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targets, plans and measures

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Chapter 1

Fiscal consolidation: targets, plans and measures

This chapter discusses OECD member countries' consolidation plans as of November/December 2010.

The time frame for the plans ranges from 2009 to 2015.

The chapter analyses current fiscal positions and announced fiscal strategies, consolidation plans, and the expenditure and revenue measures for 30 OECD member countries.

Introduction

Public finances are in a dire position in many OECD member countries

In the aftermath of the financial and economic crisis, the state of public finances across OECD member countries has worsened considerably. There is an increasingly growing consensus for the necessity of restoring public finances as countries recognise that it is a prerequisite for sustainable economic growth. Restoring sustainable finances will require that most OECD member countries implement credible medium-term fiscal consolidation strategies and plans.

This publication provides a comparative and transparent picture of OECD member countries' consolidation plans as of November/December 2010. The time frame for the plans ranges from 2009-15. The survey presents in a comparable way current fiscal positions and announced fiscal strategies, consolidation plans and detailed expenditure and revenue measures, quantified to the largest extent possible, for 30 OECD member countries.

Public finances have worsened considerably

In most OECD member countries, the government's fiscal deficits soared due to stimulus measures, sharply reduced revenues as output dropped and, to some extent, banking assistance packages (Figure 1.1A and B). The fiscal deficit in the OECD area was 7.9% of GDP in 2009 and was expected to improve only slightly in 2010 and somewhat more in 2011 (OECD, 2010h). Deficits of this magnitude are clearly unsustainable, especially when future increases in public costs related to ageing populations in many countries are taken into consideration.

For some countries, the dire fiscal situation has led to fiscal solvency concerns manifested in important interest rate hikes on sovereign bonds and downgradings by rating agencies. Higher long-term interest rates and debt levels could hamper future economic growth, increase the vulnerability of public finances to shifting market sentiments and reduce the scope for fiscal policies to counteract future economic downturns.

However, the unprecedented fiscal deficits and high levels of public debt currently observed are not only a result of the economic crisis. Continual fiscal deficits over the last few decades in OECD member countries augmented public debt in a vicious cycle – rising in economic downturns, but declining only to a small extent in prosperous times (Figure 1.1C and D). In 2011, gross government debt is expected to exceed 100% of GDP in the OECD area (OECD, 2010h).

At a time when economic growth is still fragile in some OECD member countries, no easy trade-offs exist between short-term growth and the need to consolidate. The appropriate amount of fiscal consolidation for each country will depend on a number of factors, including the strength of its economy, the public debt and interest developments, the ease of financing debt, and political decisions concerning taxes and spending.

Box 1.1. **Definitions**

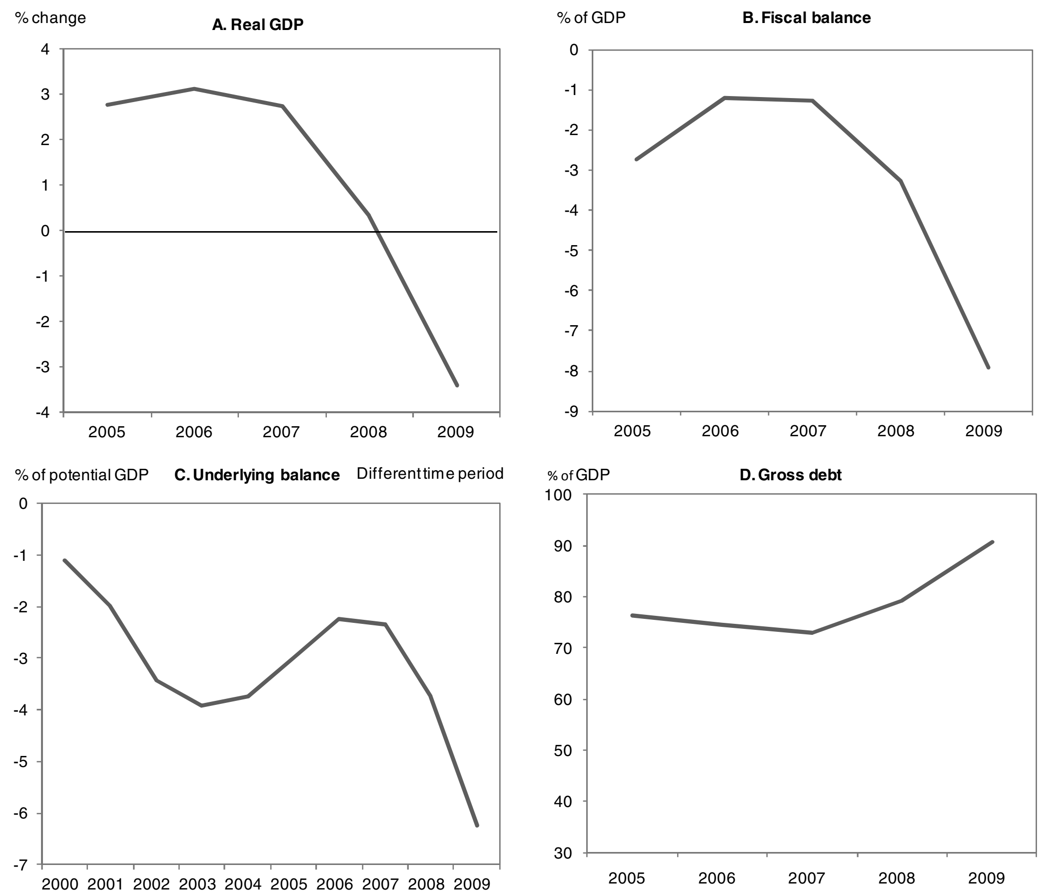
What is **consolidation**? In this publication, fiscal consolidation is defined as concrete policies aimed at reducing government deficits and debt accumulation. These consolidation plans and detailed measures are given as a per cent of nominal GDP. All measures are quantified to the extent possible. Most of the measures announced in this publication appear to be structural and could improve the underlying primary balance, but some important exceptions exist for pension accounting changes, one-off or temporary measures and rolling back stimulus measures (see the section on "How deep are consolidation measures?" later in this chapter).

Deficits can be reduced by economic growth leading to more revenues and less expenditure, e.g. for unemployment when more people find jobs (cycle effects). General labour and product market reforms are important for spurring economic growth (e.g. changes in labour regulation or liberalising product markets). Such reforms and cycle effects have not been included in the present report.

Merely announcing an ambitious deficit target over the medium term with no accompanying consolidation plan on how to achieve the deficit target is not regarded as consolidation in this analysis.

What is a **spending reduction** or **revenue increase** in a consolidation plan? There is no clear, uniform definition of what constitutes a spending reduction or revenue measure. In this analysis, measures are listed as reported by countries. Normally, these measures would relate to the last (or the current) year's budget or a forecasted baseline assuming policies are unchanged.

Figure 1.1. **Key economic indicators[1] – OECD area**



1. Fiscal balance and gross debt are general government financial balance and gross financial liabilities in per cent of nominal GDP. The underlying balance is general government financial balance adjusted for the cycle and one-offs as a per cent of potential GDP. They are weighted averages.

Source: OECD (2010), "OECD Economic Outlook No. 88", *OECD Economic Outlook: Statistics and Projections* (database), http://dx.doi.org/10.1787/data-00533-en.

Renewed growth will not be enough to stabilise debt

Economic growth may reduce some of the deficit, but will not be sufficient to stop mounting debt levels in many countries. The OECD has estimated the fiscal surpluses required from 2011 onwards to stabilise debt-to-GDP ratios by 2025. The consolidation requirements are substantial but vary considerably. According to this model, Japan, for example, will require a primary surplus of 3.7% of GDP in 2025 to stabilise the debt ratio. Assuming a deficit of 5.5% of GDP in 2010, Japan therefore needs a consolidation of 9.2% of potential GDP by 2025. Using the same calculation, tightening by more than 8% of GDP is called for in the United States, with Ireland, Poland, Portugal, the Slovak Republic and the United Kingdom all requiring consolidation of 5-7 percentage points of GDP by 2025. In the OECD area, an improvement of more than 5% of GDP from the current fiscal position is required to stabilise the debt-to-GDP ratio (Figure 1.2)[3] (OECD, 2010h).

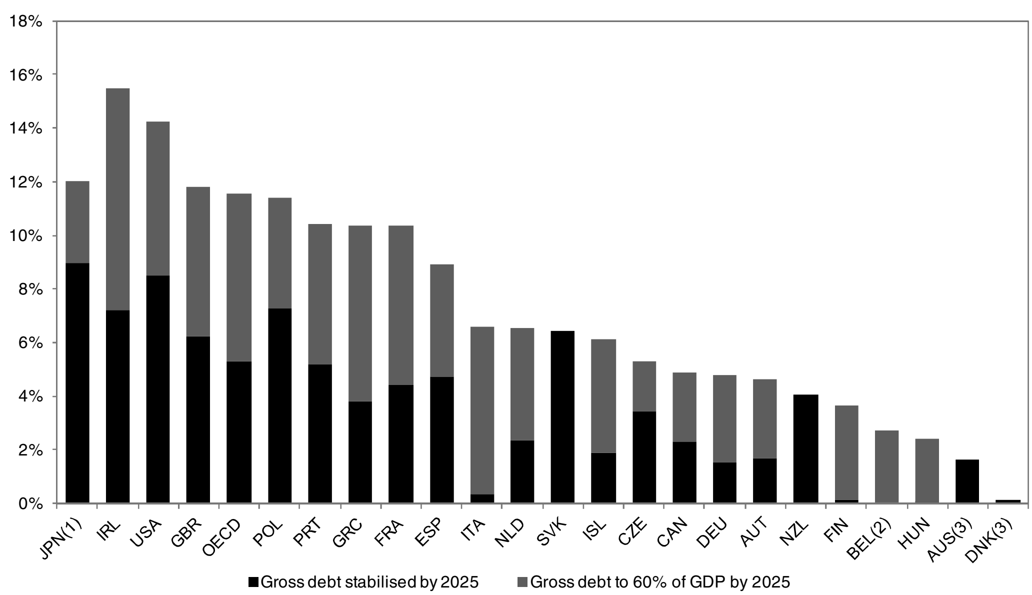
Box 1.2. **Calculation of the fiscal consolidation requirement**

Data are drawn from the *OECD Economic Outlook, Volume 2010/2*, No. 88 (OECD, 2010h). The model's projections can be considered as the minimum consolidation required to improve the sustainability of public finances. The required improvement is shown for the general government underlying primary balance which is the cyclically adjusted balance excluding one-off revenue and spending measures, and interest payments. The calculations were based on *inter alia* plausible but stylised assumptions on economic growth, interest rates and unemployment.

Figure 1.2 shows the total consolidation required to stabilise or achieve a gross general government debt-to-GDP ratio equal to 60% of GDP by 2025, assuming that the projected improvement in the underlying primary balance between 2010 and 2012 conforms with the *OECD Economic Outlook, Volume 2010/2* with an additional constant improvement in the underlying primary balance each year between 2013 and 2025 calculated so as to achieve the debt target in 2025. More details on calculations and essential assumptions are given in the *OECD Economic Outlook, Volume 2010/2* (in particular Box 4.2 on assumptions underlying the baseline scenario). The calculations of the fiscal consolidation requirement were updated in the *OECD Economic Outlook, Volume 2011/1*, No. 89 (OECD, 2011c).

Figure 1.2. **Substantial consolidation required to stabilise or reduce debt by 2025**

Required improvement in underlying primary balance, % of potential GDP



Notes: The figure shows the total consolidation required to achieve a gross general government debt-to-GDP ratio equal to 60% of GDP by 2025 and the consolidation required in 2025 to stabilise debt to GDP. For the Slovak Republic and New Zealand, the total consolidation required to achieve a gross debt of 60% of GDP by 2025 is almost the same level as the total consolidation required to stabilise a gross debt by 2025.

1. The required consolidation for Japan is to achieve a pre-crisis (2007) debt-to-GDP ratio by 2025.

2. No consolidation is needed to stabilise the debt-to-GDP ratio by 2025 in Belgium.

3. No consolidation is needed to achieve the 60% debt-to-GDP ratio by 2025 in Australia and Denmark.

Source: OECD (2010), *OECD Economic Outlook, Volume 2010/2*, No. 88, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_outlook-v2010-2-en.

For many countries, simply stabilising debt would still leave it at high levels. Consolidation requirements would be even more demanding if the aim were to return debt-to-GDP ratios to their pre-crisis levels or to bring those ratios to 60% of GDP.

All OECD member countries face growing budgetary pressure due to expected increases in ageing-related health care, long-term care and pensions (Table 1.1). For the average OECD member country, offsets of 3% of GDP will have to be found over the coming 15 years to meet spending pressures due to ageing, representing an additional cumulative consolidation requirement of about 0.3% of GDP per year (OECD, 2010h). These future cost increases related to an ageing population have not been included in the calculations of fiscal sustainability.

Table 1.1. **Projected changes in ageing-related public spending for selected OECD member countries**

Change in 2010-25, % of GDP

	Health care	Long-term care	Pensions	Total
Australia	0.5	0.4	0.3	1.2
Austria	1.2	0.4	0.7	2.3
Belgium	1.0	0.4	2.7	4.1
Canada	1.4	0.5	0.6	2.5
Finland	1.3	0.6	2.7	4.6
France	1.1	0.3	0.4	1.8
Germany	1.1	0.6	0.8	2.5
Greece	1.2	1.0	3.2	5.4
Ireland	1.2	1.1	1.5	3.9
Italy	1.2	1.0	0.3	2.5
Japan	1.5	1.2	0.2	2.9
Luxembourg	1.0	0.9	3.5	5.5
Netherlands	1.3	0.5	1.9	3.7
New Zealand	1.4	0.5	2.4	4.2
Portugal	1.2	0.5	0.7	2.4
Spain	1.2	0.8	1.2	3.2
Sweden	1.1	0.2	-0.2	1.1
United Kingdom	1.1	0.5	0.5	2.0
United States	1.2	0.3	0.7	2.1

Notes: OECD projections for increases in the costs of health care and long-term care have been derived assuming unchanged policies and structural trends.

Source: OECD (2010), *OECD Economic Outlook, Volume 2010/2*, No. 88, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_outlook-v2010-2-en.

OECD member countries' fiscal consolidation strategies

Four categories of countries

Countries that need to restore public finances from dire positions should set deficit or debt targets, announce a consolidation plan, and ensure credibility by detailing consolidation measures and how targets will be met. Almost all OECD member countries have announced fiscal deficit reduction targets at least to 2013 and, to a lesser extent, consolidation plans that need to be implemented for deficit targets to be achieved. While most consolidation plans provide details of required spending reductions and revenue enhancements in 2011, fewer contain the detailed consolidation measures required in the following years; half of OECD member countries have announced measures for 2012 and only eight countries until 2014.

Market pressure appears to be a key factor in determining the announcement of a consolidation plan, including the size and concreteness of the plan. For a number of countries, announcing consolidation plans and measures will become a prerequisite for restoring public finances and maintaining market confidence, especially if economic growth should fall short of expectations or if deficit targets are not met.

Some OECD member countries have announced consolidation plans either due to market pressure or as pre-emptive measures; other countries have not yet announced immediate consolidation plans, either because they plan to remain in stimulus mode through 2011 or because they have relatively sound public finances. Against this background, four groups of countries are emerging.[4]

Category 1: Consolidation under market pressure

The first category is the group of countries whose public finances or growth prospects have deteriorated at such a rate that substantial front-loaded consolidation packages have been announced to appease the near future demands from bond markets. These announcements have largely been reactionary in nature. For these countries, the magnitude of required fiscal consolidation is substantial, with implementation typically front-loaded for 2010 and 2011. This group includes early hit Hungary and later Greece and Ireland, and to some extent Portugal and Spain. For the latter four countries, long-term government bond spreads with Germany rose sharply in 2010.

Category 2: Pre-emptive consolidation

The next category is countries that have been pre-emptive in announcing medium-term fiscal consolidation strategies. Typically, these countries faced substantial fiscal deficits or announced consolidation plans for domestic reasons (see also note 4). The consolidation plans are of more moderate size compared to the first category (the United Kingdom's consolidation plan is relatively large), and the proactive nature of the announcement allows the country in some cases to back-load implementation of the plan to later years (2012-14). Announced consolidation plans in this group reduce the fiscal requirement of achieving the 60% debt-to-GDP ratio by around 50% or more. The announcement of the plan aims at signalling to markets and the public that the government acknowledges the extent of the current fiscal situation and is willing to address long-term fiscal sustainability issues. Countries in this category include Germany, the Netherlands, New Zealand, the Slovak Republic and the United Kingdom (Figure 1.6). Estonia could be placed in this category as well.[5]

Category 3: Consolidation needed but no substantial consolidation plan announced yet

Out of the OECD member countries with large consolidation needs that have not yet articulated a substantial or more detailed medium-term fiscal consolidation plan, two have chosen to delay the announcement until economic recovery becomes self-sustaining. Japan and the United States adopted new stimulus packages in late 2010 aimed at supporting economic recovery. Recently, the United States has adopted a stronger stance in favour of fiscal consolidation,[6] as has Japan with the 2011 budget proposal in December 2010. Other countries in this category include France and Poland. Bringing the debt-to-GDP ratio down to 60% of GDP by 2025 would require tightening structural primary balances by more than 7% for this category of countries. At the moment, only relatively modest consolidation plans have been announced, and fiscal challenges remain (Figure 1.6).

Category 4: Comparatively low fiscal consolidation needs

The final group of countries has a better fiscal position and comparatively low need for fiscal consolidation in order to reduce either deficits or debt-to-GDP ratios. Some countries benefit from the implementation of a strengthened fiscal framework prior to the crisis. Effective consolidation needs only to rely on modest spending restraints, increasing tax revenues and the winding down of temporary stimulus measures. This group includes Australia, Chile, Finland, Korea, Norway, Sweden and Switzerland.

In addition, an improved macroeconomic policy framework in Mexico has led to moderate deficits and relatively low debt levels.

Box 1.3. **Categories of countries**

1. Countries that announced substantial consolidation in response to market concerns about public finances: Greece, Hungary, Ireland, Portugal, Spain.
2. Countries that announced pre-emptive packages in terms of relatively sizeable medium-term consolidation: Estonia, Germany, the Netherlands, New Zealand, the Slovak Republic and the United Kingdom.
3. Countries that have comparatively high fiscal consolidation needs but have yet to announce large or more detailed consolidation: France, Japan, Poland and the United States.
4. Countries that have comparatively low fiscal consolidation needs: Australia, Chile, Finland, Korea, Norway, Sweden and Switzerland.

