# Medium-Term Fiscal Consolidation Plans, A-F

(In % of GDP. Source: OECD Economic Outlook 86, November, 2009)

<table>
<thead>
<tr>
<th>Country</th>
<th>Goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Return fiscal balance to surplus depending on growth but expected by 2015-16</td>
</tr>
<tr>
<td>Austria</td>
<td>Increase cyclically-adjusted primary balance from -.7% in 2010 to .2% in 2013</td>
</tr>
<tr>
<td>Belgium</td>
<td>Stabilize deficit at 5.5% in 2011; below 3% by 2013; balance by 2015</td>
</tr>
<tr>
<td>Canada</td>
<td>Return to fiscal surplus</td>
</tr>
<tr>
<td>Czech Rep.</td>
<td>General government deficits of 5.3% in 2010, 5.6% in 2011, 5.4% in 2012</td>
</tr>
<tr>
<td>Denmark</td>
<td>Budget balance of .75-1.75% in 2010 adjusted for cyclical &amp; temporary factors. Balance or surplus from 2011-15</td>
</tr>
<tr>
<td>France</td>
<td>Fiscal deficit of 5% in 2013</td>
</tr>
</tbody>
</table>
### Medium-Term Fiscal Consolidation Plans, G-N

(In % of GDP. Source: OECD Economic Outlook 86, November, 2009)

<table>
<thead>
<tr>
<th>Country</th>
<th>Goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>Federal government: cyclically-adjusted deficit of .35% by 2016. States: balance by 2020</td>
</tr>
<tr>
<td>Hungary</td>
<td>Reduce deficit from 3.8% in 2010 to 2.2% in 2013</td>
</tr>
<tr>
<td>Iceland</td>
<td>Primary surplus by 2011; overall surplus by 2013; reduce central government gross debt below 60%</td>
</tr>
<tr>
<td>Ireland</td>
<td>General government deficit below 3% by 2013</td>
</tr>
<tr>
<td>Italy</td>
<td>Increase actual 2009 primary surplus by 4% by 2013; reduce the actual deficit by 3%</td>
</tr>
<tr>
<td>Korea</td>
<td>Return to balance, excluding social security surplus, by 2013-14</td>
</tr>
<tr>
<td>Mexico</td>
<td>Deficit of .75% in 2010; balance by 2012</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Structural improvement of .5% annually depending on growth</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Net debt below 40% (&amp; above 30%) no later than early 2020s</td>
</tr>
</tbody>
</table>
# Medium-Term Fiscal Consolidation Plans, P-U

(In % of GDP. Source: OECD Economic Outlook 86, November, 2009)

<table>
<thead>
<tr>
<th>Country</th>
<th>Goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland</td>
<td>Limit debt to 60%</td>
</tr>
<tr>
<td>Spain</td>
<td>Reduce general government deficit to 3% by date required by EU (expected to be 2013)</td>
</tr>
<tr>
<td>Slovak Rep.</td>
<td>General government deficit of 3% in 2012</td>
</tr>
<tr>
<td>Sweden</td>
<td>General surplus of 1% over the cycle; balanced budgets over a 4 year period for local governments</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Debt brake aims at federal structural balance allowing for cyclical developments</td>
</tr>
<tr>
<td>Turkey</td>
<td>Reduce general government deficit from 6% in 2009 to 2.7% in 2012</td>
</tr>
<tr>
<td>UK</td>
<td>Consolidations equal to 1.33% annually from 2010 to 2014</td>
</tr>
<tr>
<td>US</td>
<td>Reduce deficit to 4% &amp; hold steady thereafter</td>
</tr>
</tbody>
</table>
18 Lessons

• 12 Deficit Reduction Lessons
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• The Final Lesson: Yes You Can!
1. Countries should establish a credible deficit reduction plan.

2. The announcement of the plan can have positive effects on consumers, businesses, and financial markets.

3. Eliminating a sizable deficit is a “social project”, not a normal budget exercise.
4. Sizeable deficit reductions plans should be implemented from the centre of government & in an all-inclusive, whole-of-government package.

