Fiscal Sustainability in the Non-Euro States

Alina - Georgiana SOLOMON

Faculty of Finances, Banks and Accountancy, “Dimitrie Cantemir” Christian University of Bucharest, Romania,
E-mail: alingasolomon@yahoo.com

Abstract
Forming an opinion about the ability of a government of any State to honor its financial obligations in the long term, raise the issue of fiscal sustainability. This subject involves analysis of the main elements useful in maintaining macroeconomic stability, fiscal sustainability. In essence, government options in terms of fiscal policy developments affecting the fiscal deficit, indebtedness and ability to mobilize the necessary financial resources coatings, respectively refinării these indicators. In this paper, the study of fiscal sustainability is focused primarily on countries outside the euro area; highlighting the extent to which they, by applying their own national tax systems are consistent with the overall objective of the European Commission, recently said the “Europe 2020 Strategy”.

Key words
Fiscal sustainability, structural balance, revenues, expenditure

DOI: 10.6007/IJARAFMS/v7-i1/2703 URL: http://dx.doi.org/10.6007/IJARAFMS/v7-i1/2703

1. Introduction
Submission and assessment of the situation fiscal sustainability in the current economic climate is extremely timely. For most European Union states out of the recession is a challenge for major structural imbalances. Thus, for achieving our medium and long term, the EU has proposed an ambitious fiscal consolidation. This concerned, mostly streamline fiscal frameworks and national budget.

From this perspective, the article elaborated includes a summary of key studies in the field, but also an analysis of fiscal sustainability in the EU, the situation subsequently customized non-euro states.

2. Literature review
Analysis of fiscal sustainability over time was a controversial topic among specialists for taxation. Study existence of a balance between GDP - investment - savings being found in many reference works. This perspective calling into question the maintenance of a state of fiscal sustainability; in other words, a new design concept macroeconomic solvency linked to the government (Solomon, 2015).

Between the first theoretical approaches on fiscal sustainability, we find the work "A Tract on Monetary Reform", in which JM Keynes (1923) Analyzing the public debt of France, observed lack of sustainability when it becomes apparent that the amounts due to holders of bonds exceed the which can be borne by taxpayers. Following the deepening of research, he concluded that to establish a sustainable environment is necessary that fiscal policy to establish “a compromise between increasing levels of taxation and the decline in the expenditure” (Keynes, 1923).

In this direction, consecrated studies were made by authors such as Alfonso A. and C. Rault, in works such as “Ricardian Fiscal Regimes in the European Union” or “What do we really know about fiscal sustainability in the EU? A Panel Data Diagnostic”. In the first of these works in terms of fiscal sustainability is dealt two variables public debt, and that the level of taxation. The study, discusses choosing one of the following options: issue debt or raising taxes. Using this hypothesis highlights the possibility to finance fiscal deficits, something found in Ricardian equivalence theory. In the second paper, Alfonso and Rault, emphasizes the possibility of testing the EU fiscal sustainability, applying cointegration tests. Assumptions being debt levels and real interest rate, which added an auxiliary variable that led to rewriting the budget constraint equation.
By using a factorial design applied to a series of 12 countries in the Economic and Monetary Union, the indebtedness relative to GDP has been the subject of analysis, Cipollini and Lo Cascio in “Testing for public debt sustainability Using a Time-Scale Decomposition analysis”, observes entry on a sustainable path fiscally, of the 12 countries analyzed.

Currently, the literature suggests a number of analysis and debate on sustainability in terms of fiscal policy, its implementation and influence on the indicators S1 and S2. These indicators express the gap has to be addressed to ensure sustainable public finances. The results of studies being presented in documents such as: “Fiscal Sustainability of Health Systems. Bridging Finance Health and Perspectives “(OECD, 2015), “Fiscal Sustainability Report 2015” (European Commision, 2016), “Romania Country Report 2016” (European Commision, 2016) etc.