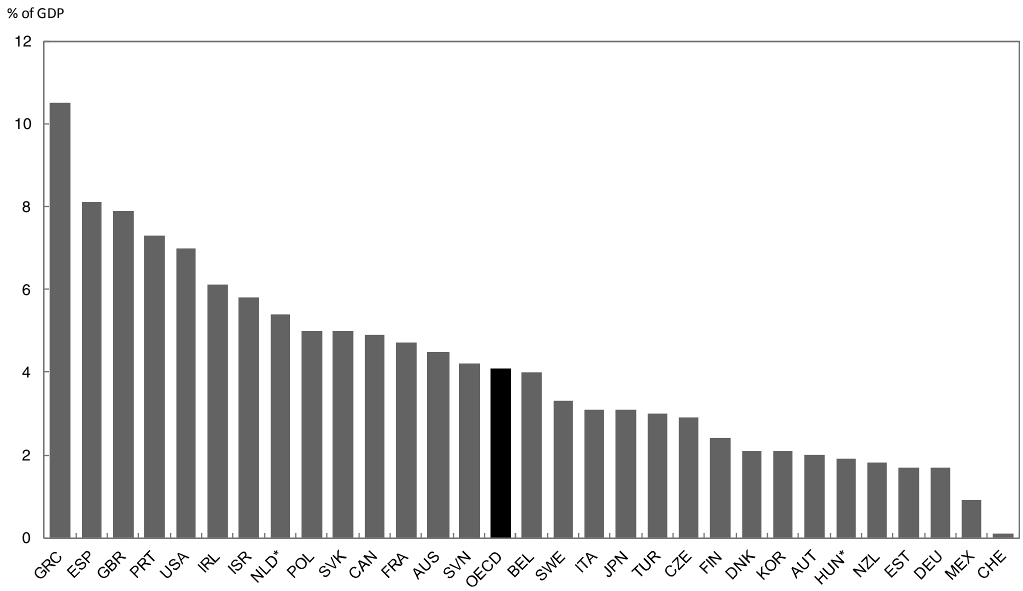
Consolidation plans vary significantly

As part of the "OECD Fiscal Consolidation Survey", OECD member countries were asked to outline and quantify their consolidation plans. Defining what exactly constitutes consolidation is somewhat open to interpretation (see Box 1.1 above), but one can use as a guideline "a requirement for active policies to improve the fiscal position". By following this guideline, expected cyclical improvements in deficits following an automatic rise in revenue and decrease in entitlement spending associated with a recovering economy are excluded.

Countries aim for large deficit reductions…

OECD member countries have announced and set ambitious fiscal deficit targets to be achieved by 2013. Figure 1.3 shows the goal for improving the budget deficit from the trough seen in 2009/10 to the objectives for 2013.

Figure 1.3. **Ambitious deficit targets: intended deficit reduction by 2013**



Notes: Deficit improvement is defined as the change from the deficit trough in 2009/10 to the targeted deficit in 2013. Change in deficit as reported by the national authorities and/or calculated by the OECD Secretariat. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

* Hungary 2012 instead of 2013; Netherlands 2015 instead of 2013.

Source: "OECD Fiscal Consolidation Survey 2010".

Box 1.4. **United States**

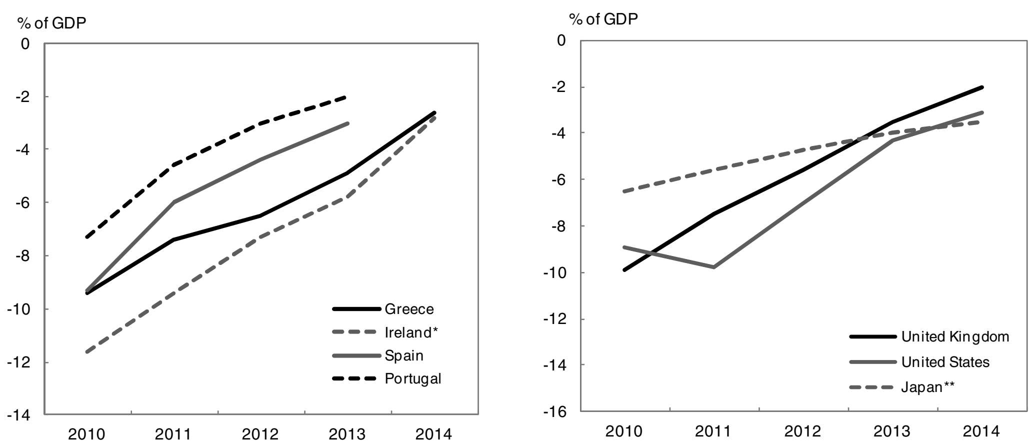
The United States federal budget demonstrates how complex the budget process can be and the ambiguity that can exist in terms of the point at which fiscal consolidation proposals actually become a government plan. The President's budget request is only the first step in the preparation of the budget. Once the Office of Management and Budget (OMB) releases the presidential budget in February for the following fiscal year, the House of Representatives and the Senate pass budget resolutions that are reconciled in a conference report which serves as a blueprint for subsequent budget legislation authorising and appropriating spending. While the presidential budget includes economic assumptions and deficit estimates, the Congress also receives estimates provided by the non-partisan Congressional Budget Office (CBO). The presidential budget's influence on tax and spending policy depends on the size of the President's party in each house of Congress, though other political factors can also add uncertainty to budget processes and outcomes.

In 2010, President Obama created the bipartisan National Commission on Fiscal Responsibility and Reform to propose recommendations to balance the budget, excluding interest payments on the debt, by 2015. Some of the commission's recommendations, which were released in December 2010, were included in the President's 2012 budget request, but as the 112th Congress is still debating the 2011 budget, including many fiscal consolidation proposals, it is unclear at what point an agreement will be reached on a fiscal consolidation plan.

Greece is aiming for the largest reduction in its deficit over the forecast horizon from 15.4% of GDP in 2009 to 4.3% of GDP in 2013. Ireland (excluding bank rescues), Portugal, Spain and the United Kingdom are targeting a deficit reduction of around 7-8 percentage points of GDP by 2013. The United States is targeting a deficit improvement of 7 percentage points of GDP. In contrast, the projected deficit improvement in Denmark and Germany is less than 3 percentage points of GDP, similar to the size of the cumulative consolidation already announced (Figure 1.2 above). The *OECD Economic Outlook, Volume 2010/2*, No. 88 (OECD, 2010h) projects the weighted average OECD deficit to improve from 7.9% of GDP in 2009 to 4.7% of GDP in 2012.

Based on survey responses, Figure 1.4 plots the deficit goals for some of the countries with the largest need for deficit reduction. Excluding Japan and the United States, these are also countries that had announced the largest consolidation programmes by the end of 2010. From slightly different starting points, the projected pace in the improvement of deficits is fairly similar across most countries.

Figure 1.4. **Deficit goals 2010-14**



Notes: The reported figures are general government financial balances (on a Maastricht basis for EU countries) as a per cent of nominal GDP except the United States (federal government).

* Ireland's 2009 and 2010 deficits exclude the bank support packages. If these packages are included, deficits are estimated at 14.4% in 2009 and 31.9% of GDP in 2010.

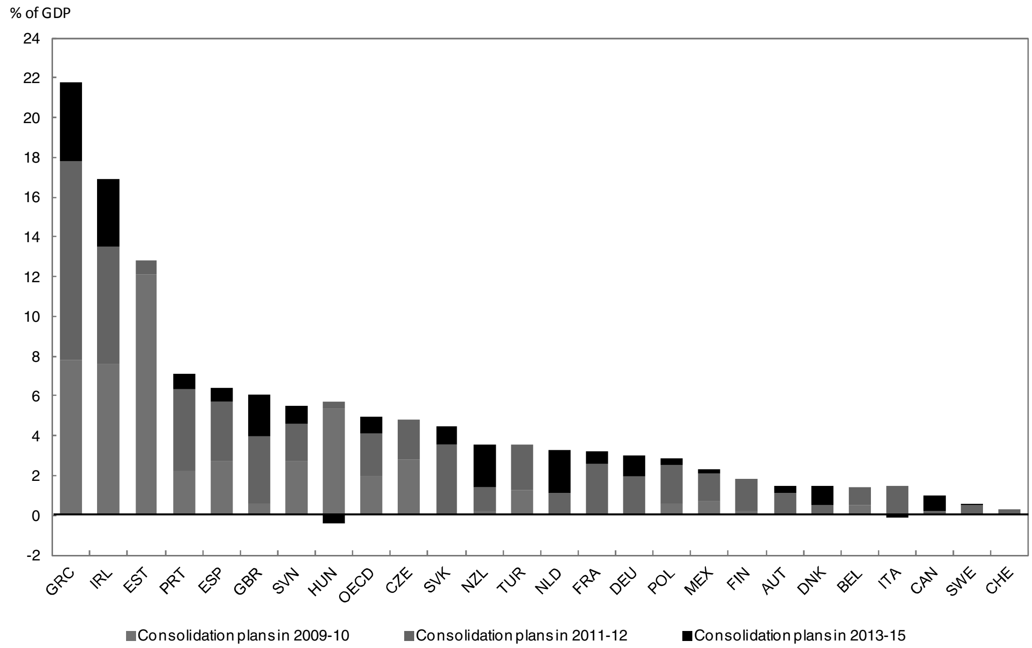
** Japan's deficit target is primary balance, which is defined by the government as fiscal balance minus net receivable interest.

Source: "OECD Fiscal Consolidation Survey 2010".

…but the announced consolidation plans vary significantly

While almost all OECD member countries have deficit targets over the medium term, only about half have announced consolidation plans that include measures over the 2010-13 period (Figure 1.5).

Figure 1.5. **Announced consolidation plans vary**



Notes: The figures are the sum of annual incremental consolidation for 2009-15 as reported by the national authorities and/or calculated by the OECD Secretariat. The figures include Estonia's and Ireland's 2009 consolidation. Hungary's 2007-08 consolidation is not included. Canada and the Netherlands report consolidation until 2015.

Source: "OECD Fiscal Consolidation Survey 2010".

Box 1.5. **Japan**

As a series of fiscal stimulus packages was implemented in 2008-09 to counter the recession, the fiscal deficit of Japan deteriorated significantly to 7.1% of GDP in 2009. The large budget deficit is putting upward pressure on government debt which is projected to top 200% of GDP in 2011. Moreover, Japan introduced two fiscal packages in late 2010 in order to respond to slowing growth.

Japan announced a Fiscal Management Strategy in June 2010 that aimed to halve the primary budget deficit by 2015. To meet the deficit target, the government will freeze spending (excluding debt repayment and interest payments) from 2011-13 so as not to exceed the level in the initial budget for 2010. In addition, the government will make efforts to keep the amount of newly issued government bonds in 2011 at the same level as 2010. Japan announced the 2011 budget proposal in December 2010 with some measures including reducing public works, cutting back transfers to local governments and implementing one-off revenue measures in order to maintain the spending ceiling. After the budget negotiation process in parliament, the budget proposal is expected to be finalised by March 2011. The government has yet to announce any other specific consolidation measures.

The destruction caused by the 11 March 2011 Great East Japan Earthquake and the subsequent tsunami is so large that it is not possible at this point to estimate its economic impact. Supplementary budgets might be proposed to finance reconstruction efforts.

For countries with a consolidation plan, the size of the plan varies significantly depending on the country's fiscal position and the current status and time frame of the consolidation plan. Unsurprisingly, countries with the largest economic imbalances and the most rapid deterioration in public finances require larger fiscal consolidation. Countries in the first category figure notably, for example Greece and Ireland with their very large fiscal consolidation plans measured at around 22% and 17% of GDP, respectively. Portugal, Spain and the United Kingdom have also announced large fiscal consolidation programmes that equal 6-7% of GDP (Figure 1.5). Estonia implemented large-scale consolidation in 2009 and 2010 in order to reduce the deficit and prepare for adoption of the euro. France and Poland announced relatively modest consolidation plans by the end of 2010. In the case of France, this includes a multi-year budget law for 2011-14 and pension reform. Japan and the United States have both stated a commitment to fiscal sustainability – through President Obama's 2012 budget proposal for the United States and the 2011 budget proposal for Japan – but a more detailed set of measures will need to be defined as part of the budget negotiations process in the United States.

Box 1.6. **Ireland and Spain**

Ireland: The Irish government began announcing its multi-year fiscal consolidation plans as early as 2008, with the 2011 budget marking the sixth consolidation initiative in two and a half years. A discretionary fiscal adjustment of 5% of GDP was implemented in 2009, followed by 2.6% of GDP in 2010. In its four-year National Recovery Plan released in November 2010, the Irish government announced an additional EUR 15 billion (9.4% of GDP) in consolidation measures to be implemented between 2011-14. The latest consolidation package has been significantly front-loaded with savings of EUR 6 billion (3.7% of GDP) planned for budget 2011 alone.

Spain: The government has announced a cumulative fiscal consolidation of EUR 65 billion (or approximately 6.2% of GDP) to be implemented from 2010-13. Pressure from markets has seen consolidation plans front-loaded to 2010 and 2011. Consolidation for 2010 alone was worth 2.7% of GDP. Consolidation plans are largely expenditure-based, and a framework agreement for the sustainability of public finances was approved by all levels of government (central, regional and local) in order to reinforce commitment to fiscal consolidation.

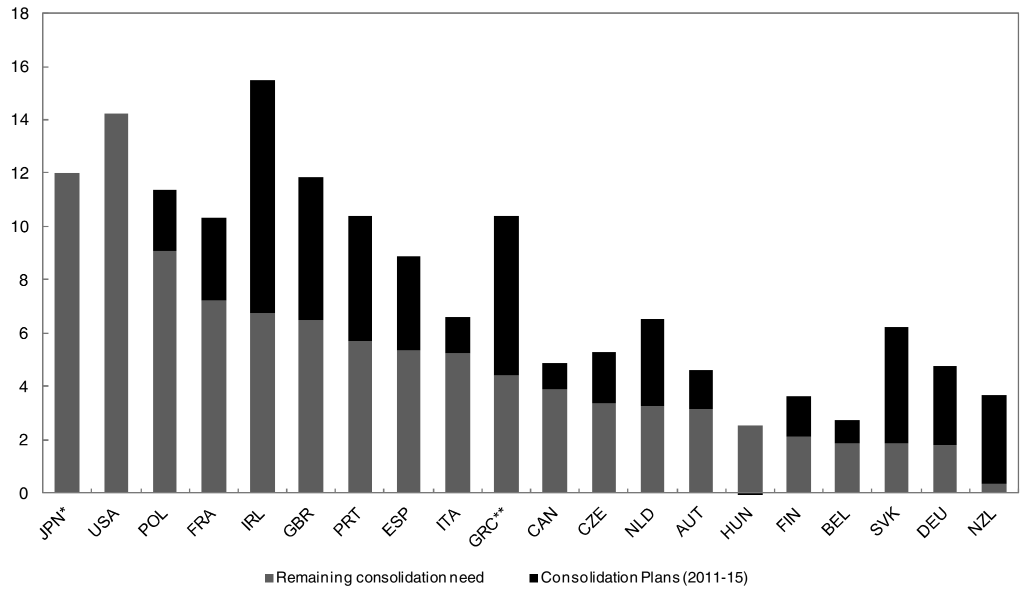
Consolidation plans improve fiscal sustainability, but challenges remain

If implemented as planned, consolidation will be an important step in restoring public finances, in particular for the first category of countries under market pressure after adopting substantial, front-loaded fiscal adjustments and for the second category of countries with pre-emptive consolidation. After subtracting OECD member countries' announced consolidation for 2011-15 (Figure 1.5) from the consolidation requirement to stabilise or reduce debt, planned consolidation from 2011 is sufficient to curb increasing debt-to-GDP levels in a number of countries.

However, more consolidation is needed if debt levels are to be reduced to more prudent levels like debt-to-GDP ratios of 60% of GDP (Figure 1.6 and Box 1.7). For Japan and the United States, the challenge remains to pass a set of fiscal consolidation measures, and for France and Poland, more ambitious consolidation packages along with detailed measures have yet to be put on the table.

Figure 1.6. **Fiscal balances need to be improved more to achieve 60% debt-to-GDP ratios**

Following announced consolidation from 2011: remaining required improvement in underlying primary balance, % of potential GDP



Notes: The consolidation requirement is the underlying primary balance change required to achieve a gross general government debt-to-GDP ratio equal to 60% of GDP by 2025 except for Japan. Iceland is not included in the figure due to missing consolidation data.

* The consolidation requirement for Japan is the total consolidation required to achieve the pre-crisis debt-to-GDP ratio by 2025.

** For Greece, the underlying primary balance is used in the calculation, derived from the government's targeted deficit path, taking into account the baseline assumptions in *OECD Economic Outlook, Volume 2010/2*, No. 88. (See the Greece country note in Chapter 2 below for further explanations.)

Sources: "OECD Fiscal Consolidation Survey 2010"; OECD (2010), *OECD Economic Outlook, Volume 2010/2*, No. 88, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_outlook-v2010-2-en.

Box 1.7. **Calculation of the remaining fiscal consolidation requirement**

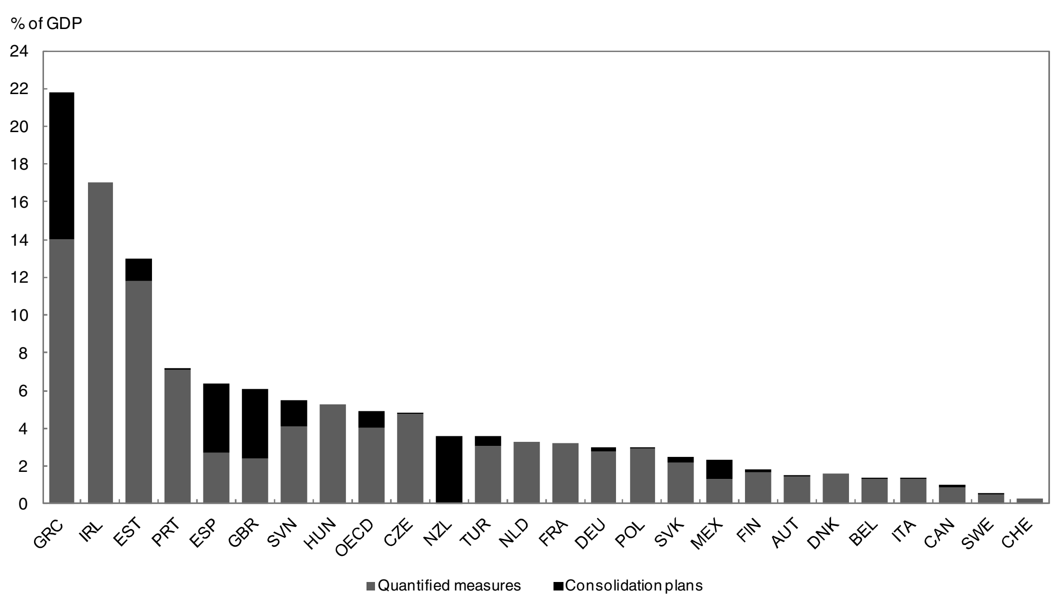
The calculation of consolidation required to stabilise or reduce debt levels to 60% of GDP by 2025 uses 2010 as the base year (Figure 1.2 and Box 1.2). The remaining consolidation needed is calculated by subtracting the consolidation announced for 2011-15 (Figure 1.5). Consolidation for 2011-15 is calculated as a per cent of OECD estimates of potential GDP from the *OECD Economic Outlook, Volume 2010/2*, No. 88 (OECD, 2010h), assuming all measures are structural. Countries not included in Figure 1.2 (Korea, Luxembourg, Sweden and Switzerland) do not need to consolidate to stabilise or reduce debt levels to 60% of GDP. Fiscal consolidation requirement calculations will be revised based on updated economic forecasts, assumptions and consolidation plans in the *OECD Economic Outlook, Volume 2011/1*, No. 89 (OECD, 2011c).