5. The most successful plans involve large, multiyear adjustments.

6. A crisis can make it easier to adopt a deficit reduction plan.
Deficit Reduction Lessons 7-9

7. Deficit reduction is more likely to be sustained when politically sensitive areas are included.

8. Fiscal improvements can also be achieved through the adoption of tax and spending policies to boost long-term growth.

9. Timing is critical: a deficit reduction plan generally should be phased in, but a fiscal policy that is counter cyclical is most important.
Deficit Reduction Lessons 10-12

10. Fiscal rules & institutions can provide additional fiscal discipline, which could be particularly useful during multiyear adjustment programs.

11. The more involvement of the public, relevant agencies, sub-national governments, & other stakeholders, the more successful the plan will be.

12. It is preferable for a country to take specific actions to reduce deficits on its own terms before actions are forced upon it by others.
1. Countries should establish a credible deficit reduction plan

- Over the past 30 years, many countries have adopted deficit reduction plans.
- Deficit reduction has important benefits.
  - It makes it easier to sustain fiscal policies.
  - It can reassure creditors & taxpayers that government is prudently managing its fiscal house.
  - It can create fiscal space that can provide room to address future economic & financial shocks & fund new priorities.
2. The announcement of the plan can have positive effects on consumers, businesses, & financial markets

- Announcement can lead to a shift in the expectations of key economic & financial players, which can have a positive impact on the economy.
  - The plan can help manage medium-term expectations of creditors, which will keep down financing costs by reducing risk premiums.
- One important aspect of successful plans is to create not only a “defensive” consolidation strategy, but to combine it with “offensive” elements (infrastructure, R&D) that may strengthen future economic development.
- Contrary to conventional wisdom, large adjustments in Denmark & Ireland (expected to be contractionary in the short-run) had positive effects on the economy. Sweden & Finland had similar experiences. These experiences illustrate that a plan can:
  - lower the risk premium on government debt instruments,
  - boost investment through lower interest rates,
  - have a positive wealth effect as lifetime tax expectations are lowered by the perception of diminished financing needs.
- Even large cuts can be expansionary because they can signal a permanent & decisive change in fiscal policy.
3. Eliminating a sizable deficit is a “social project”, not a normal budget exercise

- The purpose of eliminating a sizable deficit is to reconcile fiscal capacity with demands for funding, including funding for new government priorities.
- Eliminating a sizable deficit involves a realignment of the role of government.
- As such, this kind of project requires a more open and inclusive approach, one that engages the whole of government.
- This approach should place an even greater emphasis on program evaluations, value-for-money assessments, and cost/benefit analyses than occur in a normal budget process.
4. Sizeable plans should be implemented from the centre of government & in an all-inclusive, whole-of-government package

- Savings proposals should come from the centre—the Minister of Finance and/or the Prime Minister.
  - Development of savings proposals cannot be left to officials of line ministries as it is not in their interest to identify programmatic proposals with large savings.
  - Since the centre has less information about policy details, special procedures, such as program or spending reviews, are needed to provide important programmatic information about the operation of programs to help the centre develop proposals. These reviews have been used in Australia, Canada, the Netherlands, and the UK.

- Individual ministers & beneficiaries have been successful at insulating their programs from cuts because the benefits to them are larger than the costs to everyone else. Thus successful cuts generally can be made only when a package of reforms encompassing all programs are considered together.
5. The most successful plans involve large, multiyear adjustments

- Scale can make possible reforms that alone would not be politically feasible.
- Factors critical to the success of fiscal adjustments are:
  - the size of adjustment (larger adjustments have had a more positive impact);
  - the duration (successful adjustments have been multiyear);
  - the composition (spending cuts have tended to provide the most durable deficit reduction & to increase the likelihood of a positive macroeconomic impact, but tax changes have played an important role);
  - the state of public finances (the worse the situation, the more likely effects will be positive); and
  - the starting levels of spending & taxation (most plans have included both tax & spending provisions).
6. A crisis can make it easier to adopt a deficit reduction plan

• The worse the public finance situation, the higher the probability of implementing a lasting fiscal correction.
  – The public is more likely to see the benefits of responsible fiscal policy & support a tough program when times are obviously precarious.

