Credit Day: The Return of Fiscal Prudence

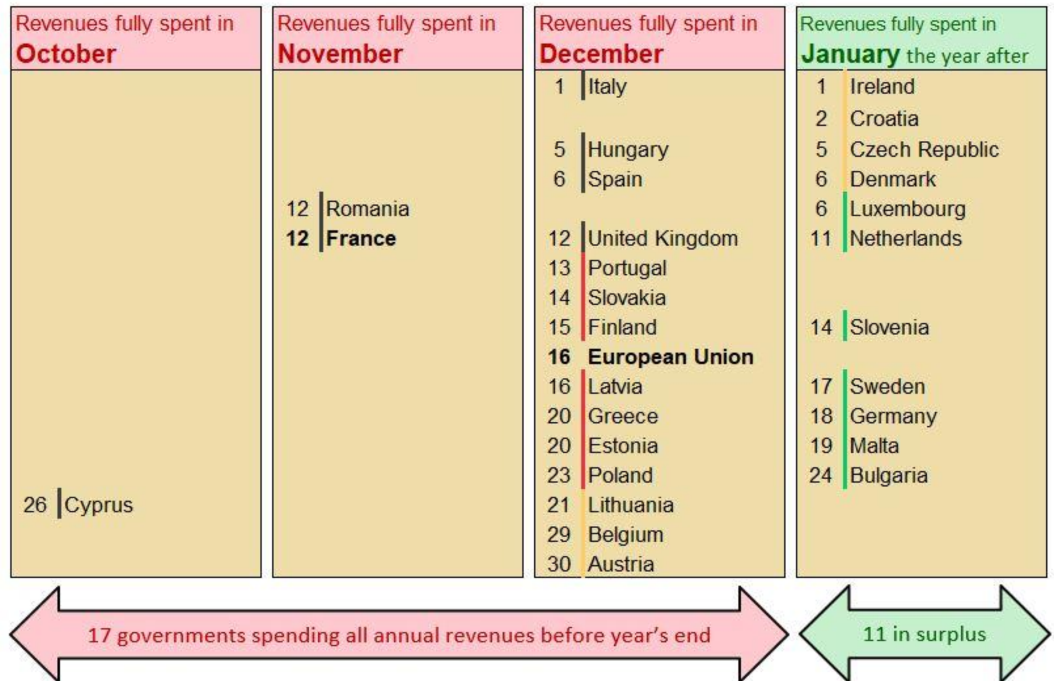
Alex Zhang, EPICENTER

16th December marks Credit Day across Europe. This is the day that, on average, EU Member State governments have exhausted their annual tax income and start to spend borrowed money. This year, EU Credit Day will come 4 days later than last year, and 10 days later than in 2017, a significant improvement.

Eleven Member States have managed to achieve a surplus this year with Ireland, Luxembourg, Slovenia, and Bulgaria joining the group. Cyprus has dramatically changed its Credit Day from January 9th the following year to October 26th. Despite outliers like Cyprus, Romania, and France we see an overall improvement on budget control as 25 of the 28 member states have delayed their Credit Day to December or January next year.

A Helpful and Intuitive Approach for Understanding Budgets

Credit Day was created by the Institut économique Molinari to help the general public achieve a better understanding of the national budget of each EU Member State. Instead of using GDP as a reference to government spending and revenue, Credit Day highlights the day in a fiscal year on which the national government has fully spent their tax revenue and become dependent on borrowed money.



This approach brings scrutiny to fiscal policy without referring to the trillion-level GDP number which is difficult to relate to. Credit Day also measures the surplus or deficit level of a country adjusted to its spending level rather than in isolation.

The General Trend and Margins

Despite the general trend of moving towards surpluses and decreasing deficits, the polarization of Member States' budget status remains a problem. While more countries achieved a budget surplus, we also found countries with surprisingly early credit days like Cyprus (26th October), who performed much better in the previous year (9th January the following year).

Another feature worth noting is that while Germany has consistently run a budget surplus and has one of the latest Credit Days, other major European economies such as the UK, France, Italy, and Spain all have Credit Days before the New Year. In other words, they all had deficits and needed to rely on borrowed money for at least half a month. Among them, France has the earliest Credit Day on 12th November.