Large consolidation plans need to be detailed

Not all consolidation plans are complete or incorporate detailed measures. This may be due to the short-term nature of government budgets, as most OECD member countries adopt budgets on a one-year (annual) basis. However, countries under pressure from markets have all announced front-loaded adjustment plans and rather detailed plans beyond 2011 (Figure 1.7).

Countries in the first category have announced the most ambitious consolidation plans in order to restore market confidence and public finances. Consolidation plans span four or five years in these countries. Hungary, Ireland and Portugal have all elaborated measures in their consolidation plans (though Hungary's and Portugal's pension transfers have been criticised). Quantified measures are only spelled out for the first years in Greece and Spain, but Greece is expected to announce more detailed measures in March 2011. For countries in the second category, fiscal consolidation plans are detailed to a large extent, with an exemption for the relatively large five-year consolidation plan in the United Kingdom as well as for New Zealand's consolidation plan. However, for the United Kingdom, a number of announced budget cuts in areas such as administration, defence, transport, etc., are not included in Figure 1.7 as these reductions are not quantified on an annual basis. In Estonia, most of the consolidation took place in 2009 and 2010.

Figure 1.7. **Share of quantified measures in the consolidation plans**



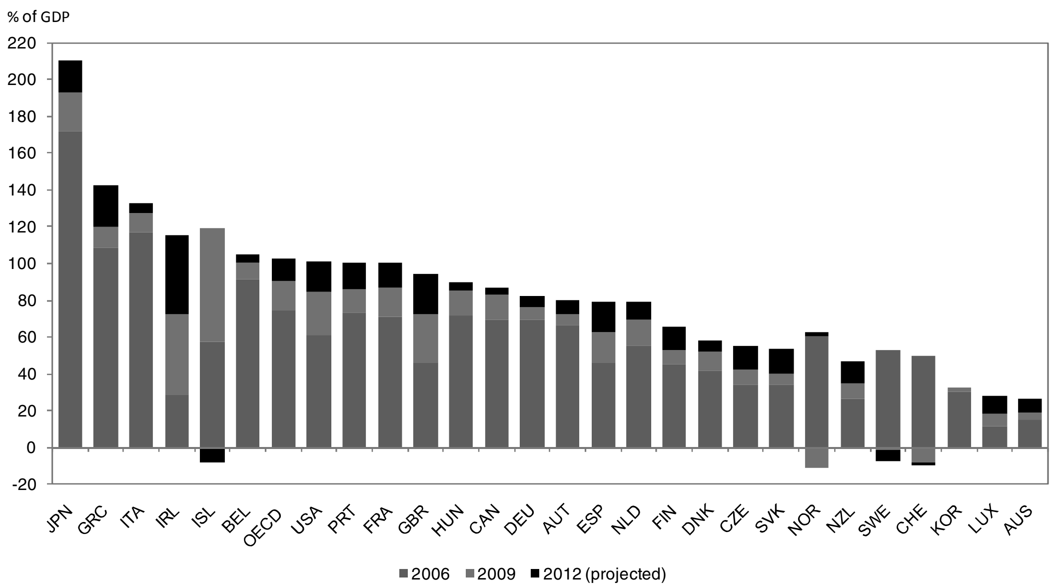
Note: The figure shows the cumulative consolidation volume and the share of quantified expenditure and revenue measures as reported in the country notes in Chapter 2 below.

Source: "OECD Fiscal Consolidation Survey 2010".

Gross debt projections

While structural deficits provide a good indicator of the current state of public finances, a country's gross debt level is also an important indicator of long-term fiscal sustainability.[7] The *OECD Economic Outlook, Volume 2010/2*, No. 88 (OECD, 2010h) projected that the weighted average gross debt of OECD member countries would increase from 91% of GDP in 2009 to 103% of GDP in 2012 (Figure 1.8). This is a significant increase from the pre-crisis level of 75% of GDP recorded in 2006. A number of other OECD member countries are expected to carry a debt load in excess of 100% of GDP by 2012, including Belgium, France, Greece, Iceland, Ireland, Italy, Japan, Portugal and the United States. EU member countries continue to target gross debt equal to 60% of GDP but, in light of the ageing population and associated pension and health-care costs, even returning to pre-crisis debt levels may prove challenging.

Figure 1.8. **Change in gross debt across OECD member countries**



Notes: The reported figures are gross government liabilities as a per cent of nominal GDP. Negative numbers for Iceland, Norway, Sweden and Switzerland indicate reduced debt.

Source: OECD (2010), "OECD Economic Outlook No. 88", *OECD Economic Outlook: Statistics and Projections* (database), http://dx.doi.org/10.1787/data-00533-en.

Box 1.8. **Iceland**

Iceland had budget surpluses in the three years leading up to the economic crisis, averaging nearly 5.5% of GDP annually during this period. The fiscal balance, however, rapidly deteriorated to a deficit of 13.5% of GDP in 2009, and was estimated at 9.9% of GDP in 2010 in the aftermath of the crisis. Iceland has implemented a fiscal consolidation programme since 2009 in order to return the government's finances to surplus in 2012. Public finances are expected to improve with the implementation of expenditure measures such as reducing operating expenses and pension insurance spending and cutting back road construction expenditures. On the revenue side, the government adopted various measures including increasing personal income tax and social security tax, and creating extra excise taxes on petrol, diesel fuel and tobacco.

Time frame for fiscal consolidation strategies

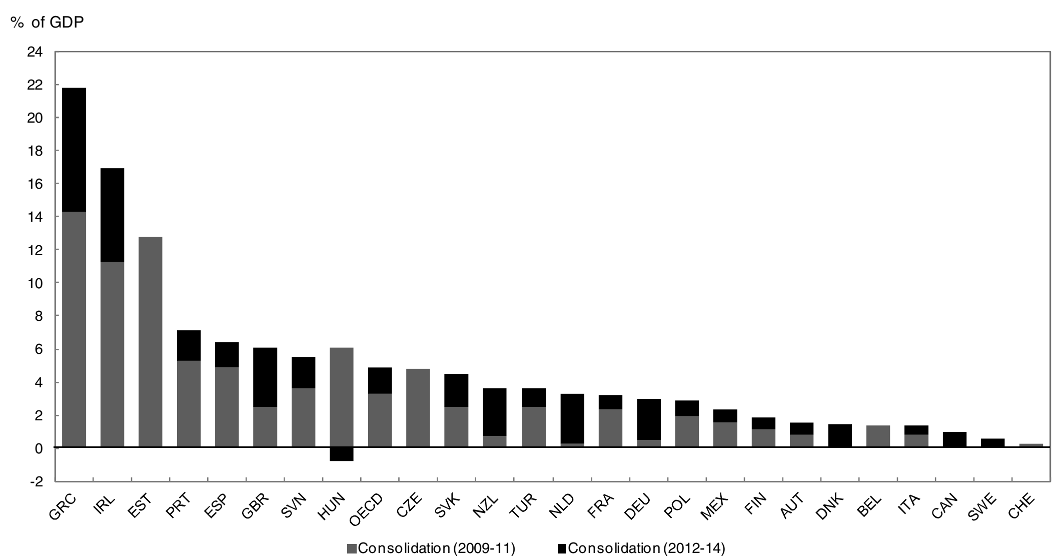
Countries in the first category announced sizeable consolidation plans and began implementing them as early as 2009 (Estonia and Hungary) and 2010. The majority of the OECD member countries that have announced consolidation programmes are planning to start implementing them in 2011. Countries in the second category have, in some cases, back-loaded the implementation of their plans to 2012-14, possibly due to less market pressure. The remaining OECD member countries have either yet to reach an agreement on the time frame for consolidation as is the case with Japan and the United States, or have little need for fiscal consolidation.

While most OECD member countries have set deficit targets for 2012 and 2013, less than half have announced details of the concrete consolidation measures that will be required to meet these targets by 2013.

The timing of fiscal consolidation depends on market pressure and the strength of recovery

The pace and size of consolidation should be aligned to the state of public finances, the ease with which government debt can be financed, and the strength of recovery. The speed at which the planned consolidation is being implemented across OECD member countries differs widely (Figure 1.9).

Figure 1.9. **Front-loaded versus back-loaded consolidation**



Note: The figures are sums of the annual incremental consolidation (three years from 2009-11; and three years from 2012-14) as reported by the national authorities and/or calculated by the OECD Secretariat, as a per cent of nominal GDP (actual and projected).

Source: "OECD Fiscal Consolidation Survey 2010".

Around two-thirds of countries responding to the survey have announced consolidation that is front-loaded to 2010 and 2011. Front-loading consolidation is associated with countries that are facing an acute risk of losing market confidence as their deficits and debt ratios deteriorate rapidly; the first category of countries are all front-loading consolidation.

Several countries have announced a relatively constant consolidation while the remaining countries have announced consolidation that is back-loaded to 2012-14. These include the second category countries of Germany, the Netherlands and New Zealand. Financial and temporal flexibility allow these countries to announce back-loaded medium-term consolidation plans. Often, these countries are in a more comfortable fiscal position, allowing the underlying pace of consolidation to be slowed should economic growth be weaker than projected.

Box 1.9. **Germany**

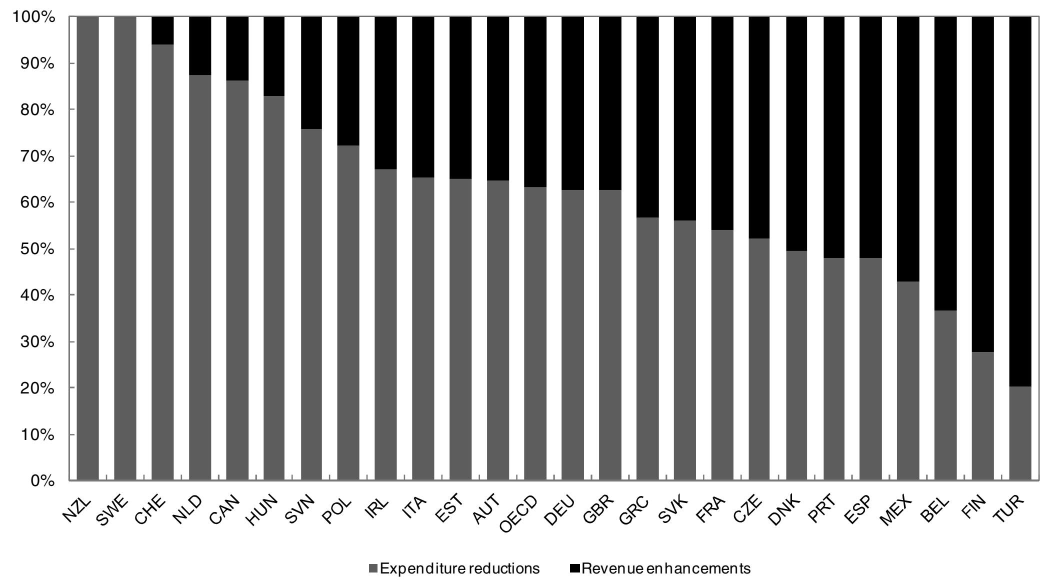
The government has announced its intent to reduce the structural deficit by 0.5% per year from 2011 onwards. In June 2010, the government also announced a EUR 80 billion consolidation programme (3% of GDP) to be implemented over a four-year period beginning in 2011 that will help Germany to meet its structural deficit target over the medium term. More than 80% of consolidation measures will be implemented in 2012-14.

Most countries rely on expenditure cuts

A total of 23 countries provided information on their specific fiscal consolidation measures. Fiscal consolidation is weighted on average two-thirds towards spending cuts and one-third towards increasing revenues (Figure 1.10). There is a significant variation in the composition of consolidation measures. A number of countries have based consolidation mostly on expenditure-based measures. These are typically countries with smaller consolidation needs. In contrast, Belgium, Finland and Turkey rely on tax increases for the majority of their consolidation. Countries that require greater consolidation, including Greece, Portugal, Spain and the United Kingdom, are choosing to take the middle ground.

The proportion of consolidation attributed to expenditure-based measures is contingent on the fiscal situation in each country. If needed for fiscal sustainability, countries with a low tax burden have greater scope to implement consolidation through revenue enhancement measures.

Figure 1.10. **Expenditure-based versus revenue-based measures**



Note: The figures are the contribution to consolidation from expenditure and revenue measures weighted by the incremental volume of consolidation across each year reported.

Source: "OECD Fiscal Consolidation Survey 2010".

Box 1.10. **Mexico**

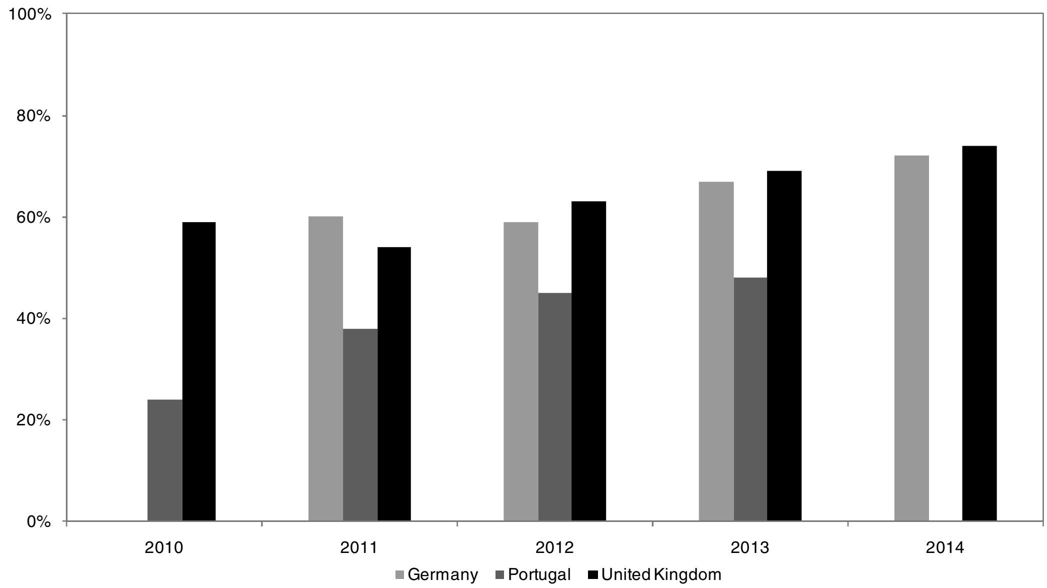
Following market concerns about future decline in revenues from oil production, the Mexican government has started consolidating public finances by raising taxes and limiting expenditure growth. The government intends to gradually reduce the fiscal deficit, excluding investments from the state-owned oil company PEMEX, and to restore balance in 2012.

The bulk of the fiscal adjustment is front-loaded in 2010-11, relying mostly on revenue-enhancing measures with an aim to make the budget less dependent on volatile oil revenues. The VAT rate was increased from 15% to 16% in early 2010, and the corporate and the top marginal personal income rates were temporarily increased to 30%. The rate of the tax on cash deposits was increased to 3% and the excise tax on cigarettes was increased.

To contain expenditure growth, the National Public Expenditure Reduction programme was launched in 2010. The programme intends to trim administrative and operational expenditures by MXN 40 billion in 2010-12 and to redirect savings to social policy programmes. In addition, the growth rate of total expenditure for the period 2011-14 will be lower than that of revenues.

The proportion of expenditure-based consolidation – as it is projected to evolve over the forecast horizon in Germany, Portugal and the United Kingdom – increases over time (Figure 1.11). Expenditure-based measures often take longer to fully implement, while increasing taxes can provide immediate gains.

Figure 1.11. **Consolidation weighted towards expenditure cuts**



Source: "OECD Fiscal Consolidation Survey 2010".

Box 1.11. **Luxembourg**

The general government deficit deteriorated from 0.7% of GDP in 2009 to a projected 2.2% in 2010. This was the result of a large stimulus package, together with lower revenues and higher social spending related to the crisis. The 2011 budget aims at bringing the deficit to 1.2% of GDP with restraint on expenditures, notably public investment and subsidies to enterprises, and tax increases, including a hike in the top income tax rate. The government has an objective of balancing the budget by 2014 and keeping gross debt below 30% of GDP.

Major consolidation measures

After presenting basic information on the composition of expenditure and revenue in OECD member countries, this section presents the types of consolidation measures and how often they are targeted or mentioned in the consolidation plans. By counting the measures in this way (frequency), it is possible to provide information about the areas on which countries are focusing when reducing expenditures or enhancing revenues. Impact information in per cent of GDP and cross-country comparison will be given for all measures that are quantified in the consolidation plans.

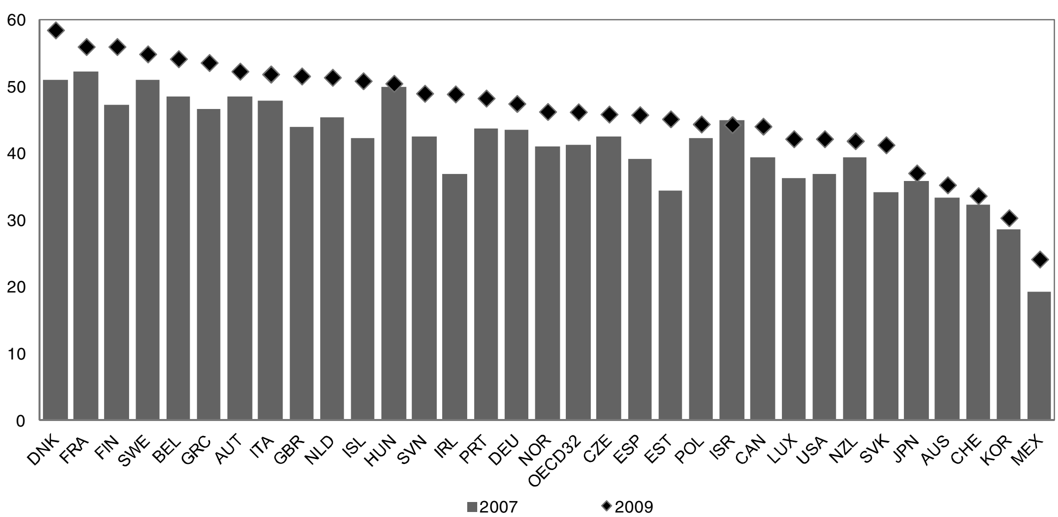
Expenditure in OECD member countries

The share of government expenditures varies across OECD member countries

Government expenditures as a share of GDP indicate the size of the government and reflect historical and current political decisions about its role in providing services and in redistributing income. However, a large part of the variation reflects the different approaches to delivering goods and services and providing social support, rather than true differences in resources spent. For instance, if support is given through tax concessions rather than direct expenditure, expenditure-to-GDP ratios will naturally be lower (OECD, 2009c).

