Lessons from past episodes of consolidation

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Ref What promotes fiscal consolidation: OECD country experiences S. Guichard, M. Kennedy, E. Wurzel and C. André. (2007) WP no. 553

Paper looking at historical experiences in OECD countries and trying to identify what was done, what worked and what did not (≠ from what should be done/avoided)

Identified 85 consolidation episodes in 24 OECD countries over 1978-2005 and looked at size, length, probability to start, to stop and to succeed.
Most episodes... 
...were short... 
...and did not involve large gains.

Most episodes had a duration of 1 to 5 years, with some lasting longer. The number of episodes decreased as the duration increased. The improvement in the underlying budget position during the episode was modest, with a median of 2.8% of potential GDP. 

=> Consolidation in coming years will be exceptional (size: mean in medium term scenario = 5½ % of GDP, median close to 4% of GDP).
Some characteristics of the large fiscal consolidation episodes 1
Some characteristics of the large fiscal consolidation episodes 2
Synchronisation was limited except during euro accession period

=> Synchronisation in coming years will be exceptional
Revenue increases accounted for a larger share than spending cuts in 2/3 of episodes…

…despite studies favouring expenditure restraint

Source: OECD calculations.
But this is not the case of large consolidations (more than 4% of GDP)…
Success was uneven=>the tactics of consolidation important to maximise the chances of success

<table>
<thead>
<tr>
<th>Criteria for success</th>
<th>% of success cases</th>
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</thead>
<tbody>
<tr>
<td>1. Sufficient to stabilised Debt/GDP</td>
<td>53%</td>
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<tr>
<td>2. = 1. + maintained for at least 2 years</td>
<td>41%</td>
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<tr>
<td>3. No substantial backtracking</td>
<td>49%</td>
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</tbody>
</table>
# Main results

<table>
<thead>
<tr>
<th>Possible interpretation</th>
<th>Proba. of success</th>
<th>Probability to stop</th>
<th>Size</th>
<th>Proba. to start</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public awareness of problems may help overcome resistance</td>
<td>-</td>
<td>-</td>
<td>+</td>
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<tr>
<td>More to gain out of fiscal consolidation</td>
<td></td>
<td></td>
<td>+</td>
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<tr>
<td>Large share of public investment cut and tax increase reduced probability to stop =&gt; reflects switching strategies?</td>
<td>+</td>
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<td>More likely to trigger a fall in private saving and interest rates? just reflect a stronger commitment to fiscal consolidation?</td>
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<td>Combination of budget target and expenditure rule</td>
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CDE
Role of rules

Our results=> Combining a budget balance and expenditure rules seems to improve the outcomes of fiscal consolidation

Overall still not a magic recipe.
- Observance of rules has been uneven
- There is no one size fits all rule
- Results may just reflect the fact that governments more committed to consolidate also adopt a rule

Some features of rules seems important
- Rules have to be simple to understand, manage and control, transparent, but also take account of the cycle.
- There should be costs to breaching rules
- Rules also have to be adapted to changing circumstances
- Mechanisms to deal with revenue windfalls can play a supporting role

Transparent information on the fiscal situation is essential as suggested by results on the role played by initial situation