• Contrary to conventional wisdom, deficit reduction can be politically advantageous in certain circumstances.
  – In Denmark, public support for the government's fiscal consolidation program was galvanized by concern that Denmark's credit rating in global financial markets would be downgraded.
  – In Ireland, the first attempt at fiscal consolidation failed and the government was thrown out, but the party returned to power several years later on a fiscal austerity platform.
  – Public support for fiscal consolidation in Sweden & Finland was related to widespread perception of a crisis & the need for a solution.
7. Deficit reduction is more likely to be sustained when politically sensitive areas are included

• Because transfer payments make up such a large portion of spending, cuts in these areas have been an instrumental part of many deficit reduction plans.

• For example, important components of the cuts in Canada & Sweden involved lasting reforms in their social security systems, which were put on a sound financial basis with their financial integrity guarded by automatic triggers.

• Cuts to transfers & subsidies tend to increase the chances of stabilizing the debt-to-GDP ratio, perhaps because such cuts demonstrate a strong commitment to reducing expenditures.
Fiscal improvements can also be achieved through the adoption of tax & spending policies to boost long-term growth

- Important factors affecting the mix include the state of the domestic & global economies & monetary policy.
- Adopting & implementing deficit reduction during an economic recovery increases the likelihood that it will have a positive economic impact.
- Greater investor confidence in fiscal management has frequently resulted in lower interest rates, which reinforced the recovery.
- Spending restraint (notably with respect to government consumption & transfers) is more likely to generate lasting fiscal consolidation & a better economy.
Timing is critical: a deficit reduction plan should be phased in, but a fiscal policy that is counter cyclical is most important

- In countries undertaking large cuts, more gradual implementation has often led to better macroeconomic effects.
  - A gradual phase-in usually allows for a more orderly adjustment, which is important politically & economically when the amount of the adjustment required is large.
- However, a gradual phase-in can induce organized resistance that grows over time.
- In current circumstances, the question of timing is especially critical.
  - Normally a delay in adjustment is not regarded as good policy.
    - Simply as a financial matter, delay increases the debt—& therefore the cost to the public—through higher debt service. As a result, the fiscal adjustment eventually required will be larger.
    - Moreover, in some circumstances, a fiscal crisis may require immediate & dramatic adjustments to restore short-term financing.
- Under current conditions, withdrawing fiscal stimulus should perhaps wait until the economy is stronger & until public confidence in the viability of financial markets has been restored.
- Concern over the recovery does not mean that policy changes cannot be announced in advance.
  - “Credible medium-term consolidation programmes should be announced already now, in order to strengthen market expectations about the determination of governments to return to sustainable fiscal positions. This would help to ensure that inflationary expectations remain stable and mitigate the increase in long-term interest rates that the withdrawal of monetary stimulus is likely to bring about.”

10. Fiscal rules & institutions can provide additional fiscal discipline, which could be particularly useful during multiyear adjustment programs

- A multiyear program combined with clear fiscal rules that limit spending (including tax expenditures) can enhance policy credibility by being countercyclical & by increasing fiscal discipline, transparency, accountability, & certainty.
  - Such a fiscal program can also help policymakers adhere to an appropriate fiscal path.
  - Fiscal rules with embedded expenditure targets have tended to be associated with larger, longer adjustments, & higher success rates.

- “The strongest rules have a constitutional base with no margin for adjusting the objectives, are monitored and enforced by independent authorities, include automatic correction & sanction mechanisms in case of non compliance, & are closely monitored by the media.” OECD Economic Outlook 81, 2007.
11. The more involvement of the public, relevant agencies, sub-national governments, & other stakeholders, the more successful the plan will be

- Creating public understanding & support for restoring fiscal sustainability through deficit reductions is hard, but not impossible.
  - A communication strategy that emphasizes social balance & fairness—between all levels of governments, government entities, income classes, & generations—should be part of the plan.
  - Coordinating with subnational governments to ensure consistency in deficit reductions is important.
  - The creation of peer pressure through the use of fiscal sustainability watchdogs or through the coordination of fiscal policies with other countries can support the difficult political actions required.

- Public policy debate should also be emphasized.
  - Debate elevates public understanding of policy options & improves the likelihood of sound public policy decisions.

