Chapter 1

Fiscal consolidation targets, plans and measures in OECD countries

This chapter discusses the consolidation efforts of OECD countries as of December 2011. The data on fiscal deficit and gross debt for EU countries are updated based on actual figures for 2010 and 2011, and recently adopted fiscal consolidation is taken into account mainly for some countries that had not adopted the 2012 budget before the survey deadline.

The chapter analyses current fiscal positions and announced fiscal strategies, consolidation plans, deficit reduction plans, the specific measures aimed at expenditure reduction and revenue enhancement, and recent reforms regarding pensions.

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.
Introduction

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

Five years after the global financial crisis and two years after the start of the European sovereign debt crisis most OECD countries have adopted fiscal consolidation packages and are implementing substantial consolidation initiatives. In some countries, the crises have led to record unemployment, economic stagnation, and vulnerable banks. A change of government has occurred in several countries where the policy towards austerity and debt reduction was an important element behind such change.

Supported by an economic recovery in 2010 and 2011 the current fiscal stance of most OECD countries has strengthened over this period. However, as the economic recovery faces obstacles, and in some countries it even turns into recession, voices calling for a renewed focus on economic growth to complement the austerity packages have become prominent. This is well reflected in financial markets, where fears come now from many fronts, not just from fiscal austerity.

This report provides a comparative and transparent picture of OECD countries’ consolidation plans. For those countries that have adopted such plans, their time frame typically extends to 2015. The survey presents, in a comparable way, current fiscal positions and announced fiscal strategies, consolidation plans, and detailed expenditure and revenue measures for 32 OECD member countries.

Box 1.1. Definitions

What is consolidation? In this report, fiscal consolidation is defined as concrete policies aimed at reducing government deficits and debt accumulation, e.g. active policies to improve the fiscal position. 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. Consolidation plans and detailed measures are given as a per cent of nominal GDP. The measures are quantified to the extent possible.

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

There is no clear, uniform definition of what constitutes a spending reduction or a revenue measure (e.g. tax expenditures) in a consolidation plan. In this analysis, measures are listed as reported by countries. Normally, these measures would relate to the budget of the year before the start of the consolidation plan (or the first year’s budget) or a forecasted baseline assuming policies are unchanged. The consolidation plans and quantified measures are presented with a cumulative impact over the consolidation period.

During the past two years, the economy in the OECD area partly recovered and deficits shrank

This sub-section presents some key economic indicators based on the latest OECD Economic Outlook projections (OECD, 2012a).

In most OECD countries, the economic recovery of 2010 was followed by subdued growth in 2011, due to an economic slowdown following the euro-area debt crisis (Figure 1.1A). At the beginning of 2012, the economy of most OECD countries came to a
halt, with growth expectations turning bleaker in the following months. The OECD expects that Japan, Canada and the United States will continue to enjoy reasonable growth, whereas in Europe the outlook remains weak. The OECD expects that growth will resume in 2013.

Owing to fiscal consolidation, structural reforms and general economic recovery, the fiscal deficit of OECD countries shrank from 8.1% of GDP in 2009, to 7.5% of GDP in 2010 and to 6.3% in 2011 (Figure 1.1B). Such deficits would be unsustainable over a longer run, but they are expected to narrow further to 5.3% in 2012 and 4.2% of GDP in 2013. The future increase of expenditures related to the ageing population in many OECD countries will add to the challenge of an unsustainable financial situation.

Figure 1.1. Key economic indicators (OECD area)

**A. Real GDP**

% change

5
4
3
2
1
0
-1
-2
-3
-4
-5

2005 2006 2007 2008 2009 2010 2011

**B. Fiscal balance**

% of GDP

0
-1
-2
-3
-4
-5
-6
-7
-8

2005 2006 2007 2008 2009 2010 2011

**C. Underlying balance**

% of potential GDP

0
-1
-2
-3
-4
-5
-6
-7


**D. Gross debt**

% of GDP

50
60
70
80
90
100

2005 2006 2007 2008 2009 2010 2011

StatLink 2 http://dx.doi.org/10.1787/888932069628

**Notes:** Fiscal balance is general government financial balance and gross debt is general government financial liabilities as a 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.

Most OECD countries are implementing consolidation measures according to their revised plans that are somewhat less front-loaded than presented in last year’s report. While most of these consolidation measures are structural, some countries have also applied substantial one-off measures and changes in accounting practices that may be ephemeral. The structural challenge remains considerable in most OECD countries, not only because of the responses to the fiscal crisis but also due to previous structural deficits (Figure 1.1C). This is partly reflected in debt stocks, that continued to grow in the past two years, pushing total gross debt in the OECD area to 103% of GDP in 2011 with further increases expected in the next two years (Figure 1.1D).

Financial markets and politics influence consolidation

At a time when economic growth is still fragile and some OECD member countries are in or on the brink of recession, no easy trade-offs exist between short-term growth and the need to consolidate.

Pressures for fiscal consolidation remain strong. There is still a risk of serious financial problems in several European countries. The high, and in some countries rising, long-term sovereign bond yields show the financial market reactions to indications that fiscal positions are unstable without substantial consolidation efforts. The high bond yields demonstrate that the financial markets have serious concerns about governments’ ability to comply with repayment terms. Three OECD countries in the euro area (Greece, Ireland and Portugal) have experienced serious financing problems and have entered into programmes with the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF) in order to secure sustainable financing. In contrast, one country (Iceland) has successfully completed its IMF programme since last year’s report. In addition, all countries are exposed to close scrutiny by the financial markets and to financial risk assessment by the rating agencies, and some OECD countries are at risk of downgrading. During the last year, some OECD countries lost their triple A rating and other countries were set to a negative outlook.

Figure 1.2 displays the development of long-term sovereign bond yields (ten years) for different sets of countries. First, there are three countries that have long-standing programmes with the EU and/or the IMF (Figure 1.2A). The situations in Greece and Portugal are especially dire. Second, Hungary and Iceland keep facing very high long-term yields – the former while seeking a programme with the IMF, the latter after completing one (Figure 1.2B).

Large and long-standing EU economies have experienced different reactions by the financial markets. While France and the United Kingdom have up to now succeeded in providing credible fiscal consolidation plans in which the financial markets have sufficient confidence, Italy and Spain have experienced serious reactions in the financial markets which have triggered policy reactions. Belgium also experienced rising long-term interest rates in 2011 (Figure 1.2C).

Some of the recent EU members that are OECD members also observed strong challenges in 2011 concerning a lack of confidence in the financial markets resulting in high and rising sovereign bond yields (Figure 1.2D).

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.
Notes: Long-term interest rates are secondary market yields of long-term (usually ten-year) government bonds as a per cent per annum. The annual data are the average of monthly figures, which are calculated as the average of weighted or unweighted arithmetic rates relating to all days or specified days in the month, or they refer to a day at or near month’s end.


Renewed growth will help but will not be enough to stabilise debt

Economic growth will reduce country deficits and debt-to-GDP ratios but will not be sufficient by itself to stop debt dynamics in many countries. Some countries may adopt an inflation policy, which may ease the burden of debt in the short run, but normally inflation will be followed by higher interest rates to compensate for the loss of purchasing power of the principal. Inflation will normally also hamper economic activity in other ways. Therefore, there is still a need for further fiscal consolidation.
Box 1.2. Iceland’s recovery

In 2011, Iceland successfully completed its three-year IMF-supported adjustment programme worth USD 2.1 billion. The programme aimed at stabilising the exchange rate, making public finances sustainable, and restructuring the financial system. All three of these objectives were met.

The Icelandic economy returned to buoyant growth above 3% of GDP in 2011. The growth rate is expected to moderate to 2.75% in 2012. Unemployment should fall to 5% by the end of 2013, and inflation should be on the way down to the authorities’ target (OECD, 2012a).

Before the crisis, Iceland had a banking sector that represented about ten times the national GDP. The government restructuring of the banks resulted in a large increase in government debt and imposed an urgent need to restore the government finances. The banking sector has now been rationalised to two times the national GDP, and the core banking system has been recapitalised and is fully functioning.

The government is pursuing needed fiscal consolidation and is committed to a surplus in 2014 as certain conditions are in place, mainly related to the stability of the financial system and the strength of Iceland’s international reserves position. The government has taken the opportunity of the crisis to redesign its fiscal rules and its medium-term fiscal framework. More details are provided in the country note in Chapter 2 of this report.

Box 1.3. Calculation of the fiscal consolidation requirement

The OECD has calculated the fiscal consolidation requirement to stabilise general government gross debt or to target a 60% debt-to-GDP ratio in the long-run perspective. 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 1.3 shows the total consolidation required to stabilise debt or achieve a gross general government debt-to-GDP ratio equal to 60% of GDP by 2030, assuming the projected improvement in the underlying primary balance between 2011 and 2013 conforms with short-term projections in the OECD Economic Outlook, Vol. 2012/1 (No. 91) (OECD, 2012a), with an additional constant improvement in the underlying primary balance each year between 2013 and 2030 of 0.5% of GDP (1% per annum for Japan) calculated so as to achieve the debt target by 2030 (2040 for Japan). Consolidation requirements following changes in ageing-related public spending and upward pressure on health spending are not explicitly included in the calculations of fiscal consolidation requirements.

The figure shows the average improvement in the underlying primary balance between 2011 and 2030 necessary to stabilise government debt-to-GDP ratios or to bring them down to 60% of GDP. When simply stabilising debt ratios, the average increase in the underlying primary balance over this period corresponds closely to the peak increase over the same period. When targeting 60%, however, the peak increase will be substantially higher than the average increase, but past the peak the fiscal policy can be loosened and the underlying primary balance can decrease before the debt ratio stabilises at 60% of GDP. More details on calculations and essential assumptions are specified in the OECD Economic Outlook, Vol. 2012/1 (No. 91) (in particular Box 4.2 on assumptions in the baseline long-term economic scenario, and Figure 4.1).
In the *OECD Economic Outlook*, Vol. 2012/1 (No. 91) (OECD, 2012a), the OECD has, from the position of the underlying primary balance in 2011, estimated the fiscal consolidation in OECD countries required to stabilise debt-to-GDP ratios by 2030. Fiscal consolidation is here defined as improvements in the underlying primary balance.

The estimated consolidation requirements are substantial but vary considerably. According to these estimates, the OECD area requires a consolidation of 3.9% of potential GDP to stabilise debt by 2030. Yet compared with last year’s report, which described consolidation requirements to stabilise debt by 2025 (from 2010), the consolidation requirements have decreased by 1.4 percentage points.

According to these estimates, Greece will require an improvement in the underlying primary balance of 7% of GDP from 2011 to 2030 to stabilise the debt ratio, assuming a primary deficit of 5.8% of GDP in 2011 (estimated 3.8% last year to stabilise debt by 2025). Using the same calculation, tightening by more than 4% of GDP is called for in Ireland, Japan (by 2040), Poland, Portugal, the Slovak Republic, Slovenia, Spain, United Kingdom, and the United States (Figure 1.3).