3. Methodology of research

Scientific research methods used for this study consisted of summaries, analyzes quantitative and qualitative comparisons etc. Almost, all research methodology involved the literature study, statistics analysis made by European and national institutions, and not least reading articles/studies published on the subject. However, the timeliness and complexity of this study allowed the application of reasoning by which transitioned from the particular to the general, and the formulation of opinions that are founded on the premise various specialists.

4. Fiscal sustainability in the European context

Application of fiscal-budgetary policy adapted to economic trends, highlights the ability of each state government to honor its financial obligations. This premise, offering the possibility of defining a new concept, namely that of fiscal sustainability. Therefore, a set of policies is sustainable if the debtor State is able to honor its debt service payments relating to, without requiring a steep correction in future general government budget (Fiscal Council, 2011).

At the European Union level, since 2009, the fiscal sustainability in the short, medium and long term is assessed by the European Commission through sustainability indicators S0, S1 and S2.

Specialists in the field, considers pointer S0 as a warning indicator that captures short-term sustainability of public finances through analysis type signals (Fiscal Council, 2015).

By including costs generated by aging, expressed S1 indicator (in relation to GDP) of the adjustment effort to achieve primary budget balance in 2060 of a debt level of 60% of GDP. In connection with the spoils, as defined set out in the Annual Report of the Fiscal Council, the S2 indicator indicates fiscal effort needed to be fulfilled on a day constraints intertemporal budget infinite time horizon.

Therefore, ensuring fiscal sustainability means implementing a set of measures aimed at achieving a stimulating environment in terms of fiscal and budget, necessary to maintain the deficit target set in the Maastricht Treaty and the setpoint debt.

For the year 2015 as the Sustainability Report, the value of S0 indicator, indicates that in short term, EU Member States have not undergone significant fiscal risks. This indicator maintaining below accepted by European standards.

Reported in the same year, medium-term and long may mention the following:

1. In terms of the indicator S1, its value reflects the improvement of hip structural primary EU-28. This favorable situation is due, in particular, implementation of structural reforms;

2. In terms of the indicator S2, its value means a risk of GAP's low long-term sustainability, EU-28. In this situation it is necessary to continue fiscal consolidation efforts in most EU countries and the stepping up reforms in social protection (pension system, health care, unemployment etc.).

Table 1 summarizes the situation of the indicators of sustainability in the medium and long term, their components and the intertemporal net worth (the indicator S2).

In the context of fiscal sustainability, the European Union prospects are geared towards three priorities: further structural reforms, implementation of responsible fiscal policy and not least a recovery in investment.
Table 1. Situation sustainability indicators $S_1$ and $S_2$ the European Union and Eurozone

<table>
<thead>
<tr>
<th></th>
<th>$S_1$</th>
<th>Due to</th>
<th>$S_2$</th>
</tr>
</thead>
<tbody>
<tr>
<td>% GDP</td>
<td></td>
<td></td>
<td>INV</td>
</tr>
<tr>
<td>EU</td>
<td>2.0</td>
<td>-0.5</td>
<td>0.3</td>
</tr>
<tr>
<td>EA</td>
<td>2.1</td>
<td>-0.8</td>
<td>0.3</td>
</tr>
</tbody>
</table>

**Source:** Adapted from: European Commission, “Fiscal Sustainability Report 2015,” January 2016

5. Particularities regarding fiscal sustainability. Case of non-euro states

Reaching the goal of ensuring a sustainable fiscal climate is considered an important target for each Member State of the European Union.

At the level of non-euro states, over time it has been reported a number of tax initiatives aiming at achieving this goal. Among these, there have been remarkable changes to the taxation of income. In most cases, the options to increase the benchmark recording of a progressive nature of taxation, or tax burden for those who obtained low-income social categories. Reforms and tax changes adopted in the non-euro states in 2012-2013 and 2013-2014 are summarized in Table 2.

