

SGI Sustainable Governance
Indicators 2009

Economy and employment

Budgets report



Indicator **Budgetary policy**

Question **To what extent is budgetary policy fiscally sustainable?**

30 OECD countries are sorted according to their performance on a scale from 10 (best) to 1 (lowest). This scale is tied to four qualitative evaluation levels:

- 10-9 = Budgetary policy is fiscally sustainable.*
- 8-6 = Budgetary policy achieves most standards of fiscal sustainability.*
- 5-3 = Budgetary policy achieves some standards of fiscal sustainability.*
- 2-1 = Budgetary policy is fiscally unsustainable.*

Canada

value 10

Canada's fiscal framework has been successful not only in reducing public debt but also in creating a consensus among Canadians of support for its prudent fiscal policies. The federal commitment to a balanced budget on an annual basis has yielded fiscal surpluses in nine consecutive years. This has resulted in a reduction of about 30 percentage points in the federal debt-to-GDP ratio over the last decade, from 56.3 percent in 1996 to 27.9 percent in 2006, according to the OECD. It is important to mention that all three budgets – in 2005, 2006 and 2007 – were put in place by minority governments.

In 2006, the newly elected Harper minority government vowed to address the vertical fiscal imbalance between the federal and the provincial levels. The vertical fiscal imbalance refers to the mismatch between revenues raised by each level of government, on the one hand, and its spending obligations, on the other. Whereas Liberal governments have denied the existence of such an imbalance in the past, the Harper government has tried to restore the fiscal balance through the 2007 budget by transferring an additional CAD 39 billion over the next seven years to the provinces.

Ireland

value 10

The decline in the debt-to-GNP ratio since the 1990s to the second-lowest level in the euro zone provides evidence not only of the soundness but also of the sustainability of Ireland's tax and budgetary policies. There is a surplus on the primary (non-interest) budget and until the fiscal year of 2007 the current budget was in surplus as well. Continued strong economic growth has facilitated policies of simultaneously reducing taxation and increasing public expenditure. However, the outcome for 2007 has begun deteriorating as the exceptional growth of the economy slows, and it seems that a current budget deficit will re-emerge.

A general note of caution is in order regarding this matter. GDP has traditionally been taken as a measure for national wealth. In the case of Ireland, however, GDP is a misleading base for standardization. This is due to the importance of the outflow of profits and incomes generated in the country by multinational companies. Consequently, Irish national wealth should be measured using GNP rather than GDP.

Norway

value 10

The Norwegian government receives a large flow of financial resources from the extraction of oil. This flow started in the 1980s, and is projected to remain substantial until around 2040. In many countries, the abundance of natural resources has given way to corruption and irresponsible fiscal policies. Norway has so far avoided this “resource curse.”

One important achievement has been the establishment of a so-called petroleum fund, created in 1990 by the Norwegian parliament as a means to share oil proceeds between current and future generations, as well as to smooth out the effects of highly fluctuating oil prices. The fund is administered by Norges Bank Investment Management (NBIM), an arm of Norway’s central bank. It is currently the largest pension fund in Europe; it is estimated that the fund will exceed the equivalent of \$500 billion by the end of 2009.

Under current rules, the government is required to invest all oil revenue in the fund. Each year, at most 4 percent of the fund’s value is made available for current expenditure. This principle is supported by all political parties except for the populist Progress Party. When including the oil fund, the net asset position of the Norwegian government amounts to about 120 percent of GDP. This surplus is sufficient to cover outstanding and future pension liabilities, putting the country in a unique position compared with most Western countries. The petroleum fund is invested 60 percent in stocks and 40 percent in bonds, and is not allowed to own Norwegian assets. The latter constraint is motivated by the desire to avoid an implicit nationalization of the economy that might threaten the independence of the nation's corporate sector. Budgetary policy has therefore been largely effective in ensuring fiscal sustainability.