**Figure 1.3.** Substantial consolidation required to stabilise or reduce debt by 2030

Notes: The figure shows the average improvement in the underlying primary balance between 2011 and 2030 necessary to stabilise government debt-to-GDP ratios and to bring them down to 60% of GDP. In this figure, consolidation is defined as the average improvement in the underlying primary balance between 2011 and 2030.

1. In the case of Japan, the consolidation shown would be sufficient to stabilise the debt-to-GDP ratio but only after 2030.


For many countries, simply stabilising debt would still leave the debt at high levels, which would cause a vulnerable financial position. A more sustainable solution may be to bring debt-to-GDP ratios down to 60% of GDP, a benchmark that is consistent with the European Union’s Stability and Growth Pact. In such a scenario, Greece would require a total consolidation of 9.7% of potential GDP to reach the benchmark debt ratio by 2030. Using the same calculation, tightening by more than 6% of GDP would be called for in
Ireland, Japan, Portugal, Spain, the United Kingdom and the United States. The following countries would need to consolidate between 4% and 6% of GDP by 2030: France, Hungary, Iceland, Italy, the Netherlands, New Zealand, Poland, and Slovenia. The OECD area will need a total consolidation of 6.3% of potential GDP to curb debt to 60% of GDP by 2030 (an increase of 0.1 percentage points from the estimate aiming for 2025, as reported in last year’s report).

Four categories of countries in regard to fiscal consolidation

OECD countries are facing different consolidation needs and are responding differently to them. Since last year’s report, the background for grouping countries has changed somewhat: three countries have entered into programmes supported by the European Commission, the European Central Bank and the International Monetary Fund; several countries with relatively high consolidation needs are experiencing distinct market pressure measured by the long-term government bond yields; and most countries have adopted new measures and extended the implementation period. To capture such heterogeneity, this report classifies countries into four groups as described below.

Category A. Countries with IMF/EU/ECB programmes

This category includes countries with a formal and ongoing programme with the International Monetary Fund, the European Central Bank, and/or the European Commission. Three OECD countries are in this position: Greece, Ireland and Portugal. Such countries have formally committed to introducing substantial consolidation measures and wide-ranging structural reforms. These countries have adopted the largest consolidation packages for 2012-15, between 5.2% and 8.2% of GDP, averaging 6.6% of GDP. According to OECD calculations, these countries have to consolidate by 8.7% on average to achieve a debt-to-GDP ratio of 60% of GDP by 2030.

Category B. Countries under distinct market pressure

This category includes OECD countries with an average consolidation requirement over the period 2012-30 above 3% of GDP and with an experienced change in long-term interest rates over the period 2006-11 equal to or above zero. This category includes Belgium, Hungary, Italy, Poland, the Slovak Republic, Slovenia and Spain.

These countries have observed close scrutiny from volatile financial markets; however, they have been able to finance their debts without external programmes. In particular, Italy and Spain have observed rising long-term interest rates since late 2011. The markets eased to some extent thanks to the intervention of the ECB earlier in 2012. However, the long-term interest rates are very high compared to Germany. Iceland still faces high long-term interest rates after the completion of its IMF programme but high interest rates are not new for this country and the interest rates actually have been reduced over the period 2006-11. Belgium and Poland have experienced a positive development of their long-term interest rates in the first half of 2012, which indicates a renewed confidence of the financial markets. Nevertheless, the two countries still have a substantial spread compared to Germany.

These countries have seen their interest rates increase over the period 2006-11. In addition, these countries have large long-term fiscal consolidation needs, as calculated by the OECD, ranging from 3.2% of GDP to 6.1%, and averaging 4.3% of GDP. They are obliged to demonstrate decisive and credible fiscal policy to curb the deficit. Except for Poland, the struggle to design and adopt fiscal consolidation has led to political
turbulence and the fall of governments. These seven countries have adopted consolidation packages for 2012-15 ranging between 2.3% and 5.2% of GDP, averaging 3.7% of GDP.

**Category C. Countries with substantial deficits and/or debt but less market pressure**

Category C includes OECD countries which meet one or more of the following criteria: an average consolidation requirement over the period 2012-30 higher than 3% of GDP, an estimated average general government fiscal deficit of 2011-12 above 3% of GDP, or the 2011 general government gross debt above 60% of GDP.

Several OECD countries that are members of the EU and have an ongoing excessive deficit procedure with the European Commission fall into this category. In addition to the seven EU countries in category B and the three countries in category A, the following seven countries are being assessed by the European Commission in their efforts to reduce the general government deficit below 3% of GDP: Austria, the Czech Republic, Denmark, France, Germany, the Netherlands, and the United Kingdom. According to OECD calculations, these seven countries have varying long-term consolidation needs, ranging up to 7% of GDP. All of these countries have adopted consolidation packages for 2012-15 ranging between 1.4% and 4.3% of GDP, of which France and the United Kingdom have the largest volumes.

Other countries have not experienced external pressure to the same degree as the countries mentioned above. However, four of these countries have introduced fiscal consolidation plans or fiscal strategies in order to curb deficit and/or reduce debt: Canada, Finland, Israel and New Zealand. In addition, Iceland has finished its IMF programme to curb debt. These countries have either a deficit above 3% of GDP, a gross debt above 60% of GDP or a long-term average consolidation requirement above 3% of GDP. Most of these countries have substantial long-term consolidation needs, ranging between 2% and 4.8%. Most of the countries have adopted consolidation packages for 2012 and beyond, ranging between 1.5% and 4.1% of GDP, to reduce the deficit or curb the debt.

Japan and the United States also have large long-term consolidation needs, high debt-to-GDP ratios, and persistent and substantial deficits, but have not yet adopted comprehensive consolidation strategies.

The average fiscal consolidation for 2012-15 adopted by the countries of category C is 2.6% of GDP against a calculated average long-term consolidation need of 4.5% of GDP.

**Category D. Countries with no or marginal consolidation needs**

Finally, there are ten countries that do not have consolidation at all or have announced a very limited consolidation effort, for the simple reason that they do not need to consolidate to achieve fiscal sustainability: Australia, Chile, Estonia, Korea, Luxembourg, Mexico, Norway, Sweden, Switzerland and Turkey. These countries have low long-term consolidation needs (on average 1.5% of GDP), their long-term interest rates are reduced over the period 2006-11, and they have both low deficits (below or close to 3% of GDP, or surpluses) and low gross debt-to-GDP ratios (below 50% of GDP).
Evolution of fiscal deficits and gross debt

In this report, fiscal consolidation is defined as “active policies to improve the fiscal position” (see Box 1.1 above). This guideline excludes any expected cyclical improvements in deficits following an automatic rise in revenue and/or decrease in entitlement spending associated with a recovering economy. By the same token, changes in the fiscal stance stemming from policies aimed at promoting growth, while important and desirable, are also more difficult to predict and quantify with confidence, and are thus outside the scope of this report.

This section begins by first studying how fiscal deficits and debt have developed up to 2011. Then it looks at targets for fiscal balance and gross debt. The next section (1.4 below) will describe fiscal consolidation plans and the share of quantified, specific measures in those plans.

Strengthened fiscal position after two-three years of fiscal consolidation

Substantial improvements in fiscal balances 2009-11

Most OECD countries have implemented substantial deficit reductions since 2009, the year in which the most countries faced their highest fiscal deficit due to the combined effects of the financial crisis and fiscal stimulus to recover economic growth. The average improvement in overall fiscal deficit is about 2% of GDP in the OECD area. Hungary (category B), Greece and Portugal (category A), followed by Iceland (category C) and Turkey (category D) have achieved the largest improvements of the fiscal balance. Greece, Hungary and Portugal are the three countries with the most impressive improvements of the fiscal balance, by respectively 6.4, 8.6 and 5.9 percentage points of GDP (from deficits of 15.6%, 4.5% and 10.2% respectively). Iceland and Turkey have improved the fiscal balance by more than four percentage points from 2009 to 2011 (Figure 1.4).

On the contrary, the only country with a substantially widened fiscal deficit in this period is New Zealand, primarily due to the impact of the earthquake in the Canterbury region in 2010. Japan and Slovenia had a small increase in the fiscal deficit in this period.

Reductions of deficits in the period 2009-11 cannot be attributed to fiscal consolidation only. The economy in most OECD countries recovered in this period, which also had an impact on the development of the overall fiscal balance due to cyclical improvements on the balance. Countries like, for example, Germany and Turkey have experienced stronger improvements of the overall fiscal balance in this period than were anticipated in their consolidation plans.

The impression shifts a little when looking at the underlying balance (structural). All countries in category A have made substantial improvements in the underlying balance, more than 2.8 percentage points of GDP. Greece and Iceland have improved their underlying balance by 8.5 and 7.7 percentage points of GDP respectively. In category B, all countries except Hungary improved their underlying balance between 0.5 percentage points (Belgium) and 3.9 percentage points of GDP (Spain). In category C, the Czech Republic has improved its underlying balance by 3 percentage points of GDP. Estonia (category D) has improved the balance by 1.9 percentage points of GDP.
Figure 1.4. Change in general government fiscal balances between 2009 and 2011

Notes: The fiscal balance is the general government financial balance as a per cent of GDP. The overall financial balance includes one-off factors, such as those resulting from the sale of mobile telephone licenses, and are composed of the underlying, structural balance and the cyclical balance. The underlying balance, or structural balance, is adjusted for the cycle and one-offs. The OECD average is unweighted (the Slovak Republic and Turkey are not included).


Deviations from the deficit targets in 2010-11 vary

The OECD has calculated the deviation of the actual fiscal balance in 2010 and 2011 compared to the targeted fiscal balances described in last year’s report. Estonia, Denmark, Germany, Hungary and Turkey have achieved a substantial positive deviation from the planned figures. Except Hungary, these countries belong to categories C and D and are not very affected by severe consolidation. Hungary substantially improved its balance by one-off measures adopted in 2011, including the transfer of the assets of the private sector pension funds to the government. Denmark, Estonia, Germany and Turkey have experienced a more solid economic recovery than expected, which has resulted in a better fiscal balance. Belgium, Poland and Portugal (categories A and B) also performed better than targeted over the period, as well as Austria, the Czech Republic, Finland, France and the United States (category C). By contrast, New Zealand experienced a widening deficit in 2011 due to the negative fiscal shock of earthquakes in the Canterbury region. Greece (category A), Slovenia and Spain (category B) and the United Kingdom (category C) experienced a negative deviation from targets larger than 1% of GDP over the two-year period (Figure 1.5).
Figure 1.5. Difference between implemented and planned fiscal balance in 2010 and 2011

Notes: This figure shows the annual deviation of the fiscal deficit in 2010 and 2011 compared to the targeted fiscal deficit presented in last year’s report. 2010 data for Denmark, Italy, the Netherlands, Switzerland and the United States are not available and these countries are not included in the OECD average.