Figure 1.12. **General government expenditure**

% of GDP (2007 and 2009)



Notes: Data for Chile and Turkey are missing. For Australia, Japan, Korea and New Zealand: 2008 instead of 2009. For Mexico: 2008 instead of 2009. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

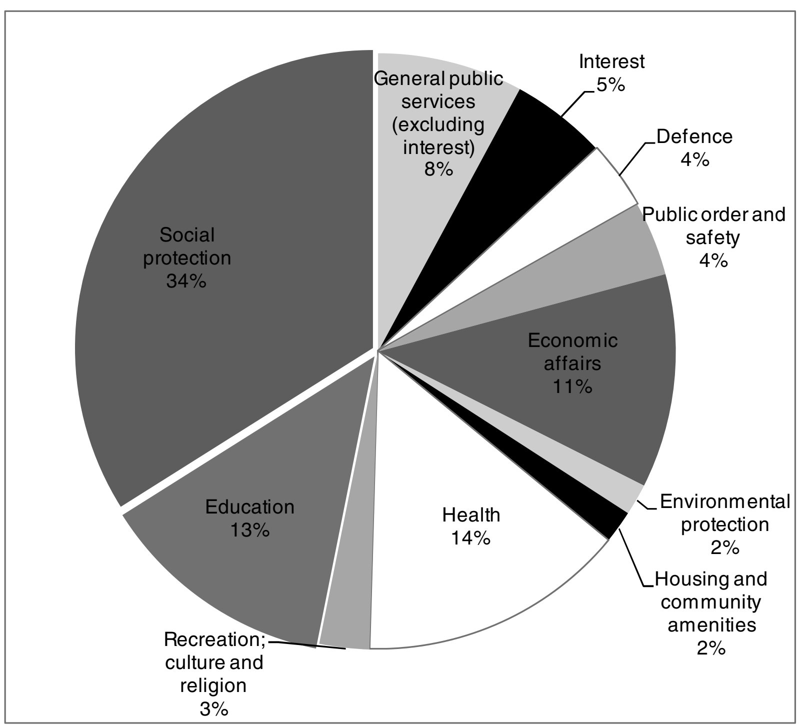
Source: OECD National Accounts Statistics, October 2010, http://dx.doi.org/10.1787/na-data-en.

The OECD average of expenditure to GDP was just above 40% in 2007, increasing in 2009 by several percentage points due to governments' adoption of various stimulus packages, rises in cyclically-sensitive mandatory spending and a denominator effect due to dropping GDP levels (Figure 1.12).

Welfare and health are "big ticket" spending items…

Governments can choose to spend their financial resources on a variety of goods and services, from providing child care to building bridges to subsidising alternative energy sources. Welfare or social protection is the largest category of spending. The second-largest share of GDP is spent on health and education followed by economic affairs, which include *inter alia* subsidies, and spending on general public services. Payments on interest constitute around 5% of public expenditures across the OECD area. In general, OECD member countries spend the least amount of government financial resources on environmental protection and housing and community amenities (Figure 1.13).

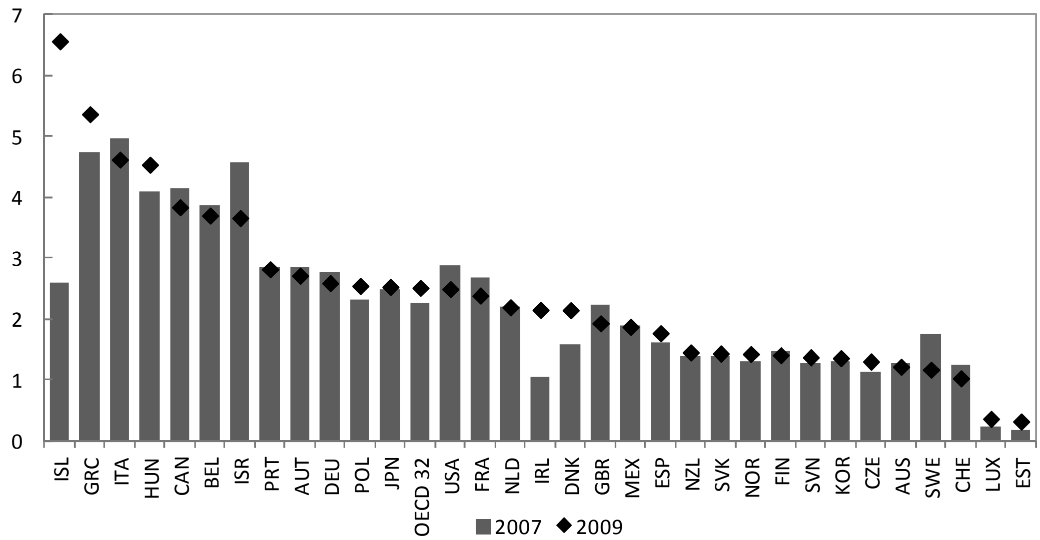
Figure 1.13. **Structure of general government expenditures, 2008**



Source: OECD National Accounts Statistics, October 2010, http://dx.doi.org/10.1787/na-data-en.

Figure 1.14. **General government interest payments**

% of GDP (2007 and 2009)



Note: Data for Australia, Japan, Korea, Mexico and New Zealand are for 2008 instead of 2009. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

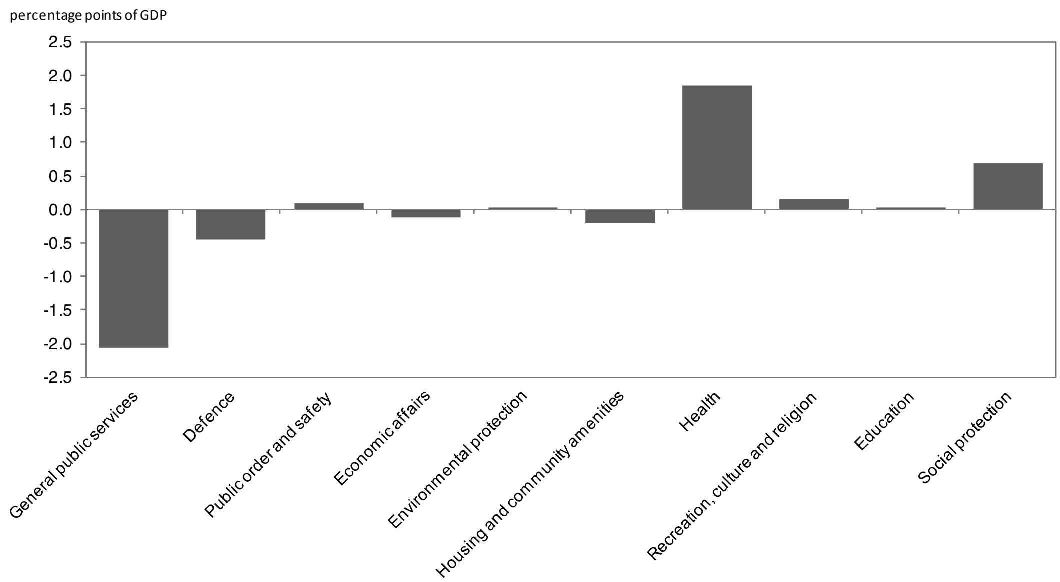
Source: OECD National Accounts Statistics, October 2010, http://dx.doi.org/10.1787/na-data-en.

In the OECD area, governments' interest payments represented on average 2.5% of GDP in 2009, slightly up from 2007. But the amount a government pays on interest varies greatly among OECD member countries, from 0.3% of GDP in Estonia to 6.6% of GDP in Iceland (Figure 1.14). If not curbed, higher debt levels can induce a fierce cycle, since the perceived risk of sovereign default further raises interest rates.

…and welfare and health have gained importance over the last decade

The share of resources devoted to different activities has also shifted over the past decade (Figure 1.15). In particular, OECD member countries today spend a larger proportion of resources on health and social protection than they did in 2000. The proportional increases in funds spent on health and social protection were roughly balanced by proportional decreases in funds spent on general public services, the latter to some extent due to lower interest payments.

Figure 1.15. **Change in structure of spending between 2000 and 2008**

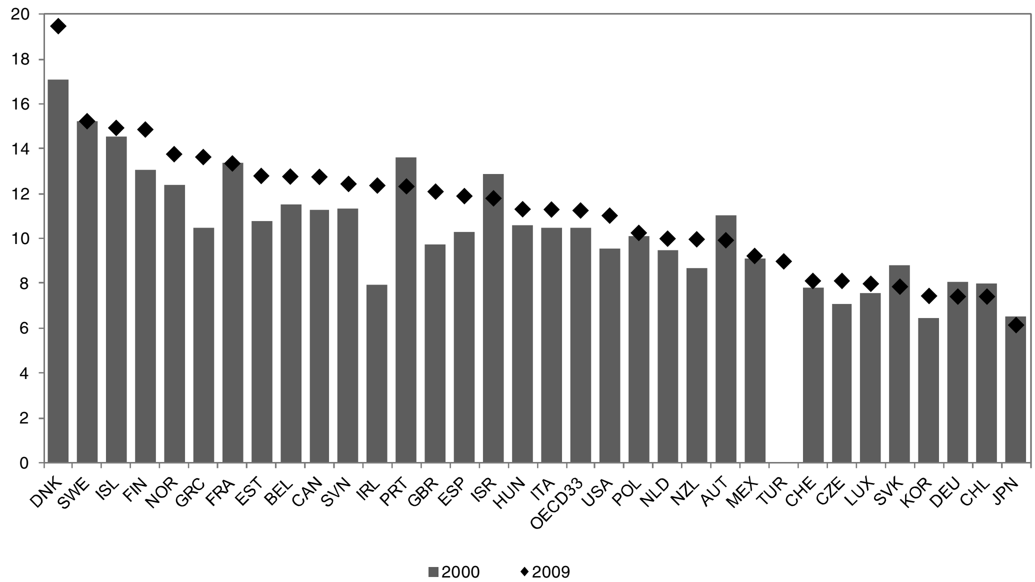


Source: OECD (2009), *Government at a Glance 2009,* OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264075061-en.

The public sector is also human capital intensive. The wage bill varies from a comparatively low level in Japan of around 7% of GDP to around 15% of GDP on average in the Nordic countries in 2009 (Figure 1.16A). A similar pattern is found in the share of public employment in the total labour force. While general government compensation increased in most countries from 2000-09, the public employment share of the labour force remained fairly constant over the same period (Figure 1.16B). In a few countries such as Austria, Germany, Mexico and Sweden, the share of public employment decreased over the decade.

Figure 1.16. **General government compensation and employment**

A. General government compensation of employees, % of GDP (2000 and 2009)

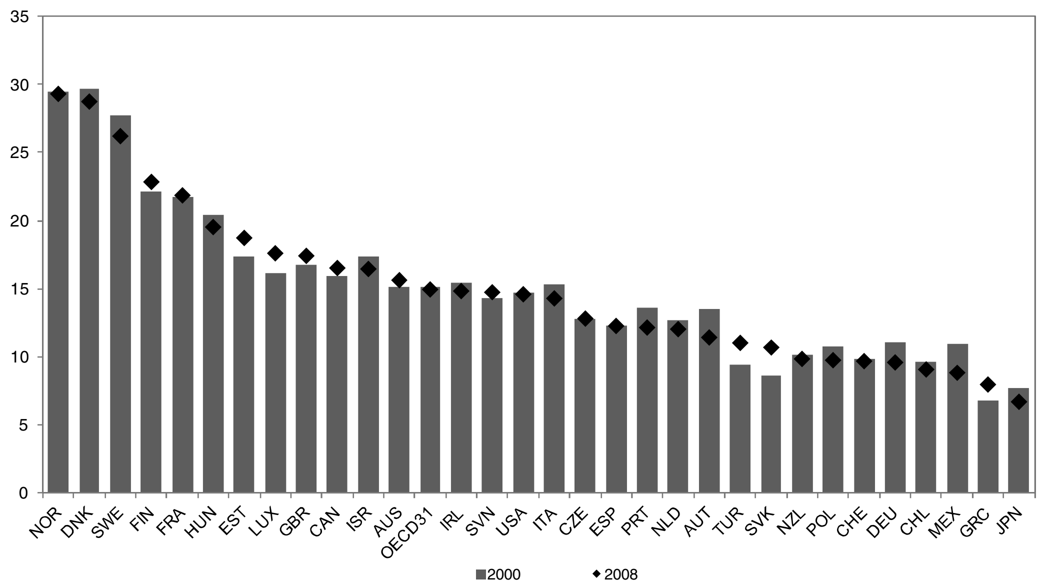


Notes: Data are missing for Australia. 2000 data for Turkey are missing. OECD33 does not include Turkey. For Chile, Japan, Korea and New Zealand: 2008 instead of 2009. For Mexico: 2003 instead of 2000. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD National Accounts Statistics, http://dx.doi.org/10.1787/na-data-en.

Figure 1.16. **General government compensation and employment** *(cont'd)*

B. Employment in general government, % of the labour force (2000 and 2008)



Notes: Employment is not classified according to the SNA definition, i.e. activity (market/non-market) and control by the government but status of employers as legal entities. The figure for employment in general government is substituted by direct employment in national or local governments instead of employment in general government. Data for Belgium, Iceland and Korea are missing. Data for Australia, Chile and the United States refer to the public sector (general government and public corporations). Data for Austria, the Czech Republic, Italy, the Netherlands New Zealand and Poland are expressed in full-time equivalent employment. For Finland, Israel, Mexico, Poland and Sweden: 2007 instead of 2008. (The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.) For France, Japan, New Zealand and Portugal: 2006 instead of 2008. For Ireland, Japan, Luxembourg, Slovenia and Switzerland: 2001 instead of 2000.

Source: OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, http://dx.doi.org/10.1787/gov_glance-2011-en.

Major expenditure measures

The "OECD Fiscal Consolidation Survey" presents consolidation on the expenditure side according to three categories:

- operating measures;
- programme measures;
- other initiatives.

The first category, operating measures, can be broadly defined as containing governments' running costs. These measures include wage or staff reductions, government reorganisation, and across-the-board efficiency reductions in the administration.

The second category, programme measures, reflects by and large expenditures by functional classification in the *OECD National Accounts*, including transfers to sub-national government. This classification includes health, changes to social benefit systems, old-age pensions, capital infrastructure and official development assistance.

In the *OECD National Accounts*, the classification of expenditure by function also includes personnel costs – for example, doctors' and teachers' salaries are included in health and education. Therefore, to avoid double accounting in the "operational" and "programme" categories, the questionnaire submitted to member countries separated wage and staff measures from programme measures.

The third category, other initiatives, includes measures that do not naturally fall into the other two categories. Initiatives in this category are mostly overall spending cuts or freezes on public consumption.[8]

The impact of quantified expenditure reductions varies widely

When it comes to the impact of quantified expenditure reductions as a per cent of GDP in the consolidation plans, as expected countries responding to market pressures are reducing expenditures the most. Slovenia also has a large share of expenditure reductions. In the Netherlands, despite GDP contraction in line with the OECD average and a better fiscal position than most OECD member countries, the target of closing the deficit within the five-year medium-term expenditure framework prompted the government to propose a sizeable cumulative consolidation (Figure 1.17A).

If total quantified expenditure measures are turned into annual averages, the ranking changes. The highest annual average impact of quantified expenditure measures is now found in Estonia, Greece and Ireland with annual impacts well above 1% of GDP (Figure 1.17B). Due to market pressure, and euro zone criteria in the case of Estonia, these countries front-loaded consolidation plans including large fiscal adjustments earlier than other countries.

Figure 1.17. **Quantified expenditure reductions**

A. Cumulative impact

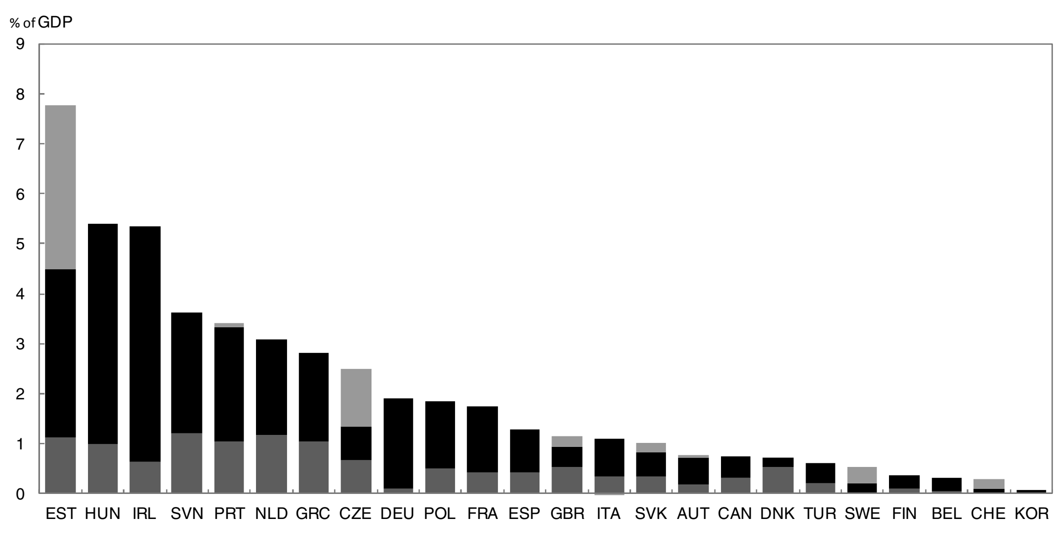
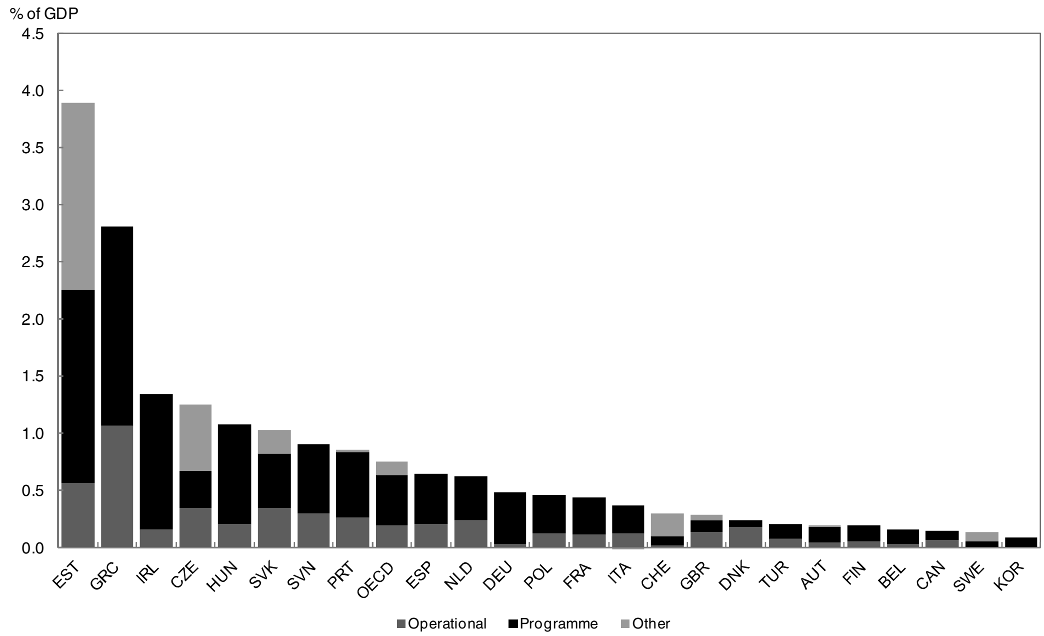


Figure 1.17. **Quantified expenditure reductions** *(cont'd)*

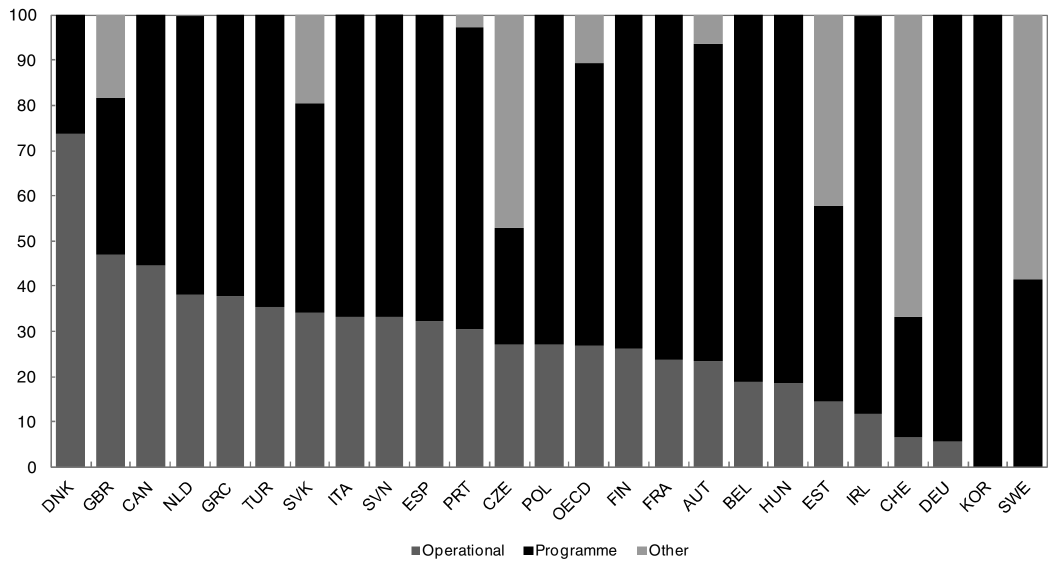
B. Annual average



Source: "OECD Fiscal Consolidation Survey 2010".

