



## The Benefits of Long-term Fiscal Projections

**What is fiscal sustainability?**

**What are long-term fiscal projections?**

**Which OECD member countries produce long-term fiscal projections?**

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### Introduction

Fiscal sustainability is a multi-dimensional concept that incorporates an assessment of solvency, stable economic growth, stable taxes, and intergenerational fairness. It has not only financial implications but also social and political ones related to both present and future generations. The current economic crisis has weakened the fiscal health of many countries around the world. Most of these countries are also facing long-term challenges that could threaten their fiscal futures, especially when these challenges are combined with financing the stimulus packages that were developed to spark an economic recovery.

In facing these challenges and trying to become better prepared for their fiscal futures, OECD member countries have experimented with several institutional budget reforms, including introducing fiscal rules, especially spending rules; using performance information to encourage better value for money and entitlement spending reforms; and, more recently, preparing long-term fiscal projections.

This *Policy Brief* examines the need for long-term fiscal projections, presents the results of a related survey of OECD member countries, outlines how to assess their effectiveness, and offers suggestions on how to develop long-term fiscal projections so that they can help governments respond to possible future financial pressures. ■

### What is fiscal sustainability?

Fiscal sustainability implies four main characteristics:

- solvency, or governments' ability to finance existing and probable future liabilities/obligations;
- growth, or the capacity of government to sustain economic growth over an extended period;
- fairness, or governments' ability to provide net financial benefits to future generations that are not less than the net benefits provided to current generations; and
- stable taxes, or the capacity of governments to finance future obligations without increasing the tax burden.

While the level of government debt and whether it rises or falls are important indicators of fiscal stability in the medium term, they are not sufficient measures of fiscal sustainability. In the long term, fiscal pressures and risks are mostly based on demographic change, global climate change, and contingent government liabilities. Governments need indicators, like long-term fiscal projections, that will help them get a handle on these risks.

**Demographic change** includes changes in fertility, longevity, and the age structure of the population. These changes affect government spending through mandatory age-related outlays, such as public pensions, health spending and care for the aged, and government revenues, such as when the tax base shrinks as the old-age dependency ratio increases. Given the fact that populations across OECD member countries are ageing, and that transfers to and spending on older people are rising, the old-age dependency ratio is an important factor in assessing a country's fiscal future.

**Climate change** may require new public spending and investment to adapt to extreme weather and low probability/high impact climatic events, many of which are likely to be national in scope. Fiscal risks may be related to public insurance schemes. The uncertainty and irreversibility of climate change require balancing the need for precautionary spending against the risk of undertaking costly expenditures that may eventually prove unnecessary.

**Government contingent liabilities** are potential obligations whose budgetary impact is dependent on uncertain future events. These obligations are hard to estimate because future events are hard to predict and because the amount associated with the obligation cannot be reliably forecast. Government contingent liabilities, including guarantees on government loans, investments and insurance schemes, bailouts of the banking sector, state-owned enterprises, and sub-national governments, uncertain public-private partnerships, and natural disasters, have in the past provided some of the largest fiscal risks for industrialised countries. ■

### What are long-term fiscal projections?

Fiscal projections provide a means to assess fiscal sustainability based on assumptions of current policies, stable taxes, and other key demographic and micro- and macroeconomic parameters. Fiscal projections offer invaluable signposts to help current governments to respond to known fiscal pressures and risks in a gradual manner, earlier rather than later, and help future governments avoid being forced to adopt sudden policy changes. In doing so, they can also help future governments to position themselves better to manage unforeseen or less predictable fiscal pressures.

The OECD Best Practices for Budget Transparency (2002) recommend that fiscal projections should cover between 10 and 40 years and be prepared or updated at least every five years or when major changes are made in revenue and expenditure programmes. In addition, all key assumptions underlying the long-term fiscal projections should be made explicit, together with a range of plausible scenarios. Governments should publish periodic reports on long-term public finances, and the focus of these projections should be on more than just demographic changes.

Confusion can arise when differentiating among fiscal projections, medium-term budget frameworks, and actuarial projections of specific budgetary funds. Medium-term budget frameworks support fiscal stability. They indicate the likely resources in subsequent budget years to enable managers to plan and allocate budget resources efficiently to achieve the government's objectives. Insofar as they look at debt, medium-term budget frameworks focus on short-term vulnerability to macroeconomic changes.

Fiscal projections differ from actuarial long-term projections of the sustainability of specific budgetary funds, such as public pensions and social security funds. Fiscal projections should include all public revenues and expenditures to support fiscal stability and efficient allocation of resources. While actuarial projections serve as an important practice in many countries, general tax revenues may be necessary to cover shortfalls. Fiscal projections may build upon the work of projections of specific budget funds, as in the case of the United States, where the independent long-term projections of Social Security, Medicare and Medicaid are used to develop long-term fiscal projections by the Office of Management and Budget, the Congressional Budget Office and the Government Accountability Office.

