THE INFLUENCE OF THE ECONOMIC CRISIS ON THE STATE OF PUBLIC FINANCES IN THE COUNTRIES OF THE VISEGRAD GROUP

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Abstract: The paper analyzes the relation between the economic crisis, budget deficit, public debt and the fiscal policy. The current economic crisis occurred in the conditions of a high level of public debt in the majority of the developed countries, which on one hand makes it impossible to use expansive fiscal policy and, on the other hand threatens the solvency of some of the countries. In the first part of the paper a theoretical characteristics of the influence of the economic crisis on the condition of public finances is presented. In the second part the statistical analysis of the economic growth, budget deficit and public debt of the countries of the Visegrad Group was conducted. Statistical data confirm the thesis that the economic crisis caused the worsening of the condition of public finances in the countries that belong to the EU.

Keywords: economic growth, budget deficit, public debt, economic crisis, Visegrad Group.

1 Introduction

The condition of the public finances is, to a dominant degree, dependent on the condition of the business cycle. The recovery of the cycle is accompanied by the decrease of budget deficit or even achieving a budget surplus, while the economic crisis is the cause of complete opposite phenomena. The budget deficit can become deeper in the conditions of the economic crisis if the country takes expansive fiscal policy aimed at rejuvenation of the business cycle. The experiences of the current economic crisis indicate that such actions are possible only in the conditions of a relatively low level of debt of the country. Some of the developed countries, because of the excessive public debt are forced to conduct the restrictive fiscal policy which contributes to the deepening of the economic crisis. The objective of the paper is to check whether such situation also occurs in the countries of the Visegrad Group.

The thesis accepted for verification is the statement that the economic crisis caused the worsening of the state of public finances in the countries that belong to the European Union, while in case of the countries of the Visegrad Group this worsening was not as deep as to threaten them with insolvency.
In order to verify the thesis above the analysis of statistical data published by Eurostat was conducted, concerning the business cycle, public debt and budget deficit in the countries of the Visegrad Group in years 2002-2011.

2 Economic cycle and the condition of public finances

Business cycle fluctuations are an inseparable element of the market economy. From the long-term perspective the trend, around which the fluctuations of business cycle occur ,is rising as the stage of the high dynamics of growth is usually longer than the period of the decline of the level of economic activity. From the short-term perspective, business cycle fluctuations cause the destabilization of the economy, nervous reactions from the investors, significant fluctuations of the unemployment level and therefore, also the fluctuations of the level of living conditions for citizens, causing their dissatisfaction. Because of it, the country may try to restrict the fluctuations of the level of economic activity, deciding to use the stabilization policy (Barczyk *et al.*, 2006). The stabilization policy is based on two basic tools – fiscal and monetary policy (Nellis and Parker, 2006).

In the theory of economics it is still disputed whether and to what extent the country has to interfere in cases when the market mechanism fails as well as to what extent such interference is successful (Snowdon *et al*., 1998). Economic decision-makers, by deciding about the way of conducting economic policy, are choosing between the laissez-faire ideas (represented by the neoclassical approach in the theory of economics) and national interventionism or etatism (which is referred to by the neo-keynes approach). Those approaches in different ways describe the functioning of economy, in relation to which they estimate the effectiveness of the interventions of the government on real values in the economy in different ways. Neoclassical economists prefer stable, passive rules of conducting the economic policy (constant increase of the supply of money reflecting the long-term pace of economic growth and budget balance), as according to their opinions, the discretionary actions cause disturbances in the functioning of the market mechanism, making it difficult for the economy to return to the equilibrium. The neo-keynes economists on the other hand, prefer the active (discretionary) economic policy, adapted to the current economic situation, believing that relying on stable and passive rules of economic policy lengthens the period of economy functioning in the condition of less than full use of production capabilities as well as in the high level of involuntary unemployment (Wojtyna, 1998).

