# Fiscal Consolidation Efforts in Ten New EU Member States

In a recent paper, Jan Zápal and Ondrej Schneider (2006) analyse the fiscal consolidation efforts of the ten new EU member states[1] that joined the EU in May 2005. In principle, the new members are expected to fulfil the provisions of the Stability and Growth Pact of 1997 (revised in 2005), i.e. to adhere to the 3 percent public deficit and the 60 percent public debt rule. However, six of the ten new EU members were put under the Excessive Deficit Procedure immediately after they entered the EU because of violations of the established fiscal rules.

The authors do not simply describe the fiscal stance of the countries and its development over time; rather they create a system of measurement that allows a closer look at those – mainly political – factors that are responsible for the resulting fiscal deficit and debt. They distinguish fourteen relevant factors to which scores (points) are assigned.

*Pension:* Is there a three-pillar pension system and is the first pillar ruled by the defined contribution principle?

[1] Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia and Slovakia.

*Health:* Has there been "considerable" health-care reform?

*Excessive Deficit Procedure:* Has the country respected the rules of the Stability and Growth Pact since accession (and, thus, is not and has not been under the named procedure)?

*Revision:* What is the average size of revisions of the public deficit in consecutive Pre-Accession Economic Programmes and Convergence Programmes? The lower, the better.

*Speed:* Has the size of fiscal consolidations, as outlined in consecutive Pre-Accession Economic Programmes and Convergence Programmes, increased or decreased? A decrease is better.

*Dependency:* What is the size of the demographic dependency ratio? The lower, the better.

*Fertility:* What is the size of the fertility rate? The higher, the better.

*Benchmark:* Is the average factual primary deficit in period 2000 through 2004 higher or lower than the benchmark primary deficit (the latter being that deficit which leads to a constant public debt ratio)? Lower is better.

*Sustainability gap:* This gap is measured by the difference between benchmark and factual deficit. The lower, the better.

*Stabilising function:* Has the number of years with anti-cyclical fiscal policy been larger or smaller than the number of years with pro-cyclical policy? The larger, the better.

**Table 1**

**Scores for variables influencing the fiscal stance in the ten new EU member states**

| | Pension | Health | EDP | Revision | Speed | Dependency | Fertility | Benchmarking | Sustainability gap | Stabilizing function | Fiscal stance | Room to manoeuvre | Consolidations | Ability to manoeuvre | **Sum** | **Rank** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| No. | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | | |
| Cyprus | 0 | 1 | 0 | 0.2 | 0.8 | 2.0 | 2.0 | 1 | 1.6 | 1.2 | 0.4 | 1.4 | 1.0 | 0.4 | **13.0** | **5** |
| Czech Rep. | 0 | 0 | 0 | 0.4 | 0.6 | 1.2 | 0.2 | 0 | 0.2 | 1.2 | 0.4 | 1.0 | 0.2 | 2.0 | **7.4** | **10** |
| Estonia | 1 | 1 | 1 | 2.0 | 1.8 | 0.2 | 1.6 | 1 | 2.0 | 1.2 | 1.2 | 1.6 | 1.6 | 1.6 | **18.8** | **1** |
| Latvia | 2 | 1 | 1 | 1.4 | 1.6 | 0.4 | 0.8 | 0 | 1.0 | 1.2 | 1.2 | 1.8 | 0.2 | 1.4 | **15.0** | **3** |
| Lithuania | 1 | 1 | 1 | 1.6 | 1.0 | 0.8 | 0.8 | 0 | 1.2 | 0.8 | 0.4 | 2.0 | 1.6 | 1.0 | **14.2** | **4** |
| Hungary | 1 | 0 | 0 | 0.6 | 1.4 | 0.6 | 1.4 | 1 | 1.8 | 0.2 | 0.4 | 0.6 | 0.6 | 1.2 | **10.8** | **8** |
| Malta | 0 | 1 | 0 | 0.8 | 0.2 | 1.4 | 1.8 | 0 | 0.4 | 0.8 | 1.6 | 0.8 | 1.6 | 0.2 | **10.6** | **9** |
| Poland | 2 | 1 | 0 | 1.8 | 0.4 | 1.6 | 0.8 | 0 | 0.8 | 1.2 | 0.2 | 0.4 | 0.6 | 0.6 | **11.4** | **7** |
| Slovenia | 1 | 1 | 1 | 1.0 | 1.2 | 1.0 | 0.6 | 0 | 1.4 | 0.4 | 1.6 | 0.2 | 1.0 | 0.8 | **12.2** | **6** |
| Slovakia | 2 | 1 | 0 | 1.2 | 2.0 | 1.8 | 0.4 | 0 | 0.6 | 0.4 | 2.0 | 1.2 | 1.0 | 1.8 | **15.4** | **2** |