Gross debt has surged since the financial crisis

Gross debt in most OECD countries has surged after 2007. The OECD average rise in debt is 28.5 percentage points of GDP. Greece and Ireland (category A) and Iceland (category C, previously with an IMF programme) are the three countries with the largest increase of debt burdens. The debt in these countries has increased by 55 to 85 percentage points of GDP, owing to the collapse of the banking sector in Iceland and Ireland and to the severe problems of the Greek public finances. Portugal (category A), Spain (category B) and Japan, the United Kingdom and the United States (category C) have all seen their debt rise by 32.9 to 50.7 percentage points of GDP during the four years 2007-11 (Figure 1.3B). The only countries that have reduced general government gross debt during this period are Israel, Norway, Sweden and Switzerland (except Israel, all these countries are in category D with no or marginal consolidation needs); their debt has dropped by up to 5.8 percentage points of GDP, except Norway which reduced its debt by 22.9 percentage points of GDP.
Deficit reduction targets for 2014

Considerable deficit reductions are planned in the next few years

From their fiscal position in 2011, 15 OECD countries still intend to reduce their fiscal deficit by 2.4 percentage points of GDP (the OECD area average) or more by 2014 (Figure 1.7). As many countries have extended their consolidation plans beyond 2014, the total deficit reduction target is even larger. New Zealand is aiming for the largest reduction in its deficit over the forecast horizon, from 9.2% of GDP in 2011 to 0.4% of GDP in 2014. Greece, Ireland, Slovenia and Spain (categories A and B) are targeting a deficit reduction of 4.4-6.3 percentage points of GDP by 2014, though these countries (except Ireland) in 2010 and 2011 missed the deficit targets considerably (see Figure 1.5 above). Iceland and the United States (category C) plan to reduce their deficits by 4.1 and 6.4 percentage points of GDP respectively. Italy and Poland (category B), France and the United Kingdom (category C) and Australia (category D) aim for deficit reductions between 3 and 4 percentage points of GDP. Portugal (category A), Belgium and the Slovak Republic (category B) plan for deficit reductions ranging between 2.4 and 2.9 percentage points of GDP. On the contrary, Hungary (category B) will see the 2011 surplus reverted into a deficit of about 2% of GDP given the concentration of large one-off revenue-enhancing measures in 2011. Finland (category C) experienced a better result than expected in 2010 and 2011, but the Finnish government expects a larger deficit in the following years.
Figure 1.7. **Intended fiscal balance from 2011 to 2014**

![Graph showing intended fiscal balance from 2011 to 2014.](http://dx.doi.org/10.1787/888932696742)

**Notes:** Deficit improvement is defined as the change from the overall fiscal deficit in 2011 to the targeted deficit in 2014. The change in the fiscal deficit is reported by the national authorities and/or calculated by the OECD. Denmark: 2013 instead of 2014. Japan: data based on last year’s report. 2014 data for Norway are not available and this country is not included in the OECD average. Data for the United States are drawn from Congressional Budget Office (2012), “Updated Budget Projections: Fiscal Years 2012 to 2022”, CBO, March, www.cbo.gov/publications/43119.

**Source:** OECD Fiscal Consolidation Survey 2012.

Figure 1.8 plots the programmed fiscal balances for countries with the largest deficit reduction targets to 2015. The figure also includes countries that had announced the largest consolidation programmes by the end of 2011 (see Section 1.5 below). From slightly different starting points, the projected pace in the improvement of deficits is fairly similar across most countries. One clear exception is Hungary, due to the exceptional one-off measures described above.

**Gross debt projections 2007-15: still rising debts**

A country’s gross debt level is an important indicator of long-term fiscal sustainability. In the last *OECD Economic Outlook* (OECD, 2012a), the OECD projected that the weighted average gross debt of OECD member countries would increase from 103% of GDP in 2011 to 111% in 2015 (Figure 1.9). This is a significant increase from the pre-crisis level of 74% of GDP recorded in 2007, when only three countries (Greece, Italy and Japan) exceeded a debt level of 100% of GDP. The OECD expects that, by 2015, ten OECD countries will carry a debt load in excess of 100% of GDP, namely Greece, Ireland and Portugal (category A), Belgium and Italy (category B), France, Iceland, Japan, the United Kingdom and the United States (category C) (Figure 1.9).
Figure 1.8. Deficit trends (2011-15)

Notes: The reported data 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). Data for the United States are drawn from Congressional Budget Office (2012), “Updated Budget Projections: Fiscal Years 2012 to 2022”, CBO, March, www.cbo.gov/publications/43119. Data for Italy are drawn from “Italy’s Stability Programme” (Ministry of Finance, April 2012).

1. Japan’s deficit target is the primary balance, which is defined by the government as the fiscal balance minus net receivable interest. Data for 2011-14 are based on last year’s report.

Box 1.4. Hungary

In 2011, the general government fiscal balance of Hungary surged to a surplus estimated at 4.2%, influenced by significant one-off items – primarily an asset transfer from private pension funds to the state pension pillar. Despite a relatively favourable fiscal position in 2011, three years of sizeable fiscal consolidation from 2006 to 2009, and additional planned consolidation for 2012 and beyond, a recent deterioration in the underlying balance called for renewed efforts in 2012. This need was recognised by the financial markets, as long-term interest and credit default swap rates on public debt have risen significantly since the second quarter of 2011, the sovereign rating was downgraded to non-investment grade, and several debt auctions failed or partially failed in late 2011.

The Hungarian government plans for a fiscal deficit of 2.5% of GDP in 2012. The government has forecasted that the debt-to-GDP ratio will decline each year from 80.6% due to one-off measures in 2011, continuing fiscal consolidation and the impact of structural measures.

On 24 January 2012, the European Council decided to take action against Hungary, noting that the country did not comply with the Council recommendation to correct the excessive deficit in a sustainable manner. On 21-22 June 2012, the European finance ministers agreed that Hungary has taken the necessary corrective action to achieve its targets and adopted a proposal for a Council decision to lift the imposed suspension of EU funds in 2013. However, in July 2012 the IMF together with representatives from the European Commission and observers from the European Central Bank started discussions on an IMF/EU-supported programme following a request by the Hungarian authorities.

The current difficulties in Hungary come after substantial fiscal consolidation in the past, adjustments of the fiscal rules and the budgetary framework, and an EUR 12.3 billion programme with the IMF in 2008-10. More details are provided in the country note in Chapter 2.

Figure 1.9. Evolution in gross debt across OECD countries (2007-15)

Note: The reported data are gross government liabilities as a per cent of nominal GDP.


Ten OECD countries are expected to reduce debt by 2015 (Belgium, Canada, Germany, Hungary, Iceland, Italy, Korea, Norway, Sweden, Switzerland). Except Norway, the improvement of the debt is only limited, between 0% and 3.8% of GDP.
The OECD expects that most countries will still face rising debt levels in the next three years. For six countries, the projected debt increase is more than ten percentage points: Ireland and Portugal (category A), Spain (category B) and Japan, the United Kingdom and the United States (category C).

Box 1.5. Israel¹

Since 2003, Israel has achieved a significant reduction in government expenditure, the deficit and the debt-to-GDP ratio. The share of public expenditure in GDP has declined from more than 50% of GDP in 2003 (and 59% in 1987) to 43% in 2008; and the debt-to-GDP ratio was reduced from 99% in 2003 to 79.5% in 2009 and further to 74.2% in 2011. The global economic crisis was quite moderate in Israel compared with concurrent developments in developed countries, mainly reflecting the operation of automatic stabilizers.

From 2010, the Deficit Reduction and Budgetary Expenditure Limitation Law has contributed to maintaining the fiscal stability of Israel, by setting limitations on both the deficit level and the rate of growth of government expenditure. The main objectives of the proposed fiscal rule are to balance between a continuing reduction of the public debt-to-GDP ratio and the share of public expenditure required for supplying a proper level of public services.

A rapid return to a decreasing deficit trend (halted as a result of the global economic crisis) is the main target for the short term. A decline in the debt-to-GDP ratio to about 60% within a decade, similar to the EU target, serves as the main target for the medium term. The long-term target is to reduce the debt-to-GDP ratio further. The fiscal rule determines that the real growth of central government expenditure will be equal to the ratio of 60% of GDP (the medium-term target) and the last known debt-to-GDP ratio, multiplied by the average GDP growth rate during the ten previous years – provided there is consistency with the declining deficit ceiling as per the legislation that targets 1% of GDP from 2014 onwards.

1. 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.

OECD member countries’ fiscal consolidation plans

This section will focus on countries’ fiscal consolidation plans: the size of consolidation, the time span, and the composition of consolidation, based on the country responses in the fiscal consolidation survey. The fiscal consolidation plans are expressed as a cumulative effort since the financial crisis. For most countries, the fiscal consolidation started in 2010. Some countries already made a decisive and prompt effort in 2009, which is also included in this study. Fiscal consolidation implemented in 2008 is not included (for example, in Estonia and Hungary).

Implemented fiscal consolidation 2009-11 and consolidation plans 2012 and beyond

Most OECD countries have revised their announced consolidation plans

This sub-section will analyse the impact of fiscal consolidation partly from the perspective of what has been implemented up to 2011, and partly from the perspective of plans for 2012 and beyond. The first topic is the impact of revisions of fiscal consolidation plans.
Figure 1.10 shows the reported change of cumulative consolidation volume (2009-15) observed in the survey this year compared to the described consolidation in last year’s report. The cumulative consolidation volume reflects the countries’ total consolidation, from 2009/10 when first adopted up to the end of the present plan. Two different approaches emerge. Most OECD countries with fiscal consolidation have increased the total consolidation volume. For example, Austria (category C), Belgium, Hungary and Italy (category B) and Portugal (category A) have adopted substantially larger consolidation plans than reported last year, between 2.4% and 5.1% of GDP. Also, Poland and the Slovak Republic (category B) have increased their consolidation plans by 1.9% and 1.6% of GDP respectively. On average, the countries in category A have increased their fiscal consolidation by 1 percentage point of GDP since last year’s report, while the countries in category B have increased their consolidation by 2.2 percentage points of GDP. In category C, the average increase of fiscal consolidation is 0.9 percentage points of GDP.