The opinions of those approaches concerning the use of budget deficit as a stabilizing function are also different. The neoclassical approach is in favor of the policy of budget equilibrium, assuming that it is impossible to stimulate the business cycle by using the active fiscal policy. Budget deficit brings a number of negative economic effects, such as: influencing the rate of inflation and the interest rate, causes the resources to be ‘pushed out’ of the private sector of the economy (which in the opinions of neoclassical economists is more effective than the public sector), causes the increase of public debt and the costs of servicing it, which in result leads to passing the burden of the debt to future generations (Fletcher, 1989). Conducting the policy of a permanent budget deficit may effect in the excessive debt of the country, threatening its solvency. If the financial markets believe that a given country may not be solvent it will be forced to conduct the restrictive fiscal policy regardless of the state of the business cycle.

For the neo-keynes approach, budget deficit is a tool of supplementing the global demand, influencing in a positive way the rise of the national income (Bougrine, 2004). The neo-keynes economists disagree with the aforementioned negative effects of budget deficit. In their opinion if budget deficit is financed from the issuance of governmental bonds, it does not influence the rise of inflation as the supply of money in the economy does not change. The weakening of the economic cycle stems from the enterprises refraining from investments, in such situation the governmental expenditures supplement but do not replace private expenditures (Owsiak, 2002). In similar fashion, the public sector does not compete with the private sector for loan funds (it does not increase the interest rate). The state loan funds which are not intended for the private sector either due to the lack of interest from its side (in the conditions of high risk relating to investments) or due to the restriction of the pool of means for credits for the private sector from the banking system (because of the loss in credit credibility). While it is true that budget deficit translates into the rise of the debt of the country, but if it results in the improvement of the business cycle, paying the debt back will not be a great burden for the economy.

The neo-keynes approach opposes the suggestion of the policy of budget equilibrium proposed by the neoclassical economists. The concepts of using budget deficit for stimulating the demand suggested by the neo-keynes economists are: the concept of systematic deficit (according to it the budget deficit can occur continuously as it is a beneficial phenomenon) and the concept of cyclic budgets (the peak of the business cycle should be used in order to achieve budget surplus which will be used to finance budget deficits generated in the period of economic downturn) (Krasowska-Walczak, 1996).

The changes in the level of the deficit may be the results of changes of the business cycle and/or changes in the approach of the fiscal policy. In the period of recession, the budget deficit grows (because of the restriction of the tax base and increase in the number of citizens needing social help from the state) and in the peak of the business cycle it falls. The changes of the level of budget deficit are only an indicator for the determination of the character of fiscal policy conducted by the state. When assessing this policy, apart from the level of budget deficit, the current state of the business cycle has to be taken into consideration.

3 Changes in levels of the economic growth in the countries of the Visegrad group in years 2002-2011

The current business cycle is the basic factor influencing both the state of public finances as well as the way in which the fiscal policy is conducted. In table 1 the data concerning the rise of GDP in the countries of Visegrad Group in years 2002-2011 is presented.

Table 1. Economic growth in the countries of the Visegrad Group in years 2002-2011

Years	Country				
	EU 27	Czech Republic	Poland	Slovakia	Hungary
2002	1.3	2.1	1.4	4.6	4.5
2003	1.5	3.8	3.9	4.8	3.9
2004	2.5	4.7	5.3	5.1	4.8
2005	2.1	6.8	3.6	6.7	4.0
2006	3.3	7.0	6.2	8.3	3.9
2007	3.2	5.7	6.8	10.5	0.1
2008	0.3	3.1	5.1	5.8	0.9
2009	-4.3	-4.7	1.6	-4.9	-6.8
2010	2.0	2.7	3.9	4.2	1.3
2011	1.5	1.7	4.3	3.3	1.6

Source: Eurostat, Economy and finance, National accounts, recovered on 10.08.2012

For the analyzed period, the lowest indicators of the economic growth occurred in year 2002 (and in year 2003 in case of Hungary) as well as in year 2009. By analyzing the pace of the economic growth for the entire examined period one can state that the countries of the Visegrad Group were developing faster than the average for the European Union. Therefore, there is successive bridging of the gap from the side of the analyzed in comparison to the European Union. Hungary is the weakest in this listing as in the period of 2007-2010 it noted the level of economic growth lower that the average for the European Union. The fastest developing country in the Visegrad Group is Slovakia, even despite recession faced in year 2009.

