

**MACROTHERORETICAL FOUNDATIONS OF FISCAL CONSOLIDATION**

*The article analyses the unexplored category of "fiscal consolidation". The study shows a different interpretation of the content of fiscal consolidation. It was emphasized that in today's fiscal policy in the EU aims mainly at implementing fiscal consolidation programs that provide sustainable public finances by implementing measures to limit the fiscal imbalances (especially deficit of governance and public debt). The paper analyses the fiscal consolidation program aimed at stabilizing of public finances and improve their sustainability. The research proved that fiscal rules and norms contribute to the process of fiscal consolidation.*

**Keywords:** *fiscal policy, fiscal rules, fiscal consolidation, budget balance, public debt, structural and cyclical changes sustainability of public finances.*

**1. INTRODUCTION**

The imperative of sustainability of public finances, fiscal consolidation appears as a set of measures to optimize budget spending, structural reforms, increasing the revenue not only through changes in the tax system, but with the use of measures to stimulate the economy and business [1]. These results were obtained by radical changes in fiscal regulation, implementation of new approaches to fiscal policy in the post-crisis period. Fiscal policy is primarily aimed at solving problems arising in the coordination of fiscal space. Mechanisms of fiscal policy (within the program of fiscal consolidation), to reduce public spending, are considered a more effective tool in comparison with measures reforming the tax system. Changes in government spending should not lead to containment of economic growth.

Also, the need for fiscal consolidation due to the fact that for any type of economic system the main purpose is to provide the public finances financial investments of needs that can not be met through the market mechanism. In order to limit public sector imbalances in most countries decided to enhance the rigidity of fiscal policy. It introduced a variety of approaches to achieve fiscal sustainability targets, which included: institutional reforms in the fiscal sector, the implementation of programs of fiscal consolidation, the introduction of new and old reform fiscal rules, the medium-term budget planning, improving transparency in fiscal, etc. [2]. However, in recent years, fiscal balances, even in developed countries with a deficit reduced, reaching its highest level in 2009. In these circumstances, many governments are forced to move to a policy of fiscal stimulus (macroeconomic tools of fiscal consolidation). The ultimate objective of fiscal consolidation is to ensure sustainability of public finance violations during the systemic crisis of the world economy 2008-2009.

**2. ANALYSIS OF RECENT RESEARCH AND PUBLICATIONS**

Retrospective shows that the formation of financial theory in the early twentieth century took place mainly in the form of crisis development concepts, launched on ideas A. Berle, T. Veblen, P. Krugman. In particular, the provisions regarding the effectiveness of stabilization measures in view of the experience of governments of countries with stable economies (US, UK, Austria), which in 1920-1930., were not yet ready to support the balance of national financial systems during the devastating waves of financial crises and had no effective tools needed to overcome stagnation and deflation. Therefore, recipes and ideas on macroeconomic regulation J. Keynes [3] and M. Friedman [4] for a while considered effective enough for further levelling to the financial instability. However, despite the number of studies of sufficient financial and economic crisis, and the government's attempt to avoid the mistakes of the Great

Depression, fiscal imbalances that emerged in national economies in the late twentieth century were almost the same as in 1930. At that time conventional macroeconomic measures proved ineffective, as the achievement of budget balance was needed to develop and implement measures of fiscal adjustment. Generally accepted methodology for evaluating fiscal consolidation does not exist. International institutions and specific countries use different methodologies on fiscal consolidation, but there is no "finished methodology" which we could attach to assess fiscal consolidation in Ukraine. We can assume that within certain theoretical ideas about the nature of public finance and macroeconomic stability tools of public finance, fiscal consolidation is self-sufficient problem. Such an approach aims to demonstrate the lack of institutional factors to effective fiscal consolidation and extension of anti-crisis mechanisms in the context of fiscal space increase revenues, optimize costs, reducing the debt burden on the public finance sector.

**The purpose** of the article – is a comprehensive study of the effect of macroeconomic methods and instruments for fiscal consolidation, the implementation of measures to ensure the sustainability of public finances in the systemic financial crisis.