While projections are one way of promoting fiscal sustainability, they are projections and not predictions. Nor do fiscal projections automatically restore or strengthen the government's fiscal position. Projections should complement – and themselves be complemented by – the government's short-term fiscal position and structural content of fiscal policies. Effective communication and the linkage of projections to decision-making practices and procedures and subsequent political action are important to manage the short-term political incentives shaping government spending. ■

### Which OECD member countries produce long-term fiscal projections?

Over the last decade, fiscal projections have become increasingly common within OECD member countries. In the mid-1990s, projections were published in only a handful of countries, namely New Zealand, Norway, the United Kingdom and the United States; in 2009, 27 member countries published them. The time horizon of projections varies among countries, from 25 years in Korea to approximately 100 years in the Netherlands, though for most it is 41-50 years. Over half of all OECD member countries prepare fiscal projections on an annual basis, five countries prepare them on a regular periodic basis (every three to five years), and four prepare them on an *ad hoc* basis.

Many European Union countries annually report fiscal projections as part of their stability or convergence programme reports, as required by the EU Stability and Growth Pact. European Commission guidelines establish a minimum reporting requirement, a template, and a deadline for reporting. Reports include projected budget aggregates in a standardised table along with additional information to determine whether the reporting country's public finances are sustainable. While

**How can the effectiveness of long-term fiscal projections be assessed?**

EU member countries may publish fiscal projections solely for the Commission’s reporting requirements, some also do so for domestic procedures. ■

Although a growing number of countries publish fiscal projections, cross-country analysis is limited and there has been no assessment of the effectiveness of fiscal projections to date. Fiscal projections have both analytical and institutional dimensions. The analytical dimensions include:

- What types of fiscal indicators are used, and are these compared against previous projections?
- Is sensitivity analysis (or are alternate scenarios) of the projection presented to reflect different underlying assumptions?
- Do projections highlight the long-term fiscal costs of past and possible future policy change?

Explicit disclosures of the methods, assumptions, and other supporting information help to assure the quality of projections. These may include the modelling approach, key assumptions, and sources of data used in the projections, and a discussion of any changes that may have arisen since the previous projection.

**Table 1.**  
**OVERVIEW OF REPORTS IN THE 12 OECD MEMBER COUNTRIES SURVEYED (2009)<sup>1</sup>**

	Formal reporting obligations	Most recent report title	Responsibility for preparation and release	First/most recent release	Level of analysis/ reporting entity	Most recent time horizon	Frequency produced
Australia	Charter of Budget Honesty 1998	Intergenerational Report 2	Department of the Treasury	2002/2007	Central government	40 years	At least every three years <sup>2</sup>
Canada	n.a.	Staff working papers	Department of Finance	2000/2002	General government	40 years	<i>Ad hoc</i>
Denmark	EU Stability and Growth Pact	Convergence Programme Report	Ministry of Finance	1997/2008	General government	Until 2070 (fixed) <sup>3</sup>	Annually
Germany	EU Stability and Growth Pact	Report on the Sustainability of Public Finance	Federal Ministry of Finance	2005/2008	General government	Until 2050 (fixed) <sup>3</sup>	At least every four years
Korea	n.a.	Vision 2030	Joint Task Force Team <sup>4</sup>	2006/2006	Central government	25 years	<i>Ad hoc</i> basis
Netherlands	EU Stability and Growth Pact	Aging and the Sustainability of Dutch Public Finances	Central Planning Bureau	2000/2006	General government	Until 2100 <sup>5</sup>	<i>Ad hoc</i> basis
New Zealand	Public Finance Act (1989, as amended) <sup>6</sup>	New Zealand’s Long-term Fiscal Position	New Zealand Treasury	1993/2006 <sup>7</sup>	Central government	40 years	At least every four years

Notes:

1. Data are current as of May 2009.
2. Australia: In December 2008, the government announced that it would produce the intergenerational report once every three years. Previously, the requirement was that an intergenerational report be produced at least once every five years.
3. Denmark, Germany, Sweden and United Kingdom: Fiscal projections also prepared for an infinite time period.
4. Korea: Joint Task Force Team consisting of government officials and other experts. Government officials were mainly from the Ministry of Finance and Economy, the Ministry of Planning and Budget, and the Ministry of Health and Welfare. Other experts were involved from the Korea Development Institute and the Korea Institute of Public Finance.
5. The Netherlands: Time horizon spans until 2100 though report also separately discusses policies until 2040.
6. New Zealand: Legal obligations were first required under the Public Finance Act, 1989, as amended in 2004.
7. New Zealand: In 1993 and 1996, as a pre-election report spanning approx. 50 years; since 2000, integrated in the budget for 10 years; since 2006, as a stand-alone report for 40 years.