While considering the conditions of conducting the fiscal policy, the period of maintaining a high business cycle, allowing the improvement of the financial condition in the public sector is important. For all of the 27 European Union countries, as well as for three out of four Visegrad Group countries included in the listing, the lower turning points of the business cycle appeared in years 2002 and 2009. The interval between the neighboring low turning points was six or seven years, the last period of improvement of the business cycle was therefore very short. Economic decision-makers could expect further economic growth, based on the experiences from the previous business cycles, hoping for an eight to ten year period of business cycle improvement. It has to be added that in year 2002, which was the previous turning point of the business cycle, the economic growth for the 27 European Union countries amounted 1.3% and in case of the countries of the Visegrad Group it amounted from 1.4% to 4.6%. In the next lower turning point there was a deep recession on the level of 4.3% drop in the GDP (for the EU-27) and in the countries of the Visegrad Group (excluding Poland) exceeding the European Union average. Even if the economic decision maker expected the downturn of the business cycle, the scale of it was surprisingly high. In the worst situation among the analyzed countries was Hungary, which noted the economic growth of the level below 1% as early as from year 2007.

4 Changes in the level of budget deficit and public debt in the countries of the Visegrad group in years 2002-2011

Data concerning budget deficit in the countries of the Visegrad Group are presented in table 2.

Table 2. Budget deficit as the percentage of GDP in the countries of Visegrad Group in years 2002-2011

Years	Country				
	EU 27	Czech Republic	Poland	Slovakia	Hungary
2002	-2.6	-6.5	-5.0	-8.2	-9.0
2003	-3.2	-6.7	-6.2	-2.8	-7.3
2004	-2.9	-2.8	-5.4	-2.4	-6.5
2005	-2.5	-3.2	-4.1	-2.8	-7.9
2006	-1.5	-2.4	-3.6	-3.2	-9.5
2007	-0.9	-0.7	-1.9	-1.8	-5.1
2008	-2.4	-2.2	-3.7	-2.1	-3.7
2009	-6.9	-5.8	-7.4	-8.0	-4.5
2010	-6.5	-4.8	-7.9	-7.7	-4.3
2011	-4.5	-3.1	-5.1	-4.8	4.2

Source: Eurostat, Economy and finance, Government statistics, recovered on 10.08.2012

The data from table 2 confirms the theoretical assumption that the budget deficit diminishes in the period of the business cycle improvement while it grows in the period of the worse business cycle. This regularity occurs both in the entire economic grouping (EU-27) as well as in the analyzed countries of the Visegard Group. It has to be emphasized that up to the occurrence of the economic breakdown in the year 2009, the countries of the Visegard Group were characterized by budget deficit levels higher than the average for the European Union. In years 2002-2008 this was especially seen in case of Hungary. The only country in which budget deficit in the entire period exceeded the EU average is Poland.

The comparison of data from tables 1 and 2 allows us to answer the question what fiscal policy was conducted by the particular countries in the examined period. The only country in case of which the forming of budget deficit can indicate a deliberate fiscal policy is Hungary. In the period 2002-2006 Hungary was characterized by a very high level of budget deficit which may indicate the conducting of systematic deficit policy, characterized by the surplus of public expenditures over income even in the period of economic growth, in order to further stimulate the business cycle. Unfortunately, this policy did not lead to the sufficiently high level of economic growth that would allow the repaying of the high debt of the country. Hungary was forced to increase the restrictiveness of the fiscal policy which resulted in the stagnation of the economy even as early as in year 2007. The data characterizing Hungary indicate that, contrary to the assumptions of the neoclassic approach, the fiscal policy influences the forming the level of economic activity. Unfortunately, the restrictive fiscal policy is more effective in cooling the economy than the expansive fiscal policy is in accelerating it.