In most countries, programme expenditure measures add more to consolidation than operational measures, which is not unexpected given the large share of programme measures (Figure 1.18). In Germany, almost all consolidation is based on reducing programme expenditures. In other countries like Canada, the Czech Republic, Denmark and the United Kingdom, operating expenditure reductions have a much larger share: they account for more than 40% of the total quantified expenditure reduction (Figure 1.18). In the Czech Republic and Estonia, "other initiatives" have a relatively larger share of the expenditure consolidation. In these countries, a general expenditure freeze and lower expenditure growth than revenue growth contribute substantially.

Figure 1.18. **Quantified expenditure measures – composition**



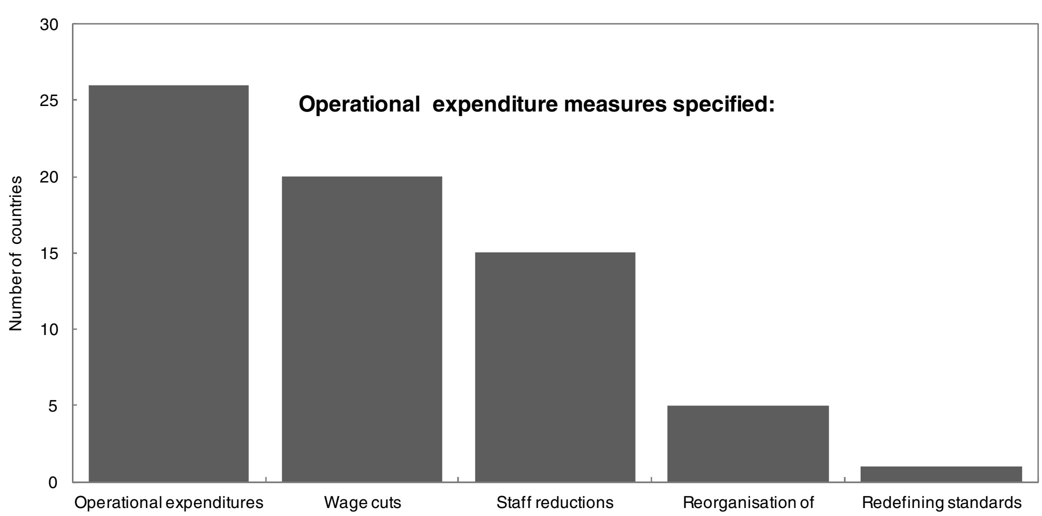
Source: "OECD Fiscal Consolidation Survey 2010".

Major operational measures

<u>Targeting public wages and staffing</u>

As the public wage bill accounts for a large share of public expenditures and public employment is substantial in several countries (Figures 1.16A and B), most member countries have announced operational savings in their respective consolidation plans, though ambition and level of detail vary.

Figure 1.19. **Operational expenditure measures – frequency**



Note. Out of a total of 30 countries.

Source: "OECD Fiscal Consolidation Survey 2010".

Almost all OECD member countries have marked operational expenditures for savings (Figure 1.19). Operating expenditures will be cut by 10% in the central government in France. The Netherlands and the United Kingdom have announced far-reaching and very substantial operational expenditure cutbacks. In the Netherlands, across-the-board savings on operational expenditures will be implemented at all levels of government, amounting to EUR 6 billion by 2015. All ministries' operational budgets in the United Kingdom will be reduced between 33% and 42% by 2014. The cumulative reduction in operating expenditures reaches more than 1% of GDP in the Netherland's five-year consolidation plan and in Estonia. In Greece, savings of 0.8% of GDP are targeted in 2011 alone (Figure 1.20A).

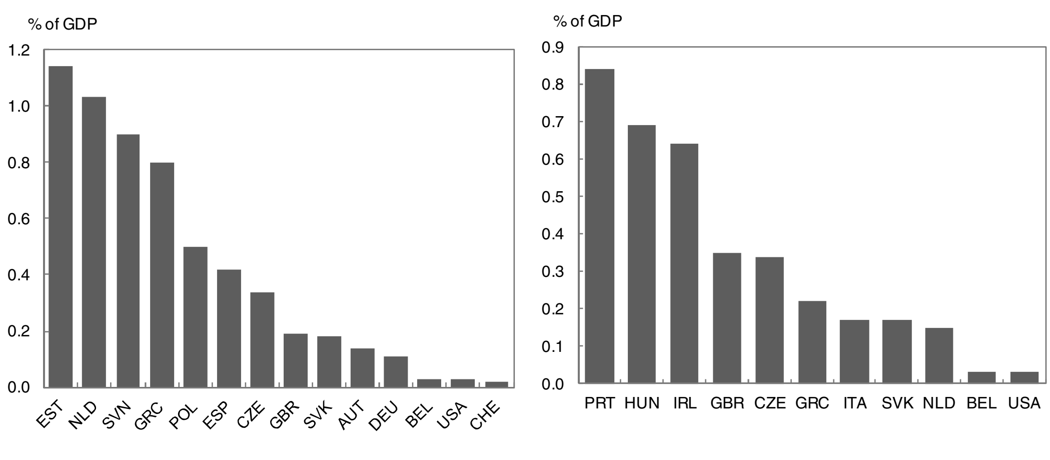
A number of countries have unspecified operational savings, i.e. no details are provided concerning reductions in wages, staffing or intermediate consumption. Examples are the freeze on operational expenditures by 2013 in Canada and the savings of 0.5% of GDP on operating costs in Danish ministries. Other countries with unspecified operational savings include Finland and New Zealand (see the section on "How deep are consolidation measures?" for a discussion of unspecified savings).

While intermediate consumption may implicitly be targeted in operational expenditure cutbacks or programme reductions such as health and infrastructures, it is interesting to note that intermediate consumption is not often explicitly targeted by OECD member countries.

Figure 1.20. **Operational measures – impact**

A. Operational expenditures

B. Wage cuts



Notes: The figures for the United Kingdom only sum up wage freezes and initial savings on operational expenditures. The data for Greece only include 2011 measures.

Source: "OECD Fiscal Consolidation Survey 2010".

Around 15 countries have specified operational savings and announced targets for reducing public wages and staffing. The range of wage cuts is wide and crosses categories of countries, from a two-year wage freeze in the United Kingdom to a 10% wage cut in the Czech Republic and approximately a 14% wage reduction in Ireland (Table 1.2). The cutbacks are even higher in Greece if reductions in allowances and earlier implemented cuts from 2009 and 2010 are included. The total quantified wage reduction is between

0.6% of GDP and more than 0.8% of GDP in Hungary, Ireland and Portugal (Figure 1.20B).

Table 1.2. **Wage reduction targets**

Country	Reductions
Belgium	0.7% savings on personnel expenditures.
Czech Republic	10% wage cut in the public sector (excluding teachers).
Estonia	9% savings on personnel expenditures.
France	Freezing public sector wages in 2011.
Greece	Allowances cut by 20% in 2010. Abolishing the 13th and 14th month bonuses for monthly earnings above EUR 3 000 (=14%).
Ireland	13.5% public sector wage cut in 2009-10. More cuts expected in 2011-14.
Portugal	5% wage cut in the public sector. 0.11% to 0.84% of GDP wage cut by 2013.
Slovak Republic	10% wage cut in central government.
Slovenia	14% wage and public intermediate consumption cut.
Spain	5% wage cut in 2010, frozen in 2011.
United Kingdom	Two-year wage freeze.

Source: "OECD Fiscal Consolidation Survey 2010".

In some countries, public sector employment will be scaled back considerably (Table 1.3). The Czech Republic plans to remove 10% of the public workforce excluding teachers. By 2014, there should be 330 000 fewer public sector employees in the United Kingdom and around 25 000 fewer in Ireland. Other countries will only replace a certain number of vacant positions or retiring employees (France, Greece, Portugal and Spain).

Table 1.3. **Staff reduction targets**

Country	Reductions
Austria	3 000 federal officials by 2014.
France	97 000 public sector jobs by only replacing 1 out of 2 retiring state employees.
Germany	10 000 federal public sector jobs by 2014.
Greece	20% of retiring employees replaced, fewer public short-term contract employees.
Ireland	24 750 public sector jobs by 2014.
Portugal	Recruitment freeze of civil servants (no replacements).
Slovenia	1% of public sector employees from 2010-11.
Spain	10% replacement of vacant positions between 2011-13.
United Kingdom	330 000 public sector jobs by 2014.

Source: "OECD Fiscal Consolidation Survey 2010".

There may be several reasons for countries to reduce the wage bill and public employment. The public sector wage bill is a substantial portion of public expenditure, and reducing wages provides immediate relief to strained public budgets, hence improving fiscal balances quickly. Staff reductions also help governments to reduce deficits, but this usually takes time to fully implement and the budgetary gain might appear with a certain time-lag. However, equally important may be the signal sent to markets and the public regarding the government's determination to improve fiscal balances by taking politically tough decisions like public wage and staff reductions.

Some countries have announced savings by reorganising the way the public administration functions, but only two countries have detailed plans for such reorganisation. Greece aims to substantially reform its government administration with changes at the central and local level. For example, the number of local administrations will be reduced substantially with local entities and agencies closed down. In addition, there will be fewer elected and politically appointed officials, and the budget process will be reformed. The United Kingdom provides another example (see Box 1.10) of how budget administration reform is being used to reduce public expenditures.

Box 1.12. **"Quango" reform in the United Kingdom**

In order to improve spending control and drive down the costs of the administration, from April 2011 the government will extend operational budget limits to cover so-called non-departmental public bodies and other arm's-length bodies ("quangos") which were not previously included. By doing so, the government intends to remove incentives for ministries to set up arm's-length agencies in order to reduce their administrative costs, allowing them to better manage the costs of wider central government, not just the civil service.

These ministries' administrative budgets (including the budgets of arm's-length bodies) are set to be cut substantially between 2011 and 2016; from 33% to 42% in real terms. An announced two-year wage freeze will help realise savings. In addition, the estimated reduction of 330 000 public sector jobs will include administrative layoffs.

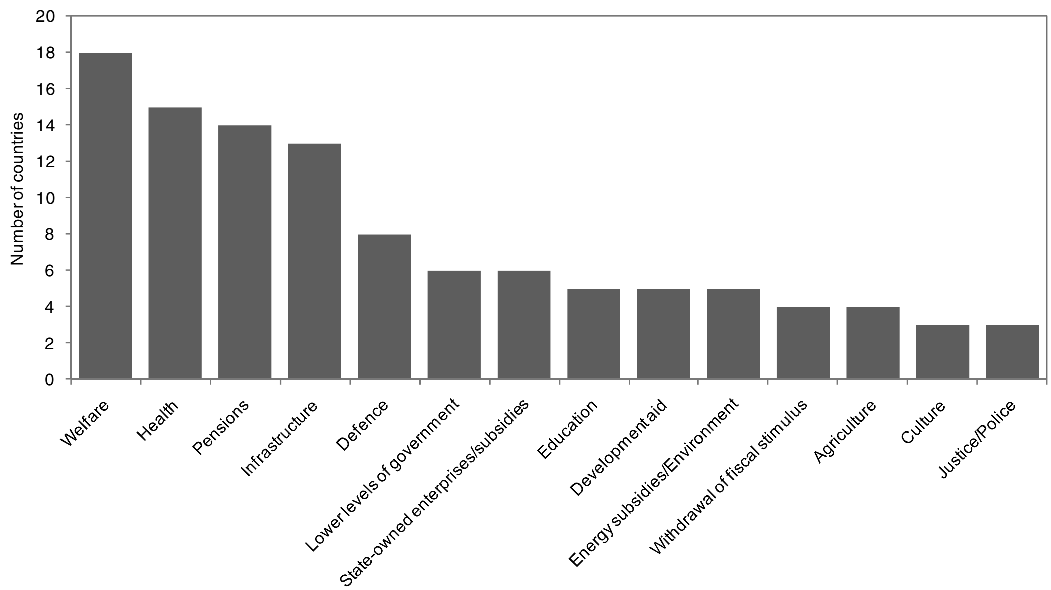
Source: HM Treasury (2010), *Spending Review 2010*, HM Treasury, London, *http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf.*

Major programme measures

Welfare and pensions targeted; health less than expected

The largest expenditure reductions come from reducing programme expenditures. Welfare is targeted by 18 out of 30 countries which is not surprising given the large share of public expenditures devoted to welfare (Figure 1.13). Welfare and pensions are discussed in more detail below. In addition to welfare, expenditures on health, infrastructure and pensions are most frequently targeted for savings (Figure 1.21).

Figure 1.21. **Major programme measures – frequency**



Note: Out of a total of 30 countries.

Source: "OECD Fiscal Consolidation Survey 2010".

Health savings are on the agenda in almost half of the countries that responded to the survey. These measures provide a major share of expenditure savings in Belgium and Turkey. However, of the 15 countries with health expenditure reductions in their consolidation plan, reduced pharmaceutical expenses are the main measure in five countries. For example, Turkey plans to reduce the medicine price margin from 80% to 66% and Greece has a goal of substantially cutting pharmaceutical spending (by 0.9% of GDP in 2011). In the other cases, health expenditure savings are not a major share of the consolidation, contributing less than 0.4% of GDP in countries other than Ireland and Greece where health expenditure reductions contribute 0.7% and 0.9% of GDP respectively (Figure 1.22A).

A total of 13 of the 30 responding countries scale back public investments in their plan (Figure 1.19). In Portugal and Spain, stopping or postponing infrastructure projects by downscaling investment expenditures is one of the most important contributions on the expenditure side. In Spain, a reduction of 0.5% of GDP is planned between 2011 and 2013. In Portugal, cumulative savings on investments will amount to 1.2% of GDP by 2013. In Ireland and Slovenia, infrastructure spending will be reduced, respectively, by 1.6% of GDP from 2011-14 and 0.8% of GDP in 2010-13 (Figure 1.22B).

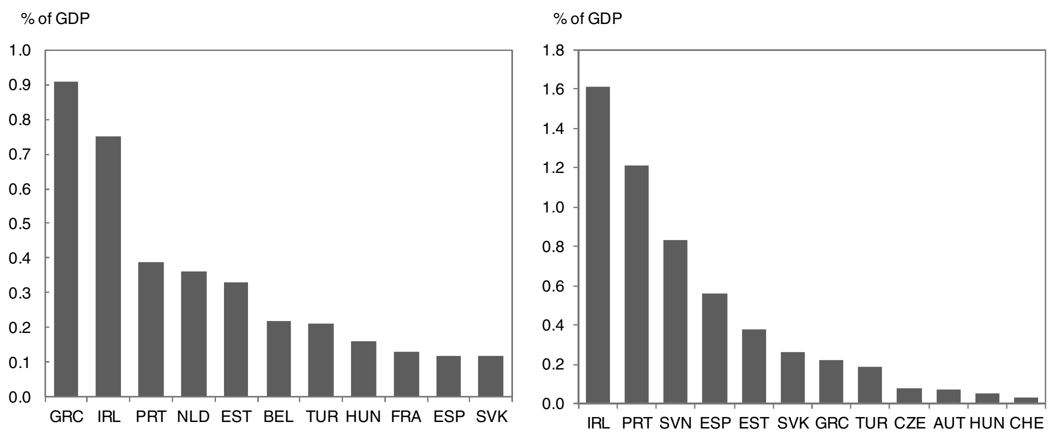
Defence expenditures are also targeted by a number of countries, but few of these savings substantially add to consolidation in OECD member countries, except for Estonia, where a cut of 0.2% of GDP was implemented in 2009.

Sub-national governments are specifically targeted for savings in a few member countries. Greece, Hungary and Italy are reducing transfers to local governments, while Estonia is reducing the municipal share of income tax.

Education, culture and justice/police are less targeted, not contributing considerably in any country. In Finland and Sweden, withdrawing fiscal stimulus measures is key for consolidation, while reducing development aid accounts for a large share in Canada and to some extent in Spain. The United Kingdom plans to increase appropriations to development aid.

Figure 1.22. **Health and infrastructure – impact**

A. Health B. Infrastructure

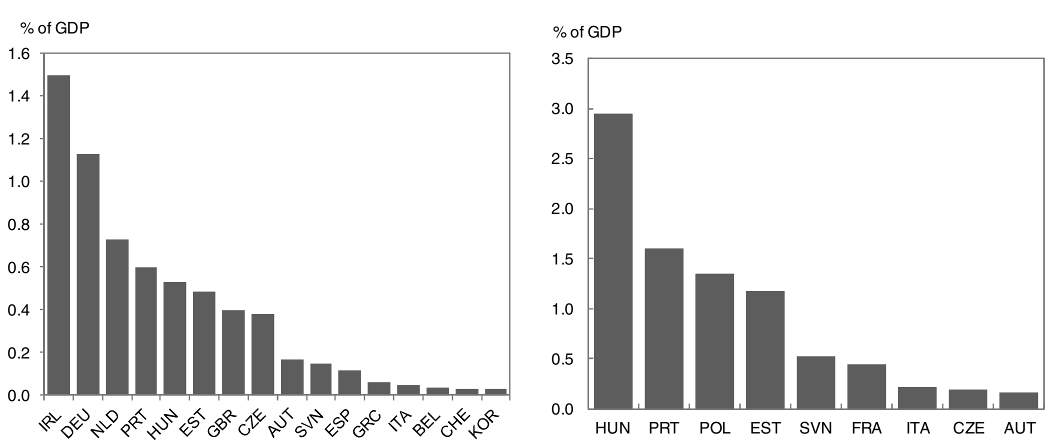


Source: "OECD Fiscal Consolidation Survey 2010".