Institutionally, an examination should explore the extent to which fiscal projections are complemented by, and integrated with, other budget practices and procedures. Institutional dimensions include:

- Are fiscal projections presented to the legislature together with the annual budget?
- Is consideration given to the long-term costs of new programmes or reforms?
- Do projections trigger adjustments to expenditures or revenues, or to fiscal rules in the medium term?

A study of fiscal projections in 12 OECD member countries found that, while most countries include sensitivity analysis of fiscal projections to reflect changes in demographic and macroeconomic assumptions, few compare their projections to analyses of past projections. (See Table 1 for a summary of the fiscal projections in the countries surveyed.) Although many OECD member countries prepare fiscal projections, linking projections to other budget practices and procedures remains weak in many countries and risks being considered as solely an analytical exercise by economists. Projections are presented together with budgets in only a small number of the countries surveyed. ■

Table 1. (cont.)

OVERVIEW OF REPORTS  
IN THE 12 OECD MEMBER  
COUNTRIES SURVEYED  
(2009)<sup>1</sup>

	Formal reporting obligations	Most recent report title	Responsibility for preparation and release	First/most recent release	Level of analysis/reporting entity	Most recent time horizon	Frequency produced
Norway	n.a.	Long-term Perspective for the Norwegian Economy	Ministry of Finance	1993/2009 <sup>8</sup>	General government	50 years	At least every four years
Sweden	EU Stability and Growth Pact	Sweden's Economy (Budget Bill)	Ministry of Finance	1999/2009	General government	Until 2060 (fixed) <sup>9</sup>	Annually
Switzerland	n.a.	Long-term Sustainability of Public Finances in Switzerland	Federal Finance Administration	2008/2008	General government	50 years	At least every four years
United Kingdom	Code of Fiscal Stability 1998 <sup>9</sup>	Long-term Public Finance Report	HM Treasury	1999/2008	General government	50 years <sup>3</sup>	Annually
United States	n.a.	Analytical Perspectives (Long-run budget outlook)	Office of Management and Budget	1997/2008 <sup>10</sup>	Central government	75 years	Annually
	n.a.	The Long-term Budget Outlook	Congressional Budget Office	1991/2007	Central government	75 years	Approx. every two years
	n.a.	Long-term Fiscal Outlook	Government Accountability Office	1992/2008	Central government	75 years	Three times per year

8. Norway: Since 1954, the Cabinet's "Long-term Program" showed the Cabinet's policies for the next four years. Between 1954 and 1973, fiscal projections spanned four years. Between 1973 and 1993, projections spanned 20 years, but only focused on the development of government expenditure compared to projected GDP. From 1993, projections spanned 40-50 years and covered both government expenditure and income/net lending.

9. United Kingdom: While the Code does not explicitly mention the words Long-term Public Finance Report, the "Explanation to the Code" states that illustrative projections should be published by the government, covering a period of not less than 10 years.

10. United States (OMB): The five-year budget projections prepared during the 1970s and 1980s were labelled "long-term" projections. These are considered as medium-term budget estimates in this report.

Source: Anderson and Sheppard (2009).

Box 1.

**AUSTRALIAN  
APPROACH TO FISCAL  
SUSTAINABILITY**

Australia has given consideration to the issue of long-term fiscal sustainability, and has implemented many best practices for budget transparency (OECD, 2002). Projections of government spending per capita, the primary balance (the difference between revenues and expenditures, not including interest payments on debt) and net government debt are prepared by the Treasurer and presented to the House of Representatives. These data are complemented by a measure of the fiscal gap at the end of the projection period. Projections span 40 years and are updated at least every five years as required under the Charter of Budget Honesty Act 1998. However, the government has agreed to produce the Intergenerational Report (IGR) more frequently, each report to appear within three years of the preceding one, instead of five years. Two projections have been prepared to date, in 2002/03 and 2007/08.

The 2007/08 report compared its projections of government spending per capita and the primary balance with those in the 2002/03 report. Figure 1 compares the projections of the primary balance between the two reports, illustrating that the projected fiscal position improved.