In the other countries of the Visegrad Group, the level of budget deficit in the analyzed period was more the result of spontaneous economic processes rather than deliberate fiscal policy. The level of budget deficit was the resultant of the business cycle rather than the instrument of stimulating or cooling the business cycle. The analyzed countries did not strive to balance the budget. While it is true that budget deficit in Slovakia was kept on low level, this country did not try to balance the budget (as it is advised by the neoclassical approach and the concept of cyclic budgets) even in year 2007 when the economic growth exceeded the level of 10%. In case of Czech Republic and Poland higher levels of budget deficit did occur in the period of weaker business cycle, lower levels on the other hand, in the peak of the economic business cycle. A relatively high level of budget deficit in Poland in years 2009-2010 has to be noted, as it exceeded the average for the European Union in the conditions when Poland as the only country of the European Union was not experiencing recession. Probably it is one of the basic factor (next to a significant weakening of the Polish zloty which caused the increase of export) supporting the maintaining of the economic growth. Taking into consideration the determination of the Polish government to lower budget deficit, it seems to be more of the effect of shifting the cuts in time rather than of a deliberate policy of creating high budget deficit in order to maintain the business cycle. Conducting the fiscal policy in a passive way (correcting it only to small extent in the periods of budget tensions), on one hand makes it possible to avoid potential errors related to the active policy, on the other hand deprives the decision makers of its potential successes. By conducting a more flexible fiscal policy than in case of cyclic fiscal policy, the state does not gather ‘supplies’ in the period of good economic cycle which restricts the possibilities of supporting the economy in the period of crisis.

The fact whether the state even can use the fiscal policy to be the tool of stimulating the economic cycle in the period of crisis depends on its existing debt. In the conditions of high public debt, investors on the financial markets expect significantly higher interest rates of debt securities. This can lead to spiraling debt. The state is perceived to be insolvent, is forced to introduce the restrictive fiscal policy which deepens the drop of the economic activity, automatically making the fiscal troubles worse. In table 3 the data concerning the level of public debt in relation to GDP in the countries of Visegrad Group in years 2002-2011 is presented.

Table 3. Public debt as a percentage of GDP in the countries of the Visegrad Group In years 2002-2011

Years	Country				
	EU 27	Czech Republic	Poland	Slovakia	Hungary
2002	60.4	27.1	42.2	43.4	55.9
2003	61.9	28.6	47.1	42.4	58.6
2004	62.3	28.9	45.7	41.5	59.5
2005	62.9	28.4	47.1	34.2	61.7
2006	61.6	28.3	47.7	30.5	65.9
2007	59.0	27.9	45.0	29.6	67.1
2008	62.5	28.7	47.1	27.9	73.0
2009	74.8	34.4	50.9	35.6	79.8
2010	80.0	38.1	54.8	41.1	81.4
2011	82.5	41.2	56.3	43.3	80.6

Source: Eurostat, Economy and finance, Government statistics, recovered on 10.08.2012

The data concerning public debt confirm the observations made on the occasion of the analysis of budget deficit. The condition of public finances is improving in the period of the business cycle upturn while it is becoming weaker in the period of economic downturn. When comparing the data concerning the entirety of the European Union and the countries of the Visegard Group, it has to be noted that in case of the latter the levels of public debt are noticeably lower than the average for the European Union. The only exception is Hungary, public debt of which in the years 2006-2010 exceeded the average level of the Union. It was probably the basic reason for the increase of the restrictiveness of the fiscal policy which led to the drop of the level of public debt in Hungary in the year 2011 to the level below the Union average. Unfortunately, the level of public debt in Hungary still exceeds 80% of GDP which forces the state to keep the restrictive fiscal policy.

In year 2011 the Czech Republic and Slovakia were in the best situation, as their public debt barely exceeded the level of 40% of GDP. With such level of debt the country has the possibility of loosening the fiscal policy (or reducing the fiscal restrictions) in order to stimulate the economy. Poland is in a bit worse situation, while the level of its debt is not on the level threatening its solvency which therefore leaves the potential possibility of easing the restrictions of the fiscal policy.

5 Summary

Statistical data concerning the forming of the pace of economic growth, the level of budget deficit and public debt in the countries of the Visegrad Group confirms the argument stated in the introduction. The condition of public finances changes according to the business cycle and the level of public debt in the countries belonging to the Visegrad Group is low enough so that it does present the danger of insolvency. The only country that could have been threatened by insolvency was Hungary which accepted the fiscal restrictions early enough (in year 2007). Unfortunately, the side effect of those was the economy facing stagnation, even before the global economic crisis. Still the debt of Hungary was so high that it was necessary to maintain the restrictive fiscal policy. The level of debt of the Czech Republic, Slovakia and also (to a lesser degree) Poland is low enough that these countries may decide to reduce the fiscal restrictions or even to conduct the expansive fiscal policy.

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