- However, the extensive involvement of the public in formulating consolidation plans should not be allowed to delay the development of medium-term consolidation programmes.
12. It is preferable for a country to take specific actions to reduce deficits on its own terms before actions are forced upon it by others

- Full-blown fiscal crises have typically been experienced by developing rather than developed nations, as developing countries usually have less margin to manoeuvre fiscally & financially.
  - Because they are more dependent on external financing (primarily short-term capital as creditors seek to minimize risk), developing countries are usually more vulnerable to capital flight.

- Whether faced by a developed or a developing country, the classic fiscal-related stabilization crisis occurs as investors flee a country in the face of debt sustainability challenges & solvency concerns, with fears of hyperinflation or even default.
  - In response, governments can be required to make immediate & dramatic adjustments by raising interest rates sharply to defend the currency & by undertaking rapid fiscal consolidation through large tax increases and/or cuts to stabilize the fiscal position.
  - These steps can result in output losses & hardships for citizens, & take a long time to rebuild investor confidence so that external financing will return. It is obviously much better to avoid this situation.
Regulatory Reform Lesson

- **Reducing regulation inside government can also help.**
  - Simplifying regulation inside government can improve efficiency and productivity, contributing to fiscal consolidation.
  - The administrative burdens that governments impose on their own units and officials—regulation inside government—can represent a significant cost.
    - The multiplication of reports and procedures can cause delays, reduce staff time on substantive work, and contribute to a culture which discourages initiative and risk-taking.
  - The methods and strategies to reduce regulation inside government can be adapted from “cutting red tape” programmes applied to regulation of the private sector.
    - These include measurement of existing regulatory burdens by ministry, target-setting, a whole-of-government approach, data sharing protocols & system re-engineering, & ex-post evaluation.
Lessons for Reductions in Public Employment

• **Staff reductions** based on explicit policy decisions to undertake programmatic reductions or based on credible productivity gains can be long lasting.
  
  – Staff cuts should be driven by organizational performance reforms including the redefinition of missions & expected outputs (business & delivery planning), new workforce planning policies, & a move towards competency management.

• **However, across-the-board cuts & freezes that affect programs & services in an undifferentiated way can have significant perverse effects & may not help promote fiscal sustainability.**
  
  – Such cuts can erode the quality of public services, reduce the quantity of available services for the same level of taxpayer contribution, & affect morale.
  
  – Over time, they can erode citizens’ confidence in government, in the public sector, & in public organizations.

• **Although efficiency measures may help with internal reallocations from lower to higher priorities, they are not likely to be major contributors to eliminate a sizable deficit.**
  
  – One way to create an incentive for process innovation is to share productivity dividends between public sector bodies and treasuries.
    
    • While reducing the share of saving per program, this approach can increase buy-in & acceptance of productivity efforts & therefore the long-term sustainability of reductions.
Outsourcing Lesson

• Outsourcing has not proven to produce long-term savings unless it is based on sound economic analysis & reflects non-political judgments about the most efficient way to provide public services.
  – Similar to arbitrary staff cuts mentioned above, outsourcing programmes motivated by staff reduction goals usually end up adding to deficits after a few years and/or providing a significantly poorer quality and quantity of services.
  – The use of outsourcing & private sector providers in & of itself is no guarantee of improved public sector efficiency.
    • Even successful outsourcing contracts are very difficult to manage as the risk of non-delivery requires additional resources that can reduce the amount of any savings obtained.
Yes You Can!

- Perhaps the most important lesson of all is that large deficit reduction programs can be done.

- With strong political support, the experiences of many countries show that it is possible to implement ambitious reforms & to make choices in a principled & defensible way for citizens & public servants.

- Transparency is a crucial feature for any successful program.
  - If the public understands why actions are being taken & is convinced of their necessity, the likelihood of sustained success is greatly increased.
Conclusions

• As countries come out of the economic & financial crisis with a sharp deterioration in their public finances, they need a fiscal recovery plan to get their finances in order to reduce debt burdens before long-term pressures (especially aging & health care) hit with full force.

• As the examples cited above suggest, the adoption of a fiscal consolidation plan is important—and necessary.
  – A multiyear plan allows citizens & creditors to adjust gradually & provides a disciplinary framework to achieve more sensible government finances.

• Agreement on, & announcement of, a credible plan can help encourage the recovery by reducing the fears of inflation or currency instability.

• It is not too early to plan for the future. In fact, it is critical that countries get started now.