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Budget deficit and the achievement of fiscal equilibrium

– institutional approach

The study critically summarizes, assesses, and comments on the political institutional theories created by institutional economic theorists about the correlations between the appearance of budget deficit and political decision-making. There is a special section on whether political business cycles make the budget deficit fluctuate, and whether there is large enough force attached to general elections to explain fiscal expansion. Budgetary models and indices that evaluate fiscal efficiency from the point of view of the political institutional structure are examined. At the end, based on experience gathered, the best institutional structure to create fiscal equilibrium is outlined.

ADVANTAGES AND DISADVANTAGES DERIVING FROM THE NATIONAL INSTITUTIONAL STRUCTURE OF POWER WITH REGARD TO THE BUDGETARY REFORM

Fundamentally, budgetary decision-making is not based on economic rationales but on political lobbying. This makes it worthwhile to examine the fragmentation of the eco-political institutional system. Several studies have attempted to provide political and institutional explanations for the development, the permanence, as well as the elimination of budget deficits. In general, they assume a systematic connection between the outcome of the fiscal policy and a certain variable of the political institutional system. Studies examine three phases within the political institutional system:

1. the governmental phase,
2. the parliamentary phase, and
3. the executive phase.

The so-called theory of partisan macroeconomic strategy (Hibbs 1977, Borelli and Royed 1995, Hahm et al. 1996, Schmidt 1996, Wagschal 1998, Clark and Hallenberg 2000) seeks to find the budgetary effects of the party composition of the government. For example, according to *Hibbs* (1977), "left-wing" governments have stronger ties to employees, and, consequently, are willing to spend more on social-political and egalitarian expenses. At the same time, they are more inclined to raise taxes to this end. On the other hand, "right-wing" or "conservative" governments endeavour to reduce the size of the state and to lower taxation.

Alesina (1987), Alesina and *Perotti* (1995), Clark and *Hallenberg* (2000), and *Demertzis et* al. (2004) claim that right-wing governments are not prone to easing up, left-wing/liberal[1] governments are more successful at consolidation, while centrist – or more typically, grand coalition – governments have the least discipline and tend to succeed at fiscal equilibrium only to a slight extent. Coalition governments are more inclined to expansion than single-party ones, and that inclination increases in direct proportion to the number of coalition parties. (Roubini and Sachs 1989) Theoretically speaking, the parliament is able to impose strict control over minority governments, so, presumably, such governments are disciplined. Unfortunately though, this discipline manifests itself in addressing the needs of parliamentary parties, and not in executing budget consolidation and reform.

In fact, the related empirical studies drawing comparisons between different countries (de Haan and Sturm 1994, Hahm et al. 1996, Alesina et al. 1998, 215–16, Borelli and Royed 1995, Wagschal 1998), with the exception of *Roubini* and *Sachs* (1989), have failed to conclusively establish a direct connection between the ideological disposition of the government and budget deficit. According to *Tabellini* and Alesina (1990), although conservative and left-wing/liberal governments have different preferences concerning the size of the state, fiscal equilibrium, the composition of expenses, and the distribution of tax burdens, they both undertake fiscal expansion in order to be re-elected, and only differ in their "deficit strategies". *Persson* and *Svensson* (1989)'s model suggests that conservative governments are ready to undertake deficit financing to avoid defeat, which leads to an increased state debt and heavier budgetary interest burdens, while they reduce future consumption. To avoid defeat, left-wing/liberal governments tend to accumulate a budget surplus, relying on which they can decrease national debt and consequently budgetary interest expenditures as well. Based on that, they can boost future public expenditures.

On the other hand, it has been confirmed several times that governmental structure and the institutional process of creating the annual budget can considerably influence the extent of fiscal expansion and deficit. Based on different government structures, two approaches are applied to find out the outcome of an expected fiscal policy. (von Hagen et al. 2002, pp. 96–97) The so-called delegation approach can be applied to one-party governments, where solely hierarchical relations exist between government members. In such cases, there is a chance to establish a strong prime ministerial, and what is even more important from the point of view of fiscal discipline: a strong finance ministerial position. This means that it is the finance minister who determines the agenda of budgetary negotiations *(agenda-setting power)*, has the right to propose restrictions concerning the main budgetary categories, is in control of all information on public funds, which presumes significant controlling capacity, and has the power to adjust as well as to veto the spending ministries' divergence from the budget plan. However, this type of one-party governance is mostly conceivable in a system of two-party alternating governance, which, based on pluralist or majoritarian representation, is primarily the result of such election systems as the ones that we find in the United Kingdom, the United States or France.