Sweden

value 10

During the economic crisis of the early 1990s, Sweden’s national debt rose dramatically. Since the mid-1990s, however, a strong budget reconstruction program has been successfully implemented. Moreover, while budgetary policy was arguably the most important political issue in Sweden during the 1990s, it did not receive the same amount of attention during the period under review. Today, budgetary policy is long-term-oriented, disciplined, in harmony with EU criteria for inflation and budgetary deficits, and seemingly successful at fostering economic growth.

Australia

value 9

The annual budget balance provides Australia's best measure of fiscal sustainability. The federal government has run surpluses in 10 of the last 11 budgets, to the point that net government debt was eliminated in the 2005 – 2006 budget year. The government has also set up a scheme to fund future public-sector worker pension liabilities, using budget surpluses and its remaining holdings (and the proceeds of the 2006 sale of part of its remaining holdings) in Telstra, a telecommunications company. This good news is somewhat muted by the fact that a number of state governments have significant net debts. Since Australia has a vertical fiscal imbalance – the states are responsible for expenditures well in excess of their tax revenues, while the federal government raises greater tax revenue than is required for its expenditures – many commentators have noted the probability of long-term adverse implications such as the underprovision of state-provided services and unsustainable state fiscal policies.

For most of the 1980s and 1990s, Australia's budgetary policy was based on the premise that reducing the budget deficit was the most effective means of ensuring fiscal sustainability. Particularly after the election of the Coalition government in 1996, this goal was achieved by a reduction in government spending, notably in the area of higher education. As the economy expanded in the early 2000s as a result of the resources boom, budgetary policy further emphasized fiscal consolidation. Budgetary policy has therefore been largely effective in ensuring fiscal sustainability.

Denmark

value 9

The so-called 2010 plan has guided fiscal policy in Denmark for a number of years. This plan has several targets, including significant debt reduction, tight expenditure controls and reforms to increase the labor supply and employment. When measured in terms of public debt and employment, the objectives have been met. However, this success can be attributed in large part to a very favorable business cycle situation as well as to other temporary revenue increases for the public sector. Nevertheless, the key target of the plan – that is, the growth target for public expenditures – has been regularly exceeded during the period under observation and, as a result, the part of the plan under direct policy control has not met its target. Moreover, there is some doubt as to whether the necessary structural changes have been made regarding demographic changes and increased pension requirements.

In June 2006, the government reached a welfare agreement with three main opposition parties, which includes a higher retirement age. Moreover, sound public finances are part of the government's National Reform Program, which aims to ensure long-term fiscal sustainability, and the government has introduced a tax freeze

in order to constrain any increases in government spending.

In addition, a new medium-term plan – the so-called “2015 plan” – was also launched in September 2007. This plan is less explicit than the “2010 plan” in how it formulates precise targets, but it also includes guidelines for the budget balance (i.e., a surplus between 0.75 percent and 1.75 percent of GDP), growth in public spending (which is rather high at first before becoming more moderate) and the share that public services have of total expenditures (not to exceed 26.5 percent of GDP by 2015).

Finland

value 9

Finland’s public finances have traditionally been balanced, but the collapse of markets in the Soviet Union caused an economic crisis in Finland in the early 1990s, with debt levels increasing sharply. A fiscal consolidation program significantly reduced expenditures, and Finland now enjoys budget surpluses and is able to pay down accumulated debt. In 2005 Finland’s state debt was among the lowest in Europe, and the relative surplus of state finances was the highest in the euro zone. However, economic growth must be improved further to offset the impact of the country’s aging population.

New Zealand

value 9

New Zealand’s budgetary policy is fiscally sustainable. The country’s debt-to-GDP ratio is among the lowest of OECD countries. The government has run a surplus for years, enabling the government to cut the public debt substantially. However, the private saving rate is not very high, so gross national saving as a share of GDP was down to 15 percent for 2005, a low rate by international standards. The reduction in public debt has thus led to a crowding-in effect, as it has gone along with an increase in private debt. The government is aware that private savings rates may be too low, and has tried to encourage household saving beyond the property market.