Table 2. Changes in tax to the non-euro states

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal income tax</td>
<td>Increase BG</td>
<td>-</td>
<td>CZ, UK</td>
<td>Increase HR</td>
<td>CZ, HR, SE</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Decrease DK, HU, SE, UK</td>
<td>Decrease BG</td>
<td>BG, CZ, DK, SE, RO, SY, UK</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>Increase HU</td>
<td>Decrease DK, SE, UK</td>
<td>HR, HU, RO, SE, UK, CZ</td>
<td>Decrease DK, UK</td>
<td>HR, PL, SE</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Decrease HR</td>
<td>Increase HU</td>
<td>CZ</td>
<td>Decrease RO</td>
<td>HR, SE, UK</td>
<td></td>
</tr>
<tr>
<td>Social contributions</td>
<td>Increase CZ, HR</td>
<td>Decrease HR</td>
<td>PL</td>
<td>Increase PL</td>
<td>DK, HR, PL</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Decrease HR</td>
<td>Increase SE</td>
<td>RO</td>
<td>Decrease -</td>
<td>DK, RO</td>
<td></td>
</tr>
<tr>
<td>VAT</td>
<td>Increase CZ, UK</td>
<td>Decrease SE</td>
<td>RO</td>
<td>Increase RO</td>
<td>HR, UK</td>
<td></td>
</tr>
<tr>
<td>Property taxes</td>
<td>Increase CZ, UK</td>
<td>Decrease SE</td>
<td>RO</td>
<td>Increase RO</td>
<td>HR, UK</td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Adapted from: „Tax reforms in EU Member States”, 2013, 2014

During 2015-2016, efforts aimed at ensuring a sustainable fiscal environment were continued in most non-euro states. Thus, the main fiscal measures aimed:

- Taxation of personal income, and consisted of: increasing the personal income tax (by eliminating exemptions from tax on minimum wage) increase insurance contributions, broadening the tax base of the interest;
- The taxation of corporate income. It was observed trend of reduced corporate tax rate, and a number of changes made to the way of establishment of the tax base;
- The tax on property. In countries like Romania and Great Britain were introduced progressive rates of tax on residential properties and those used for carrying out economic activities;
- Value Added Tax. The new measures were geared towards the broadening of the VAT reduced rate of taxation or increase. Some states, including the Czech Republic, Denmark, Croatia, Hungary and Romania have opted to reduce the standard VAT rate and extending the scope of the tax.
Overview of the collection of budget revenues from taxes and social contributions, as a fraction of GDP, is highlighted in Figure 1.

*Figure 1. Revenue in non-euro budget in 2015*

![Figure 1](chart.png)

**Source:** Adaptation: European Commission, “Tax Reforms in EU Member States: 2015 Report”

Chart analysis reveals that the level of non-euro member Denmark recorded the increased degree of collection in terms of direct taxation, of 30.45% of GDP, the lowest in terms of social contributions (0.81% of GDP). In terms of indirect taxation, a significant percentage is held by Sweden. Collection degree being 22.17% of GDP, followed by Croatia with 18.67% of GDP. The structure of tax revenue for non-euro states analyzed, shows a higher level of collection of social security contributions 12.26% of GDP for Croatia.

As can be seen about significant share of tax revenues is lower in countries with similar economies such as Romania, Poland and Bulgaria where the collection thereof is below the Eurozone average (12.53% of GDP in direct taxes, 13.12% of GDP for indirect taxes and 14.23% of GDP for social contributions).

However, entry on a sustainable path, assume that the next time horizon, 2016-2017, most states to permanently improve the structural primary balance. In this context, the main challenges to fiscal sustainability lies in attenuating the risk mainly due to: increased spending on health and long-term care, due to aging (ECB, 2016) - the situation in Bulgaria, Czech Republic, Romania and Sweden; pursue a fiscal policy geared towards improving the efficiency of public spending and tax behavior in the case of Croatia.

Evolution structural primary balance of the non-euro, for the period 2013-2017, is outlined in Figure 2.

*Figure 2. Evolution of structural primary balance, in 2013-2017*

![Figure 2](chart.png)

**Source:** Adaptation: European Comission, „Report on Public Finances in EMU”, 2016
Following the decisions on fiscal and budgetary policy stance, dynamic primary balance presented in Figure 2 shows that in 2013-2017, its value ranged between a minimum of -2.7% of GDP (2014) in the UK and a maximum of 3.1% of GDP (2013), in Hungary. Primary balance values hovering in most Member non-euro EU-28 average over the entire period under review.