Because National Governments inherit the budget from the previous year, it will be particularly interesting to analyse the change of Credit Day as a measurement of national fiscal policy. With Greece and Romania as the medians, which held the same Credit Day and delayed it by 1 day respectively, we see a polarisation of Credit Day movement within the Member States. Poland and Portugal delayed their Credit Days by 43 and 28 days respectively. Cyprus finished spending its tax revenue more than two months earlier than the previous year.

What Happened?

Poland

Poland witnessed a positive surprise with strong economic growth in 2017, and the growth is expected to be sustainable. This good performance resulted in an increase in VAT returns, generating more tax revenue for the government. The Polish government has made policy commitments to support innovation and social benefits in order to reduce unemployment and poverty, while having strict enforcement of VAT collection.

Portugal

Despite the EU's austerity measures, Portugal's borrowing has significantly decreased since 2012, as it is the only centre-left government in the EU that achieves a positive economic growth under such pressure. By decreasing taxes and investing in health, education and welfare, the government lifted economic growth and made it easier to balance the budget. However, macroeconomic factors such as the low oil price, a tourism boom and a global economic recovery have also been favourable to the Portuguese.

United Kingdom, France, and Italy

Unlike Germany, the other three economic powerhouses in the EU, remain on the list of countries with a deficit. Additionally, these three Member States have not seen significant changes of their Credit Days for the past few years.

For the UK, the general aim is to achieve only a 2% deficit by the year 2020-21 and a balanced budget in the next decade. With unemployment of 4% in 2018, the UK is estimated to have achieved or be close to its productive potential already. Theoretically this should result in a budget surplus or balance. The remaining budget deficit implies there is a significant gap between government spending and tax revenues.

Benchmarked with its EU commitments on long-term sustainability, the French Government's fiscal policy is still behind schedule. Despite public declarations, Government spending on items such as public servants' salaries and national defence increased significantly. The number of public-sector workers has also grown again, making it harder to achieve a structural budget balance. Public spending is extraordinarily high, although the Macron administration intend to cut public spending and respect its 2017 commitments.

The new Italian Government has made a huge impact on changing the economic and fiscal policy goals. They have planned for a higher deficit with new increases in spending of social welfare and pensions. A Tax reduction effort is also being made, in order to fight poverty and stimulate the economy. At the same time, the unemployment rate dropped, although many analysts suspect this is a short-term effect.

Spain, Denmark, and Sweden

Although relatively smaller in size, these three economies have performed well in terms of maintaining balanced budgets. Sweden and Denmark maintained a surplus in 2018 and the Spanish government has managed to delay Credit Day by 11 days. This means the Spanish government only relies on borrowed money for 25 days.

Accompanied by steady growth in investment and exports, strong private consumption has boosted the Spanish economy in the past few years. Although austerity has been relaxed, the new social-democratic government planned to reform tax policy by increasing tax related to financial services and banking and imposing a higher level of income tax. However, household income is still below the pre-crisis level and the unemployment rate remains unstable.

With its “flexicurity” model which boosts labour-market mobility, the Danish government has managed to reduce its unemployment rate back to the pre-crisis level. This has been accompanied by a positive macroeconomic environment of steady and sustainable growth. High income tax and value-added taxes with moderate financial regulation has secured the government's balanced budget.

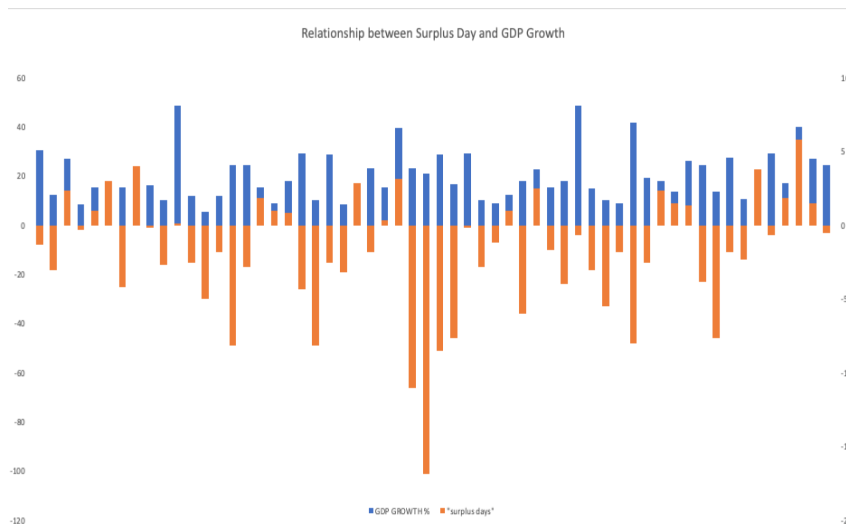
Sweden, as another North European welfare state, has succeeded in integrating high immigration into the labour market and investing in R&D. The economic boom supported the Swedish Government to consistently rank as one of the countries with the latest Credit Day.