Note: The higher the score, the better the policy.

Source: Zápal and Schneider (2006).

**Table 2**

**Scores of indexes composed of a selection of the variables in Table 1**

| | Reform efforts | Rank | Ageing impact | Rank | Fiscal functions | Rank | Past behav-iour | Rank |
|---|---|---|---|---|---|---|---|---|
| Cyprus | 2.4 | 8 | 9.4 | 2 | 2.6 | 6 –7 | 6.2 | 6 |
| Czech Rep. | 0.6 | 10 | 4.6 | 10 | 1.8 | 9 | 3.0 | 10 |
| Estonia | 4.8 | 2 | 10.0 | 1 | 4.0 | 1 – 2 | 11.8 | 1 |
| Latvia | 4.4 | 4 | 8.4 | 4 | 2.6 | 6 – 7 | 7.6 | 2 – 4 |
| Lithuania | 4.0 | 6 | 7.8 | 5 | 2.8 | 5 | 7.6 | 2 – 4 |
| Hungary | 2.0 | 9 | 7.6 | 6 | 1.2 | 10 | 6.0 | 7 |
| Malta | 4.2 | 5 | 5.6 | 9 | 4.0 | 1 – 2 | 5.4 | 8 |
| Poland | 3.8 | 7 | 7.2 | 7 | 2.0 | 8 | 5.0 | 9 |
| Slovenia | 4.6 | 3 | 6.0 | 8 | 3.0 | 4 | 7.6 | 2 – 4 |
| Slovakia | 6.0 | 1 | 8.8 | 3 | 3.4 | 3 | 7.2 | 5 |

Note: The higher the score, the better the policy.

Source: Zápal and Schneider (2006).

*Fiscal stance:* Has the number of years with restrictive fiscal policy been larger or smaller than the number of years with expansionary policy? The larger, the better.
*Room to manoeuvre:* General government revenues as a percentage of GDP: The lower, the better.
*Consolidations:* Has the number of successful consolidations been larger or smaller than the number of unsuccessful consolidations? The larger, the better.
*Ability to manoeuvre:* What is the share of open-ended expenditure in total government expenditure? The higher, the better.

Table 1 contains the scores assigned by the authors. A ranking according to the simple sum of the scores supports one of the main findings of the study, namely that two groups of countries can be distinguished: one with successful reforms and fiscal consolidations, the other with much less success. The former group consists of Estonia (far ahead), Slovakia, Latvia and Lithuania, while the other group consists of Poland, Hungary, Malta, and, far behind, the Czech Republic.

On the basis of these scores the authors have constructed four indexes from the fourteen variables. These indexes are intended to measure the reform efforts, the impact of ageing, the quality of fiscal policy in terms of stabilisation (including a stable economic environment) and in terms of the criteria of the Stability and Growth Pact. Each of the four indexes is composed of a selection from the fourteen variables (Table 2).

The four indexes of Table 2 shed some additional light on the question of why some countries are ranked higher or lower than one might have expected. Cyprus, for instance, having been put under the Excessive Deficit Procedure since accession, ranks relatively high (rank 5) in the summary ranking of Table 1. This seems to be mainly the result of high scores for *Dependency* and *Fertility* (Table 1), which do not represent any policy effort. The more complex index *Ageing impact* in Table 2, by contrast, is composed of 8 of the 14 variables and indeed contains variables that indicate reform effort.

R.O.

## Reference

Zápal, J. and O. Schneider (2006), "What are their Words Worth? Political Plans and Economic Pains of Fiscal Consolidations in the New EU Member States", *CESifo Working Paper* no. 1655.