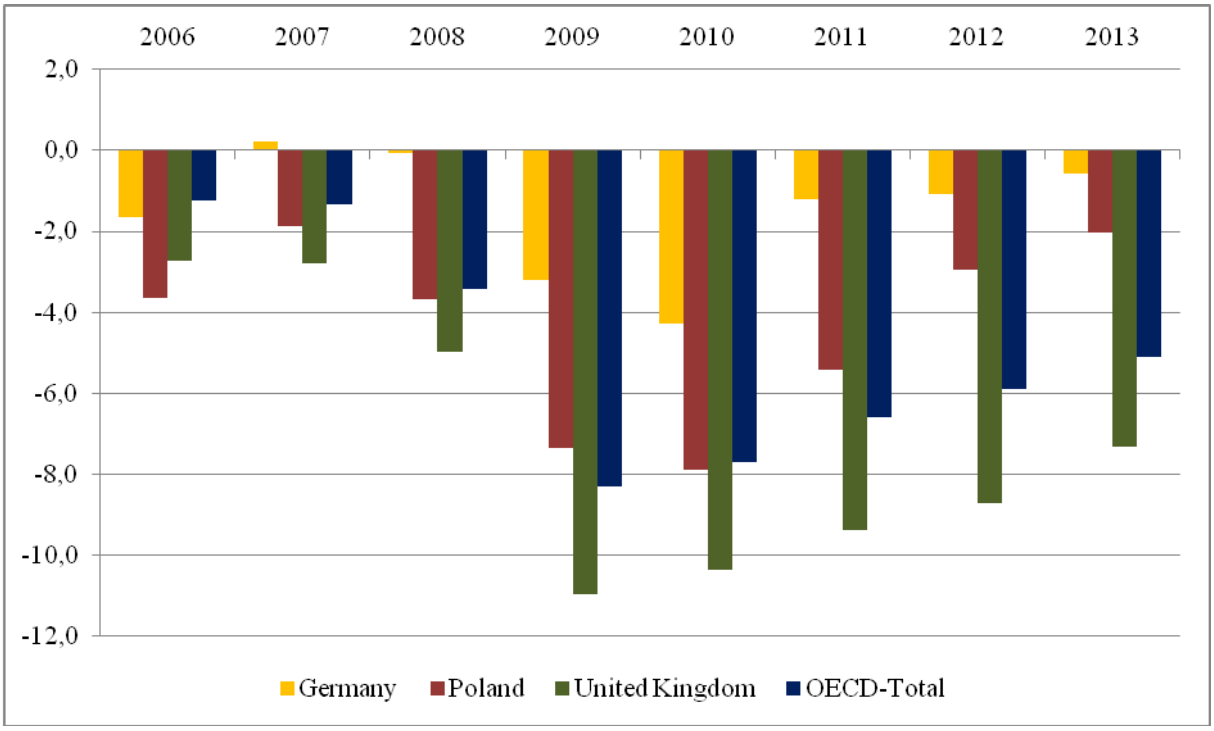
7. The Case of Poland

The Visegrád countries, compared to developed countries, have greater GDP fluctuation, significant deficit deflection and higher current account balance deficit. Visegrád countries depend more highly on foreign capital (FDI) inflows than the more developed Western countries. Corruptions on a high level, lower tax potential, higher tax evasion are some of the characteristics of these countries. The enforcement of law abiding behaviour is inefficient. Compared to more developed countries, the national debt is lower and the growth potential is higher. It is also important to highlight the differences in development. In the case of a developed country the debt rate which the investors are willing to finance, is higher. Resources used efficiently can also affect the development (Ódor and Kiss, 2011).

Still, the economy of Poland differs from the economies of the other Visegrád countries: its economy is much larger, more diversified and it is the seventh most populous country of the EU with the population of 38 million. Due to the more closed economy and larger inner market, they better counteracted the effects of the crisis. Poland chose the rule-based solution to be able to carry out sustainable and transparent fiscal policy. On the other hand, in Germany and the UK the institutional solution dominates. Poland used the „small steps" policy to handle the crisis. Investments were at the centre of its growth[12]. The country managed to create a budgetary law that is able to forestall the increase of sovereign debt. It has a loose fiscal policy unlike earlier when a strict fiscal policy was used. It has an increasing sovereign debt, but it is lower in comparison with other regional countries.

