# The cyclical character and determinants of fiscal policy in old, new and prospective EU member states

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## Non-technical summary

This study examines the cyclical character and determinants of fiscal policy in European countries between 1995 and 2012. It contributes to the empirical literature on fiscal policy in several important aspects. First, it includes the old and new EU member states, as well prospective EU members from South-eastern Europe. Second, after the analysis of the cyclical stance of fiscal policy, it investigates the effects of a wide array of political and institutional factors, which enables a richer analysis of fiscal policy determinants. Third, the study uses an appropriate model specification and empirical method, thus avoiding some of the weaknesses in existing studies. Finally, it provides several robustness checks on the results, which both test their stability and explore additional aspects of fiscal policy.

Baseline results of the study indicate the following:

- There are considerable differences in the cyclical character and determinants of fiscal policy among old, new and prospective EU member states.
- In both groups of transition countries, overall fiscal policy is a-cyclical, but discretionary policy is pro-cyclical, which means that policymakers are exacerbating economic fluctuations.
- Discretionary policy in old EU member states is a-cyclical, while automatic stabilizers shift overall policy to a counter-cyclical stance.
- Discretionary policy is considerably more relaxed in election years.
- Old EU member states undertook significant fiscal adjustment before the euro introduction, but there is little evidence that the common currency in itself is imposing higher discipline.
- Policymakers in all country groups pay little attention to public debt, which is a worrying sign for debt sustainability.

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The analysis of the political and institutional factors confirms the robustness of baseline results, and also shows that determinants of fiscal policy differ among country groups. In particular:

- The number of checks in the system and presidential political systems worsen fiscal outcomes in both groups of transition countries.
- The strength of government is an important factor for successful fiscal adjustment in new EU member states.
- In old EU member states, plurality electoral systems and changes in the ideological composition of the cabinet to the left result in lower fiscal discipline.
- There is no evidence of less disciplined and more pro-cyclical fiscal policies in corrupt democracies, although democracy and corruption have separate positive effects on fiscal outcomes.
- Fiscal rules impose more disciplined policies in the EU member states, while particular types of fiscal governance have different effects in old and new member states.
- There is no difference in the cyclical stance of fiscal policy between the early transformational period and more 'normal' later years in transition countries.

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