The systems based on so-called proportional representation mostly result in multi-party legislation, and consequently, most probably, in forced coalitions. In such cases, the process of the creation and the execution of the budget can be best described by using the contract approach. This is because forecasting the expected budgetary outcome of multi-party coalition governance is to be based on the coalition contract. This contract evolves from the equal, horizontal relation of the parties through negotiations, and it includes the budgetary objectives. Under such circumstances, it is almost impossible to establish a highly restrictive finance ministerial position in control over the other ministries because that would cause the coalition parties – apart from the one delegating the finance minister – to consider their equal position to be jeopardized. They would be afraid that the finance minister might take advantage of his/her influence at their expense. Also, it is difficult to dispose of over-spending ministers because such a step requires bargaining within the coalition. Based on these factors, Alesina and Perotti (1999) believe that coalition governments "produced" by systems of proportional representation are likely to be inclined to delay undertaking fiscal adjustment, and thus national debt is accumulated more quickly than in the case of one-party governments' being in power. This is because, according to *Von Hagen* and *Harden* (1996), systems of proportional representation result in a political environment in which several parties have parliamentary representation and all these parties have strong inner discipline, but their being compelled to form a coalition weakens governmental discipline.

It needs to be mentioned that in the course of his analysis, *Baldini* (2000) opted for dealing with one- or two-party coalitions and multi-party coalitions separately when analyzing the system of proportional representation due to the numerous differences that had been detected between these two groups.

In Alesina and Perotti (1998)'s "power-sharing" approach, the composition of the government does not affect the extent of its influence over the execution of fiscal restrictions. However, the growing circle of those involved in decision-making tends to result in an increased insecurity about the final formulation of the fiscal policy. Shared power means weaker fiscal discipline and slower fiscal adaptability, especially in the case of a coalition government made up of a high number of ministries. Perotti and *Kontopoulos* (2002) more specifically believe that the most important characteristics are the following: which coalition party's members are the hesitant voters in the parliament, what the extent of the coalitional majority over the opposition is, and how consistent the actions of non-governing parties are. If the coalition is over-fragmented, or the vote of the opposition does count, a situation in which several political blocks fight for the influence over revenues tends to arise. If one relinquishes any sort of financial resources, another coalition partner will carve a larger chunk for itself, thus self-restraint at party level is not a rational decision. This is termed "non-cooperative free rider decision-making" by *Hughes-Hallett et* al. (2003).

Although all this may raise the issue of the reform of institutional decision-making, basic democratic frameworks and the bases of national electoral and representational systems need to be treated as extern factors, or external conditions, the assessment of which is not the task of the studies cited above. Based on either theoretical or practical considerations, it is not necessarily worth superimposing the objectives of fiscal discipline and equilibrium onto these systems. Thus, it makes more sense to rely on institutional experience in order to make it possible to reach fiscal equilibrium within the type of institutional system of either the delegation or the contract approach, through structural reforms.

National parliaments also have a part in the process of the creation and the supervision of national budgets. However, in a system of proportional representation, the role of the parliament is restricted by inner party discipline, which makes the parliamentary phase less important. In practice, legislation is a weak player with a small stake in the process despite the fact that several European country studies have thoroughly analyzed the role of the parliament in the course of examining the budgetary process. (See Blöndal 2001, Blöndal et al. 2002, Blöndal and Kristensen 2002, Blöndal and Ruffner 2004, Kraan 2005, von Hagen and Harden 1996, Poterba and von Hagen 1999, Baldini 2000.) Fundamentally, it is the government that determines the budgetary timetable. The parliament has one severe sanction against the government, namely the rejection of the budget, which means the downfall of the government everywhere in Europe. However, there exists a deterrent operating against applying this tool, i.e. the so-called *guillotine effect.* Causing the downfall of the government, members of parliament (of the governing parties) risk their own downfall and stake their own influence, should an extraordinary election be called, or should a new coalition excluding their parties be formed.

Some of the studies emphasize the consequences of political, or more narrowly, governmental instability. The basic assumption is that a relatively short-lived government is unable to tackle the problem of the lack of fiscal equilibrium successfully in the long run because it needs to plan for a significantly shorter term together with its hoped-for re-election than a stable government that can confidently count on a long mandate. (de Haan and Sturm 1994, Freitag and Sciarini 2001) The approach presuming longer-lived governments' inclination for a smaller deficit has been verified by Baldini (2000) *inter alia,* linking this topic to the idea that the actual length of the mandate of a government is largely determined by governmental structure. Baldini has established three country groups within the OECD:

❶ systems based on proportional representation with multi-party coalitions,

❷ systems based on proportional representation with one- or two-party coalitions,