On the other hand, some countries report having reduced the total consolidation volume, of which Estonia (category D) is the main example. On average, the countries in category D that have announced a fiscal consolidation plan have reduced their fiscal consolidation by 2.4 percentage points of GDP since last year’s report. Estonia has implemented large front-loaded consolidation and is now gradually removing the planned expenditure measures, thus reducing the total cumulative impact of consolidation implemented from the start of the fiscal crisis in 2008. Greece (category A) also appears to have reduced its total cumulative consolidation compared with the description in last year’s report, by 3.3% of GDP. The main reason for this reduction is that Greece has reported a considerably lower impact of consolidation implemented in 2011 than planned last year, 2.5% of GDP against the planned impact of 6.5% of GDP.
1. FISCAL CONSOLIDATION TARGETS, PLANS AND MEASURES IN OECD COUNTRIES

The time span of the consolidation plans is extended

The time span of the consolidation plans is more or less extended one year compared to the situation described in last year’s report. Approximately 80% of the consolidation plans cover the period up to 2014, and more than half of the plans cover the period up to 2015. One plan also includes 2016 (Austria). Two plans will end in 2013 (Denmark and Portugal). The consolidation plans normally follow the time span of the medium-term perspective of the budget estimates. Table 1.1 shows the distribution of plans according to the planning horizon this year (row 2012) compared to the plans described in last year’s report (row 2011). The columns show how many of the consolidation plans continue up to the different years.

Table 1.1. Time span of consolidation plans (2009-15)

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<tbody>
<tr>
<td>2012</td>
<td>26a</td>
<td>3</td>
<td>6</td>
<td>16</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>25</td>
<td>1</td>
<td>2</td>
<td>8</td>
<td>11</td>
<td>2</td>
<td>1</td>
</tr>
</tbody>
</table>

StatLink 2 http://dx.doi.org/10.1787/888932698528

a. The following countries did not provide data on an announced consolidation plan with a specific volume of consolidation: Japan, Korea, Norway, Turkey (from 2012) and the United States. Australia reports consolidation (especially in FY 2013) but applies a broader definition of the term consolidation than this report.


The size of cumulative fiscal consolidation plans (2009-15) varies significantly

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. The three countries with programmes with the IMF/EU/ECB (category A: Greece, Ireland and Portugal) have adopted and announced the largest fiscal consolidation packages, all above 12% of GDP (Figure 1.11). On average, the countries in category A have adopted fiscal consolidation plans of 16.2% of GDP. Eight countries have announced plans ranging between 6% and 9.1% of GDP: Hungary, Italy, the Slovak Republic, Slovenia and Spain (category B); and the Czech Republic, Iceland and the United Kingdom (category C). Belgium and Poland (category B), and Austria, France, Germany and New Zealand (category C) have announced plans with a cumulative impact of between 3% and 5% of GDP. The average fiscal consolidation plans in categories B and C are 6.1% and 4.3% of GDP respectively.
Figure 1.11. Implemented (2009-11) and planned consolidation (2012-15)

Notes: The data are the sum of annual incremental consolidation from 2009/10 until 2015 as reported by the national authorities. Only the following countries reported consolidation in 2009: Estonia, Hungary, Ireland, Poland and Slovenia. Hungary’s 2007-08 consolidation is not included. Austria reports consolidation until 2016. The following participating countries have not reported an announced concrete consolidation plan and are not included in the figure: Korea, Japan and the United States. Australia reports consolidation (especially in FY 2013) but applies a broader definition of the term consolidation than this report. Norway does not apply a consolidation plan.

Source: OECD Fiscal Consolidation Survey 2012.

Box 1.6. Estonia is gradually withdrawing from fiscal consolidation

Estonia has implemented large front-loaded consolidation since the start of the fiscal crisis in 2008 and is now gradually removing the expenditure measures, thus reducing the total cumulative impact of the implemented consolidation. The overall size of fiscal consolidation measures in Estonia is now driven by the revenue side, reflecting mainly the effects of earlier tax rate increases. As Estonia will be gradually withdrawing from consolidation over the next few years, the size of fiscal consolidation in 2012-15 appears as a negative value in Figure 1.11.

Estonia does not have an official consolidation plan after 2010 but continues to apply a conservative fiscal policy that encompasses, among others, requirements for a structural surplus, for a nominal surplus from 2013, and for the tax burden to return to the pre-crisis level. More details are provided in the country note in Chapter 2.

Half of the planned cumulative consolidation for 2009-15 is already implemented

In total, around 50% of the countries that have announced consolidation plans have implemented front-loaded fiscal consolidation efforts in 2010 and 2011 (more than 40% of total announced consolidation); down from 66% reported previously. The OECD countries of category A, for example, have the largest consolidation plans and have tended to front-load those plans. Greece and Ireland implemented large consolidation
1. FISCAL CONSOLIDATION TARGETS, PLANS AND MEASURES IN OECD COUNTRIES

efforts in 2010 and 2011: 10.3% and 12.8% of GDP respectively. Through these efforts, the two countries have already implemented more than 50% of the total announced consolidation volume of 18.5% and 17.9% respectively. On average, the countries in category A have implemented fiscal consolidation up to 2011 of 9.6% of GDP.

Front-loading consolidation is not only associated with the countries in category A that are obliged to consolidate by an agreement. For countries in the other categories, however, it is mostly those with smaller consolidation needs that have chosen to front-load consolidation. In category B, only Hungary, the Slovak Republic and Slovenia are front-loading. In category C, only the Czech Republic and Iceland are front-loading. Thus, many countries in categories B and C have scheduled the main part of consolidation in the coming years. Notwithstanding, on average the OECD countries with a consolidation plan have implemented 50% of the announced consolidation in 2009-11. On average, the countries in categories B and C have implemented fiscal consolidation up to 2011 of 2.5% and 1.7% of GDP respectively.

The only countries that have started to gradually reverse the impact of fiscal consolidation are Estonia and Switzerland. Estonia has implemented a consolidation volume of 3.7% of GDP already, but has ended the expenditure cuts and announces only gradually diminishing revenue measures as from 2012. Turkey has not reported fiscal consolidation as from 2012.

Compared to last year’s report, the implemented consolidation of OECD countries in 2009-11 is somewhat behind the plan. In this period, the OECD countries have implemented fiscal consolidation by 2.8% of GDP against last year’s planned consolidation of 3.3% of GDP.5 Belgium, Estonia, Finland, France, Greece and Hungary have reported less implemented consolidation in 2009-11 than previously planned. However, except for Estonia, these countries have extended their consolidation plans, resulting in a slightly more back-loaded consolidation. On the other hand, Denmark, Ireland and Portugal have reported more implemented consolidation in this period than previously planned.

Planned fiscal consolidation for 2012 and beyond

Notwithstanding having implemented substantial fiscal consolidation, the three countries with IMF/EU/ECB programmes (Greece, Ireland and Portugal) still have a substantial remaining fiscal consolidation of 5.2-8.2%, averaging 6.6% of GDP in the years 2012-15. Also, Italy has announced a considerable fiscal consolidation in 2012 and beyond, of 5.2% of GDP (Figure 1.12). Nine countries have a remaining fiscal consolidation of between 3% and 5% of GDP: Belgium, Hungary, Poland, the Slovak Republic and Spain (category B); and Austria, France, New Zealand and the United Kingdom (category C). On average, the countries in categories B and C have planned fiscal consolidation for the years 2012-15 of 3.7% and 2.6% of GDP respectively.

Most OECD countries which have announced a fiscal consolidation plan with remaining fiscal consolidation in 2012 and beyond have planned to implement the largest part by 2013. Portugal plans to implement fiscal consolidation in 2012-13 of 6.5% of GDP in order to complete the requirements of the programme with the EU and the IMF. Greece (4.9% of GDP), Ireland (3.7%), Italy (5%) and Spain (4.4%) will also implement large fiscal consolidation in 2012-13. Belgium, Hungary and Poland plan to implement about 3% of GDP in 2012-13. The average of the OECD area is calculated at 2.1% of GDP in 2012-13 and 0.7% in 2014-15. On average, the countries in category A have
planned fiscal consolidation in the years 2012-13 of 5.1%. The average planned fiscal consolidation in this period for the countries in categories B and C is 3.1% and 1.7% of GDP respectively.

**Figure 1.12. Consolidation plans in 2012-15**

Note: The data are the sum of annual incremental consolidation from 2012-15 as reported by the national authorities. Austria reports consolidation until 2016. Turkey did not report consolidation from 2012. The following participating countries have not reported an announced concrete consolidation plan and are not included in the figure: Korea, Japan and the United States. Australia reports consolidation (especially in FY 2013) but applies a broader definition of the term consolidation than this report. Norway does not apply a consolidation plan.

Source: OECD Fiscal Consolidation Survey 2012.

Estonia and Switzerland are the only countries that are planning to decrease the total fiscal consolidation from 2012 and beyond. Turkey has not reported fiscal consolidation as from 2012.

**Remaining consolidation needed for 60% debt/GDP ratio**

The governments of most OECD countries are well under way implementing fiscal consolidation. If the governments’ consolidation efforts remain consistent with the announced consolidation plans, the countries will take a considerable step on the path towards a more sustainable fiscal position. This applies especially to the countries in category A: Greece, Ireland and Portugal. Also Belgium, Hungary, Italy, Poland, the Slovak Republic and Spain (category B) will achieve a substantial part of the required average consolidation to curb gross debt-to-GDP ratio to a sustainable level (Figure 1.13).
**Box 1.7. Luxembourg**

Luxembourg has lower deficits and lower gross debt than most OECD countries, and appears in category D in this report. However, the government envisages increasing public deficits and debt-to-GDP ratios in the coming years, with the public gross debt increasing to 25.9% of GDP in 2015. The government’s objective is to implement a series of budgetary consolidation measures in order to reduce the public deficit and thus to create a greater budgetary margin of manoeuvre to absorb possible negative shocks.

Luxembourg may serve as an example of a country that practices what Professor Allen Schick prescribes: fiscal discipline must be maintained during growth periods in order for governments to avoid crisis when the economy weakens (Schick, 2012). More details are provided in the country note in Chapter 2.

The announced consolidation will be enough to stabilise debt in most of the countries, but curbing debt-to-GDP ratio to 60% will require a stronger improvement in the underlying primary balance than the announced consolidation plans (2012-15) will provide. This assessment takes for granted that all measures in the announced consolidation plans are structural. We know that some measures are one-offs. Furthermore, the assumptions made by the governments may differ from the assumptions in the OECD calculations of long-term consolidation needs, for example on economic

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**Notes:** The remaining consolidation need is the difference between the required average improvement in the underlying primary balance to achieve a gross general government debt-to-GDP ratio equal to 60% of GDP by 2030 (by 2040 for Japan) and the consolidation announced by the government for the period 2012-15. For Austria, Belgium, Denmark, Germany and Italy, the underlying primary balance is used in the calculation of consolidation (short-term 2012-15 and long-term by 2030). For Italy, the short-term 2012-15 consolidation will more than fulfill the long-term consolidation requirement. The consolidation requirement is not available for Mexico and Turkey. Consolidation plans in 2012-15 are not available for Japan, Korea and the United States. Australia reports consolidation (especially in FY 2013) but applies a broader definition of the term consolidation than this report. Estonia and Switzerland announced a reversed consolidation in their plans for 2012-15 (not included in the calculation). For Denmark, a reversed consolidation in 2012-15 is estimated (not included in the calculation). Norway does not apply a consolidation plan.

growth. Therefore the estimated remaining consolidation requirement will express a minimum effort to achieve the debt targets in the long run, relative to the consolidation efforts already planned by the governments.