Recent forecasts project a further decline in public debt until 2007, but an increase for the years 2008 and 2009, because the government intends to make substantial investments in this period. Governments have also identified social welfare benefits and education spending as potential future fiscal challenges, and have actively focused on long-term fiscal objectives

Four pieces of legislation constitute New Zealand’s fiscal management framework. Two of these are focused on sustainable budgeting: The Public Finance Act of 1989 provides for spending authorizations and reporting of financial results, while the Fiscal Responsibility Act of 1994 sets principles and practices such as the maintenance of debt at prudent levels, the establishment of long-term fiscal objectives, and the full reporting of fiscal policy, spending intentions and forecasts. The framework as a whole provides the context for developing fiscal policy and

translating it into spending intentions.

An anchor of the government's fiscal policy is the long-term gross Crown debt objective, currently set at 30 percent of GDP. To achieve this objective, the government's policy has been to run surpluses across the economic cycle, while also meeting capital pressures and priorities.

Switzerland

value 9

Swiss budgetary policy largely fulfils the goal of fiscal sustainability, something made easier thanks to the country's tradition of being a "lean state." There has been some discernible deterioration in the last 15 years, but various measures have led to a stabilization of the budget. There is far-reaching consensus between politicians in terms of aiming at a low level of national deficit and debt. To achieve these goals, various regulations have been implemented, which stem constitutional debt at the federal level. In addition, the direct democratic elements of the Swiss political system provide an effective opportunity to limit the budget; in referendums the population has taken a very restrained approach towards state expenditure and has therefore acted to restraint the growth of the national debt. However, individual cantons' budgetary policies are very different, and not all of them achieve fiscal sustainability.

United Kingdom

value 9

Public finances in the United Kingdom are in good shape. The administration's direct or indirect control over most spending permits a favorable environment for exercising control over budgetary policy. The combination of a clear policy framework (i.e., fiscal stability), a politically strong chancellor, and strong economic development during the last ten years have facilitated positive developments in budgetary policy.

Despite substantial real increases in the level of public expenditure over the last five years (e.g., health or education), the United Kingdom's public finances are robust, showing a low level of public debt and a public deficit that has generally remained below the 3 percent threshold used to define an excessive deficit in the European Union.

The government aims to adhere to the golden rule stipulating that the public sector borrows only to invest over the course of the economic cycle. Borrowing is constrained to keep the ratio of net public debt-to-GDP below a prudent level of 40 percent of GDP. There have been problems in applying this rule due to readjustments in defining the economic cycle, which were implemented apparently to ease compliance with the rule.

At the time of this writing, the government is not running a balanced budget and there are potential risks associated with lower revenues from North Sea oil taxation

and pension financing. Nevertheless, fiscal sustainability remains clearly a core principle of government policies.

Austria

value 8

Austria has generally pursued a moderate policy of budget consolidation that uses an approach derived from Keynesian economics that only allows for budget deficits in times of economic decline.

In 2000, the ruling ÖVP-FPÖ coalition aimed at reaching a balanced budget, which it achieved in 2001. Since this restrictive course resulted in a slowdown in economic growth, the budget-consolidation policy was replaced with programs for stimulating economic growth, reducing taxes and increasing expenditures for labor-market policy. A balanced budget has been deferred until 2009/2010.

Belgium

value 8

After two oil crises in the 1970s and 1980s, Belgium amassed a huge public debt which peaked at 138 percent of GDP in 1993. Extreme overspending was the main culprit here, as federal and regional governments hired more employees, thus expanded the public sector, while subsidizing aging industries such as steel, textiles and coal-mining.