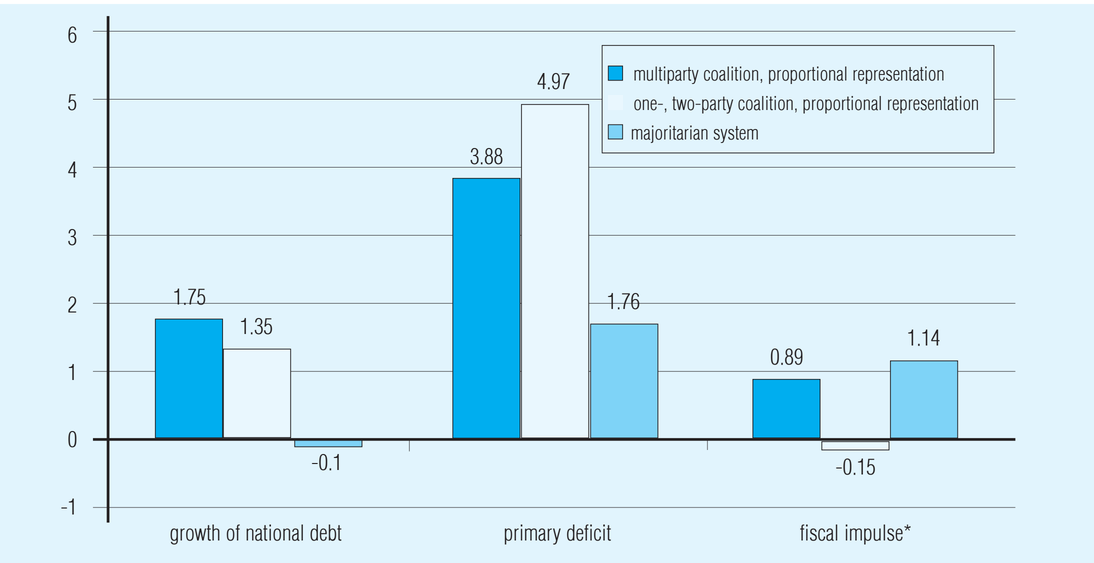
❸ "majoritarian" systems with two-party alternating governance.

Focusing on the governments between 1945 and 1992, he sought an answer to the following question: to what extent governmental structure influenced the length of a government's actual term and its fiscal performance. Group (1) includes Belgium, Finland, Italy, the Netherlands and the fourth French Republic between 1945 and 1958, but the last one had

Figure 1

AVERAGE FISCAL PERFORMANCE OF DIFFERENT GOVERNMENTAL TYPES

[based on Baldini (2000), GDP-proportionately, percent]



Source: Baldini (2000) p. 27, Table 2

* fiscal impulse = primary deficit adjusted to unemployment – primary deficit of the previous year. The indicator of fiscal impulse was created by Alesina and Perotti (1995) in order to filter out the endogenous cyclical component from governmental budget, thus arriving at the discretional component.

better be excluded from the sample as an extreme case. Group (2) includes Austria, Denmark, Germany, Ireland, Norway and Sweden, while Group (3) has Australia, Canada, Japan, New Zealand, the United Kingdom and post-1958 France. The analysis indicates that in the case of multi-party coalitions, an average of 3 governments were in power within one legislative term, while in the case of the other two groups approximately 1.5. As far as the length of the actual mandate of the government is concerned, those in Group (1) were able to stay in power for as few as 16 months on average, which is a mere two-thirds of the average of 24 months spent in power by the other two governmental types.

Based on Baldini (2000)'s results concerning fiscal performance *(see Figure 1)*, majoritarian representational systems appear to be able to perform the most stably concerning fiscal equilibrium.

In the executive phase of the budget, the basic question is to what extent the executive branch of power can deviate from the budget act and the draft budget. The finance minister's supervisory and observing roles have a strong impact on compliance with the original budget, while his/her veto right is crucial for the execution of public consumption. It is a question to what extent the surplus needs of certain ministries can be managed through the flexible, inter-ministerial reallocation of resources, staying within the original budget figures. A government's ability to have a supplementary budget passed easily and its inclination to use this tool may severely undermine the discipline of the execution of the budget, not to mention the credibility of the government's fiscal policy.

The credibility and the discipline of a fiscal policy would also be enhanced by ensuring the transparency of the budgetary process. However, politicians have no interest in that transparency. They prefer keeping voters under a budgetary illusion by hiding obligations and costs, while overemphasizing benefits. They try to make them overestimate the "free" public services, which they are entitled to in return for the taxes that they have paid, while trying to make them underestimate the costs of these public goods. Alesina and Perotti (1999) mention the following tricks:

- Governments overstate economic growth, so they overestimate the volume of tax revenues and underestimate anticyclical expenditures. When facing the results that have fallen short of such expectations, they simply refer to bad luck and/or claim that unexpected events have occurred.
- Overestimating the effects of budgetary measures with the "obligatory" optimism of those in power may cause them to delay the execution of fiscal adjustment. For instance, having overestimated the weight of some insignificant tax revenue, they do not cut expenditures to the necessary extent, or do not raise taxes significantly.
- They place assets, funds, and investments outside budget so that they do not appear in the budgetary accounts.
- They inflate past benchmark figures serving as a basis for budgetary planning.
- In the case of budget lines expanding over several years, they keep postponing serious consolidation or reform measures to the second and third year by revising the budget line each year.

