FISCAL IMPULSE UNDER CONDITIONS OF THE SLOVAK REPUBLIC

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ABSTRACT: *"The consolidation of public finance should create room for sustainable economic growth with low inflation, low interest rates, a stable exchange rate and positive expectations of stakeholders concerning future economic policy." (Convergence programme D 2007, pp. 30) So far, the consolidation of public finance appears to be the only tool that can maintain the running of individual economies of the EMU member countries. Slovakia is not an exception. Throughout its 20-year history, Slovakia has experienced several phases of the public finance consolidation which have proved to be more or less successful. Just as in other countries, in times when its economy thrived, the push for consolidation was abandoned; however, at present, Slovakia is forced to return to the consolidation. Our goal and the object of this article is to highlight interconnections between the state of public finance, public finance management and investment activities under the conditions of Slovakia. We have focused primarily on the fiscal impulse which is one of the determinants of investment activities.*

KEY WORDS: *Fiscal impulse, Consolidation, Fiscal indicators, Fiscal position, Investment*

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INTRODUCTION

The primary problem of the EMU member countries is their debt and deepening indebtedness. Due to the effect of different economic shocks, many countries have started implementing various cost-saving measures in their economy, enabling them to use more effective management. Currently, under the pressure of rules introduced by the EC, and under the threat of severe sanctions imposed due to the failure to meet these rules, many countries either restore cost-saving measures, or implement them in their economies for the first time. EU representatives monitor individual actions taken in this particular area under the heading of the consolidation process. (EU Fiscal Pact, 2012) So far, the consolidation of

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public finance appears to be the only tool that can maintain the running of individual economies of the EMU member countries. Slovakia is not an exception. Throughout its 20-year history, Slovakia has experienced several phases of the public finance consolidation which have proved to be more or less successful. Just as in other countries, in times when its economy thrived, the push for consolidation was abandoned; however, at present, Slovakia is forced to return to the consolidation. Based on the analysis made by Alesina et al. (1999), and in the light of the findings that, in fact, the economy of the SR, with the exception of one period - year 1995 - has always ended up with the public finance deficit, we have focused our attention on the analysis of an indicator which is closely related to the public finance management, namely the fiscal impulse. The underpinning reason is that we consider this indicator to be one of the determinants of investment activity in the economy.

According to Schinasi & Lutz (1991) „the fiscal impulse is defined as the change in the government budget balance resulting from changes in government expenditure and tax policies. Fiscal impulse measures have been designed to summarize in a single measure the aggregate effects of fiscal policy actions on the government's budget balance and have served as a basis for policy discussions and international comparisons of fiscal policy actions.“(Schinasi & Lutz 1991, pp.2) De Castro, Kremer & Warmedinger (2010) add to this by saying that “a fiscal impulse arises from financial flows between the general government and the private sector, which are in general reflected by budgetary developments.“ (De Castro, Kremer & Warmedinger 2010, pp.104) There are two basic approaches to calculate the fiscal impulse. The first one is based on the so called “input side” perspective, according to which the impulse is assessed on the basis of changes in public finance. The other approach represents the so called “output side” perspective according to which a fiscal stimulus is assessed in terms of its effect on macroeconomic developments. Both approaches have their pros and cons. It is not always possible to assess, which approach is more suitable, and which would reflect the actual situation in the economy in a better way.

Accordingly, given the pros and cons of the different alternatives, the changes in the headline balance or in the primary balance, as a percentage of GDP, would be the most comprehensive and, at the same time, manageable indicators for the impulse provided by public finances. They offer two main advantages. Firstly, they include the reaction of automatic stabilisers to the economic situation, whose functioning, in general, involves non-negligible economic effects on the private sector without the risk of incurring pro-cyclical policies. This also implies that contemporary feedbacks between macroeconomic and fiscal developments, transmitted via fiscal multipliers and automatic stabilisers, are accounted for. Thus, the indicators might be interpreted as a “net fiscal impulse”. Secondly, as the government deficit is made public and is subject to wide scrutiny, this indicator is easier to monitor and appears less open to manipulation than others. Moreover, in view of the interest in the role of fiscal policy and the economic effects of the impulse, it can be accompanied by useful information on the different budgetary sources behind it and the transmission channels thereof. (De Castro, Kremer & Warmedinger 2010, pp.105)

FISCAL INDICATORS OF SLOVAKIA

As mentioned in the introduction, the management and state of public finance is an important indicator of possibilities for the fiscal impulse in the economy. The following table shows the overview of the basic fiscal indicators.