However, Belgium's desire to join the Economic and Monetary Union (EMU) inspired substantial restraint in budgetary policy. Consolidation has worked quite well since then. This trend was supported in recent years by favorable economic conditions that generated higher tax incomes. Accumulated debt today sits around 88 percent of GDP, while from 2005 to 2007 the overall budgetary balance was basically even. The current deficit at the time of writing is 1.6 percent of GDP.

The Belgian government is able to service its financial obligations. It has a Standard & Poors credit rating of AA+, the second-highest rating possible. Nevertheless, Belgium has to pay higher interest rates on its bonds than does Germany, as just one example. This does, of course, suggest that there will be additional financial burdens for Belgium's future generations.

There are budgetary risks ahead. On the one hand, to reduce the gross deficit, both regional and federal governments resorted to "one-shot" selling of public properties to obtain additional revenues. More important and alarming, however, is the aging of the Belgian population. An aging population is likely to stress public coffers, especially with the rising costs for health care and a growing need for pensions. Such costs may weaken Belgium's fiscal sustainability severely in 15 to 20 years.

Luxembourg

value 8

In the wake of the economic slowdown that started in 2003 and for the first time in 20 years, the government budget began to run current deficits in 2004 and 2005. Thus after a long period of consolidation it once again began increasing the total debt and debt-to-GDP-ratio. Although the deficit stayed far below the Maastricht treaty's debt-to-GDP threshold of 3 percent and well below the debt-to GDP-ratio of most other countries, the government acknowledged that the country was confronted with structural problems, and considerably slowed the growth rate of public expenditures. There was also a growing awareness of the fact that nearly 30 percent of tax revenues originated within the highly volatile financial sector. This helped lead to a much more conservative budgetary policy. The government imposed some drastic spending cuts, including the postponement of some major infrastructural projects and a freeze in civil servants' salaries. Budget policy in Luxembourg remains cautious and budgetary law for 2008 shows prudence in its spending approach.

Netherlands

value 8

Budgetary policy has been sound over the course of the period under observation. The fiscal goals set by the European Monetary Union (EMU) are being met, and the government will even try to realize a small surplus in 2008.

The long-term outlook, however, is far less positive. An ageing population will demand a very significant increase in spending on age-related care, and a shrinking active labor force will be forced to pay taxes and social premiums sufficient to finance the public sector. Health care expenditure will significantly increase, and the government will also need to invest far more money in education, infrastructure and the knowledge economy in general so as to improve labor productivity and thereby avoid economic stagnation.

South Korea

value 8

Korea is known for very conservative fiscal policies, with balanced budgets or even surpluses. In 2006, the consolidated government fiscal surplus was 0.3 percent. However, this surplus was mainly due to the effects of the social security system's early stages, in which there are many contributors and few benefit recipients. When adjusted for these effects, the budget balance showed a slight deficit in 2006, which is still much better than the OECD average.

The government debt level is relatively low at roughly one-third of GDP, or less than half of the OECD average. Despite Korea's good performance, there are concerns about these budgetary policies' long-term sustainability. There is no doubt that taxes and social security contributions will have to increase due to the fast-aging

population, and to mitigate the social costs of increasing integration into the world market. In its “Vision 2030” plan, the Ministry of Planning and Budget projects that welfare spending will increase by 9.8 percent every year until 2030, which will bring Korea close to the current OECD average.

Moreover, the government’s financial burden will greatly increase as a result of the population’s rapid aging, and the potential costs of economic integration with North Korea. In 2007, the government announced that it may need to issue national bonds to provide funds for national projects, such as basic old-age pension services, measures related to the Korea-United States free trade agreement and the second phase of the national balanced-development plan. Given that possible unification may incur costs as well, this burden would be simply passed on to the next generations without maintaining finances in a sound way.