According to Alesina and *Cukierman* (1990), the less voters know and understand concerning the budgetary process, the more opportunities political decision-makers have to make strategic steps and to use the tools of deficit and overspending for their own benefit. If voters are less well-informed, there is a better chance to have a looser fiscal policy, which induces the phenomenon of alarming budget deficits before election years and quickening state debt growth, followed by political business cycles. (Rogoff and Sibert 1988)

POLITICAL BUSINESS CYCLES WITHIN THE OPERATION OF THE DEMOCRATIC INSTITUTIONAL SYSTEM

Verifying the existence of political business cycles is a special subject of interest within fiscal equilibrium and the political institutional background. Analyses centering on this area focus on the extent of the loosening of fiscal discipline in the years of political elections or the ones preceding it. Even though not every examination has succeeded in verifying the existence of political business cycles (de Haan and Sturm 1994, Alesina and Perotti 1995, Andrikopoulos et al. 2004,), *Buti* and *van den Noord* (2003), and von Hagen (2003) have demonstrated a significant impact of election cycles within the EU-15 country group in the period between 1998 and 2002, and so have *Tujula and Wolswijk* (2004) concerning the OECD countries in the period between 1970 and 2002, according to which findings the average fiscal impulse was significantly higher in years preceding elections than in other years. These results have been confirmed by *Mink* and *de Haan* (2006), who have also demonstrated that the Stability and Growth Pact increased the budgetary discipline in the countries that have already joined the euro-zone compared to the EU member states that have not introduced the euro yet in pre-election years. When the theory of political business cycles first appeared, *Nordhaus* (1975, cited by Mink and de Haan 2006) presumed that voters evaluated governments and reached their decisions in retrospect, which was why governments increased the benefits provided for the majority of voters before elections and boosted the economy through fiscal expansion – in order to be re-elected. However, others think that due to informational asymmetry, voters do not have knowledge of politicians' real abilities or competence, and are only aware of what politicians show of themselves, i.e. the measures of a momentary, observable fiscal policy. (Rogoff and Sibert 1988, Shi and Svensson 2004) For this reason, before elections, a fiscal policy that is beneficial for the majority of voters increases the chances of the government in power to be re-elected. This, in turn, according to Mink and de Haan (2006), makes fiscal expansion a "cheaper" solution than restrictions for political decision-makers. Through all this, however, ethical risk becomes a part of the system. This is because politicians need to appear (more) competent, so they make so-called hidden efforts to keep up appearances. (Persson and Tabellini 2000, Shi and Svensson 2002) For instance, governments cover the costs of the enhancement of the standards of public services from short-term loans. These are only made public after the elections, in the next quarterly report on the national debt, or in the report on the annual budget deficit, which is bound to have grown due to the increasing interest burden. (Mink and de Haan 2006) Instances of such behavior can be detected within the OECD country group, regardless of countries or parties (see Shi and Svensson 2004). Scrutinizing on the period between 1960 and 1998, Persson and Tabellini (2002) have pinpointed significant pre-election year tax cuts in 60 countries operating in a democratic system.

Alesina et al. (1998) find politicians too sensitive to political business cycles despite the fact that, according to their account, the political "cost" of strict discipline is often low, and voters usually keep successfully consolidating governments in power. Though it is true that voters occasionally vote for the promise to increase expenditures relating to their own interests or constituencies, and for this reason, politically speaking, consolidation does not appear to pay off; Hughes-Hallett et al. (2003) add that political success also depends on several other factors.

Alesina and Perotti (1995) claim that economic circumstances also influence the reactions of the decision-makers of a fiscal policy, who are far more likely to reach for the tools of budgetary loosening during recessions. This will, in turn, lead to the almost certain failure of an economic policy.

Still, two reasons make it worthwhile to treat the theory of partisan macroeconomic strategy with reservations. Firstly, according to Hughes-Hallett et al. (2003), it is questionable whether the political behavior determined by voters' long-term rationality and politicians' need of a good reputation has in fact any validity. Secondly, according to *Brender* and *Drazen* (2005), this kind of political cyclicity concerning budgeting is typical of the less advanced "new democracies", and it is impossible to demonstrate a significant impact of election years on the budget by an analysis excluding them and only focusing on the most developed OECD countries. *Alt* and *Lassen* (2006) claim that the reason for this is that budgetary transparency is ensured in the most developed democracies, while less transparent institutional systems in less developed countries generate political business cycles. To disperse the doubts raised by skeptics, according to Hughes-Hallett et al. (2003), it would be necessary to compare election and pre-election years and it would be worth examining the latter, seeking to find expansional follies.

TO WHAT EXTENT ARE THE FINDINGS OF INSTITUTIONAL ECONOMICS VALID IN THE COUNTRIES OF CENTRAL-EASTERN EUROPE?

All the empirical analyses mentioned so far have restricted themselves to examining the most developed OECD countries. It is a question how far this experience is valid in the case of the Eastern EU member states, with their own particular economic and social circumstances and development paths.[2] What justifies the generalization of the theory of institutional economics is that very similar political institutional systems operate in the new and old EU member states. Still, can the same thing be implemented in the same manner in two different countries? In one parliamentary democracy, political parties are able to reach a consensus about important issues, grass-roots organizations are organized bottom-up and efficiently pressurize the political elite, and corruption can be eliminated – mostly through voluntary, civic self-restraint, while in other national systems the same things fail to work. In respect of such differences, it can be presumed that it is not inside the institutional system of parliamentary democracy that a paradox has appeared, but certain factors outside the system bring out the differences between the countries.