Germany and Ireland are reducing welfare expenditures more than other countries, and a number of countries have quantified reductions in magnitudes of close to 0.4% of GDP or more (Figure 1.23A). In addition to being one of the largest expenditure items, countries reduce social transfers because they do not have adverse economic growth effects, or to a lesser extent. Within this category, reduced unemployed benefits are most frequently marked for savings (positive growth effects) as well as child benefits.

Figure 1.23. **Welfare and pensions – impact**

A. Welfare B. Pensions



Note: The transfer of Portugal Telecom's pension assets to the state is accounted on the revenue side but included here for comparison reasons.

Source: "OECD Fiscal Consolidation Survey 2010".

Pension reform is also on the agenda in many countries. A number of countries have announced an increase in the retirement age by two to five years (Table 1.4), reduced benefits and restrictions on early retirement schemes. While these measures are important for longer-term fiscal sustainability, a few countries have implemented changes with short-term effects, including transferring private pension assets to the state and suspending government contributions to pension schemes. Estonia, Hungary and Poland have accounted for relatively large pension savings in their consolidation plans by weakening the second pension pillar and including private sector accumulated pension funds (Hungary) (see Figure 1.23B and the section on "How deep are consolidation measures?"). In Portugal, the transfer of Portugal Telecom's pension assets to the state is accounted on the revenue side, amounting to a total of 1.6% of GDP in 2010-12.

Table 1.4. **Changes in retirement age for pension benefits**

Country	Year reformed	Retirement age (before reforms)	Retirement age (after reforms)	Implementation period
Australia	2009	65	67	2017-23
Estonia	2010	63	65	2017-26
France	2010	65 (for full pension benefits)	67	By 2018
		60 (minimum retirement age)	62	
Germany	2007	65	67	2012-29
Greece	2010	60 (women workers)	65	
Hungary	Planned	Lowering the retirement age for women who have at least 40 years of work experience		
Ireland	2011	66 (new entrants to the public service)	68	By 2028
Korea	2007	60	65	2013-33
Spain	Planned	65	67	
United Kingdom	Planned[1]	65	66	By 2020
United States	1983	65 (for full social security benefits)	67	By 2027

1. The Pension Bill 2011 was submitted to the House of Lords in January 2011.

Source: "OECD Fiscal Consolidation Survey 2010".

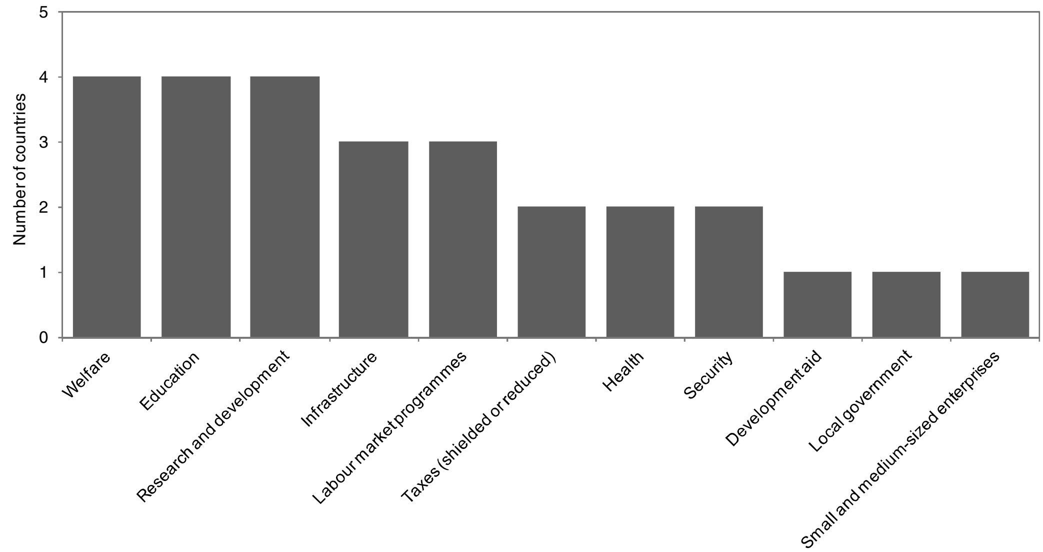
Agriculture and subsidy reductions not targeted

Agriculture expenditures, subsidies to state-owned enterprises and energy subsidies are among the least prioritised areas for savings among OECD member countries despite sizeable support for agriculture and levels of subsidies in many countries. Not only would reducing subsidies improve governments' fiscal balances, but it would also improve the efficiency of the economy and increase potential output in many cases, hence having beneficial effects on public finances over the medium term (OECD, 2010h).

Welfare, education, and research and development shielded by some countries

Some countries are shielding specific areas from reductions for political reasons and/or to protect vulnerable groups by, for example, shielding certain welfare expenditures and labour market programmes (Figure 1.24). Other countries are shielding specific areas in order to support economic growth. This category includes education, research and development, and infrastructure in particular.

Figure 1.24. **Shielded areas**



Note: Out of a total of 30 countries.

Source: "OECD Fiscal Consolidation Survey 2010".

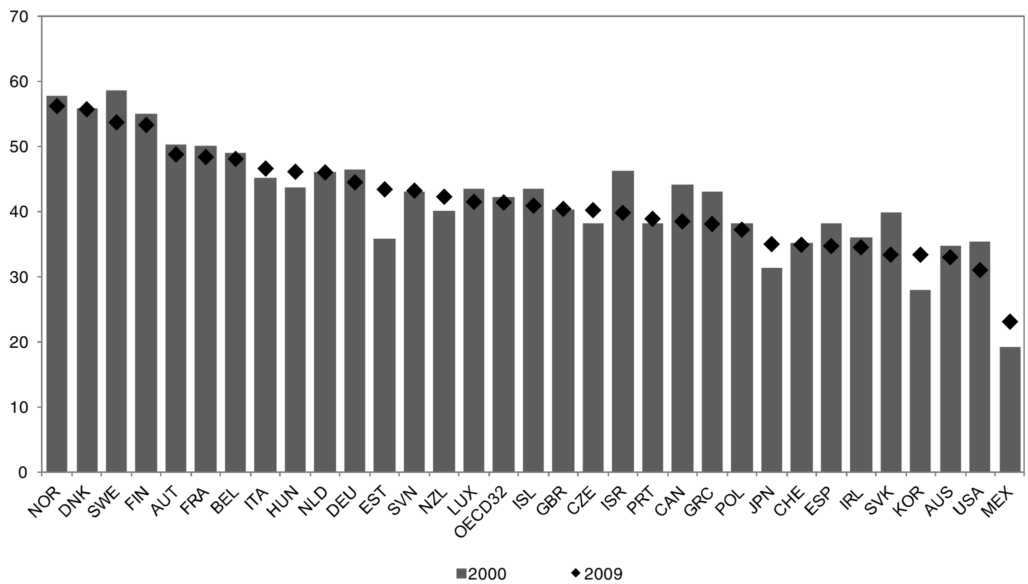
Revenue in OECD member countries

Most of the surveyed countries have plans for enhancing revenue in their fiscal consolidation plans.[9] Various factors, including size of government revenue, composition of revenues, and the size of needed fiscal adjustments, play an important role in determining which strategies to implement to increase revenues.

Government revenue as a share of GDP was stable at around 40% in the OECD area as a whole from 2000-09. However, government revenues between countries show significant differences, ranging from 23% of GDP in Mexico to 56% of GDP in Norway (Figure 1.25). Nordic countries collect on average ten percentage points of GDP more revenue than other countries. In contrast, revenue-to-GDP ratios for some countries such as Japan, Spain and the United States are well below the OECD average.

Figure 1.25. **General government revenues**

% of GDP (2000 and 2009)



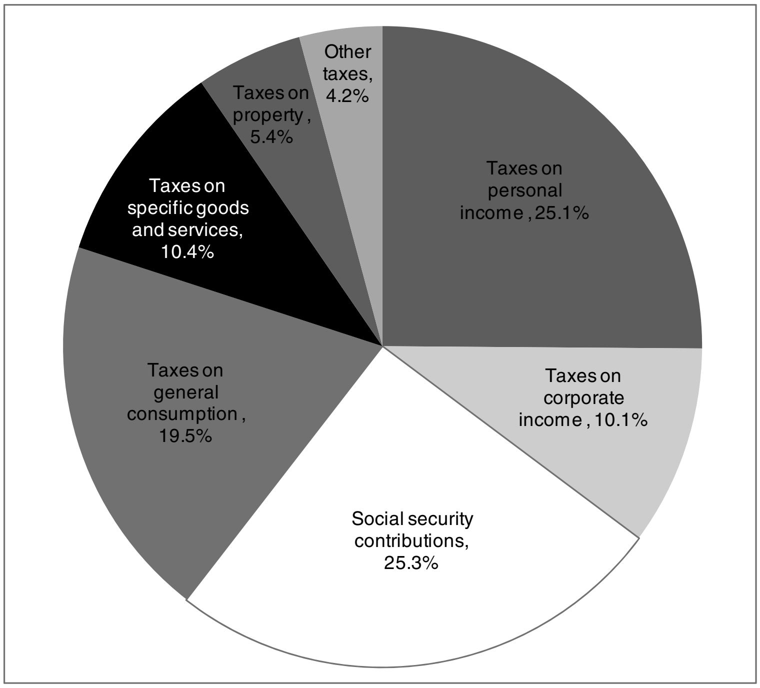
Notes: Data for Chile and Turkey are missing. For Australia, Japan, Korea and New Zealand: 2008 instead of 2009. For Mexico: 2008 instead of 2009; 2003 instead of 2000. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD National Account Statistics, October 2010, http://dx.doi.org/10.1787/na-data-en.

Of total general government tax revenues, the largest share (35% of total tax revenue) is made up of personal income taxes and corporate income taxes, followed by social security contributions and payroll tax (Figure 1.26). Taxes on goods and services such as value-added tax and excise duties also represent a significant amount of total tax revenue.

Figure 1.26. **Tax structures**

% of major tax categories in total tax revenue, 2008

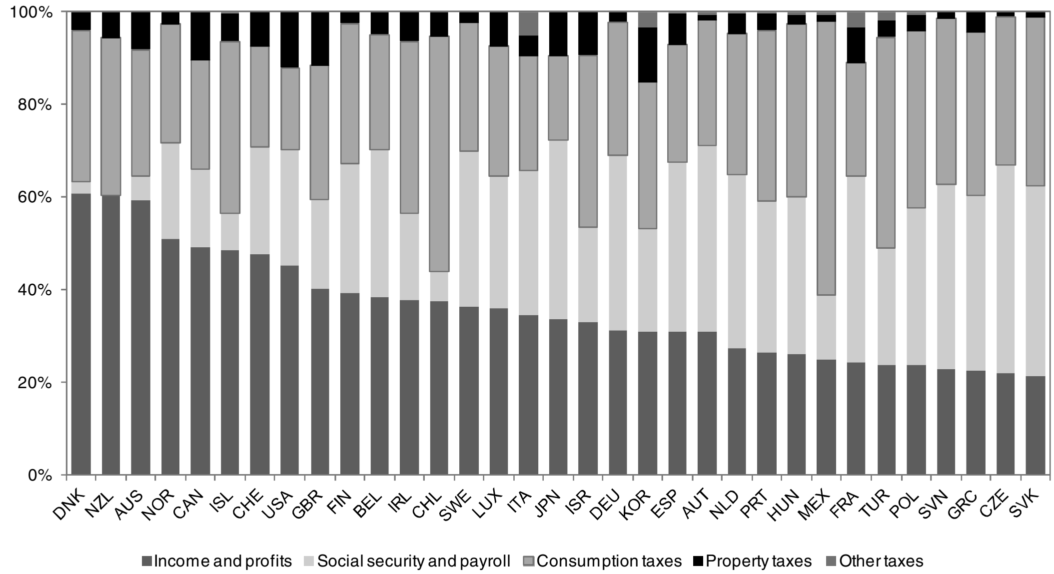


Source: OECD (2010), *Revenue Statistics 2010*, OECD Publishing, Paris, http://dx.doi.org/10.1787/rev_stats-2010-en-fr.

There is considerable variance between OECD member countries in terms of relative reliance on tax sources, especially consumption taxes (Figure 1.27). These differences suggest that, for some countries, the scope for increasing consumption taxes might be greater compared to other countries.

Figure 1.27. **Relative reliance on tax revenue sources**

2007



Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

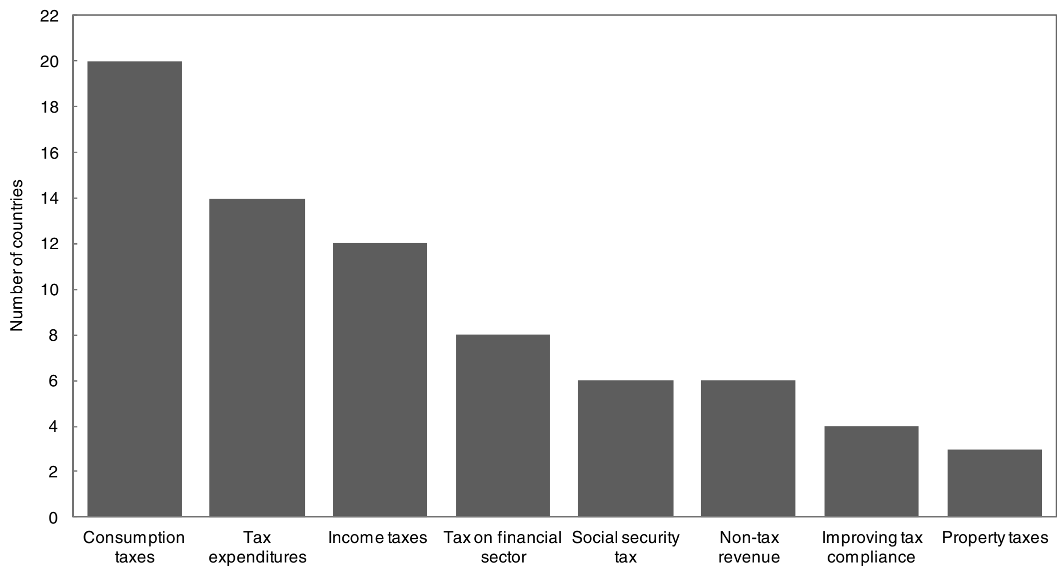
Source: OECD (2010), *Revenue Statistics 2010*, OECD Publishing, Paris, http://dx.doi.org/10.1787/rev_stats-2010-en-fr.

The size of fiscal adjustments is also an important factor in explaining diverse revenue measures. The majority of fiscal adjustment programmes include some revenue measures in order to complement expenditure-based fiscal adjustments. But countries like Estonia, Greece, Hungary and Ireland, which have large fiscal adjustment needs, have supplemented expenditure-based plans with substantial revenue measures since spending cuts alone might be not enough to stabilise their public finances.

Major revenue measures

The most frequently announced tax measure is raising consumption taxes followed by reducing tax expenditures and increasing income taxes (Figure 1.28). In contrast, property taxes are only used by three countries. Frequent use of consumption taxes implies that policy makers believe they are likely to bring in significant revenue in the short term with less of a negative impact on economic growth compared to income taxes. This view is supported by a number of empirical analyses of the impact of taxation on economic growth.

Figure 1.28. **Revenue measures – frequency**



Notes: Out of a total of 30 countries. Consumption taxes include value-added taxes, general sales tax, and taxes on specific goods and services (excise duties). Income taxes include personal income taxes and taxes on corporate profits. Non-tax revenue includes raising or introducing user fees (such as tolls for motorways), privatising state-owned enterprises, selling state-owned real estate, etc. Improving tax compliance includes reforms to make tax administration systems effective and transparent, efforts to reduce tax evasion and fraud, etc.

Source: "OECD Fiscal Consolidation Survey 2010".

Box 1.13. **Tax reform in Greece**

Greece has implemented a wide range of tax reforms in order to secure fiscal consolidation targets. The government expects that this will result in additional revenues amounting to 3.5% of GDP in 2011. The tax reforms include an increase in the standard VAT rate, broadening the VAT base by including services that are currently exempted, and increasing excises on fuel, tobacco and alcohol to bring them in line with other EU countries. Other measures include a higher assessment of real estate, temporary surcharges on highly profitable firms, a tax on CO_2 emissions, and new gaming royalties and license fees.

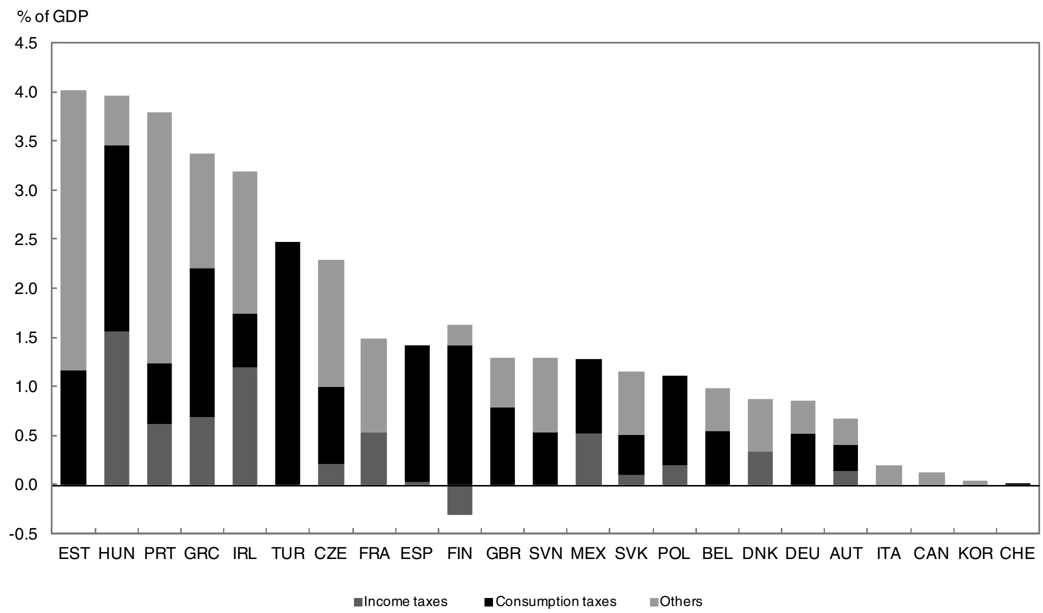
Besides these direct measures for enhancing revenues, the government is making efforts to reduce tax evasion and improve the efficiency of the tax administration since, according to the government, revenue efficiency is significantly lower than the EU average (5.5 points of GDP below average) with similar statutory rates. Greece passed a law in April 2010 to tighten obligations to issue receipts for VAT, ensure stronger enforcement and auditing of very wealthy individuals, and launch the reorganisation of local tax offices.

The impact of revenue enhancement measures varies widely.[10] Not surprisingly, countries with the largest economic imbalances and more rapid deterioration in public finances announced larger quantified revenue measures. Estonia, Greece and Hungry are aspiring to increase their revenues by more than 3% of GDP (Figure 1.29A). The increase of consumption taxes accounts for the largest share in many countries. Income tax measures are used by a number of countries, but their share of total revenue increase is smaller than consumption taxes.