**3. RESULTS**

Fiscal consolidation as a special type of macroeconomic policies aimed at maintaining budget balance that stabilizes budget deficits and public debt at some specified level [5]. It is the failure of most countries to maintain a high level of government spending from current tax revenue caused many focusing reputable foreign and domestic scientists and governments in many countries on the policy of fiscal consolidation. Theoretical understanding of fiscal consolidation in times of economic instability is associated mainly with new phenomena and processes in the global economy, their nonlinear dynamics at the end of the XX – XXI century, while institutional theory, in particular financial, fiscal, regulation has an earlier period of formation [6]. Currently, the scope of the category of "consolidation" is quite broad. This category has long crossed the fiscal framework of understanding, as a concept, is caused by the movement patterns of financial systems, and became general. In theoretical understanding of the terms "consolidation" and "treasury", "definition", "fiscal consolidation" is a "strengthening and consolidation of the budget" [7, p. 92].

Today in the economic literature presents different approaches to defining the essence of fiscal consolidation. For example, "Financial Times Lexicon reduces it to reduce the prevailing fiscal deficits. It is not intended to eliminate public debt [8]. In the context of the proposed definition it is emphasized that fiscal consolidation is carried out in the public system to reduce deficits and stopping the accumu-

lation of public debt. Ignoring the problem of public debt leads to an escalation of the fiscal sphere.

Thus, supporters of discretionary fiscal policy believe that fiscal consolidation is reduced to imbalance of the budget by the application of discretionary fiscal policy for a specified period or the period after which they are introduced. Balance of the budget means balance of financial operations of the general government [9].

According to J. Sachs, fiscal consolidation is to eliminate fiscal and quasi-fiscal deficit, which is the cause of high inflation. This consolidation always implies a sharp reduction in subsidies, and substantial reductions in government spending on investment with the transfer of the bulk of these expenditures from the budget to the enterprises themselves [10]. Some outstanding Western scholars such as S. Barrios, S. Langedijk and L. Pench interpret this question differently, according to which fiscal consolidation is reduced to improving the cyclically adjusted primary balance by at least 1.5% during one or for three years if a year balance does not deteriorate by more than 0.5% of GDP (gradual consolidation). Given this approach, the annual consolidation is seen as an episode, as each coming year of consolidation of many years is the episode of its implementation [11]. Hence a clear appeal to the fact that fiscal consolidation is related not only to overcoming the problem of protracted deficits, but also to budget deficits and public debt, and is the basis of most scientific approaches of the interpretation of the meaning of this definition.

So fiscal consolidation is designed to change the modeling sustainability of public finances. The directions of such fiscal constraints include shortage of general government with the aim of reducing deficits and improving the structure of public debt. It is in this sense, that the definition of fiscal consolidation R. Price is more fundamental. Target definition according to R. Price is "maintaining budgetary balance that budget deficits and stabilize public debt at some specified level" [12]. According to R. Price, the definition of consolidation means that in the economy there is a certain optimum level of public debt, which is necessary to reach otherwise a society will face unjustifiably costly welfare if a debt burden drops significantly. Given the current macroeconomic context, fiscal consolidation is not a momentary event but is a targeted permanent regime of a fiscal policy.

Highlighting the meaning of multidimensionality, R. Price's fiscal consolidation stresses that it is designed to minimize the risks of debt lingering budget deficits. According to the researcher: "At its broadest sense, and from the most normative point of view, fiscal consolidation may be defined as a political process aimed at achieving a sustainable fiscal balance, where sustainability means the issuing of debt to finance government expenditure only to the extent that it creates a future debt burden that does not interfere with the attainment of macro-economic objectives: excessive government borrowing can be inflationary, economically destabilising, allocationaly distorting and generationally arbitrary in its impact." [12].

Analysis of the expanded definition shows that fiscal consolidation is not only macroeconomic imperative, as it implies that the mechanism of balancing the budget in the medium term affects diverse political and economic interests of many stakeholders, can cause political risks that would cast doubt on the possibility of reducing the deficit and restoring sovereign solvency. Fiscal consolidation process as political economy assumes that its implementation requires the introduction of fiscal rules agreed for a period that is a direct consequence of the fact that, according to fundamental R. Price's definition it is not a momen-

tary event, but not a permanent regime of fiscal policy. It is no accident that fiscal consolidation is implemented as a program that includes changing budget deficits, implementation of target on initial balanced budget, structural reforms oriented to improve the sustainability of public finances as a prerequisite for the formation of efficient market structures, but also financial security reforms in all areas, including administrative reform, implementation of new macroeconomic tools to build an effective fiscal policy. A. Sokolovskaya noted that these instruments can be considered the optimization of public spending and effective use of budget funds, which operate on the public finances through its impact on investment and economic growth [2, p. 91].