Table 1 Fiscal indicators of the SR during the period from 2006 to 2014

Fiscal indicator	%	2006	2007	2008	2009	2010	2011	2012	2013	2014
Overall Fiscal Balance	**of GDP**	-3,2	-1,8	-2,1	-8	-7,7	-4,8	-4,8	-2,9	-2,9
Primary Balance	**of GDP**	-1,9	-0,8	-1,1	-6,7	-3,4	-3,3	-1,3	-1,3	-1,3
General Government Cyclically Adjusted Balance	**of potential GDP**	-3,1	-3	-3,1	-6,6	-7,3	-4,6	-4,4	-2,5	-2,6
General Government Gross Debt	**of GDP**	30,5	29,6	27,9	35,6	41,1	43,3	46,3	47,2	47,6
Output Gap	**of GDP**	-0,6	1,7	3,9	-4,1	-4,3	-3	-1,2	-	-

Source: own table, data from Fiscal monitor IMF 2012

As obvious from the shown values, the Slovak economy demonstrated the best results during the period from 2007 to 2008. It is also underpinned by the fact that during that period the economy reached the growth level of 10 %. The outbreak of the economic crisis fully manifested itself in the values from the year 2009. A significant deterioration of all indicators occurred. While in the area of balance, the last three years have been characterized by a gradual improvement resulting from the usage of a combination of fiscal policy tools, the development of the government debt continues to follow a negative trend. As shown in Table 1, the development prognosis for the next two years does not imply any improvement in this situation, either. However, these values are not representative of how successful the used fiscal policy is in terms of the support of investment activity in the economy, and thus the support of the economic growth.

FISCAL IMPULSE

In our analysis we have been designing procedures for the determination of the fiscal impulse development. Its task is to measure the contribution of public budgets to the year-over-year change in the aggregate demand. “It indicates whether the government is pursuing an expansive or a restrictive fiscal policy. In conjunction with the output gap it serves to characterize the fiscal policy as either pro-cyclical or stabilizing. (Convergence programme D 2007, pp. 33) When calculating the fiscal impulse, the attention should be paid to one-off measures. Their counting distorts the actual reaction of the economy to the used fiscal policy; thus, it may become a tool for political manipulation. Therefore, we have used the value of the cyclically adjusted public finance balance in order to calculate the fiscal impulse, which was adjusted by the:

- “One-off measures”– we have detected several one-off measures throughout the monitored period. These are measures, which influenced the balance of public finance in a particular year or time period.
- “Impact of the implementation of the 2nd pillar of pension scheme” – these costs do not affect the overall household expenditure. At the same time, pension expenditure does not change. However, in terms of the balance of public finance, this item is shown as a loss of revenue with a negative impact on the deficit, as it does not constitute the income of the Social Insurance Company but the income of private pension fund management companies.
- “Impact of relations with the EU” – as contributions to the European Community (EC) budget do not increase domestic demand; and vice versa,

revenues from the EC budget do not reduce spendable income of enterprises and households.

- "Interest payments within the public debt management" – as the amount of interest payments depends on the amount of the public administration debt, which is affected by the economic performance of previous governments and conditions on financial markets (interest rates and foreign exchange rates), this item should not influence government's consolidation efforts in a given period. Due to this reason, the public administration balance has also been given net of interest payments.