Box 1.8. Calculation of the remaining fiscal consolidation requirement

The calculation of consolidation required to stabilise debt or to reduce debt levels to 60% of GDP by 2030 uses 2011 as the base year (Figure 1.3 and Box 1.2). Remaining consolidation needed is calculated by subtracting the consolidation announced for the period 2012-15 (Figure 1.5). Consolidation for the period 2012-15 is calculated as a per cent of the OECD estimates of potential GDP from the “OECD Economic Outlook, Vol. 2012/1” assuming all measures are structural. Countries included in Figure 1.3 but not in Figure 1.13 did not provide data.

Most countries have specified and quantified measures in their plans

Most of the consolidation plans for 2009-15 are quantified with detailed specific measures. However, a few countries did not provide a complete overview of detailed concrete measures. Some countries did not spell out measures over all years, and for some countries the specification of measures in all years did not completely add up to the total announced plan covering the same period.

The countries in category A have announced the most ambitious consolidation plans in order to restore market confidence and public finances. The two countries with the largest consolidation, Greece and Ireland, have specified about two-thirds of the total consolidation plan. Portugal has provided a complete specification of the consolidation plan. These three countries are assessed quarterly by the EC, the ECB and the IMF regarding progress in implementing the fiscal consolidation (Figure 1.14).

Most of the countries with large deficits in categories B and C have specified the consolidation plan completely. However, for the United Kingdom, a number of announced expenditure reductions in areas such as administration, defence, transport, etc., are not included in Figure 1.14 as these reductions are not quantified on an annual basis. These measures are well specified, but the impact over years and in total has been difficult to estimate.

Composition of measures: most countries rely on expenditure reductions

The survey responses indicate that fiscal consolidation for 2009-15 has a similar focus on expenditure measures as last year, weighted on average two-thirds towards expenditure reductions and one-third towards increased revenues (Figure 1.15). Still there is a significant variation in the composition of consolidation measures. A number of countries have structured their consolidation mostly (more than 80%) around expenditure measures. Except for Hungary and Slovenia (category B), these are typically countries with smaller consolidation plans. Some countries with large consolidation plans focus their consolidation on expenditure reductions between the OECD average of 65% and 80%: Ireland (category A), the Slovak Republic and Spain (category B) and Austria, Germany, Iceland and the United Kingdom (category C). In contrast, Estonia and Turkey (category D) rely on tax increases for the majority of their consolidation, taking into account that these countries are withdrawing from consolidation. Some countries with larger consolidation including Greece and Portugal (category A) and Belgium, Italy and Poland (category B) are choosing to take the middle ground.
Figure 1.14. **Share of quantified measures in the implemented/planned consolidation (2009-15)**

Notes: The figure shows the cumulative consolidation volume and the share of quantified expenditure and revenue measures as reported in the country notes for the period 2009-2015 (2016 for Austria). Data for Korea and the United States are not available. Data on quantified measures for Mexico are not available (not included in the OECD average). Australia and Japan reported quantified measures (0.7% and 2.8% of GDP, respectively) although they did not provide fiscal consolidation plans (Australia applies a broader definition of the term consolidation than this report). Norway does not apply a consolidation plan.

Source: OECD Fiscal Consolidation Survey 2012.

Figure 1.15. **Expenditure-based versus revenue-based measures (2009-15)**

Notes: Data are the cumulative contribution to consolidation from expenditure and revenue measures. New Zealand and Slovenia have reported some revenue measures but they are not completely quantified (see Chapter 2 for details).

Source: OECD Fiscal Consolidation Survey 2012.
On average, the countries in category A focus on expenditure cuts by 58% and on revenue increases by 42%. The countries in categories B and C rely more on expenditure cuts, focusing on average on expenditure cuts by 68% and 69% versus 32% and 31% on revenue increases, respectively.

**Major consolidation measures**

After presenting basic background 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 of 2009-15. 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. Information on the impact in per cent of GDP and on cross-country comparison will be given for all measures that are quantified in the consolidation plans. Likewise, this section compares the frequency and impact of the current measures with those described in the report last year to find out how OECD countries have revised their consolidation priorities and the measures dealing with changes in the macroeconomic environment.

**Expenditure in OECD member countries**

*The share of government expenditures varies across OECD member countries*

Government expenditure as a share of GDP indicates the size of the government and reflects 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 the resources spent. For instance, if support is given through tax breaks rather than direct expenditure, expenditure-to-GDP ratios will naturally be lower (OECD, 2009).

The OECD average ratio of expenditure to GDP was just 39% in 2007, and it increased in 2009 to 45% due to worldwide adoption of various fiscal stimulus packages. In 2011, it decreased to 43% due to the initiation of fiscal consolidation effort by numerous governments. This trend of fluctuation in terms of the ratio occurred in almost all of OECD member countries during this period, though the variation of the ratio was usually more significant for many debt-ridden countries such as Iceland and Ireland, and for countries that have already implemented large consolidation, like Estonia (Figure 1.16). However, there is no evidence of a one-to-one correlation between expenditure as a percent of GDP and the cumulative fiscal consolidation.

*Welfare and health are “big ticket” spending items*

Governments can choose to spend their financial resources on a variety of goods and services, such as providing child care, building infrastructure and subsidising alternative energy sources. As of 2010, social protection including social welfare is the largest category of spending and is on an increasing trend when compared with 2007. The second-largest share of total expenditures is spent on health, followed by education, which are both on a slightly decreasing trend from 2007 (reduced by 0.3 percentage points and 0.4 percentage points since 2007 respectively). Economic affairs also account for a major part of GDP, and are on an increasing trend since the financial crisis. 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 on housing and community amenities (Figure 1.17).

**Figure 1.16. General government expenditure (2007-11)**

<table>
<thead>
<tr>
<th>% of GDP</th>
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<tr>
<td>60</td>
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*Note:* The OECD average does not include Turkey.


**Figure 1.17. Structure of general government expenditures (2007-10)**

<table>
<thead>
<tr>
<th>% of total expenditures</th>
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<tr>
<td>36</td>
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<td>32</td>
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<td>28</td>
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1. Interest expenditures are part of general public services (according to the COFOG classification).

**Source:** OECD National Accounts Statistics.
Figure 1.18 shows that, in the OECD area, interest payments by governments represented on average 2.7% of GDP in 2011, a slightly increasing trend since 2007. In particular, the countries with an IMF/EU programme (category A: Greece, Ireland, Portugal) and some countries under close market scrutiny (category B) such as Slovenia and Spain showed a significant increase in interest payments during 2009-11. The United Kingdom also demonstrates the same pattern of increase. In contrast, interest payments decreased over the same period by 2 percentage points of GDP in Iceland and 0.5 percentage points of GDP in Hungary due to completion of their IMF programmes (Figure 1.18). Turkey reduced its interest payments between 2009 and 2011 by 0.9 percentage points of GDP. Although the amount a government pays on interest varies greatly among OECD member countries, the expenditure on interest payments was much higher than the OECD average in many debt-ridden countries such as Greece, Hungary, Iceland, Italy and Portugal, as expected (Figure 1.18).

Notes: The data of Australia, Chile, Japan and New Zealand for 2011 are not available and these countries are not included in the OECD average. The data for 2010 instead of 2011 were used for Canada, Israel, Korea, Mexico, Switzerland, Turkey and the United States. 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.

But employee compensation in general government has decreased due to wage cuts

The public sector is human capital intensive. Compensation of employees in general government varies across member countries, and it is comparatively lower in Japan and Korea – around 6-7% of GDP in 2009 – than in the Nordic countries – above 14% of GDP in 2009 (Figure 1.19). Likewise, the wage bill in the OECD area decreased from 11.4% of GDP in 2009 to 10.8% of GDP in 2011 due to wage cuts and staff reductions across OECD countries. Not surprisingly, the fluctuations of the compensation level during that period were much higher in the countries with an IMF/EU programme (category A) such as Greece and Portugal than most of the other member countries.
Moreover, Estonia, Hungary and some Nordic countries such as Denmark, Finland and Sweden also reduced the compensation level by more than the OECD average (Figure 1.19).

Figure 1.19. General government compensation of employees (2007-11)

Notes: Data for Australia are not available. The 2011 data for Chile and New Zealand are not available and these countries are not included in the OECD average. Data for 2010 instead of 2011 were used for Canada, Israel, Japan, Korea, Mexico, Switzerland, Turkey and the United States. 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.

**Major expenditure reduction measures**

In this report as in last year’s report, consolidation on the expenditure side is presented according to three categories:

- operational measures;
- programme measures;
- other measures.

The first category, operational measures, can be broadly defined as expenditure reductions of 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 expenditures by functional classification in the OECD National Accounts. This classification includes health care, social benefit systems, old-age pensions, capital infrastructure, official development assistance, and transfers to sub-national government.
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, this report separates wage and staff measures from programme measures.

The third category, other measures, includes mainly overall spending cuts or freezes on public consumption.

In this section, the expenditure reduction measures cover the whole period of the countries’ consolidation plans, from 2009 to 2015 (2016 for Austria) depending on the announced plan in each country.

The impact of quantified expenditure reductions reflects external pressure and the extent of debt

A total of 26 countries provided quantified data on their expenditure reduction measures. When it comes to the impact of quantified expenditure reductions as a per cent of GDP in the consolidations plans, countries with an IMF/EU programme are reducing expenditure the most, as is to be expected. On average, the countries in category A have reported quantified expenditure reduction measures amounting to 6.5% of GDP. The average of quantified expenditure reduction measures in categories B and C is 4.2% and 2.4% of GDP respectively.

Hungary (category B) and Ireland and Portugal (category A) topped the list with a reduction of more than 6.7% of GDP, followed by Greece (category A) and countries observed closely by the market (category B: Italy, the Slovak Republic, Slovenia and Spain) as well as Iceland, which successfully completed its IMF programme last year, and New Zealand (category C), all with a reduction of more than 3% of GDP. Some countries with a substantial deficit – Austria, Czech Republic, France, the Netherlands (category C) and Belgium and Poland (category B) – plan quantified spending cuts of more than 2% of GDP (Figure 1.20).

Most countries focus on quantified expenditure reductions in programmes for 2009-15

In most countries, programme expenditure measures contribute more to consolidation than operational measures, as was the case in last year’s report. In particular, countries with an IMF/EU programme (category A) such as Greece and Ireland depend more than 70% on programme measures to reach the fiscal deficit reduction target effectively. However, Portugal (category A) dedicates around 40% of its expenditure reduction measures to operational measures, including wage cuts, to show the strong commitment of the government to stabilise public finance. Only one country assigns a large portion of its expenditure reduction measures to operational expenditure: in Denmark, operational expenditure reduction amounts to 87% of the total expenditure reduction measures (out of a small total) (Figure 1.21).