It is important to note that the matrix budget balance and public debt clearly indicates that fiscal consolidation will be effective if the implementation of the program of fiscal consolidation will be aimed at improving the sustainability of public finances through instrumental use of targets on budget balance to minimize public deficits and reduce government debt [13].

To implement these programs and consolidate them administration of new rules, monitoring the process of institutionalization of fiscal policy has been proposed: expenditure policies, income generation and financing of the general government. For the Ukrainian economy optimization of institutional spending on economic growth and macroeconomic stability indicates the formation of a new quality of financial system modernization and the need for space, based on – the formation of an effective mechanism of fiscal consolidation. What is important according to S. Hasanov, Vladimir Kudryashov, G. Balakyn they in public expenditure embarked on optimization of volumes and rationalization of the structure and efficiency of spending public resources. Measures aimed at increasing the revenue of the general government are being introduced on conditions of preventing pressure on the development of business activities in a real sector. Revenue growth is achieved mainly by adjusting a tax system (introduction in some countries taxes on wealth and financial transactions, securities transactions, etc.), as well as improving efficiency of tax payment administration. Particular attention is paid to the legalization of the economy, improving credit conditions, improving real sector of state support of small and medium-sized businesses [14].

Reforming a tax system is considered complicated and risky, so commonly used in countries where the share of taxes in GDP is relatively low. However, amendments to the tax system is often a signal about efforts to stop structural reforms [15].

During the economic crisis of 2008-2009. Significant fluctuations in the rate of dynamics of the expenditures and revenues of the general government in Ukraine were observed. These trends persisted during the period after the crisis (Table 1).

Ukraine has failed (due to the aggravation of the situation in both economic and political spheres) to much reduce fiscal imbalances in recent years. So the question remains relevant that needs updating fiscal adjustment. EU experience in the development of programs of fiscal consolidation, determining mechanisms of its implementation, enhancing institutional reform (introduction of fiscal rules, rehabilitation of the financial sector, increasing transparency of fiscal operations, etc.), the management of public debt, changes in monetary policy to maintain economic growth is quite important for our country. Its relevance is increasing during the implementation of the Association Agreement "Ukraine – EU".

**Table 1. The dynamics of growth / decline in revenues and expenditures (including transactions of lending) of general government in Ukraine, % to previous year**

Index	2007	2008	2009	2010	2011	2012	2013	2013 to 2007
Income	29,47	35,70	-6,54	16,62	23,53	12,38	1,18	106,90
Expenditures	28,80	38,50	2,37	18,27	13,07	15,68	1,74	123,11
The difference between the growth in expenditures and revenues	-0,67	2,80	8,91	1,65	-10,46	3,30	0,56	16,21

Note: Compiled by the author's calculations based on: State Statistics Service of Ukraine. Special Data Dissemination Standard of the IMF. Economic and financial performance. Fiscal sector.

Source: <http://www.ukrstat.gov.ua>.

It is also necessary to consider that efforts to implement the program of accelerated fiscal consolidation may lead to increased negative impacts on the socio-economic development. Achieving fast results in fiscal sphere involves substantial public spending cuts or increased tax burden, which is often accompanied by a decline in economic growth. In case of implementation of measures of fiscal consolidation by reducing public expenditure social problems exacerbate and funding economic reform programs is restricted. A sharp decline in government borrowing and changes to their structure may change position on the financial markets [2, p. 13].

In the event of a significant reduction of economic growth during the implementation of programs of fiscal consolidation measures, countries with low measure, can usually stop the fiscal regulatory efforts with expectations of favourable forecasts of economic growth. According to the views of foreign researchers, fiscal adjustment needs to implement macroeconomic policies that take into account the priorities and rules of behaviour of world economic activity. Given the fiscal consolidation policy cycle should focus primarily on purpose structured or cyclic regulation [16].

A number of structural and cyclical changes in fiscal policy started in many countries, designed to change the very structural model of public finances and their institutional influence that goes beyond the mechanical balancing of the budget. The base vector take of implementation of structural and cyclical changes in the model of public finance concerns going exclusively beyond focus on fiscal rules. Controversial experience of their effectiveness as a limiter biasing deficit requires a comprehensive solution to the problem of motivation change in fiscal consolidation [17]. Despite the fact that the rules that include the cyclical component of the fiscal adjustment, continue to be perceived positively [18], we must admit that they themselves are not a guarantee of debt sustainability in the long term. As G. M. Milesi-Ferretti shows, [19], if the government is prone to "creative accounting", the introduction of fiscal rules can indeed be a compromise between the real fiscal adjustment and politicians attempt to "earn points" in the eyes of the electorate. Having flexible fiscal rules and norms and the combination of the objectives of stability of public finances, needs the flexibility to respond to financial and economic shocks, making them vulnerable to prolonged economic shocks and distort the symmetry of reactions on structural and cyclical changes in the mechanism of fiscal consolidation.