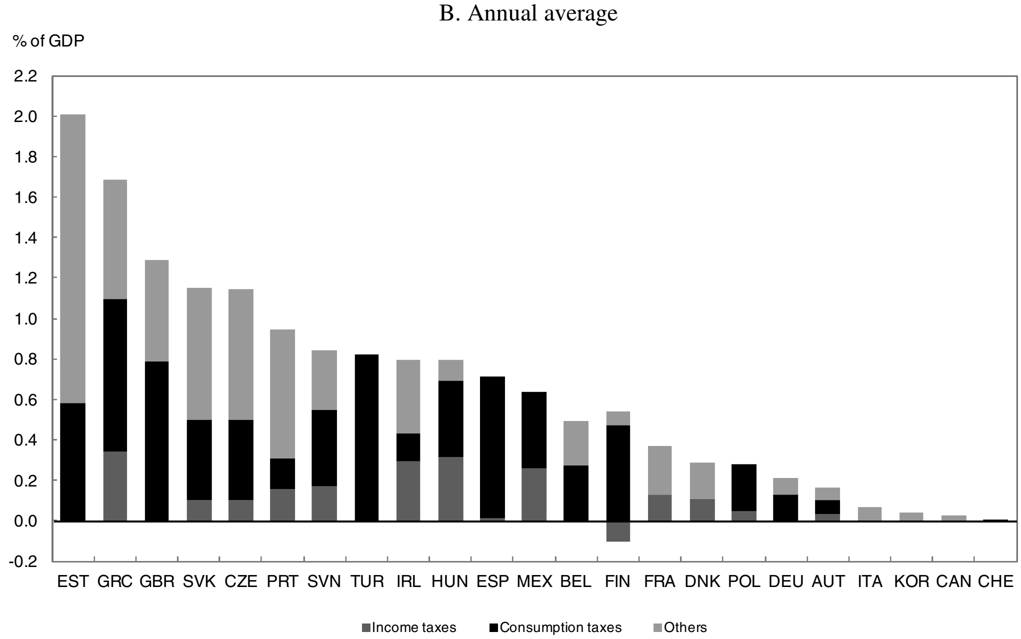
By examining the annual impact of revenue measures, a slightly different picture emerges (Figure 1.29B). The Czech Republic, the Slovak Republic and the United Kingdom stand out along with Estonia and Greece, who expect their revenues to grow more than 1% of GDP annually over their consolidation time horizon.

Figure 1.29. **Quantified revenue measures**

A. Cumulative impact



B. Annual average



Source: "OECD Fiscal Consolidation Survey 2010".

Consumption taxes

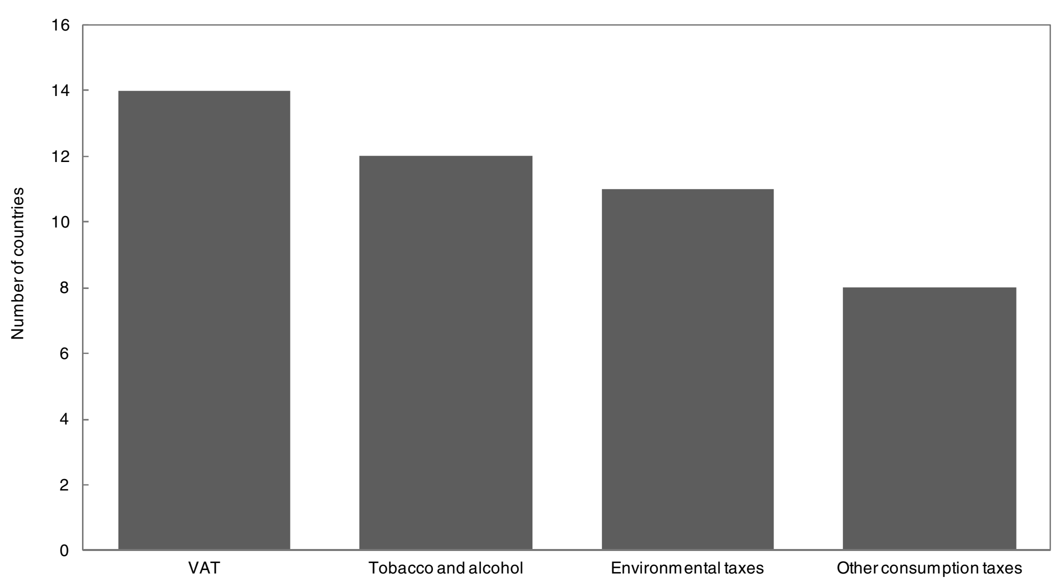
Most countries announced consumption tax measures including hiking up the rate of value-added taxes (VAT), extra excise duties on tobacco and alcohol, and environmental taxes[11] (Figure 1.30A). The impact of the measures is more than 1.5% of GDP in Hungary, Greece and Turkey (Figure 1.30B). Since 2009, a total of 14 countries have raised standard VAT tax rates or have plans to do so. VAT rate hikes range from a one percentage point increase in the Czech Republic and Finland to five percentage points in Hungary (Figure 1.31). The Portuguese government increased the standard rate for VAT by 2 percentage points, from 21% to 23%, effective since January 2011. This is the second increase, following the previous 1% increase in July 2010. Greece also increased the VAT rate twice, from 19% to 21% in March 2010, and then to 23% in July 2010.

Box 1.14. **Revenue measures in Hungary**

The government increased the standard VAT rate by 5 percentage points in July 2009. Hungary has also introduced levies on financial institutions, temporary sector-specific income taxes on energy, telecoms and commercial chain companies, and the nationalisation of private pension contributions into the budget, and reformed the pension scheme to lead more employees into the state pension pillar. In addition, a significant simplification of the taxation system itself is envisaged.

Figure 1.30. **Consumption taxes**

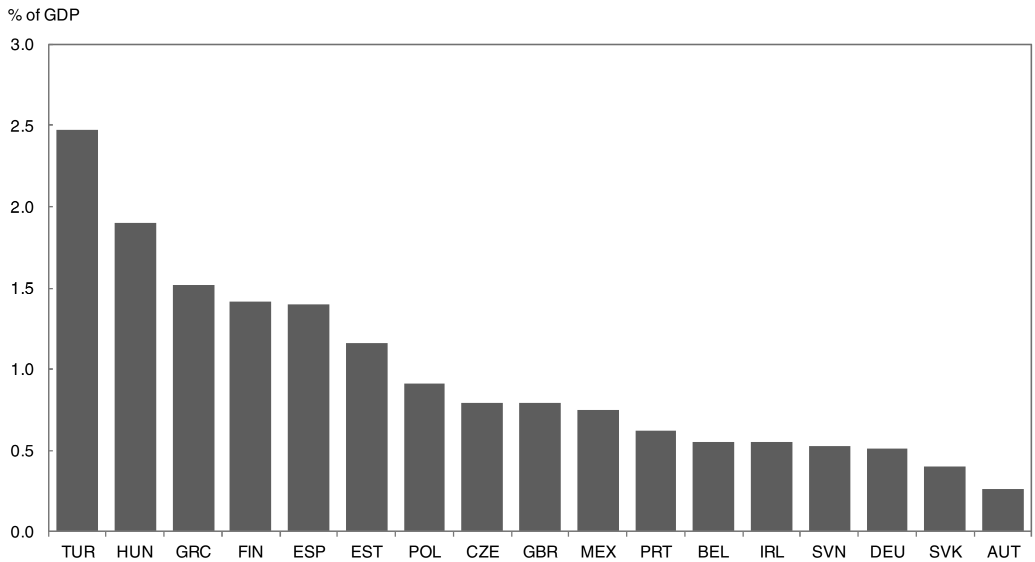
A. Frequency



Note: Out of a total of 30 countries.

Figure 1.30. **Consumption taxes** *(cont'd)*

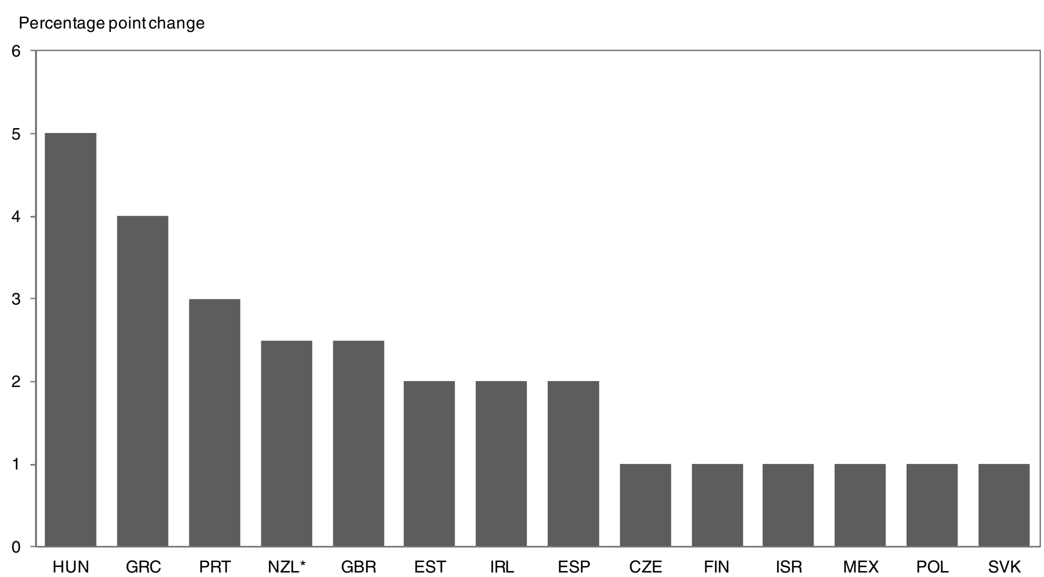
B. Impact



Source: "OECD Fiscal Consolidation Survey 2010".

Figure 1.31. **VAT rate hikes**

Increases in standard VAT rates since 2009



Notes: All countries have already implemented tax rate hikes except Ireland (2% increase foreseen by 2014). The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

* In New Zealand, it is a general consumption tax.

Source: "OECD Fiscal Consolidation Survey 2010".

Some European countries also announced the adoption or extension of environmental taxes. Environmental taxes include excise taxes on fossil taxes, motor vehicle registration taxes, taxes on energy and energy waste, and taxes on carbon or auctioning of CO_2 emission permits. It is important to note that, unlike other tax measures, the main goal of environmentally related taxes is to reduce environmental damage, including reducing emissions of greenhouse gases. While environmental taxes are currently a small proportion (around 2% of GDP in total revenues among OECD member countries), they have the potential to substantially increase revenues. According to OECD (2010f), auctioning emission permits to reduce greenhouse gas emissions by 20% of the 1990 level would generate revenues of 2.3% of GDP on average in OECD member countries by 2020.

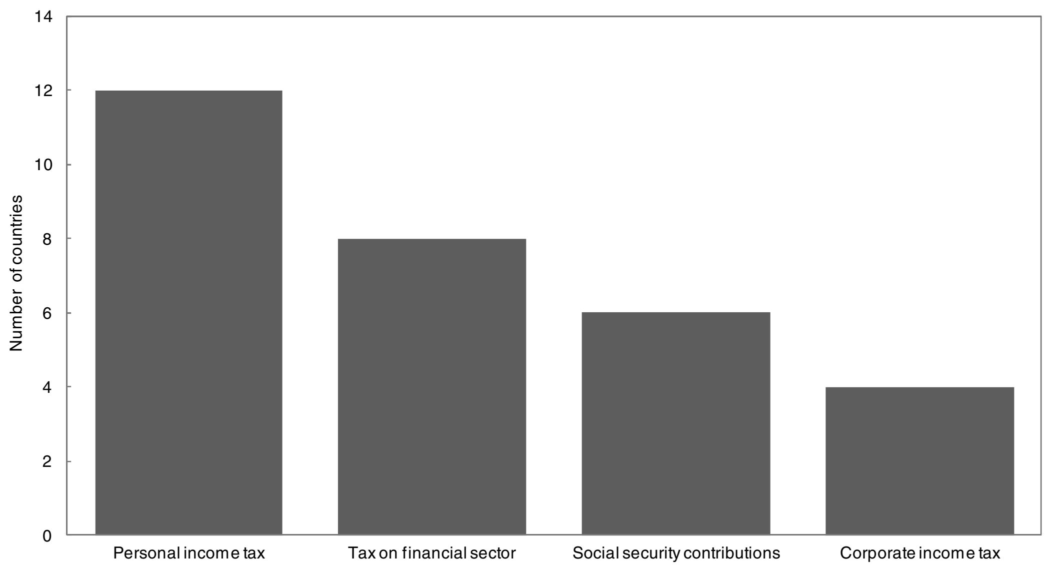
Income taxes, social security taxes and taxes[12] on the financial sector

To strengthen revenue, many countries have envisaged measures to enhance personal income taxes (PIT), broaden social security contributions and introduce new taxes on the financial sector (Figure 1.32A). The Czech Republic, Hungary, Ireland and Portugal expect to bring extra revenues of more than 1% of GDP from these measures (Figure 1.32B). More than ten countries have announced measures including raising PIT rates for top income earners (France, Portugal and Spain), lowering the minimum PIT threshold (Ireland) or suspending automatic adjustments of nominal tax thresholds (Denmark).

In response to the economic crisis, some OECD member countries have provided significant support such as recapitalisation, asset purchases and liability guarantees to their financial sector. Governments are now shifting their focus both to reduce future financial failures through strengthening regulations and to recover the cost of fiscal support through introducing new taxes on the financial sector.[13] A total of eight countries including Austria and Germany have implemented or proposed new taxation on the financial sector. Taxes on the financial sector can be considered sector-specific taxes since financial companies and their employees are subject to general taxes such as corporate income taxes on companies and personal income taxes on employees. Financial sector taxation takes various forms in terms of the perimeter of the tax (tax on bonuses paid to employees or special taxes on financial institutions), the tax period (temporary or permanent), and the proceeds of taxation (general revenues or a separate fund).

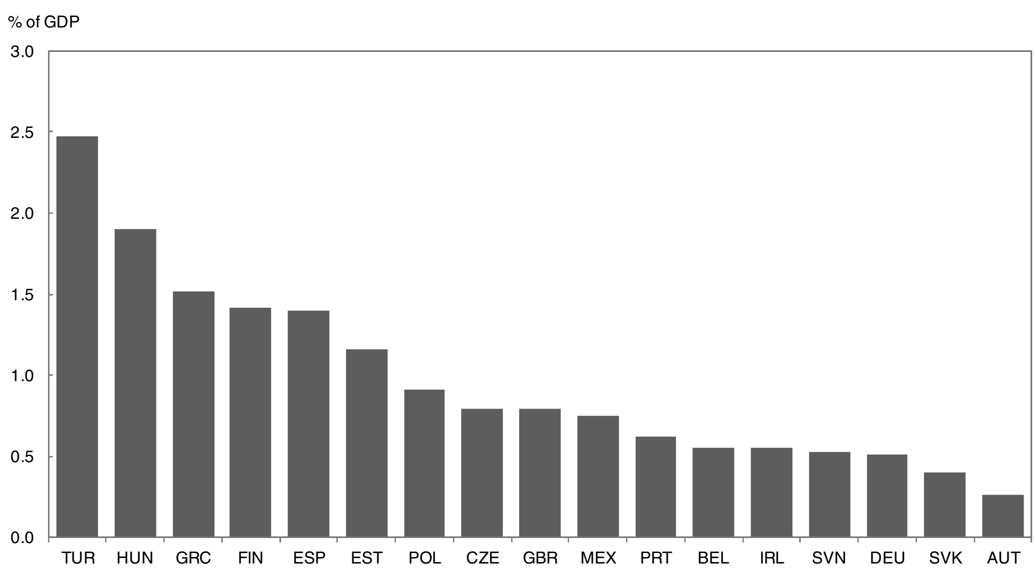
Figure 1.32. **Income-related taxes**

A. Frequency



Note: Out of a total of 30 countries.

B. Impact



Note: The figures add the impact of income taxes, social security contributions, and tax on the financial sector.

Source: "OECD Fiscal Consolidation Survey 2010".

Box 1.15. **Bank levies in Germany and the United Kingdom**

Germany: The German government announced plans for a levy on banks in March 2010. The perimeter of the levy includes all banks, and the rate of the levy will reflect systematic risk which will be based on the size of the banks' liabilities. The levy is likely to be permanent and is to be paid into a restructuring fund which will finance a special resolution regime for systematically important banks.

United Kingdom: In December 2009, the United Kingdom introduced a temporary "bank payroll tax" which is levied on bonuses paid to bank employees. The tax applies at a rate of 50% to the bonuses over GBP 25 000 paid by banks to their employees between December 2009 and April 2010. It was intended to cover the period until the government established new regulations on remuneration practices.

Other revenue measures

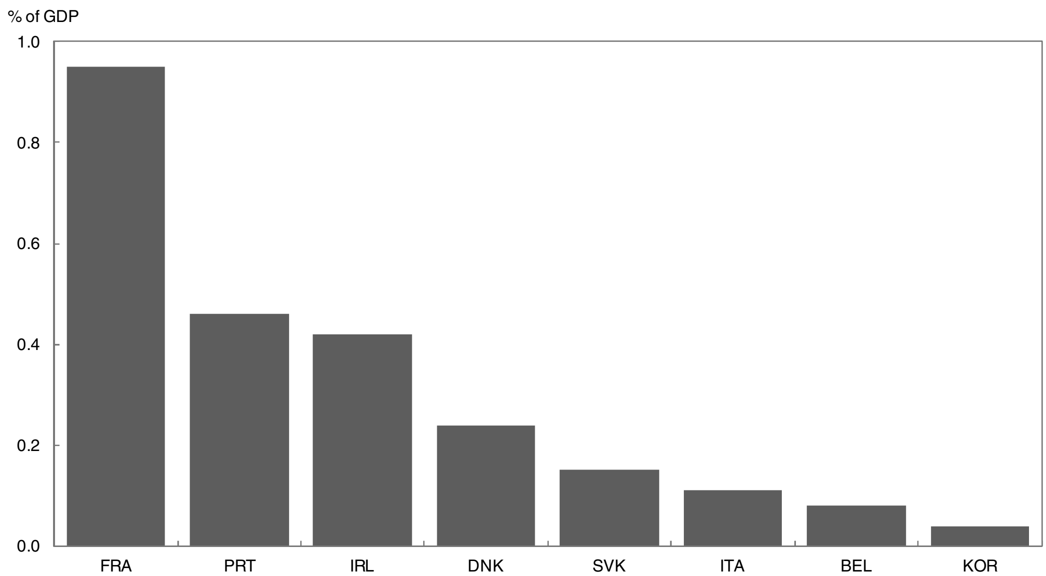
Tightening tax deductions and other tax benefits has also been used by countries to increase revenues (Figure 1.33A). France and Portugal announced a wide range of measures to reduce tax expenditures, such as a reduction of tax allowances and benefits for personal income tax and a review of the fiscal benefits for corporate income tax. These measures are expected to enhance revenue by more than 0.9% of GDP (France) and 0.4% of GDP (Portugal).