Spain

value 8

In recent years, Spain has performed remarkably in terms of economic growth, The country has advanced significantly in its pursuit of fiscal consolidation and in the field of budget stability, Spain has showed a progressive surplus in 2004 and a surplus of up to 1.8 percent of GDP in 2006. At the same time, public debt as a percentage of GDP has been cut by more than 20 points from 1997 to 2006. The Socialist government aims to redirect public expenditures toward productive spending, by effectively increasing the public budget on research, development and innovation, infrastructure and education. The increased contributions to the reserve pension fund aims to further the sustainability of the welfare system.

One of the main objectives of the 2007 fiscal stability law is to secure a balanced state budget over the fiscal year. The law imposes strong restrictions on any policy that has a negative draw on the budget, establishing a total deficit ceiling of 1 percent of GDP and requiring a surplus in years characterized by strong economic growth. These developments are favorable both in terms of solvency and in guaranteeing the system’s intergenerational fairness.

Yet even if the current public account situation is satisfactory, the financial burden of an aging population remains one of the most salient issues to be tackled.

Iceland

value 7

Budgetary management has improved in recent years, but still cannot be described as fully sustainable. Until recently, the government budget passed by parliament was rarely adhered to, because additional government expenditures were routinely appended to the original budget in the course of the fiscal year, and approved by parliament in a special supplementary budget. The government budget deficit at the end of each fiscal year was thus almost invariably larger than the budget deficit envisaged in the original budget, significantly weakening the stabilization role of

fiscal policy operations. This was one reason for Iceland's high inflation in the past. In addition, fiscal operations were defined too narrowly, leaving out various public undertakings and parastatal operations that should, for fiscal policy reasons, have been included in the government's consolidated budget accounts. These problems have now been largely corrected, but fiscal planning remains short-sighted and weak. For example, during the almost uninterrupted economic upswing in Iceland beginning in the mid-1990s, it would have been prudent for the government to run large budget surpluses, paying down public debt and accumulating assets in order to prepare for the inevitable downswing or return to normalcy. Instead, the government increased tax revenues significantly and increased public expenditures less. This created a welcome opportunity to reduce outstanding public debt, but only on a fairly modest scale.

For example, the government was forced to take a foreign loan equivalent to 10 percent of GDP in 2006 to bolster the central bank's foreign exchange reserves. In one stroke, this increased the country's foreign debt by an amount equivalent to half of recent years' foreign-debt repayments. In consequence, the expected slowdown in economic activity in the near future will, by reducing tax revenues, once again produce significant government budget deficits and debt accumulation, according to the government's own forecast. This could have been avoided through far-sighted fiscal planning. Instead, this prospect will limit the government's ability to improve health services and strengthen the welfare system, among other policy goals.

Mexico

value 7

Oil revenues and a succession of fiscally responsible governments have resulted in an adequately balanced budget and a healthy debt policy. However, this seems unsustainable in the long run, as the budget depends dangerously on oil reserves that will ultimately disappear. In 2005 and 2006, sound monetary and fiscal policies contributed to macroeconomic stability. The 2006 Budget and Fiscal Responsibility Act further contributed to strengthening the fiscal framework, with public spending now under control.

The painful effects of previous economic crises have helped sustain a broad public understanding of the need for fiscal stability. But points of vulnerability remain. A sharp fall in oil prices, or a gradual but sustained decline in oil production (the latter being quite likely), would hurt the revenue side of the economy. Higher taxes elsewhere would be necessary.

Some public-sector companies, notably Pemex, have incurred their own debt, and these liabilities may be unsustainable. The federal government will quite possibly have to bail out Pemex at some point, and that will be costly. Mexico has a relatively young population that is slowly aging. Pension liabilities are likely to rise in the future, and Mexican savings are for the most part insufficient to finance an effective pension system.