But for fiscal rules and regulations to become an effective regulator of the macroeconomic situation in the country, they should be supplemented by additional institutional structures, designed to influence the direction of fiscal policy coordination rather than signal a limitation. Thus, the institutional model of public finances should be based on multi-level and effective control of fiscal rules in the mechanism of fiscal consolidation. Fiscal rules are beginning to increasingly seen as an integral element of neutrali-

zation of possible negative consequences of the implementation of fiscal consolidation programs to strengthen control over the debt of the general government, as well as the general government budget balance.

In recent years, many countries have begun to adopt fiscal rules of the future generation and combine them with the objectives of fiscal sustainability with the needs of flexibility to adjust to the financial and economic shocks. Overall fiscal rules tied to the phases of the economic cycle, focus on stabilization targets of fiscal policy and at the same time are designed to ensure sustainability of public finances during the implementation of programs of fiscal consolidation in the long term [2, p. 36].

#### 4. CONCLUSIONS and DISCUSSION.

Conducting research makes it possible to formulate a number of conclusions.

In modern scientific literature the unity of views of the interpretation of the meaning of fiscal consolidation that demonstrates theoretical explication and summarizes etymological nuances of the concept has not been established.

The study confirmed that fiscal consolidation as a system of discretionary fiscal policy measures to improve the budget balance, structural and institutional reforms, requires continuous in-depth study, especially from the perspective of justification of the main public finances issues to be addressed during the period. It has been reasoned that fiscal consolidation program are aimed at stabilizing public finances and improving their sustainability.

Structural and cyclical changes in fiscal sphere and implementation of fiscal consolidation programs were accompanied by the extension of the fiscal rules, which should be an effective regulator of the macroeconomic situation in the country.

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**І. Лютий, д-р екон. наук, проф.,**

**Д. Осецька, асп.**

Київський національний університет імені Тараса Шевченка, Київ, Україна

### МАКРОТЕОРЕТИЧНІ ЗАСАДИ ФІСКАЛЬНОЇ КОНСОЛІДАЦІЇ

*У статті аналізується малодосліджена категорія "фіскальна консолідація". Наведено різні трактування змісту фіскальної консолідації. Наголошено, що в сучасних умовах фіскальна політика у країнах ЄС націлена переважно на реалізацію програм фіскальної консолідації, які передбачають забезпечення стійкого стану державних фінансів шляхом здійснення заходів із обмеження фіскальних дисбалансів (передусім дефіциту сектору управління та державного боргу). Проаналізовано програми фіскальної консолідації, спрямовані на забезпечення стабілізації розвитку державних фінансів та підвищення їх стійкості. Доведено, що фіскальні правила і норми сприяють процесу фіскальної консолідації.*

*Ключові слова: фіскальна політика, фіскальні правила, фіскальна консолідація, бюджетний баланс, державний борг, структурні та циклічні зміни, стійкість державних фінансів.*

**И. Лютий, д-р екон. наук, проф.,**

**Д. Осецкая, асп.**

Киевский национальный университет имени Тараса Шевченко, Киев, Украина

### МАКРОТЕОРЕТИЧЕСКИЕ ОСНОВЫ ФИСКАЛЬНОЙ КОНСОЛИДАЦИИ

*В статье анализируется малоизвестная категория "фискальная консолидация". Приведены различные трактовки содержания фискальной консолидации. Отмечено, что в современных условиях фискальная политика в странах ЕС нацелена преимущественно на реализацию программ фискальной консолидации, которые предусматривают обеспечение устойчивого состояния государственных финансов путем осуществления мероприятий по ограничению фискальных дисбалансов (прежде дефицита сектора управления и государственного долга). Проанализированы программы фискальной консолидации, направленные на обеспечение стабилизации развития государственных финансов и повышения их устойчивости. Доказано, что фискальные правила и нормы способствуют процессу фискальной консолидации.*

*Ключевые слова: фискальная политика, фискальные правила, фискальная консолидация, бюджетный баланс, государственный долг, структурные и циклические изменения, устойчивость государственных финансов.*

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