The existence of this outside factor was to be – and failed to be – demonstrated by *Druckman* and *Roberts* (2005) in one institutional segment of parliamentary democracy, namely the coalitional bargaining process. The democratic institutional patterns of Western European countries were adopted in Eastern Europe fifteen years ago, which has provided an excellent opportunity to compare groups of countries of different characteristics concerning historical development and crucial economic problems, which, however, have identical political systems. The pivotal question of their research has been whether the same institutions generate the same final results in the new and the developed democracies, or all this is influenced by the historical, cultural and economic differences. The researchers empirically compared the final results of Eastern and Western coalition negotiations with regard to allocating influences. The fundamental question concerning the connection analyzed was to what extent the parties negotiating the coalition were able to assert the proportion of the parliamentary seats that they had gained during the process of portfolio allocation in each country.[3] Provided that the same correlation was found in each region, it would be impossible to maintain that the institutional system was distorted by such outside impacts as the lack of parliamentary experience, or the communist heritage and the difficulties arising from the transformation of the economy in Eastern Europe.

Following the economic and political transitions of Eastern European countries, time series relating to countries which have fundamentally different characteristics in view of factors outside the institutional system have become available. According to the assumption of Druckman and Roberts (2005), firstly, Western European countries have had decades or even centuries of experience relating to the operation of the institutions of parliamentary democracy, whereas in the case of Eastern Europe, the single-party systems controlled through orders from above have left deep marks on the political elite's way of thinking. Thus those in the latter group are less inclined to negotiate and compromise, and believe more in the game called "the winner takes it all". Secondly, Eastern countries needed to undertake profound economic transformations simultaneously with the adaptation of the democratic political system, which forced the parties forming governments to involve as great power in governing as possible. Thirdly, the authors claim that due to the communist heritage, communist successor parties in Eastern Europe are treated in a particular way by the other political parties, who, in certain cases, even refuse to consider forming coalitions with them. Thus successor parties are more often forced to accept governmental influence that is unfavorable, if compared to the proportion of their parliamentary seats, than other political parties.[4]

The authors differentiate between advanced and less advanced countries within the Eastern European group, which is justifiable so far that in the countries that have more stable economies there is a slighter chance of a political crisis, and, consequently, of an interim reshuffling of the balance of power in the parliament. The study has shed light on the fact that the east-west differentiation is not justifiable as all the differences between the group variables have stayed under significance level. It is far more justifiable to separate advanced and less advanced countries. However, this only confirms the trivial statement that it is necessary for the countries that joined the development process later to have a certain apprenticeship period before the new political institutional system can be operated with due efficiency.

Regarding the east-west differentiation, correlational data show that there is a slightly stronger relation between the proportion of parliamentary seats and parties' shares in portfolio allocation in Western European countries than in Eastern countries, which manifests itself in the following manner: Western government-forming parties have had to make larger allowances than their Eastern counterparts, but in both regions it is typically the government-forming parties that have made allowances. However, if we further divide the Eastern country group into advanced and less advanced countries based on their EU membership, we do not experience significant differences between advanced Eastern and Western countries. In other words, the differences detected while comparing east and west exist owing to the less advanced Eastern countries. In the less advanced countries there is a far weaker correlation (0.71) between parliamentary seats and the allocation of portfolios than in the advanced Eastern (1.03) or the Western countries (1.04). And while government-forming parties in the latter two country groups are typically forced to under-represent themselves regarding the number of portfolios, the above weak correlation induces the significant over-representation of government-forming parties in the less advanced countries.

Thus, fundamentally, maturity for integration also reflects a kind of maturity relating to political institutions. Therefore, it can be presumed that the statements about fiscal discipline in respect of the budget process and the structure of the political institutional system that have been made in this chapter are also valid when examining the Eastern member states.

MODELING AND MEASURING INSTITUTIONAL CHARACTERISTICS

According to Von Hagen et al. (2002), the lower the degree of the centralization of the budget and the taxation system, the higher the extent of the budget deficit and the national debt is. Von Hagen and Harden (1996, pp. 7–11) examined how the demand for governmental expenditure rose if there were a growing number of interest groups in a decision-making position concerning the extent of the consumption of public goods when revenues were being spent. In the model, each task is assigned an expenditure target (xi^*) and the fund available is allocated to the different tasks (xi). The government aims to maximize the following preference function:

$$V = -\Sigma^{n}_{i} = 1[\alpha/2\ (x_i - x_i^*)] - m_i/2\ {}^*TB^2 \qquad (1)$$

where

TB is tax burden,

$m \pm 1$, the tax burden falling on the supporters of the government,

and n is the number of the ministers of spending ministries in a decision-making position.

Interpreting the maximizing of the function, we see that the first part of the expression means that the gap between actual and planned expenditures needs to be minimized, while the second part means that the tax burden needs to be kept low.