Slovakia

value 7

The Dzurinda government substantially reduced the fiscal deficit in 2003, and it succeeded in keeping the deficit at about 3 percent of GDP, with a view to making euro zone entry possible in 2009. The decline in deficits has been accompanied by a decrease in government spending and has contributed to a reduction in the public debt, which stood at a 12-year low in 2006. Despite strong economic growth and calls from the European Commission, the Dzurinda government refrained from further fiscal tightening in 2005/06. The Fico government was quick to announce its commitment to euro zone entry in 2009, but overshot the deficit target in 2006.

Turkey

value 7

In the last legislative period in the years under review – the first term of the Justice and Development Party (AKP) – fiscal discipline and a sustainable budgetary policy was after a long absence finally established in Turkey. In 2002, the proportion of the budget deficit to GNP was 14.6 percent. In 2007, it fell to 0.8 percent, as a result of strict budgetary discipline. As explained by the finance minister in a speech to the Grand National Assembly, this level represents a lower figure than that held in countries such as Germany, Greece or Italy, and is well in line with the Maastricht criteria.

The budgetary deficit, in relation to GDP, was reduced from 16.5 percent in 2001 to 0.7 percent in 2006, also well below the Maastricht criteria. However, in absolute numbers, Turkey's foreign debt increased from \$118.5 billion in 2001 to \$206.4 billion in 2006, and among developing countries, Turkey was most affected by international financial shockwaves in May 2006.

Despite this situation, real interest rates for Turkey's domestic debt fell from 12 percent in 2003 to 7.41 percent in April 2007; however, this rate is still extraordinary per international levels. Moreover, the positive outlook of previous years darkened in the second half of 2006 due to growing domestic pressure on the government. Immediately after the parliamentary elections, however, fiscal discipline was again pursued.

Current obligations are paid. However, by all accounts, the country's social security system is not sustainable, and with its present (and generous) rules, the system is headed for bankruptcy. The government is painfully aware of this situation and is taking steps to reduce the various burdens on the system. These include the raising of the retirement age and the elimination or substantial reduction of certain benefits.

Czech Republic

value 6

Indicators for public debt and associated interest charges show the Czech Republic to be in a strong budgetary position. This position reflects good conditions inherited from the communist past and small deficits lasting into the late 1990s. Since then, debt has tended to increase as a proportion of GDP, although accelerating growth in GDP has recently held it in check. Growth in spending has been eased by access to EU financial support, which should facilitate a return to the previous budgetary position. Despite strong economic growth and pressure from the European Commission, the center-left government failed to meet the Maastricht deficit criterion of reducing the budget deficit below 3 percent of GDP. Protracted coalition negotiations following the 2006 elections complicated and delayed fiscal reform. The new center-right government has not placed high priority on adopting the euro and has placed greater emphasis instead on its agenda of cutting direct taxes. Its promises to reduce the deficit will therefore depend on spending cuts and continued strong economic growth.

Germany

value 6

Germany's budgetary policy between 2002 and 2005 was consistently in breach of the European Stability and Growth Pact. Despite Germany's strong stance against other EU member states in 1997 regarding the Stability and Growth Pact, the country itself constantly breached the agreement's 3 percent annual budget deficit criteria, putting the government under enormous pressure and severely damaging its image. However, an improving economy, which led to an increase in tax revenue, along with the grand coalition's fiscal consolidation, meant that the country's budget was balanced in 2007.

Finance Minister Peer Steinbrueck used European pressure to his advantage in order to combat the wishes of his fellow ministry colleagues. This shows that budgetary constraints implemented by the European Union are considerably more effective than the deficit-prevention rules contained in the German constitution. Article 115 of the Basic Constitutional Law states that state borrowing cannot be higher than its proposed budgetary investments. However, this rule has been ignored in recent years, due to the argument that it distorts overall economic balance. In such cases, the Basic Constitutional Law allows a higher level of state borrowing.