In addition to tax policy measures, several countries have implemented measures to make their tax administrations more effective and to reduce tax evasion (Figure 1.33B), or are planning to do so. Greece and Slovenia expect to collect extra revenue amounting to more than 0.6% of GDP by combating tax abuse. In particular, the Greek government is focusing on reforming tax administration operations and increasing the collection of tax arrears, since revenue efficiency is significantly lower than the EU average (of countries with similar statutory rates). Ineffective tax collection in Greece may be associated with a large informal economy and institutional weaknesses of the tax administration (OECD, 2009d). Slovenia estimates increased revenue collection through a new tax information system.

While tax measures may exert a long-lasting influence on revenues, some countries implemented one-off non-tax measures to increase revenues (Figure 1.33C): the sale of state-owned real estate and additional dividends from state-owned enterprises (Estonia); the transfer of Portugal Telecom's pension plans to the state and the privatisation of state-owned enterprises (Portugal); and introducing/raising user fees (Italy) (see the section on "How deep are consolidation measures?"). The Estonian government relies more on non-tax revenues than other countries; additional dividends from state-owned enterprises and sales of state-owned real estate increased revenues by more than 2% of GDP in 2009-10.

Figure 1.33. **Impact of other measures**

A. Tax expenditures



B. Tax compliance

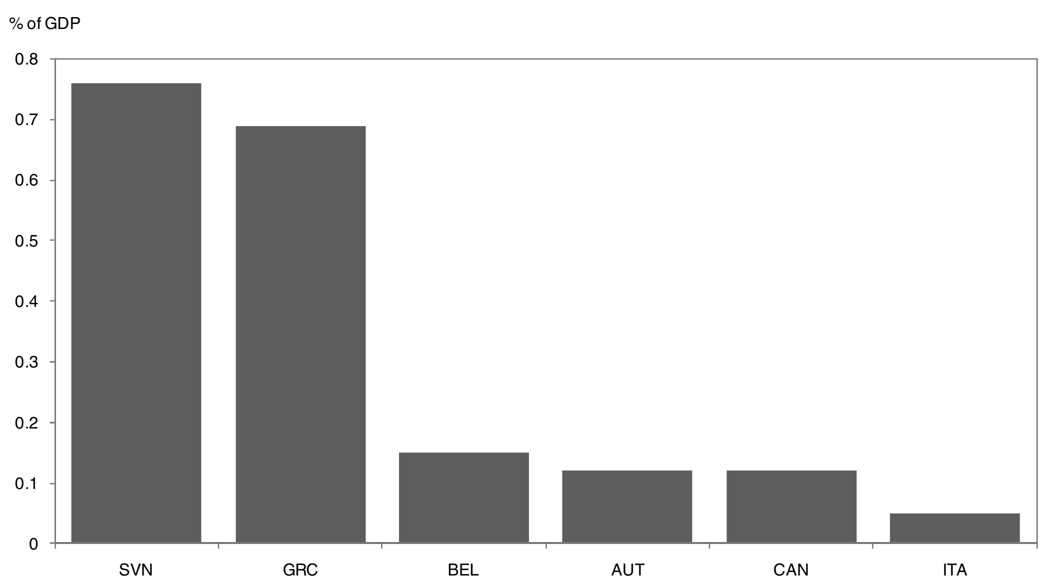
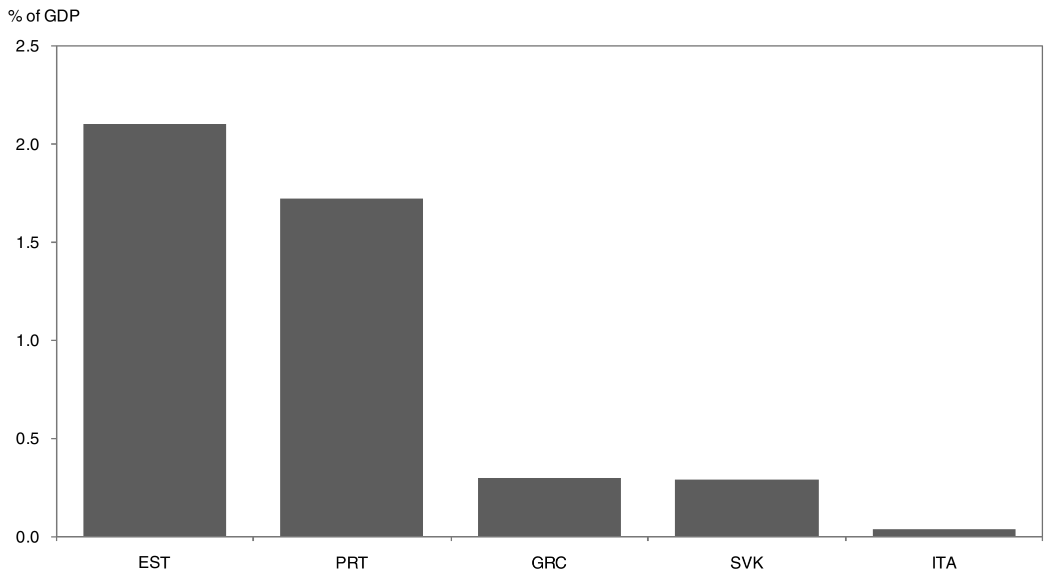


Figure 1.33. **Impact of other measures** *(cont'd)*

C. Non-tax revenues



Source: "OECD Fiscal Consolidation Survey 2010".

How deep are consolidation measures?

Consolidation plans provided by countries can be classified into three categories: *i)* long-term structural measures;[14] *ii)* the rolling back of stimulus measures; and *iii)* short-term additional adjustments. Of these, the majority of plans, both on the expenditure and revenue sides, appear to be long-term structural measures that improve fiscal sustainability.

A small number of countries, particularly those with comparatively low fiscal consolidation needs (category 4: Finland, Sweden), include the planned roll-back of temporary stimulus measures for deficit reduction. The end of temporary stimulus measures makes up about half of the expected deficit reduction between 2010 and 2012 in Canada, and a third of the consolidation in 2011 in France.

Other consolidation measures are not considered to have a structural impact because they are either one-off or temporary measures, or because they rely primarily on accounting changes that do not improve the underlying primary balance. Such measures may appeal to countries under market pressure to consolidate (category 1: Hungary, Portugal) either to help relieve liquidity pressures, or because they are seeking to front-load deficit improvements in order to reassure capital markets.

Countries that have not yet announced large consolidation plans (category 3: Poland) or are under less pressure to do so (category 4: Finland) are less likely to have detailed plans, relying instead, for example, on unspecified operational measures. In addition, some operating and administrative efficiency measures may not realise the expected fiscal impacts, either because their effects may fade over time, as in the case of wage reductions or limiting wage increases, or because they are based on assumptions of user behaviour, as in the case of improving tax compliance.

Finally, economic assumptions that are systematically overly optimistic understate fiscal consolidation needs, undermining countries' ability to meet their deficit reduction targets over time.

One-off measures

Some countries implemented one-off non-tax measures to increase revenues, as in the case of Estonia (Figure 1.33C) which increased revenue by more than 2% of GDP in 2009-10 through the sale of real estate and land and from additional dividends from state-owned enterprises. In Poland, the privatisation of state assets has been relied upon to help lower borrowing requirements. Japan has transferred surplus foreign exchange funds and repayment from independent administrative agencies to the state treasury. While such measures might improve the general government primary balance, privatisation and selling government property should be used to reduce public debt based on government policy and subject to a cost-benefit analysis, rather than as a deficit reduction tool.

Temporary taxes can also help governments to reduce deficits but are by their very nature non-structural and may create distortions by discriminating between sectors. Examples include Hungary's use of temporary taxes on energy, telecoms and commercial chain companies in 2010 and 2011, and the Slovak Republic's use of temporary taxes on CO^2 emissions in 2011 and 2012.

When inadequately documented, one-off measures can make it more difficult to assess the underlying fiscal position. In addition, by creating temporary fixes, they can postpone necessary structural reforms (Koen, 2005).

Accounting measures

Accounting measures can be used to provide the appearance of deficit reduction without any real impact on the underlying balance. For example, Poland off-loads public infrastructure spending to its National Road Fund which does not count against debt. Accounting changes to pension systems were used in some countries to improve their fiscal position. For example, Estonia is temporarily suspending its second pillar funded pension scheme. Portugal shows the transfer of Portugal Telecom's pension fund to the state as revenue; as the fiscal position does not include pension liabilities, however, this measure may actually overstate the impact, if any, on overall debt. Similarly, Hungary is also privatising the pension pillar, while Poland plans to redirect 5 percentage points of pension contributions from the second pillar of the pension system (reduced from 7.3% to 2.3% of gross wages) to the first pillar (Social Security Fund). Such a "nationalisation" of private pension contributions does not reduce net debt.

Operational measures

When accompanied by reductions in the administrative budget and/or in staff, operational measures decrease deficits. Unspecified operational measures (e.g. Canada, Denmark, Finland and New Zealand), however, or a general cap on spending (e.g. Australia, the Czech Republic, Hungary and Ireland) may not put sufficient pressure on the public administration to realise efficiency savings. Poland has put in place a temporary expenditure rule limiting the growth rate of flexible and new legally mandated expenditures. While small unspecified operational cost reductions can be used as an incentive for the public administration to achieve efficiency savings through internal process improvements, larger measures need to be detailed and their implementation ensured.

Reorganising the government can be seen as a highly visible way to signal the government's commitment to reform. This is particularly true regarding the reining in of new agencies that have been created in many OECD member countries since the 1990s. Partial data show that, in some OECD member countries, arm's-length agencies in central government now account for more than 50% of public expenditure and public employment (OECD, 2005). Governments should be aware, however, of the direct and indirect costs related to reorganising government, as well as the possible impacts on the level and quality of services delivered to citizens and the legislative changes that may be needed to implement reforms. Assessing the costs and benefits of reorganising helps to ensure a successful implementation.

Proposals to cut wages (e.g. Czech Republic, Greece and Ireland) or to limit wage increases (e.g. Slovenia) as an operational deficit reduction measure (Figure 1.20B and Table 1.2) have the benefit of a relatively quick deficit impact, but could prove to be only one-time measures, as wages will again increase in the future depending on how public sector wages compare to private sector wages.

In addition to tax policy measures, several countries (e.g. Greece and Slovenia) have implemented measures to make their tax administration more effective and to reduce tax evasion (Figure 1.33B) or are planning to do so. While the revenue impact of improving tax compliance can be real, it is also subject to some complex behavioural assumptions. In order to ensure that estimated revenues are achieved, the estimated fiscal impact of tax compliance plans should be based on concrete measures that change programme rules or compliance tools rather than simply increasing the level of effort.

Optimistic economic assumptions

Deficit estimates can also be reduced through sustained optimistic growth assumptions. Bornhorst et al. (2010) compare national and IMF forecasts and show that overly optimistic economic assumptions can overstate the portion of fiscal targets that will be met by improved economic growth, artificially reducing the need for fiscal consolidation measures. For advanced countries, this bias averaged 0.3 percentage points of annual average per cent growth for the period 2011-13.

The European Commission also found that economic assumptions about nominal growth, tax elasticity and interest rates underpinning stability and convergence programmes are relatively optimistic, thereby understating fiscal consolidation needs (European Commission, 2010).

Non-structural measures might be justified at times either because of immediate liquidity needs or as part of minor adjustments in countries with low consolidation needs. One-off and temporary measures, however, do not have a lasting impact on fiscal sustainability, while accounting measures and optimistic economic assumptions misstate the true extent of fiscal consolidation needs. Operational measures can be structural but need to be detailed and transparent in order to demonstrate how countries intend to meet their targets.

Conclusion

In the aftermath of the economic crisis, the state of public finances across OECD member countries has worsened considerably; in 2011, gross government debt is set to exceed 100% of GDP across the OECD area. While not all countries have been hit equally, almost all OECD member countries have felt the need to respond to global financial pressures by setting deficit targets.

In order to stabilise or reduce debt-to-GDP ratios to prudent levels, many OECD member countries will need to undertake substantial fiscal consolidation measures. By the end of 2010, however, only about half had announced medium-term fiscal consolidation programmes. Four groups of countries have emerged: consolidating under market pressure, pre-emptive consolidation, adequate consolidation plan yet to be announced, and low fiscal consolidation needs. Market pressure appears to be a key factor in determining the announcement of a consolidation plan, including the size, concreteness and timing.

Countries should announce credible plans and ensure transparency and accountability

The announcement of a credible plan can alter the expectations of key economic and financial players. By providing specific expectations and greater certainty about fiscal outcomes, credit markets may lower the risk premiums demanded in financing public debt. Such a plan can provide for a phased-in approach to accommodate the continuing need to provide fiscal stimulus in the shorter term, countered by a longer-term fiscal consolidation strategy (OECD, 2010d and 2010h).

The experience of previous consolidations shows that the scale of consolidation can make possible reforms that alone would not be politically feasible. Factors that are critical to the success of fiscal adjustments include the size of the adjustment (greater adjustments have had a more positive impact), the duration (successful adjustments have been multi-year), the composition (spending cuts have tended to provide the most durable deficit reduction and to increase the likelihood of a positive macroeconomic impact) and the state of public finances (the worse the situation, the more likely the effects will be positive) (OECD, 2010d).

Clearly announcing the size, time frame, and make-up of fiscal consolidation plans in a transparent way sends a strong signal to the international community about a country's commitment and readiness to take the necessary steps to meet its fiscal targets. While most adjustment plans have detailed the required spending cuts and revenue enhancements for 2011, less contain the detailed consolidation measures required for the following years; half of OECD member countries have announced measures for 2012 and only eight countries until 2014.

If implemented as planned, announced consolidation for 2011-15 will be an important step in restoring public finances and will be sufficient to curb increasing debt-to-GDP levels in a number of countries, in particular for the first and second categories of countries. However, more consolidation is needed if debt levels are to be reduced to more prudent levels.

Consolidation plans should reduce spending

Not all of the announced measures have the same impact on fiscal sustainability. In particular, structural measures have the most lasting impact in terms of stabilising finances and achieving deficit goals. Most of announced fiscal adjustments are based on structural measures, though some notable exemptions exist for pension accounting changes and temporary taxes. Expenditure reductions are emphasised relative to revenue enhancements, which is in line with historical evidence that spending cuts tend to provide the most durable deficit reduction.

Pension reforms have been adopted or are planned in many countries. Sufficient pension reforms restore longer-term fiscal sustainability and the credibility of public finances with limited impacts on short-term demand.

On the expenditure side, most countries seek to reduce operational expenditures by reducing wages and public employment. Welfare and health expenditure reductions are targeted, albeit to a lesser extent than expected given the large share in public outlays, future increases in age-related costs and the scope to increase efficiency in many countries. Reduced subsidies and support in the agriculture sector are only included in a few plans and could be targeted to a larger extent, producing a double dividend due to both improved public finances and reduced economic distortions created by subsidies.

Consumption taxes including VAT rate hikes, extra excise duties on alcohol and tobacco and environmental taxes are dominant measures on the revenue side. Concerns about the impact of taxation on economic growth lead countries to adopt consumption tax measures since the measures are less harmful to growth than income taxes. Reducing tax expenditures and raising personal income taxes have also been adopted by more than ten countries. Notably, few countries plan to increase property taxes. The impact of revenue enhancement measures varies widely among OECD member countries.

Public understanding is critical for implementation

Given that most of the fiscal consolidation plans discussed in this report will be implemented from 2011 and onwards, the next step will be to ensure that countries live up to their commitment to fiscal stewardship. Creating public understanding and support for restoring fiscal sustainability through deficit reductions is hard, but not impossible. A communication strategy that emphasises social balance and fairness – between all levels of government, government entities, income classes and generations – should be part of the plan. Announcing plans and providing supporting analysis will help to promote a healthy public policy debate to demonstrate both the need for cuts as well as how they should best be distributed (OECD, 2010d).

While many announcements have been made on achieving deficit targets, less is known about the steps that countries are taking to achieve sustainable finances. This report establishes a transparent benchmark to show how much further countries need to go in terms of announcing consolidation plans and meeting the quantified goals that they have set for themselves. In this way, the report allows countries to establish a track record for fiscal consolidation, further strengthening their credibility with citizens and international markets. To this end, the monitoring of fiscal consolidation on a regular basis is an important step in informing the international community of progress made on setting and meeting fiscal consolidation commitments.

Notes

1. Iceland, Israel, Luxembourg and Portugal did not respond to the survey. Chile and Norway responded as having no immediate intention of consolidating public finances due to a relatively sound fiscal position. In light of the market scrutiny of Portugal's public finances in the autumn of 2010 and Israel's unique budgeting framework (two-year budgets), the Secretariat has produced notes for these countries. The Secretariat also prepared Box 1.8 on Iceland's consolidation and Box 1.11 on the situation in Luxembourg. In this publication, "member countries" refers to the 30 participating member countries out of 34.
2. OECD (2010), *Restoring Fiscal Sustainability: Lessons for the Public Sector*, OECD, Paris, *www.oecd.org/dataoecd/1/60/44473800.pdf*.
3. European Union member countries participating in the economic and monetary union (EMU) are required to follow the Stability and Growth Pact, a rule-based framework for the co-ordination of national fiscal policies.
4. The analysis does not include measures decided after the cutoff date of the report in December 2010. Additional fiscal consolidation measures could result in a reclassification of countries.
5. Estonia implemented large-scale consolidation in 2009 and 2010 in order to reduce the deficit and prepare for the adoption of the euro.
6. Draft Budget of the United States Government, Fiscal Year 2012.
7. In addition, debt dynamics (increasing, stable or falling debt levels) are important when assessing fiscal stance.
8. This category consists of, among others: a roll-back of stimulus to lower levels of government in Sweden, a budget ceiling and interest rate adjustments in Switzerland, and several relatively minor expenditure reductions in the United Kingdom.
9. Four out of 30 countries have not announced any revenue measures or have announced revenue-neutral tax packages. Japan is considering comprehensive tax reforms including consumption taxes and income tax but had not disclosed specific plans as of December 2010. Sweden does not have plans to increase the tax burden due to its relatively sound fiscal position. New Zealand and Slovenia announced neutral tax packages in that both countries will keep their tax burden at current levels but the composition of the tax burden might be modified for certain policy reasons (the measures in neutral tax packages are not counted in the OECD survey).
10. The size of revenue measures is based on the numbers provided by countries. If a country has a consolidation plan but did not provide quantified figures, the consolidation plan was not taken into account. If a country provided quantified measures for part of its total measures, then only the detailed part was taken into consideration.

11. According to OECD (2010f), environmental taxes are defined as any compulsory, unrequited payment to general government levied on tax bases deemed to be of particular environmental relevance. The relevant tax bases include energy products, motor vehicles, waste, measured or estimated emissions, natural resources, etc.

12. There is discussion whether raising more revenues from the financial sector should be treated as tax or non-tax revenues (i.e. special levy). This report uses the term “tax”.

13. G20 leaders, at the 2009 Pittsburgh Summit, asked the IMF to report on “…how the financial sector could make a fair and substantial contribution toward paying for any burden associated with government interventions to repair the banking system.”

14. Structural reforms in, for example, labour and product markets are not included in this report. Structural fiscal balances are adjusted for the cycle but include one-off factors, such as those resulting from the sale of mobile telephone licenses. Underlying fiscal balances are adjusted for the cycle and for one-offs.