Carrying out the reduction $xi^* = x^*$, we find that the optimum expenditure level is:

$$B_c = \alpha n x^* / (\alpha + nm) \qquad (2)$$

Each of the n ministers only considers their own fields in order to minimize the difference between planned and actual expenditures, which, according to von Hagen and Harden (1996), places expenditures in a new dimension. It is because the volume of funds assigned to the ministries is a matter of influence and prestige for the ministers, and, in the case of a coalition, for the parties behind them; which is the reason why they endeavor to boost that volume. Moreover, they only tend to take the tax burden that concerns the voters of their own fields into consideration. (For this reason, it would be better for ministries not to function as fund-allocating and asset-managing organizations, but as program planners and coordinators.) It is worthwhile to write a preference function for each minister:

$$Ui = \gamma xi - \alpha/2(xi - xi^*) - mi/2\ {}^*TB2 \qquad (3)$$

where

i indicates the given minister, and xi the minister's individual benefit derived from having obtained a large budget for their ministry, $\gamma > 0$.

At the same time, γxi represents the common pool problem (concerning the allocation of public goods) in the model, namely, that a budget is determined by several people through a group decision-making process.

Applying Von Hagen and Harden (1996)'s further reduction, if $mi = m/n$, aggregate expenditure is:

$$B_d = [n(\alpha x^* + \gamma] / [\alpha + m]\ , ami > B_c \qquad (4)$$

Thus a decentralized budgetary process results in divergence from planned expenditures for two reasons: firstly, due to the advancement of individual interests, and secondly, because of the allocational problem of public goods. However, the increased expenditure of a given ministry manifests itself as a cost externality for the whole economy, because the tax burden of the extra expenditure is borne by each taxpaying economic player, even if only indirectly, through later credit repayment and interest payment. However, decision-makers of decentralized budgets do not recognize this externality as it derives from the above deduction, so expenditures will exceed the optimum level. Mathematically speaking, this also derives from the fact that B_d (the output function assuming group decision-making) will always be higher than B_c (the function considering the government to be one decision-maker), presuming that there always exists an individual interest within the group to initiate overspending ($\gamma \geq 0$), since B_d takes into account the demand for extra expenditures caused by individual motivations.

To dissolve this problem, i.e. to "soothe" excessive deficit and overspending, von Hagen and Harden (1996) recommend that elements that strengthen the advancement of collective interests be included in the budget process. Such an element may be the joint agreement of the ministers of the spending ministries on the allocation of public goods, or the position of strong strategic influence of one member of the government, i.e. the finance minister.

Ministers' negotiations and agreements merely decrease the source of overspending and excessive deficit (see B_n), while, on the basis of the above-described contract

Table 1

THE CONTENT OF THE CENTRALIZATION INDICES

Basic indicators	Content of basic indicators
(1) governmental phase	• existence and extent of general limitations • the finance minister's power to determine the negotiation timetable in the course of budgetary negotiations • quality of budgetary norms of bilateral budgetary negotiations between the finance minister and the minister of each spending ministry • participation in conflict resolution
(2) parliamentary phase	• existence of limitations of parliament's adjustment opportunities • necessary adjustment proposals in order to be able to counter-balance • political weight of rejecting adjustment proposals or the budget appropriation bill • comprehensive vote on budget • comprehensive vote on expenditures
(3) flexibility of executive phase	• can the finance minister prevent expenditures? • existence of financial safety valves (cash limit) • extent of re-allocation among budgetary chapters • opportunity to make changes during execution • part of funds carried forward to the following year
(4) information content of documents in draft budget	• exclusion of special funds • whether one or several documents are submitted (is it possible to vote by budgetary chapters?) • transparency (less transparent means weaker parliamentary control) • connectedness to national accounts • exclusion of governmental credits and credit guarantees

Source: von Hagen and Harden (1996, p. 23, Table 6) approach, the strong position of the finance minister (see B_a and B_v) means that it is completely up to him/her to decide what proposals on expenditures are put on the agenda of government meetings (agenda-setting), or that he/she can veto any expenditure operation ordered by the ministers of spending ministries.

$$B_n = n(\alpha x^* + \gamma) \,/\, (nm+\alpha) \quad (5)$$

$$B_a = n[\alpha x^* + (1-\delta)\gamma] \,/\, (nm+\alpha) \quad (6)$$

$$B_v = n[\alpha x^* + (1-\delta)\gamma] \,/\, [\alpha + m(n-(1-\delta)(n-1))] \quad (7)$$

where

δ is the finance minister's bargaining power against the influence of the spending ministries (1-δ). The stronger the finance minister's word, i.e. the higher the value of δ is, the more disciplined the preparation and execution of the budget are.

To measure the extent of centralization, von Hagen and Harden (1996, pp. 23–25) have drawn up two centralization indices:

$$S = \tfrac{1}{4}\, \Sigma^{4}_{j=1} I_j, \quad (8)$$

$$M = (\Pi^{4}_{j=1} I_j)^{1/4}. \quad (9)$$

The two indices combine four basic indicators concerning the creation and execution of the budget *(see Table 1):*

(1) the decision-making structure of the governmental phase,

(2) the decision-making structure of the parliamentary phase,

(3) the flexibility of the execution of the budget,

(4) the information content of the draft budget.