Greece

value 6

Although on the decrease since 2001, the Greek national debt remained at 120.6 percent of GDP in 2006. This was the second highest level in the European Union, after Italy's 120.8 percent, and the third highest in the OECD countries after Japan's

176.2 percent. Since 2005, the government's fiscal consolidation measures have had a positive effect. The growth rates of the budget debts have decreased since 2004 (2004: 8.4 percent, 2005: 5.6 percent, 2006: 3.4 percent of the GDP). Despite this positive development, the overall volume of the national debt remains very high. Interest payments amount to 4 percent of GDP at the moment, and will be a heavy burden for the national budget for many years. Moreover, the budget consolidation has disproportionately affected the less well-off parts of the population, triggering some social instability.

Looking ahead, the aging of the population, the debts of the social security funds and the comparatively high replacement rates (among other pension system problems), and the high cost of public health care constitute impending problems, pointing to the need for reforms. Intergenerational fairness has not been a priority for most of the incumbent governments of the last two decades. However, if no reforms are implemented, the cost to future generations will be very high.

Portugal

value 6

Portugal has faced a rather worrying fiscal situation during most of the 2000s. The country was placed under the "excessive deficit procedure" of the European Commission's Stability and Growth Pact (SGP) twice. In the time period under review, sustainable fiscal policies have been a top priority for the government, and several politically costly reforms it introduced have signaled its serious commitment. Fiscal consolidation was achieved by means of a combination of raising revenues and reducing expenditures as well as by a mix of one-off and emergency measures (e.g., an increase in the VAT and the freezing of wage increases and hiring in the public sector) and longer-term measures (e.g., the ongoing changes in the health sector and reforms of the pension system, the rationalization of the public education system, and the approval of a new budgetary stability law that also redefines relations between central and local administrations).

The SGP was reformed in 2005/2006 and further increases the framework's economic rationale, the flexibility and the medium-term sustainability focus. Complying with its SGP obligations would help Portugal assure the solvency and sustainability of its budgetary policy. Furthermore, implementing a true medium-term expenditure framework (MTEF) would also benefit the country. Although a MTEF was announced in 2001, it has yet to be implemented. Likewise, measures focused more decisively on long-term consolidation and spending cuts have recently been adopted.

The revised consolidation program, which Portugal and the European Commission agreed to in April 2007, already foresees a deficit below 3 percent of GDP in 2008, owing to a better-than-expected performance in 2006 and early 2007.

United States

value 6

The current U.S. public debt-GDP ratio is higher than the OECD average. Contrary to public perception, the U.S. government's budget deficit as a percentage of GDP has been falling since its recent peak of 2004 (3.4%) to 1.9 percent in 2006. A possible downturn owing to the subprime mortgage crisis has not been fully factored in.

In the long run, based on current law, the CBO estimates that small surpluses will be achieved by 2012. This holds true even if the supplemental appropriations are extrapolated into the future. All of this presupposes that the Bush tax cuts expire, as stipulated by law. In the long run, however, the budgetary path is unsustainable given the pressure of rising health-care costs in the public programs and the demographic shifts (e.g., the retiring baby-boomer population).

For example, the CBO estimates that, within the next 10 years, federal health-care costs will rise from 4.6 percent of GDP to 5.9 percent of GDP, which will translate into a 30-percent increase in outlays. The increase in social-security spending is smaller, but still significant. If health-care costs increase at the current annual rate, they will climb to 20 percent of GDP by 2050. If you add to this amount plans to introduce a system of national health coverage, the current budgetary path becomes unsustainable and would probably require tax increases on top of the reversal of the Bush tax cuts.

Annotation:

Congressional Budget Office, "The Budget and Economic Outlook. An Update 2007," <http://www.cbo.gov/ftpdocs/85x x/doc8565/08-23-Update07.pdf>, 1–10.