These items describe more closely the impact of fiscal policy on aggregate demand. (Convergence programme D, 2007) As a result of economic changes, a few adjustments were made in calculating the fiscal impulse in 2008. For the sake of a better calculation of the output gap it was necessary to adjust the real GDP growth to be net of one-off effects of stockpiling of cigarettes. As a result of the temporary opening of the 2nd pillar of the pension system, a new one-off effect has been identified to be considered. In addition to these newly emerging factors, it was necessary to add also a long-term PPP investment project of the express ways and motorways construction to the items affecting the deficit of public finances. (Stability Programme of Slovakia 1, 2008) In 2009, a contribution of adopted anti-crisis measures was added to these items. On the basis of this methodology, we have compiled the following Tab. 1 covering the period from 2001 to 2011 (we have extended the period in order to see the entire course clearly); with the outlook for 2012.

Table 2 Calculation of the size of the fiscal impulse for the SR during the period between 2001 and 2011

(%GDP)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012*
1. Net lending / net borrowing	-6,6	-8,2	-3,7	-3,1	-3,1	-3,7	-1,9	-2,3	-8,0	-7,9	-4,8	-4,6
2. Cyclical component	-0,4	-0,4	0,0	0,0	0,0	0,0	0,4	1,1	-1,4	-0,6	0,0	-0,5
3. One-off measures	0,0	-1,9	-0,4	0,0	-0,8	-0,4	0,8	-0,7	0,0	-0,3	-0,4	0,1
4. Impact of the implementation of the 2nd pillar of pension scheme	0,0	0,0	0,0	0,0	-0,8	-1,2	-1,3	-1,3	-1,3	-1,2	-1,2	1,3
5. Net interest payments	-4,0	-3,6	-1,8	-1,7	-1,7	-1,5	-1,4	-1,2	-1,4	-1,3	-1,6	-1,8
6. Highways construction outside the GG balance sheet	-	-	-	-	-	-	-	-	-	0,7	0,3	-0,1
7. Cyclically adjusted primary balance	-2,2	-2,3	-1,5	-1,4	0,2	-0,6	-0,4	-0,2	-3,9	-5,2	-1,9	-3,6
8. Impact of relations with the EU	0,0	0,0	0,0	0,0	0,9	0,5	0,6	0,6	1,2	2,1	2,5	2,5
9. PPP Projects	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,3	-	-	-
10. Agregátne saldo vrátane EÚ a PPP	-2,2	-2,3	-1,5	-1,4	-0,7	-1,1	-1,0	-0,8	-5,4	-7,3	-4,4	-6,1
11. Fiscal impulse	1,0	-0,1	0,8	0,1	0,7	-0,3	0,1	0,2	-4,6	-1,9	2,9	-1,7
12. Output gap	-0,6	-0,2	0,0	0	0	0	1,5	3,9	-4,8	-2,1	-0,1	-1,6

Source: own calculation, data from Convergence programme A- D and Stability Programme of Slovakia A - C

The further analysis requires two variables. The fiscal impulse expresses the direction of the fiscal policy, while the output gap expresses the actual manifestation of the particular fiscal impulse. Their co-action expresses the fiscal position of the SR economy during the monitored period.