If the prime minister and the finance minister have strong positions at governmental negotiations, if the parliament has limited opportunities to adjust the budget, if transparency is high, if execution is inflexible, i.e. there are strictly limited opportunities to diverge from planned expenditures, and if the finance minister has a strong veto right against the spending ministries, the two indices will have high values, which indicates strong budgetary discipline.

Based on the significant regression calculations that have been carried out, the 4 basic variables explain 60 percent of the budget deficit in the case of both indices, 40 percent of the extent of the national debt according to *S* and 29 percent of the same according to *M*.

The above descriptions may already have made it clear that it is the government that has the biggest say in the process of the creation and execution of the budget. Thus it is also worthwhile to examine the impact of governmental structure on the budgetary outcome. Supplementing the previous model, relating to governmental weakness, *Kontopoulos* and Perotti (1999) examined the impact of two characteristics of fragmentation, i.e. the number of parties in the coalition *(NPC)* and the number of spending ministries *(NSM)*, on different budgetary variables $(b_t - b_{t-1})$. The above factors influence the extent of the change of both the deficit and the total expenditure or total revenue.

$$\begin{aligned} b_t - b_{t-1} &= \alpha_0 + \alpha_1 NPC_t + \alpha_2 NSM_t + \\ &+ \alpha_3 NPC_t {*} DY_t + \alpha_4 NSM_t {*} DY_t + \\ &+ \alpha_5 DY_t + \alpha_6 DU_t + \alpha_7 INFL_t + \varepsilon t \end{aligned} \quad (10)$$

where

DY_t is the growth rate of the GDP, DU_t is the change of the unemployment rate, and $INFL_t$ is the change of the price level. The reason for including these is that the macroeconomic environment impacts on expenditures and limits political decision-makers' possibilities. $NPC_t{*}DY_t$ and $NSM_t{*}DY_t$ are interactions between institutional and macroeconomic variables.

Based on Kontopoulos and Perotti (1999)'s empirical analysis, *NSM* fundamentally determines deficit, while *NPC* is a significant determinant both on the expenditure and the revenue sides, while, concerning deficit, the two impacts neutralize each other. The impact of both variables is more significant and more important in recession years than in periods of dynamic economic growth. *NPC*, i.e. the number of parties in the coalition is mostly the result of the election system – see majoritarian vs. proportional representation -, to be regarded as an external condition, through which it would indeed seem difficult to influence fiscal discipline. By contrast, determining and changing *NSM*, i.e. the number of ministries, is within the competency of the government practically in all OECD countries.

SURMOUNTING THE OBSTACLE OF LACKING POLITICAL CONSENSUS

Fundamentally, Von Hagen et al. (2002) blame coordination failure for the lack of fiscal discipline within the budget process. On the one hand, it is necessary to decrease departmentalization, i.e. the huge number of those involved in the decision-making process, and fragmentation, i.e. breaking up the budget process into too many phases. On the other hand, it is necessary to present the actual marginal costs and marginal utilities within the centralized budget process, as political decision-makers tend to overestimate the profitability of governmental expenditures under the spell of the above-mentioned budgetary illusions.

Each EU member state prepares a convergence program, which is the basis of reference in the course of excessive deficit procedures at Union level. The convergence program itself assigns certain budget input (for instance, inflation) and output (for example, budget deficit) figures for several years ahead as objectives to be achieved. Although the convergence program is not binding in itself, it may become a strong enough tool to make the fiscal policy of a government "more transparent, traceable and accountable" for both the society within a country and the partner countries. (Benczes 2004: p. 55) For this reason, identically to annual budgets, the convergence program could be enacted as a kind of multi-year budget. By analogy with this, even the National Development Plan may gain legislative effect – possibly if voted for by a qualified majority.

Apart from legislative solutions, organizational changes are also necessary. At a theoretical level, *Csillag* and *Mihályi* (2006) have made similar recommendations, and since the 1990's, we have seen functioning examples of *Fiscal* and/or *Financial (High) Councils* established, which have the right to control budget deficit. Also, this right ought to be expanded to ensure compliance with the convergence program figures or even to oversee the execution of structural reforms. Similar solutions are applied under the name of High-Council of Finance in Belgium, and Fiscal and Financial Policy Council in Spain. (von Hagen et al. 2002, p. 106)

For this solution, it is essential to establish an organization of true decision-making competency, and not an ersatz group of consultants. During debates on this topic, it has been brought up that provided this organization consisted of experts who were independent of the government and parties, it would practically have the same influence over state redistribution as the parliament, which latter organization is backed by the widest legitimacy at present. Considering the Belgian example, we can see that each member of the Council is delegated by a democratic institution. The essence of international integration is exactly this: provided a (national) institution hands over its decision-making powers to another (international) body on a voluntary basis, legitimacy and sovereignty will not be injured. Incidentally, it is expedient that the finance minister as the person responsible for the implementation of the budget act be the Chairperson of the Council. However, there is one aspect that is to be taken into consideration in any event: conflicts of economic/political interests may not be imported into this Council, as it should have but these objectives: to achieve fiscal equilibrium and/or to implement the convergence program.