Applying a more relaxed fiscal policy in the period 2016-2017, led to an improvement in the structural primary balance in countries such as Poland, Romania and the United Kingdom; where this indicator has registered a declining trend up to -1.8% of GDP for Romania, -1.5% of GDP in Poland and 0.5% of GDP in the UK (estimated values for 2017).

At the end of 2016, the European Parliament identifies the progress made by Member States on structural budget balance. In particular, the structural budgetary commitments for the period 2016-2017, the non-euro states, are summarized in Table 3.

<table>
<thead>
<tr>
<th>Non-euro States</th>
<th>PSC component</th>
<th>Annual structural effort:</th>
<th>Annual structural budget projection</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Adjustment or under the preventive arm; Correcting the excessive deficit</td>
<td>2016</td>
</tr>
<tr>
<td>BG</td>
<td>preventive</td>
<td>0.5 pp</td>
<td>0.5 pp</td>
</tr>
<tr>
<td>CZ</td>
<td>preventive</td>
<td>Remain at MTO set at -1.0 sbp</td>
<td>-0.2 sbp</td>
</tr>
<tr>
<td>DK</td>
<td>preventive</td>
<td>Remain/attain MTO set at -0.5 sbp</td>
<td>0.25</td>
</tr>
<tr>
<td>HU</td>
<td>preventive</td>
<td>0.3 pp</td>
<td>0.6 pp</td>
</tr>
<tr>
<td>PL</td>
<td>preventive</td>
<td>0.5 pp</td>
<td>0.5 pp</td>
</tr>
<tr>
<td>RO</td>
<td>preventive</td>
<td>Limit deviation from MTO set at -1.0 sbp</td>
<td>0.5 pp</td>
</tr>
<tr>
<td>SE</td>
<td>preventive</td>
<td>Remain at MTO set at -1.0 sbp</td>
<td>-0.3 sbp</td>
</tr>
<tr>
<td>UK</td>
<td>corrective</td>
<td>0.5 pp (2015/2016)</td>
<td>1.1 pp (2016/2017)</td>
</tr>
<tr>
<td>HR</td>
<td>corrective</td>
<td>0.7 pp</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: Adaptation of: European Parliament, “Briefing: Structural budget balances in EU Member States”

According to European Commission meet the target in the medium term adjustment involves meeting the requirements set out in the Stability and Growth Pact. In order to correct the excessive deficit, the annual adjustment effort in the structural balance of 1.1 pp (from 2016-2017) returns to the United Kingdom. Similar measures being undertaken by Croatia in 2016, when it imposed an adjustment of 0.7 percentage points. In countries like the Czech Republic and Sweden, under the preventive arm, it was decided to maintain the medium-term objective setting a deficit of -1.0%. For three of the non-euro (BG, PL, RO), according to Commission calculations, adjusting the structural deficit is about 0.5 pp for 2017.

6. Conclusions

EU-28 level, including non-euro countries, the main challenge to fiscal sustainability is the change in economic circumstances. Thus, fiscal sustainability can be achieved through a combination of fiscal and budgetary policy, adaptive economic situation of each country.

From fiscal sustainability analysis conducted during this research the following conclusions:

- Maintaining a high level of primary balance budget in most non-euro states, which may lead to an excessive increase in long-term debt;
- In terms of expenditures of aging, significant differences can be determined; especially due to measures implemented in the national pension, healthcare and long-term care;
- Recording a decline in the share of revenues in GDP for the period 2016-2017 (Romania case, around 3.5 pp.), aspect that highlights the fact that tax policy was not intended as a preventive measure or correction term long.
In this context, I believe that ensuring a sustainable fiscal climate can be achieved by implementing a rigorous risk management, and not least by stepping up surveillance process initiated by the European Semester.

References