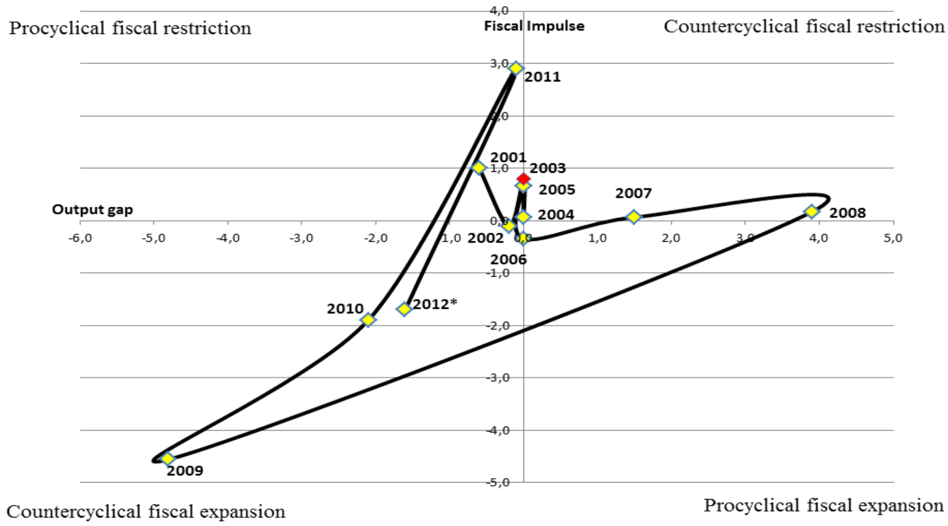

Figure 1 Fiscal position in period 2001 – 2012*. ***Source: Own figure, data from Table 2***

During the period from 2001 to 2002, the output gap value was not very considerable. It gained a negative value, which indicates the level of the real product below the level of the potential product. However, its year-over-year drop was in agreement with the fiscal impulse data. Even though its value was dropping, it expressed fiscal restrictions with the aim to approach or reach the level of the potential product. During the period between 2003 and 2006, the output gap was zero; and the public finance deficit was constituted mainly by the structural component of the deficit. From the viewpoint of the output gap, the fiscal policy was neutral during that period, as indicated by the fiscal position drawn for these years (Figure 1). Positive numbers characterizing the fiscal impulse in the given period confirm the persistent trend of the fiscal restriction, which enabled the economy to remain at the level of the potential product. However, the year 2006 was an exception. In accordance with the previously published analyses, this year is known for introducing changes in the course of economy manifested by a short-term expansive fiscal policy. (Raisová 2010) This fact is expressed also by the drawn fiscal position of the SR economy in 2006. (Figure 1) However, at the same time it can be stated that this short-term deviation did not cause any problems for the economy, and its final overall effect was in fact neutral. The following years of 2007 and 2008 witnessed a significant change in fiscal position of the SR. Catching up reforms as well as a swing-back to fiscal restriction (as indicated by the growing value of the fiscal impulse), even though containing elements of occasional expansion, resulted in the efficiency growth of economy and the output gap grew increasingly positive. And thus the economy fell to the “counter-cyclical fiscal restriction” sector. During that period, the development of the overall economic situation was the best in the history of the SR. Table 1 shows that during that period the character of fiscal policy was influenced mainly by a significant growth of financial means from the EU funds and the start of the express ways and motorways construction through PPP projects. Paradoxically, the fear of economy overheating was solved in 2009 by the market itself. The economic crisis stopped the economy overheating. As indicated by the fiscal impulse value for that year, fiscal policy became expansive under the influence of built-in stabilizers, without any effort on its part. Generally, the economy experienced decline, and this development resulted in the opening of the output gap in the opposite direction than in 2008. The real product fell under the level of the potential product. Subsequently, the fiscal position moved from the "counter-cyclical fiscal restriction" sector to the "counter-cyclical fiscal expansion" sector. It is just the opposite situation than that in 2007 or 2008. The year 2010 witnessed further deepening of the output gap, while adopted fiscal policy measures failed to result in the support of the investment environment. They primarily focused on halting the economic decline. The first wave of the economic crisis abated, and the year 2011 brought a short revival of the economy. The fiscal position of the economy improved, too. The output gap started to narrow gradually, and the fiscal policy had a positive impact on the economy. This development resulted in the shift of the fiscal position to the "pro-cyclical fiscal restriction" sector. In fact, the economy returned to a similar position as it was in 2001 or in 2003 but with stronger fiscal impulse. With regard to the current development of the economic conditions in the SR as well as in the world markets, with which the SR economy interacts, the assumption exists that figures for 2012 will show the opposite development and the economy will return to a similar position as it was in 2010. This fact is also confirmed by estimations done during our calculations.