Only three countries have grouped a substantial part of their consolidation as “other expenditure measures”. In the Czech Republic, this relates to across-the-board decreases in expenditures of 1.9% of GDP. In Italy, all new measures adopted in 2011 are grouped as “other expenditure measures” due to missing detailed data. In Switzerland, the impact of these measures is only 0.1% of GDP, relating to budget adjustments regarding changes in inflation and in interest rates.
Figure 1.20. **Quantified expenditure reductions (2009-15)**

Notes: Data are not available for Korea, Turkey and the United States. The data on operational measures for the United Kingdom are not available. The data on programme measures for Switzerland are not available. Austria has reported measures up to 2016. Estonia, Japan and Mexico did not apply any expenditure reduction measures.

Source: OECD Fiscal Consolidation Survey 2012.

Figure 1.21. **Quantified expenditure reduction measures – composition (2009-15)**

Notes: Data are not available for Korea, Turkey and the United States. Data on operational measures for the United Kingdom are not available. The data on programme measures for Switzerland are not available. Estonia, Japan and Mexico did not apply any expenditure measures.

Source: OECD Fiscal Consolidation Survey 2012.
Box 1.9. Fiscal policy in Norway

Fiscal policy in Norway is guided by the fiscal rule, stipulating a gradual phasing-in of oil revenues in the Norwegian economy in line with the expected real return on the Government Pension Fund Global (formerly the Petroleum Fund), estimated at 4%. The fiscal rule permits spending more than the expected return on the Fund in a cyclical downturn, while the use of oil revenues should be below the expected return when capacity utilisation in the economy is high. This room for manoeuvre was used in 2009 to mitigate the effects of the financial crisis on production and employment. In 2011, the use of oil revenues will again be below the 4% path.

Due to the oil revenues, the central government in Norway has run a fiscal surplus for several years: 10.7% in 2009 increasing to 13.6% in 2011. The 2012 fiscal surplus is estimated at 11.5% of GDP, and central government net assets are estimated at 155.8% of GDP in 2012.

Due to this favourable financial condition, Norway does not have a consolidation plan. Notwithstanding, the government included some expenditure cuts in the 2012 budget of 0.1% of GDP (NOK 1.7 billion). The largest part of the cuts involved a reversal of some unemployment benefits that were granted during the financial crisis (NOK 240 million), followed by reduced transfers to the regions (NOK 220 million) and several smaller cuts.

Major operational measures

Among the OECD countries participating in the fiscal consolidation survey, 81% have still marked operational expenditures for savings, although this percentage is a bit lower than in last year’s report. Wage cuts and staff reductions are on the reform agenda less frequently than was the case last year, which implies that some countries have changed their use of these measures. Among the participating countries, 59% include wage cuts and 28% include staff reductions (Figure 1.22). However, a number of countries have unspecified operational savings, i.e. no details are provided concerning the distribution of reductions in wages, staffing or general operational expenses. Examples include the temporary expenditure rule and ceiling on new spending in Poland (category B) and rationalisation of services and control of operational expenditure in general government in Portugal (category A).

The countries with an IMF/EU programme (category A) and the countries under market scrutiny (category B) have announced far-reaching and very substantial operational cutbacks. In Hungary (category B), the cuts in operational measures amount to as much as 3.3% of GDP, including a freeze of the gross wage bill and a freeze of operational budgets. Portugal (category A) also plans to cut overall operational expenditures by around 2.7% of GDP. Greece (category A), the Slovak Republic, Slovenia and Spain (category B) and Iceland and New Zealand (category C) also increased the amount of operational expenditure cuts by more than 1.4% of GDP compared with last year, reflecting the external pressure for the normalisation of public finance (Figure 1.23A).
Slovenia (category B) topped the list in terms of the wage cuts, at 1.1% of GDP. Likewise, wage cuts are commonly an important source for consolidation in operational expenditure among countries with an IMF/EU programme. Greece (category A) increased the amount of reduction to 0.95% from 0.22% of GDP described in last year’s report. Ireland and Portugal (category A) still assigned around 0.7% of GDP in wage cuts. Also, Hungary, the Slovak Republic and Spain (category B) assign wage cuts of around 0.7%-0.9% of GDP (Figure 1.23B). For example, EUR 1.2 billion is to be cut from the public service wage bill during 2011-14 in Ireland, and in Portugal government wages were cut 5% in 2011 and will be frozen during 2012-13 (Table 1.2). This indicates that wage cuts are still being used as an important signal to markets and the public regarding the government’s determination to improve fiscal balances by taking politically tough decisions.

Table 1.2. Wage reduction targets

<table>
<thead>
<tr>
<th>Country</th>
<th>Reductions</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>Freeze of general increases of the civil servant salaries.</td>
</tr>
<tr>
<td>Greece</td>
<td>Rationalisation of special wage regimes (police, military personnel, firemen, diplomats, etc.).</td>
</tr>
<tr>
<td>Hungary</td>
<td>Freezing the gross wage bill and reducing earning compensation in the public sector.</td>
</tr>
<tr>
<td>Poland</td>
<td>Freezing the nominal wage bill in the public sector.</td>
</tr>
<tr>
<td>Portugal</td>
<td>Average cut of 5% in government wages in 2011, and freeze during 2012-13.</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>10% cut in the state wage bill.</td>
</tr>
<tr>
<td>Slovenia</td>
<td>Limited to 1.2% annually and (from mid-2012) wage cuts by 8% across the entire public sector.</td>
</tr>
</tbody>
</table>

Source: OECD Fiscal Consolidation Survey 2012.
**Figure 1.23. Operational expenditure reduction measures – impact (2009-15)**

Notes: Operational measures announced by Turkey, the United Kingdom and the United States are not available in this survey. Wage cuts announced by Germany, Iceland, Italy, Turkey, the United Kingdom and the United States are not available in this survey.


Together with the wage cuts, public sector employment is still being scaled back considerably. Germany plans to abolish up to 10 000 staffing positions permanently, and general government employment is projected to fall by 710 000 by 2016-17 in the United Kingdom (Table 1.3).
Table 1.3. Staff reduction targets

<table>
<thead>
<tr>
<th>Country</th>
<th>Reductions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>Reduce recruitment.</td>
</tr>
<tr>
<td>France</td>
<td>Non-replacement of one out of two retiring civil servants will cut 150,000 posts by 2013.</td>
</tr>
<tr>
<td>Germany</td>
<td>Up to 10,000 staffing positions to be permanently abolished by 2014.</td>
</tr>
<tr>
<td>Ireland</td>
<td>EUR 1.2 billion is to be cut from the public service wage bill during 2011-14 (24,750 job cuts over peak 2008 levels).</td>
</tr>
<tr>
<td>Portugal</td>
<td>Reduce the number hired in central, regional and local governments.</td>
</tr>
<tr>
<td>Spain</td>
<td>Implementation of a 10% replacement rate for all staff in the public sector in 2011-13 (7% staff reduction by 2013).</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>General government employment will fall by 710,000 by 2016-17 (projection of the Office for Budget Responsibility).</td>
</tr>
</tbody>
</table>

Source: OECD Fiscal Consolidation Survey 2012.

Major programme measures

The largest expenditure reductions involve programme measures, as was the case in last year’s report. The most frequently targeted areas for savings are welfare, health care, pensions, and infrastructure. However, some countries did not report any consolidation plan in welfare (Estonia, Switzerland), health (Estonia, Italy), pensions (Czech Republic, Estonia) or infrastructure (Czech Republic, Estonia, Hungary and Switzerland), as was the case last year. In a few OECD countries, transfers to lower levels of government (Hungary, Slovak Republic, Sweden), education (Netherlands, Spain, Sweden), and subsidies to state-owned enterprises (SOEs) (Greece, Portugal) also contribute to consolidation (Figure 1.24). Likewise, a number of countries have reduction plans in research, social integration and transfers to business which were not categorised in last year’s report. At the same time, the consolidation plan of many countries includes unspecified savings from the programme measures, i.e. no details are provided concerning savings from general spending cuts across overall departments. Examples from Ireland include general departmental spending cuts of EUR 3 billion during 2011-14.

Welfare is the most frequently targeted area for savings, and more than 70% of member countries have consolidation plans in welfare in 2012. This is not surprising given the largest share of public expenditures devoted to social protection (see Figure 1.17 above). Greece (category A) is reducing welfare expenditures by 1.9% of GDP with reductions in social security funds and social spending (see Figure 1.25A); this percentage is the highest among OECD countries, and far higher than the 0.1% of GDP reported last year. Ireland (category A), Hungary and Poland (category B), and Germany and the United Kingdom (category C) plan reductions in the area of welfare in excess of 1% of GDP. For instance, the United Kingdom increased the expenditure cuts in welfare from 0.4% to 1.14% of GDP with the cuts on child and disability benefits. France, Iceland and the Netherlands (category C) have expenditure reduction measures in welfare amounting to more than 0.6% of GDP. Likewise, a number of countries have quantified reductions in magnitudes of close to 0.3-0.4% of GDP or more (Figure 1.25A).
About 50% of participating countries identified health savings as one of the main consolidation sources, as reported last year. These measures constitute a major share of expenditure savings in all countries with an IMF/EU programme (category A): Greece, Ireland and Portugal. For example, Portugal plans to reduce expenditure in the health system, especially in the areas of pharmaceuticals, user fees, public health systems and through hospital restructuring. The savings on health expenditures will amount to as much as 1% of GDP in Ireland and Portugal. Belgium and Spain (category B) also substantially increased their savings target in the health area, up to 1% and 0.7% of GDP respectively (Figure 1.25B).

The reduction of infrastructure expenditure is also on the agenda in many countries. Ireland (category A) and Slovenia and Spain (category B) plan to cut infrastructure investment by more than 1.3% of GDP. Portugal (category A) indicated the commitments to no new road construction, thus reducing infrastructure spending by 0.7% of GDP rather than the 1.2% of GDP reported last year (Figure 1.26A).

Pension reform is also on the agenda for many OECD member countries even if its impact on consolidation is somewhat reduced across the countries. Hungary (category B) plans savings in pensions of 1.6% of GDP through a change in the indexation system for pensions. In Portugal, savings of 0.9% of GDP are expected through special contributions for pensions (Figure 1.26B). Austria, France and New Zealand (category C) also expect savings amounting to more than 0.5% of GDP due to the increase of the retirement age and changes in pension schemes.
Figure 1.25. Welfare and health – impact of reductions (2009-15)

Note: For Figure 1.25A: Welfare programme measures announced by Italy and Korea are not available in this survey. For Figure 1.25B: Programme measures on health announced by France, Iceland, Turkey and the United States are not available in this survey.