Japan

value 5

Weak nominal GDP growth and a series of large-scale fiscal stimulation packages in the 1990s propelled Japan's ratio of public debt to GDP to the highest level in the OECD area. According to OECD estimates, gross public debt reached nearly 180 percent of GDP in 2007. While there is some debate about the height of net public debt (sometimes estimated to be closer to 65 percent of GDP) and the structure of debt (mostly owed to domestic creditors (Pascha 2007)), the fact remains that the situation requires urgent action by the government, especially as the government still benefits from extremely low interest rates which cannot be taken for granted in the long term. A reduction of overall debt, not just of annual budgetary deficits, is called for. The government's aim of bringing the primary balance (public revenues once net borrowing, public expenditures and debt redemption have been subtracted) to at least zero by 2011 constitutes a step in the right direction. However, new demands, such as an aging population and the specter of nominal interest rates that are higher than nominal growth, indicate the extent of the challenges facing the Japanese state. As a consequence, it is likely that the financial burden to be placed on future generations

is set to increase.

Annotation:

Werner Pascha, "Gesamtwirtschaftliche Megatrends und die Aussicht auf dynamische Zukunftsindustrien in Japan," in *Japans Zukunftsindustrien*, edited by Andreas Moerke and Anja Walke, (Berlin: Springer, 2007), 26-28.

Poland

value 5

Favored by strong economic growth, Poland's public debt stabilized during the period under review. Contrary to strong fears between 2003 and 2004, debt has not reached the 60 percent threshold enshrined in the Maastricht treaty and the Polish constitution. The PiS government stressed its commitment to fiscal consolidation during the 2005 electoral campaign, but failed to bring the deficit below 3 percent of GDP despite strong economic growth and general pressure by the European Commission. The government justified the postponement of fiscal changes by stressing the need to invest in infrastructure and manage the short-term fiscal costs of establishing a multipillar pension system.

France

value 4

France's budgetary policy and its high level of public debt are influenced by structural problems which are set to worsen in the future. The dismantling of public services on both the national and local levels in the past has led to poor performance and an inflexible budgetary policy. This has resulted in another break from conformity with the Maastricht criteria and increased observation by other European states of the French government and its president, Nicolas Sarkozy. The most recent attempts made by the French government to decrease the pressure on budgetary consolidation have, until present, been deemed successful by the European Commission and other European Union member states.

Hungary

value 4

Hungary has been among the EU and OECD members with the highest fiscal deficit levels. In 2005, it was heavily criticized by the European Union and other international organizations for its excessive deficit, and the European Council rejected Hungary's proposed financial convergence program. After the 2006 parliamentary elections, the Hungarian government initiated a radical budgetary consolidation program, which aimed at reducing the deficit from nearly 10 percent of GDP in 2005 to 6.4 percent in 2007, and to around 3 percent by 2009. The program included measures addressing both the revenue and the expenditure sides of the

budget. Despite fierce political opposition, the first steps of this program have been implemented successfully.

Italy

value 4

Italian budgetary policy is fiscally unsustainable, and it appears implausible that the country's public debt will be reduced significantly in the next few years. Italy is still able to pay its financial obligations, but international rating agencies have several times downgraded Rome's creditworthiness, despite Italy's status in the Euro zone. Economic growth is predominantly sustained by patronage-inspired election pledges, which only later consume limited financial resources.

The country's huge debt-to-GDP ratio (which is the second-highest among OECD countries) and its fast-growing current expenditures which are characterized by inefficiency and its subdued growth of potential GDP make for a troubling budgetary picture. Surging tax revenues over the last two years, in large part the result of PM Prodi's efforts to curb tax evasion, have led to an only moderate reduction of the deficit-to-GDP ratio, as extra receipts have been used mostly to finance higher spending in what looks like a textbook, pro-cyclical fiscal stance. Given that the Italian economy is slowing down, and with confirmation of the government's traditionally strong reluctance to trim current expenditures, a fiscal adjustment risks being postponed once again with the debt burden shifted to future generations.

This report is part of the Sustainable Governance Indicators 2009 project, which assesses and compares the reform capacities of the OECD member states.

More on the SGI 2009 at www.sgi-network.org

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