[11] Source: http://www.sachverstaendigenrat-wirtschaft.de/14.html?&L=1 (02.01.2011)
[12] For example: stadium and highway building, environmental developments, bridge constructions, mega-investments and preparation for Euro Football 2012.

Figure 5: Government deficit - Net lending/net borrowing as a percentage of GDP, surplus (+), deficit (-)



Source: author's own construction based on OECD (2010, 2011) data

The Middle-Eastern European countries inherited different levels of sovereign debt from the previous regime. These countries adopted different debt policy in the 80s and 90s. At the beginning of the 80s Poland became practically insolvent which led to the shutdown of import for years. In 1990 its debt was above 20 billion dollars (16 million after deducting net reserves) which was equal to 65% of GDP (Palócz, 2010). During the regime change the creditors let off most of the debts of Poland and Bulgaria[13]. Still the debt level of Poland remained high. In Poland from the 2000s to 2009 the rate of public expenditure was approximately equal to 45% of GDP.

The political situation in Poland (the same as in the Czech Republic) is a little bit instable, the trustworthiness of government and public confidence is not constant, the political structure is shapeless, and the structure of parties is continually changing. In Poland there is a pure rule-based solution: strict and constitutional fiscal rules apply. In the country a debt related fiscal rule is in force since 1997. In this states that sovereign debt cannot overstep the 60% limit. A law about public finances complements it with more regulations. If national debt is between 50 and 55% of GDP, the deficit cannot overstep the actual year's deficit in the next year. If sovereign debt is between 55 and 60%, a new budget must be adopted, which then prevents the growth of debt rate. If sovereign debt is above 60%, the government cannot carry out deficit financing. The finances must be balanced.

Reaching the balanced position of finances is improbable, but there are institutional, political and social bases of holding the deficit in check. Using debt rule is popular all over the world. Its advantage is that it stabilizes the debt rate on a predetermined level. This helps to achieve sustainability. There is no escape clause in the case of overspending. But in 2003 and in 2010, the rate was above 50% thus a new budget law was adopted. This specifies that the level of budget revenue in two years time cannot

[13] Poland with the help of the London and Paris Club obtained the following: part of its debt was let off, part was rescheduled and its payable interests were reduced. USA released 70% of its liabilities against Poland. It also got a favourable stand-by credit (on the basis of the agreement with IMF from 1994) (Palócz, 2010).

decrease. The government reduces the debt-to-GDP ratio under 60% with the help of consolidation programs[14]. In Poland the crisis management is carried out through the following measures: using reserves, rearranging budgetary sources and continuing structural reforms (Wisniewski, 2009). If world economy is not affected by greater shocks, Poland (from the Visegrád countries) can outride the crisis with the least detrimental effects. The explicit Polish economic policy was not enough for the country to back itself out of the effects of the crisis. Nevertheless, economic fallback will not be as considerable as in other countries of the region.

Two of the countries examined in our studies are not part of the EU zone (the UK and Poland). Poland has a pure rule-based fiscal policy while in Germany and in the UK legal actions are complemented by institutional confines. In these two countries the demand for balanced budget has an important role (Győrffy, 2008). In Germany and in the UK, electors enforce fiscal discipline by punishing the government when this does not carry out acceptable economic policy. In these countries there was economic stability until the 70s and 80s. Poland inherited a serious amount of debt. Weak budgetary position, great amount of national debt and significant governmental redistribution are present in the country.

8. Conclusion

A fiscal rule could work well, if the rules are consistent, if the system can be easily operated, but also if it is able to respond to shocks and cycles. The independent fiscal institution will be able to be effective, if it is domestic-owned, non-partisan and accountable. The organization is responsible for compliance budget rules, transparency, oversight and public debt sustainability, assessment of the macro-fiscal projections and the separation of the regulatory and decision-making functions. Its main task is to establish communication between public and policy makers. The fiscal framework will be successful, if it improves the structural balance and public debt sustainability.

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[14] From 2011 the law of finances initiated expenditure rule which is in effect until the country will be removed from the EDP. This means that the yearly real growth within the discretionary range of budget expenditure (approximately 5% of GDP) has to be only of 1%. (Kopint, 2010).

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