However, the final obstacle, i.e. political players' lack of ability to compromise has still not disappeared. In other words, it seems necessary for political decision-makers to feel an outside impact, strictly in compliance with the principles of parliamentary democracy, to make them interested in taking the above-mentioned steps. If it had ample resources, even a civil foundation could launch a campaign to raise public awareness of the problem and to make the above proposals relating to the solution of the problem widely accepted, even demanded. This would enhance politicians' popularity provided that they passed the necessary acts and executed the structural reforms. Also, leading business people who do not depend on parties could try to persuade all the parties that are potentially able to govern to accept a social/economic declaration created by them, containing basic principles and strategic directions, which political decision-makers should pledge not to diverge from in the event of being elected to form a government. Naturally, a potential danger lies in good faith and political rationality not always overlapping.

Alesina and Perotti (1999) list three theoretical solutions to implement budgetary transparency, one of which seems especially viable. Transparency could be ensured through legislative procedures, but that might lead to a never-ending regulatory process. It would be possible to establish an independent transparency corps, but in a multi-party system the credibility of its independence could soon become questionable. National courts of audit may have sufficient credibility to undertake such a task in any EU member state, though. Still, it is the third solution that seems to be the most credible, namely commissioning a non-state run institute to assess the accuracy and transparency of the budgetary process, as though in the framework of an audit, commissioned through public procurement.

At a governmental level, it is worthwhile to make the position of the prime minister and possibly that of the finance minister strategically decisive. It is worth making budgetary decisions in the course of bilateral negotiations between the finance minister and the heads of spending ministries. The ministers of the spending ministries are not to be allowed ample time to draw up their plans prior to the bilateral negotiations in order to deprive them from the opportunity to negotiate with each other (von Hagen and Harden 1996, p. 8), and thus to prevent them from making “cartel-like” informal agreements recognizing each other's expenditure demands.

In the experience of Von Hagen and Harden (1996), since the 1970's, the restriction of budgetary expenditures and the curbing of the deficit have been successfully implemented in the countries where finance ministers have strategic dominance. For instance, France, where, constitutionally, the prime minister's bargaining position is strong within the government, is such a country, and so is Great Britain, where due to historical conventions and seniority, the finance minister has a strong position. Restricting expenditure objectives in itself has only been successful in small European countries. In the European countries where finance has no special status, achieving fiscal equilibrium has always caused a serious problem (Ireland, Belgium, Greece, Portugal, Italy and Luxemburg).

Notes

[1] "Left-wing" when scrutinizing on European governments, "liberal" when examining American governments -the two words mean the same here, only the social/cultural contexts show slight differences.

[2] The next few paragraphs, entitled "Whether the Institutional Operation of Democracy is History-Dependent", were published by the author of this study in the November 2005 *issue of DEMOS Policy Observer, pp. 15–17*

[3] Concerning coalition negotiations, the examination started off based on three theories on coalitional behavior. According to the observation of Gamson's law (Druckman and Roberts 2005), which has been empirically verified, coalitional parties do not expect to receive as high a number of government portfolios or as big a share of the related resources as the number of parliamentary seats they contribute to the parliamentary majority of the government would suggest. There exist two contrary theoretical assumptions to answer the question to whose expense parties diverge from the model of "proportional payoff". In the game created by Baron and Ferejohn (1989), the party forming the government claims its own predominance (disproportionate to the number of its MP's) when submitting its allocation proposal. In Morelli (1999)'s model the negotiating parties do not submit allocation proposals but demand their shares in the order of their parliamentary weights, and provided that there is a parliamentary majority established before demands exceed the total payoff possibility, e.g. the number of ministries, a coalition can be formed. However, in this case, it is presumably the largest party, i.e. the one entitled to form a government, that is compelled to give allowances to the smaller parties, thus letting them delegate themselves in the government with a weight larger than their representational proportion because the latter parties are more important in order to gain a governmental majority in the parliament. This latter prevalence of Gamson's law can be more typically detected in all European parliamentary democracies.

[4] It is the manner of establishing the group-forming characteristics itself that first exposes the error that fundamentally questions the model: forced generalization. Among other things, it does not take into account the different development paths of the communist successor parties. Certain successor parties have shifted in a nationalist-communist, radical direction, which has made it difficult to deem them acceptable or involve them in coalition-forming. Others have changed along the social democratic lines, which enables centrist or liberal parties to regard them as acceptable coalition partners. Moreover, irrespective of their development, in certain cases successor parties themselves have gained the position of a government-forming power. Also, it is mostly disregarded that in the Baltic states the successor parties are primarily perceived as the embodiments of Soviet-Russian occupation, thus their wide-scale social acceptance may be problematic in the long term. Finally, what is meant by successor party in Slovenia, which, in view of communist heritage, practically stayed in Serbia-Montenegro?

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