Only two OECD countries have consolidation plans in agricultural expenditure (Hungary, Slovak Republic), only three countries in development aid (Canada, Netherlands, Spain), and only three countries in energy subsidies (Australia, Hungary, United Kingdom), which is more limited than reported in last year’s report (see Figure 1.24). This indicates that these areas are still the least prioritised ones for savings among OECD countries, since there is continued sizeable support for agriculture and levels of subsidies in many countries.
Figure 1.26. Infrastructure and pensions – impact (2009-15)

Note: For Figure 1.26A: Programme measures on infrastructure announced by Turkey are not available. For Figure 1.26B: Pension programme measures announced by Greece and Italy are not available.

Box 1.10. Pension reforms in Belgium, France and Hungary

Belgium: The government has introduced structural reforms of the pension system which will come into force as of 2013. First, the early retirement age will be increased from 60 to 62, in both the private and the public sector (six months per year from 2013 to 2016). Second, measures will be introduced to authorise and encourage people to work longer than age 65. Third, the pension bonus and fiscal incentives for long-term savings will be improved, to encourage longer careers.

France: On 7 November 2011, the government decided to bring forward the transitional phase of the pension reform by one year, thereby rescheduling the target age of 62 years for 2017 instead of 2018. In view of the current sovereign debt crisis, this measure will reduce the pension scheme deficit more quickly and speed up the shielding of pensions from financial market tensions.

Hungary: The government started reshaping the pension system in 2011, and subsequent steps will follow in 2012 in order to reinforce the insurance and solidarity character of the pension system and to improve its long-term sustainability and transparency. The 2012 budget includes a balanced budget for the Pension Insurance Fund. From 31 December 2011, the whole social security pension contribution flows to the Pension Insurance Fund.

Revenue in OECD member countries

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

In the OECD area as a whole, government revenue as a share of GDP was stable at around 37% during 2007-11. However, government revenues show significant differences between countries, ranging from 31% of GDP in Australia to 58% in Norway (Figure 1.27). 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, Korea and the United States are well below the OECD average.
The revenue-to-GDP ratios decreased during 2007-11 in several countries such as Iceland, Israel, New Zealand and Spain due to revenue contraction following the economic downturn and reductions of the income tax rates. In contrast, the ratios increased significantly in Hungary (category B) primarily due to asset transfers from private pension funds to the state pension pillar. Also Portugal (category A) has experienced an increase in the revenue-to-GDP ratio in the period.

Of total general government tax revenues, the largest share (33% of total tax revenue) is made up of personal income taxes and corporate income taxes, followed by social security contributions. Taxes on general consumption and on specific goods and services also represent a significant amount of total tax revenue (Figure 1.28).
There is considerable variance between OECD member countries in terms of relative reliance on tax sources, especially consumption taxes (Figure 1.29). These differences suggest that for some countries the scope for increasing consumption taxes might be greater compared to other countries.

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

**Major revenue enhancement measures**

In this section, the revenue enhancement measures cover the whole period of the countries’ consolidation plans, from 2009 to 2015 (2016 for Austria) depending on the announced plan in each country.

The most frequently announced tax measure is still to raise consumption taxes, and 75% of OECD countries plan to raise consumption tax revenue – more than was the case in last year’s report (Figure 1.30). This frequent use of consumption taxes implies that policy makers believe that such taxes are likely to bring in significant revenue in the short term with less of a negative impact on economic growth.

About 65% of OECD countries plan to raise income taxes, a higher number than last year. Property taxes, tax expenditure, social security tax and non-tax revenue including user fees and privatisation of state-owned enterprises also play a significant role in enhancing revenues in some countries. However, for revenue enhancement purposes only 6-9 countries use special taxes on the financial sector and improving tax compliance (Figure 1.30). Likewise, newly established tax items such as the tax levies on nuclear power industry in Germany and a tax on non-renewable resources in Australia are included in the other tax category in this report.

The impact of revenue enhancement measures varies widely. Not surprisingly, countries with an IMF/EU programme (category A) announced larger quantified revenue enhancement measures. Greece, Ireland and Portugal, together with Iceland, aspire to increase their revenues by more than 5% of GDP (Figure 1.31). Hungary plans to enhance revenue by 1.1% of GDP, combining a reduction of income taxes by 3.1% of GDP – aimed at boosting economic activity – and an increase of other revenue enhancement measures by 4.2% of GDP. On average, the countries in category A have reported quantified revenue enhancement measures amounting to 5.3% of GDP. The average of quantified revenue enhancement measures in categories B and C is 1.4% and 1.9% of GDP respectively.

Increases in consumption taxes account for the largest share of revenue enhancement measures in many countries (Figure 1.31). Income tax measures are used by a number of countries, but their share of the total revenue increase is much smaller than consumption taxes. Only Iceland, Ireland and Portugal expect a revenue increase from income taxes in excess of 1% of GDP. In Greece, revenue enhancements mainly derive from increases of social security fund contributions and improvements in tax compliance.
Figure 1.30. **Revenue enhancement measures – frequency (2009-15)**

**Notes:** 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.


Figure 1.31. **Quantified revenue enhancement measures (2009-15)**

**Notes:** Data on the breakdown of revenue enhancement measures announced by Italy, Korea, Mexico, the Netherlands, New Zealand, Turkey and the United States are not available. Consumption tax measures announced by Spain are not available. Austria has reported measures up to 2016. Norway and Sweden did not apply any revenue enhancement measures.

**Source:** OECD Fiscal Consolidation Survey 2012.
Consumption taxes

Most countries announced consumption tax measures including hiking the rate of value-added taxes (VAT), extra excise duties on tobacco and alcohol, and environmental taxes as in last year’s report. Taxes on tobacco and alcohol are the most frequently adopted consumption taxes followed by VAT (Figure 1.32A). Other specific new consumption taxes include levies on telecom services, and lotteries were also reported as well as many other unspecified excise duties.

Figure 1.32. Consumption taxes

StatLink 2 http://dx.doi.org/10.1787/888932697217

Note: Consumption tax measures announced by Italy, Mexico, Spain, Turkey and the United States are not available in this survey.


The impact of consumption tax measures is more than 1% of GDP in Ireland (category A), Hungary (category B) and the Czech Republic, Finland, Iceland and Japan (category C). Estonia also relies on increases of more than 1% of GDP (Figure 1.32B). Japan plans a two-staged consumption tax increase to 10% by 2015 from the current tax rate of 5%. Estonia, Finland, Ireland, Italy, Portugal, Spain and United Kingdom plan an
increase of two percentage points or more in the rate of VAT (Figure 1.33). In contrast, for example Greece (category A) and Poland (category B) shifted their focus from consumption taxes to income tax and other tax measures including bank levies, as a source of new revenue (Figure 1.32B). Some countries such as Greece, New Zealand and Spain did not report consumption tax measures in this survey (Figure 1.32B).

Figure 1.33. VAT rate hikes (2009-15)

1. New Zealand applies a general consumption tax.

Notes: VAT rate hikes in Belgium are not included (e.g. the VAT rate on TV emission is to be raised by 9 percentage points from 2012 onwards). France, Hungary and Mexico have also adopted measures on VAT, but did not provide detailed data.


Box 1.11. Consumption tax increase in Japan

The Japanese Cabinet officially adopted the “Comprehensive Reform of Social Security and Tax” in February 2012 and specified its detailed plan for revenue enhancement and social security stabilisation. To address rising social security spending, Japan is planning to double the consumption tax rate to 10%. This change will occur in two key stages: from the current 5% to 8% in April 2014 and to 10% in October 2015. The enhanced revenue will be spent in part to resolve the problem of children on waiting lists for day care and to improve the medical and long-term care services as well as measures for low-income earners (JPY 2.7 trillion, equivalent to 1% of the consumption tax rate increase). The rest of the enhanced revenue will increase the national government’s contribution to the basic pension and will reduce the shifting of burdens to future generations (JPY 10.8 trillion, equivalent to 4% of the consumption tax rate increase).

Income taxes, social security taxes, property taxes, and taxes on the financial sector

To strengthen revenue, many countries have envisaged measures to enhance revenue from personal income taxes (PIT), corporate income taxes, social security contributions, property taxes and taxes on the financial sector. PIT is the most frequently used measure,
and in 2012 more countries reported their plans to enhance revenue through PIT as well as through corporate income tax and social security contributions than described in last year’s report. Some countries such as Belgium, France, Iceland and Ireland are also expecting revenue increases from property tax, whereas the tax on the financial sector is somewhat less frequently used (Figure 1.34A).

Figure 1.34. Income-related taxes

StatLink: http://dx.doi.org/10.1787/888932697255

Notes: For Figure 1.34A: Property taxes were not presented in last year’s report. For Figure 1.34B: The figure adds the impact of income taxes, social security contributions, property taxes, and taxes on the financial sector. The comparison with last year’s report is not described as property tax was not included in last year’s components. Income-related tax measures announced by Italy, Mexico and the United States are not available.


The Czech Republic, France and Iceland (category C), Poland and Spain (category B) and all three countries with an IMF/EU programme (category A) expect to gain extra revenues of more than 1% of GDP from these measures (Figure 1.34B). Ireland tops the list with its PIT revenue increase from 1.2% to 4% of GDP, whereas Hungary plans to
reduce PIT revenue by 3.1% of GDP to provide effective incentive to workforce. Social security contributions are a significant source of revenue increases – by more than 1% of GDP – in the Czech Republic, Greece, Hungary and Poland. An example is the cancellation of a reduction in employers’ contributions in the Czech Republic.

Property taxes contribute to revenue enhancement by more than 0.1% of GDP in Belgium, France, Iceland, Ireland, Poland and Slovenia. An example is a charge of EUR 200 on second homes in Ireland. Taxes on the financial sector play a significant role in raising tax revenue by more than 0.1% of GDP in Austria, Germany, Hungary and the Slovak Republic. An example is a bank levy in Germany whose proceeds will go to restructuring the fund for banking. The levy will bring an additional EUR 6 billion (0.21% of GDP) by 2014.

Other revenue enhancement measures

Tightening tax deductions and other tax benefits (tax expenditures) is also used by countries to increase revenues (Figure 1.35A). Portugal announced that it would revise and limit tax allowances and other tax benefits in income tax, which will increase revenue by 1.05% of GDP, a higher impact than the 0.46% of GDP in last year’s report (Figure 1.35A). Belgium also plans to reduce the deduction for energy-saving investments, and the Slovak Republic plans to phase out exemptions for bio-fuels. In contrast, Denmark and Ireland did not report tax expenditure measures in this survey as they did last year.