CONCLUSION

All countries in the world – not only EMU members but also the USA and, due to the links within the global economy, other countries in the world have been facing the economic crisis since 2008. While in 2011 the crisis seemed to be averted, in the first half of 2012 the economic development indicators dropped again. The biggest problem was represented by debts of individual countries and, most importantly, a lack of funds to pay them back, also in the long-term horizon. Due to this development, new fiscal conditions have emerged that the countries have to implement in their legislation. The crisis impacts small and medium-size enterprises, both in terms of their functioning and existence. Through them, it affects employment and unemployment rate, and subsequently also consumption and domestic demand of the economy. All these impacts are negative. (Buleca, Mura & Véghová 2012; Dugasová 2011) They result in the slowdown of consumption and investment activities, thus making any economic growth impossible. Our aim in this article was to calculate the impact of the fiscal policy performed under the conditions of the Slovak Republic on the investment activity of the economy. Fiscal impulse has been selected as the key indicator. In the calculation of the fiscal impulse we have taken into account individual one-off measures according to the year they belong to. In our calculation, we have obtained fiscal impulse values for individual years of the monitored period. The obtained values have been completed with the output gap values for these particular period; and based on these two values, we have drawn a graph of the SR fiscal position in the monitored period. The analysis has confirmed our assumptions.

During the period from 2001 to 2002, the output gap value was not very considerable. It gained a negative value, which indicates the level of the real product below the level of the potential product. However, its year-over-year drop was in agreement with the fiscal impulse data. Even though its value was dropping, it expressed fiscal restrictions with the aim to approach or reach the level of the potential product. During the period between 2003 and 2006 the output gap was zero; and the public finance deficit was constituted mainly by the structural component of the deficit. From the viewpoint of the output gap, the fiscal policy was neutral during that period. The fiscal impulse represented by positive numbers in the given period confirmed the persistent trend of the fiscal restriction, which enabled the economy to remain at the level of the potential product. The year 2006 was an exception. In accordance with the previously published analyses, this year is known for introducing changes in the course of economy manifested by a short-term expansive fiscal policy. However, at the same time it can be stated that this short-term deviation did not cause any problems for the economy, and its final overall effect was in fact neutral. The following years of 2007 and 2008 witnessed a significant change in fiscal position of the SR. Catching up reforms as well as a swing-back to fiscal restriction (as indicated by the growing value of the fiscal impulse), even though containing elements of occasional expansion, resulted in the efficiency growth of economy and the output gap grew increasingly positive. And thus the economy fell to the "counter-cyclical fiscal restriction" sector. During that period, the development of the overall economic situation was the best in the history of the SR. During that period the character of fiscal policy was influenced mainly by a significant growth of financial means from the EU funds and the start of the express ways and motorways construction through PPP projects. Paradoxically, the fear of economy overheating was solved in 2009 by the market itself. The economic crisis stopped the economy overheating. As indicated by the fiscal impulse value for that year, fiscal policy became expansive under the influence of built-in stabilizers, without any effort on its part. Generally, the economy experienced decline, and this development resulted in the opening of the output gap in the opposite direction than in 2008. The period between 2009 and 2010 is characterized by the fact that the economy fell into recession and, at the same time, it had to face a significant change – transition to a new currency. Thus it is not surprising that the fiscal position of the economy deteriorated significantly, and the economy fell to the "counter-cyclical fiscal expansion" sector. A short period of improvement in the economy as well as a reversion to the fiscal restrictions resulted in the improvement of the economy position so that it has raised approximately to the same level as it was in 2001 or in 2003. It was enabled by a slight decrease of the output gap accompanied by a positive impact of the adopted fiscal measures.

On the basis of our findings we can say that in the situation, when the fiscal policy was restrictive, it enabled the economy to reach its optimum level even in the horizon of several consecutive years. This is a basis for us to deduce that the conditions set this way had also a positive effect on the investment environment of the economy. This assumption had been confirmed by earlier analyses, and it is declared also by the amount of the realized investments or the inflow of FDI during those periods. However, at the same time it must be stated that the subsequent abandoning of strict restrictions enabled the economy to reach the best macroeconomic results in the history, however, at the cost of overheating of the economy and under decreasing investment activities.

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