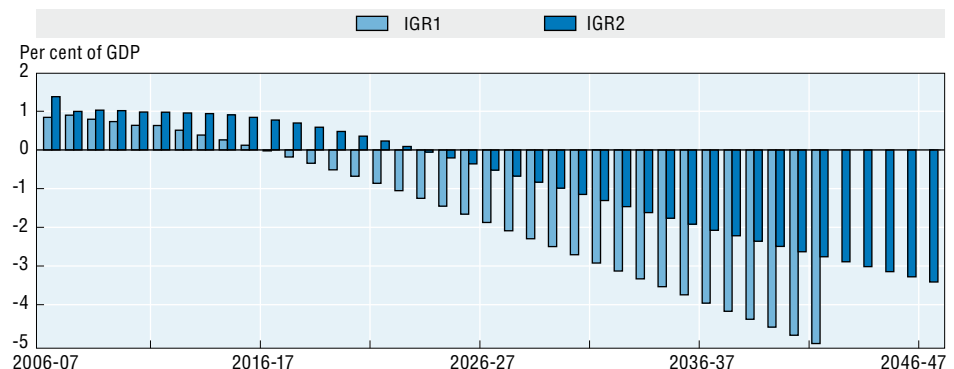
The report analyses the sensitivity of specific projected expenditure categories – but not the projected primary balance, projected net debt or adjusted primary balance – to different Treasury demographic and macroeconomic assumptions. Policy options are also presented for gradual reductions in government spending. The report presents the methodology and key assumptions behind the projections and the sensitivity analysis, which are substantiated by textual discussion. There is not, however, a single high-level summary of key assumptions.

The Commonwealth government considers the intergenerational reports to have been influential in framing public debate on economic policy and focusing attention on the long-term consequences of current policies. The intergenerational reports are widely used by the executive, ministers and cabinet to inform debates on a range of public policy areas including health, education, family benefits, welfare, superannuation and pensions. In addition to the work of the Treasury’s Budget Policy Division to prepare the IGR, issues of fiscal sustainability are now considered by a number of other units within the Treasury and the Department of Finance and Deregulation.

The reports have also generated changes to the regular budget practices and procedures. Long-term fiscal projections have been embedded into the annual budget document through the inclusion of a 15-20 year (extended medium-term) projection of the underlying cash balance as part of the medium-term fiscal outlook for the federal budget.

Figure 1.

**AUSTRALIAN  
INTERGENERATIONAL  
REPORT (IGR) 2007  
Comparison of projections  
of primary balances**



Source: Commonwealth of Australia (2007), *Intergenerational Report 2007*.  
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## What are the key areas for progress?

Fiscal projections raise the profile of fiscal sustainability, provide a framework to discuss the sustainability of current policies and the possible fiscal impact of reforms, and centralise responsibility for long-term policy analysis. While fiscal projections have been identified as good practice by the OECD since the late 1990s, the OECD now suggests that fiscal projections should:

- **Be prepared annually** to draw attention to the long-term fiscal consequences of current policies and to eliminate discretion over when projections are produced. Although publishing fiscal projections may entail some political risks, the long-term benefits brought by the transparency of the government's long-term fiscal position are more important than the short-term political rationales not to publish them.
- **Incorporate comparisons with past government assessments** to highlight whether the government's fiscal position has improved or deteriorated. While many countries prepare regular fiscal projections, most do not provide a comparison with previous projections.
- **Include sensitivity analysis (or "alternative scenarios")** for changes in demographic and macro- and microeconomic assumptions, and other changes, to illustrate the exposure to fiscal risks and the general direction of the impact of this exposure. Sensitivity analysis shows that projections are only projections and are subject to uncertainty.
- **Clearly present changes in the methodology, key assumptions, and data sources** to assure their credibility and quality. Projections are by their very nature uncertain and are sensitive to the assumptions underlying them. Disclosure and justification of changes in the underlying assumptions are one means to provide assurance about the quality of the projections and a basis for an independent review of a country's fiscal future.
- **Be used by countries to illustrate the fiscal consequences of past reforms or general policy options.** This has the potential to demonstrate to policy makers that improvements in the country's long-term fiscal position are possible but may not eliminate the long-term fiscal challenge altogether. However, the types of forward-looking simulations used should be reviewed to ensure that policy options are not presented as prescriptions or as a means of circumventing political consultation about reforms.
- **Be directly tied to the annual budget process and linked to other budget practices and procedures** to ensure that adequate attention is given to the fiscal consequences of current policies. Fiscal projections could be linked to fiscal rules, such as medium-term expenditure ceilings, or to entitlement-benefit formulas. ■

## For further information

More information about this Policy Brief and OECD work on long-term fiscal projections can be obtained from Barry Anderson, e-mail: [barry.anderson@oecd.org](mailto:barry.anderson@oecd.org), tel.: +33 1 45 24 90 85, or [www.oecd.org/gov/budget](http://www.oecd.org/gov/budget).



### For further reading

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