Several countries will implement measures to make their tax administrations more effective and to reduce tax evasion (Figure 1.35B). Greece expects to collect extra revenue amounting to 1.3% of GDP, which is higher than the 0.7% of GDP reported last year. Austria, Belgium, Canada, Finland and Portugal also expect significant revenue increases by closing loopholes and improving the fairness of the tax system. In contrast, Slovenia did not report tax compliance measures as they did last year.

In addition to increasing tax measures, some countries are implementing non-tax measures to increase revenues. These measures amount to more than 0.2% of GDP in Iceland, Poland, Portugal, the Slovak Republic and Spain (Figure 1.35C). For instance, the Slovak Republic plans to sell the CO² emission permit and increase the fees on highways, on electricity and on fuels. In Belgium, revenue stemming from the monopolised lottery and fines are expected. Portugal expects a revenue increase from the introduction of tolls in motorways.
Figure 1.35. Impact of other revenue enhancement measures

Notes: For Figure 1.35A: Tax expenditure measures announced by Germany, Greece, Italy, Korea, Spain and the United States are not available. For Figure 1.35C: Non-tax revenue measures announced by Italy, New Zealand and the United States are not available. Estonia did not report non-tax revenues although they accounted for 2.1% of GDP in last year’s report, which is not included in Figure 1.35C.

**Do the consolidation measures contribute structurally?**

As in last year’s report, the country consolidation plans may be seen as combining long-term structural measures, the rolling back of stimulus measures and short-term additional adjustments.

By now, most stimulus packages are being or have been rolled back. Still some countries with small consolidation needs include the withdrawal of such stimulus measures in the consolidation plans (Finland, Sweden, Switzerland).

Some 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 B) either to help relieve liquidity pressures, or because they are seeking to front-load deficit improvements in order to reassure capital markets. For example, Poland has introduced changes in the funded pension scheme by reducing the rate that provides funds to the second pension pillar, leading to an increase in government revenue (0.8% of GDP by 2015). Also, Hungary has made changes to the pension scheme; for example, from 31 December 2011 the whole social security pension contribution flows to the government Pension Insurance Fund, following an asset transfer from private pension funds to the state pension pillar in 2011. Hungary has also introduced other one-off measures in 2012 amounting to 0.7% of GDP. Luxembourg has introduced a crisis levy (0.2% of GDP by 2013), and New Zealand will partially privatise state-owned assets (worth NZD 5-7 billion by 2017).

Some operational 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.

Instead of adopting a specific consolidation plan, some countries rely on general strategies for cap on expenditures, like Australia, Japan, Korea and Turkey. These strategies includes rules that an increase in expenditure will be kept below the increase in revenue (Korea and Turkey), an annual cap on real spending growth (Australia), and limit spending to the level of a previous budget (Japan).

Finally, economic assumptions that are systematically “optimistic” understate fiscal consolidation needs, undermining countries’ ability to meet their deficit reduction targets over time. Due to the headwinds on economic recovery from late 2011, several OECD countries have slightly more optimistic assumptions of economic growth in the 2012 budget and in the consolidation plan than the reality now suggests. Over-optimistic growth assumptions imply that increased expenditures on social welfare like unemployment benefit and reduced tax revenue will add to the planned deficit in 2012. Therefore several countries may adopt additional measures in 2012, or may accept a larger deficit than planned. For some countries this increased deficit may be countered by the better than planned results in 2011.

So, while the majority of the plans – on both the expenditure and revenue sides – appear to include long-term structural measures that improve long-term fiscal sustainability, there is still room for further efforts to adopt lasting, sustainable consolidation measures. Additional structural efforts, however, may still need to solve political economy barriers.
Structural reforms on pensions are being implemented

Some structural reforms may not be appropriately captured by short- or medium-term consolidation estimates. This is particularly true for pension reforms, as they are usually set up in a long-term framework. In addition to the consolidation measures presented in this chapter and in Chapter 2, over the last five years many OECD countries have adopted changes in pension schemes aiming at strengthening long-term sustainability. Such changes were already under way before the crisis, as several OECD countries had recognised a long-term sustainability problem due to an ageing population. During the last five crisis years, OECD countries have intensified their work on pension reforms.

During the period 2007-11, nearly all OECD countries introduced changes in the provision of retirement income (OECD, 2012c). The only exception is Luxembourg which has seen no changes so far but has issued guidelines for a pension reform (see the country note in Chapter 2), although Iceland, the Netherlands, New Zealand, Slovenia and the United States have seen only relatively minor adjustments compared with most other OECD countries.

Changes in pension schemes include, among other elements, increases in pensionable ages, the introduction of automatic adjustment mechanisms, and the strengthening of work incentives. Some countries have also better focused public pension expenditure on lower income groups.

Some countries have cut pension benefits “across the board” with equal impact on low and high earners, namely Austria, Germany, Italy, Japan, Korea, Portugal and Turkey. The OECD has estimated that in these countries the benefits for today’s workers on average will be 23% lower than they would have been according to the old rules. Other OECD countries have protected low earners from some or all of the benefit reductions. Average earners in Finland, France and Sweden, for example, will receive pensions 15-20% less than under the old rules, while lower earners are less affected. Some central and eastern European countries have pulled back earlier reforms that replaced part of their pay-as-you-go benefits with a mandatory funded component of defined-contribution pension plans managed by the private sector. The OECD estimates that these reversals will cause lower pension benefits of about 20% for a full-career worker in Hungary and around 15% with Poland’s partial reversal.

Table 1.4 shows major elements of the pension reforms undertaken in OECD countries from the start of the crisis in September 2007, as per February 2012. The overview shown in the table covers both the private and the public sector. The elements of reform are organised into six different categories reflecting different objectives of the pension system, along with a residual grouping for other changes:

- coverage of the pension system, by both mandatory (public and private) and voluntary (private) schemes;
- adequacy of retirement benefits to maintain a decent standard of living in old age, including both public and private pensions;
- financial sustainability and affordability of pensions for taxpayers and contributors;
- work incentives: minimising the distortions of the retirement-income system on individuals’ labour-supply decisions and encouraging people to work longer as populations age;
### Table 1.4. Overview of pension reform measures (September 2007 to February 2012)

<table>
<thead>
<tr>
<th>Country</th>
<th>Coverage</th>
<th>Adequacy</th>
<th>Sustainability</th>
<th>Work incentives</th>
<th>Administrative efficiency</th>
<th>Diversification / scrutiny</th>
<th>Other</th>
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1. 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.

- administrative efficiency: keeping the cost of collecting contributions, paying benefits and (where necessary) managing investments as low as possible; and
- diversification of retirement savings, between different providers (public and private) and between different types of financing (pay-as-you-go and pre-funding), and measures to ensure security of benefits in the face of different risks and uncertainties.

About a third of OECD countries have taken significant steps to improve the coverage of pension schemes in the period since September 2007. Four countries have introduced relatively modest measures to expand the numbers in the public pension arrangements: Austria (people providing care for family members), France (recipients of maternity benefits), Ireland (low earners) and Japan (the self-employed). However, most efforts have been made to expand the reach of private pension plans.

About 40% of OECD countries have addressed issues of adequacy in the changes to pension schemes during the last four and a half years. Among the measures in this category are means-tested benefits, new targeted programmes, additional tax reliefs for older people, and increased value of the basic pension.

Approximately 50% of OECD countries have changed sustainability and work incentives in this period. Most OECD countries already have increased pensionable ages, or have planned an increase in the coming years, leaving only Chile, Finland, Luxembourg and Mexico with no change.

Most OECD countries have established a pension age of 65, and 13 OECD countries are increasing the pension age to 67 or higher (12 countries for women) or have already established this pension age. There is only a handful of countries with pension ages below 65 (for men: France, Luxembourg, the Slovak Republic and Slovenia). Only Chile, Israel, Poland, Slovenia and Switzerland have a lower pension age for women than for men. Nevertheless, even with these increases in pension ages, the expected duration of retirement will expand on average across OECD countries. According to OECD estimates, only in a few OECD countries will the pension age increases keep pace with forecast improvements in life expectancy: the Czech Republic, Greece, Hungary, Italy, Korea and Turkey. In Austria, Estonia, the Slovak Republic and the United Kingdom, pension age increases exceed the projected growth in life expectancy for women, but not for men.

Nearly all OECD countries are taking action to ensure that people “live longer, work longer”. In addition to work incentives in the pension schemes, indexation of pension benefits, higher pension ages and tighter rules for early retirement, some countries have also adopted other measures to bolster long-term pension system sustainability. These measures include reducing the pension replacement rate (Korea), extending the number of years of earning used to calculate pension benefits (Greece), abolishing additional, seasonal pension benefits (Greece and Hungary), introducing notional accounts that entail an automatic reduction in the level of pension benefits as life expectancy increases (Italy, Norway, Poland and Sweden), and changing taxes (Australia, Ireland, New Zealand and the United Kingdom).

Improving administrative efficiency was the least common area of reform even though administrative costs and charges have remained a significant policy concern for the OECD countries where there are substantial private pension providers. For public pension provisions there are a few examples of improvements in administrative
efficiency – in particular Greece, which is reducing its 133 public pension institutions into just three. Japan has established an entirely new agency to manage public pensions, and Italy merged two other major agencies into its main agency for pension provision (INPS). Sweden has merged its clearing-house for private pensions with the management of public pensions, aiming to reduce costs further.

Half of OECD countries have made changes in diversification/security. This relates to giving greater choice to individuals to influence the way their retirement savings are invested in private plans, allowing for greater diversification of pension fund portfolios, and changes related to pension fund solvency.

The category of other reform measures covers a diverse range of significant developments in pension policy. First, some central and eastern European countries have reversed earlier reforms that had introduced mandatory private pensions into the provision of retirement income (Estonia, Hungary, Poland and the Slovak Republic). Second, other countries have retreated partly or fully from earlier commitments to pre-fund future public pension liabilities (France, Ireland and New Zealand).

**Notes**

1. Ireland (March 2011), Finland (June 2011), Portugal (June 2011), Greece (November 2011 and May 2012), Italy (November 2011), Spain (December 2011), Belgium (December 2011), Slovenia (February 2012), Slovak Republic (March 2012), Netherlands (April 2012), France (May 2012).

2. No consolidation is planned in Chile; Israel did not provide complete data in time for this report.

3. On 30 May 2012, the European Commission concluded that the correction of the excessive deficit for Germany has been ensured and adopted a proposal for a Council decision to abrogate the excessive deficit procedure, which the European finance ministers agreed on 21-22 June.

4. There are some caveats on the comparability of the countries. Some countries did not provide data for the implemented consolidation (2009/10-11). For the most striking examples (like Greece), the OECD Secretariat has included the consolidation described in last year’s report as if it had been implemented as planned. Some countries did not provide cumulative data. Wherever possible, the data have been recalculated into cumulative consolidation.

5. Iceland and Luxembourg were not included in last year’s OECD average.

References