Does a Surplus indicate a Good Fiscal Policy?

Quantitative Analysis[1]

Does an early Credit Day guarantee significant GDP growth? By examining EU Member State data from 2017 and 2018, we attempted to discover if there is a correlation between the number of surplus days and their GDP growth rate.

Results



By using a correlation test, we found that there is a negligible correlation coefficient 0f 0.057, and a high p-value of 0.669, suggesting that there is no statistical significance. The following graph shows how the national GDP growth and the number of days of surplus relate to each other. As can be seen from the graph, there is little to suggest that the two variables are following a similar trend.

As a result, we simply cannot confidently state that a surplus results in stronger growth.

Qualitatively

In principle, a budget surplus does not necessarily indicate a "good" fiscal policy. If a government is trying to achieve a budget surplus before a certain period, it may impose policies such as cutting spending and increasing tax. Although these measures do not necessarily discourage growth, it is possible that the economy may not be strong enough compared to the deflationary measures.

Conclusion

Overall, we found that many EU28 governments are slowly moving towards achieving a surplus. Although a late Credit Day does not necessarily mean a healthy economy, in the post-crisis EU we see a significant difference in efforts to maintain a balanced budget. Additionally, the cases of Cyprus, Romania, and France also show how fragile Member States' budget balances can be.

Reference:

Key Points from the Budget 2018 at a Glance, *The Guardian:*
https://www.theguardian.com/uk-news/2018/oct/29/key-points-from-budget-2018-at-a-glance

SGI Spain Index, *SGI:*
https://www.sgi-network.org/2019/Spain

Policy Paper 2018, *HM Treasury:*
https://www.gov.uk/government/publications/budget-2018-documents/budget-2018

World Bank Data, *The World Bank:*
https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=LT

---

[1] **Methodology**

We first compiled the data of each Member State's GDP growth rate and their number of "surplus days", which is the date difference between their Credit Day and the end of the year. For example, if a country has Credit Day of 5th January next year, its number of "surplus days" is 5. If a country has a Credit Day of 23 December, its number of "surplus days" is -8. We use this number as a measurement of the magnitude of any surplus.

To increase our sample size, we used the data from both 2018 and 2017. We also treated countries in different years as different observations, meaning that we have 56 data points.

We then tested to see if there is a strong correlation between the number of surplus days and GDP growth. The correlation coefficient is an indicator ranging from -1 (strongly negatively related) to 1 (strongly positively related). The p-value is another indicator ranging from 0 to 1 suggesting how confident we are about our findings. Typically, a p-value of under 0.05 is strong enough to suggest there is a significant relationship between the two variables.

SGI France Index, *SGI:*
https://www.sgi-network.org/2018/France/Economic_Policies

SGI Italy Index, *SGI:*
https://www.sgi-network.org/2019/Italy

Portugal posts lowest budget deficit in 45 years of democracy, *Financial Times:*
https://www.ft.com/content/0037f404-4fea-11e9-9c76-bf4a0ce37d49

Portugal: a European path out of austerity? *Financial Times:*
https://www.ft.com/content/66fccb1a-515c-11e9-b401-8d9ef1626294

Poland Economic Snapshot, *OECD:*
http://www.oecd.org/economy/poland-economic-snapshot/

Poland Lawmakers Adopt 2018 budget, *Business Insider:*
https://www.businessinsider.com/ap-polands-lawmakers-adopt-2018-budget-2018-1?r=US&IR=T

SGI Poland Index, *SGI:*
https://www.sgi-network.org/2018/Poland/Economic_Policies